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Highlights from ACFA's 2017 Annual Report

Minister Wyatt has today released the Aged Care Financing Authority's fifth annual report. ACFA was established as a statutory committee as part of the 2012 *Living Longer Living Better* package to provide independent analysis of the impact of funding and financing arrangements on the viability and sustainability of the aged care sector and on access to services.

The fifth annual report uses mainly 2015-16 financial data, the most recent available under the Department of Health's financial reporting regulations for residential and home care providers. Because home support programs (CHSP and HACC) operate on a grant acquittal basis, conventional analysis of financial performance does not apply.

As was anticipated, ACFA concludes that the financial performance of the residential sector and investor sentiment continued to improve during 2015-16, mainly as a result of the reforms. A surprising result was the overall decline in financial performance of the home care sector. Average EBITDA and NPBT both declined by 7% in 2015-16.

The Report does not cover the period since 1 July 2016 when the progressive implementation of the ACFI changes commenced. More on this later.

Financial performance

Residential care

Average earnings before interest, tax, depreciation and amortisation (EBITDA) per resident increased from $10,222 in 2014-15 to $11,134 in 2015-16, an increase of 8.9%. When government providers (state and local government) are excluded, the average EBITDA per resident per day in 2015-16 increases by $524 to $11,658.

Average net profit before tax (NPBT) per resident over the same period increased from $5,220 to $5,962, or 14.2%. These profit results build on the positive results reported since 2012-13, which have seen average NPBT increase by 71%.

The proportion of providers reporting a profit has increased marginally from 66% in 2013-14 to 69% in 2015-16. Average returns of equity and assets in 2015-16 were 17.7% and 4.9% respectively.

Commenting on the overall profitability of the residential aged care sector, ACFA notes that 'other income' in 2015-16, ie non- operating income, offset the sector's otherwise net operating loss of $240 million, and contributed a substantial portion of the sector's overall positive EBITDA.

The large variation in financial performance noted in previous reports persists. Average EBITDA for the top quartile of providers was $25,254 in 2015-16, compared with -$3,613 for the bottom quartile. Management is a factor that explains some of the variation, including the ability to maximise ACFI revenue, but so does facility size (not so much portfolio size) and remoteness.

While all performance quartiles saw an improvement in financial performance in 2015-16, the biggest improvement was in the top and bottom quartiles. Continuing the improvement first evident in 2014-15, the bottom quartile EBITDA per resident improved by $2,201 from a negative $5,814 in 2014-15 to a negative $3,613 in 2015-16. This compares with negative $8,866 in 2013-14. The top quartile EBITDA per resident improved by $1,567.

Within the bottom quartile, there is a significant variation in average EBITDA by ownership. Government providers reported a negative EBITDA of $21,025, compared with negative $1,802 and positive $514 for not-for-profit and for-profit providers respectively. Government providers represent 59% of the bottom quartile providers.

Thirty-seven per cent of for-profit providers are in the top quartile compared with 20% of not-for-profit providers.

The for-profit sector continues to out-perform other groups in financial terms, with EBITDA and NPBT margins in 2015-16 of 13.6% and 9.1% respectively compared with 11.2% and 5.6% for the not-for-profit sector. Government providers reported the poorest returns, with EBITDA and NPBT of 0% and -11% respectively.

As was the case in 2014-15, a major contributor to the improvement in average financial performance in 2015-16 was an average real increase in ACFI care revenue of 5.2% per resident per day. This real increase in revenue per resident per day increased care revenues by $660 million (excluding growth of $249 million due to an increase in the number of residents).

Home care

Average EBITDA per package in 2015-16 was $2,086 compared with $2,235 in 2014-15, a decline of 7%, compared with an increase of 13% in 2013-14. Average NPBT per package also declined by 7% in 2015-16, from $2,081 to $1,949.

Despite the decline in overall average financial results, the top quartile of home care providers reported a 42% increase in average EBITDA per package ($6,190 compared with $4,357 in 2014-15). What also stands out is the significant divergence in performance between the top quartile and the rest. Average EBITDA for the second top quartile falls to $1,953 and the bottom quartile falls to negative $765.

Nevertheless, 75% of home care providers reported a profit in 2015-16. This is on a par with 2014-15 when 72% reported a profit (66% in 2013-14).

Government providers reported a significant improvement in average EBITDA per package, from $1,052 in 2014-15 to $2,122 in 2015-16.

Accommodation payments

Over the short period 1 July 2014 to 30 June 2016, lump sum deposits held by providers increased by $6.3 billion to $21.9 billion. Under current policies, the amount held by providers is set to become much larger, adding to the government's nervousness about its contingent liability. We await the recommendations of the 2017 Legislated Review whose terms of reference includes an assessment of the current Bond Guarantee Scheme.

ACFA has noted that there has been an increase in categories of assets other than fixed assets held by providers, such as related party loans and intangible assets. Related party loans and intangible assets reported by for-profit providers ($6.3 billion) amount to 35% of total assets held by for-profit providers. This compares with $700 million held by not-for-profit providers. ACFA has posed the question whether this build up in other assets is consistent with the permitted uses regulations for lump sum deposits.

The method of payment used by residents during 2015-16 has remained largely unchanged, with about 41% paying lump sums (RADs/RACs), 35% making daily payments (DAPs/DACs), and 24% paying a combination of lump sum and daily payments.

Lump sum deposits were the dominant method of payment by non-supported residents (52%), whereas only 20% of partially supported residents used lump sum deposits.

However, different trends appear to be emerging according to ownership type. Not-for-profit providers reported a decline in the proportion who choose to pay by lump sum (from 42% to 36% in 2015-16), whereas the for-profits reported a slight increase from 46% to 48%. ACFA reported anecdotal evidence that some providers may be influencing consumer decisions over choice of payment method.

The average maximum RAD price published as at April 2017 was $391,000, compared with $377,000 at May 2016, a 3.7% increase. The proportion of published RAD prices that were over the $550,000 threshold and required approval by the Pricing Commissioner remained at 6%.

The average agreed price as at April 2017 was $380,000 ($373,000 for not-for-profit; $400,000 for for-profit; and $302,000 for government services). Agreed prices decreased with remoteness, from an average of $410,000 in metropolitan areas through to $256,000 in rural and remote locations.

The average agreed price when presented as a DAP equivalent was around $65 per day, depending on the applicable MPIR. This is in line with the accommodation supplement paid by the Commonwealth on behalf of supported residents living in new and significantly refurbished homes ($55.09 per day at 1 July 2017), but significantly more than the accommodation supplement payable in all other homes ($35.90 per day).

As at 30 June 2016, the proportion of aged care homes eligible to receive the higher accommodation supplement has increased from 15% to 25% of facilities (559 refurbished homes and 127 newly built homes).

Commonwealth accommodation payments to providers on behalf of supported residents increased by $144 million in 2015-16 to $971 million.

Sustainability

Investment

The level of investment in new and refurbished homes is an indicator of the financial health and sustainability of residential aged care.

The level of investment continued to increase in 2015–16, influenced by the introduction of market-based accommodation prices for non-supported residents and the higher maximum accommodation supplement for supported residents living in new and significantly refurbished aged care homes.

The 2016 Survey of Aged Care Homes estimated that $1.6 billion of new building, refurbishment and upgrading work was completed during 2015–16, compared with $1.7 billion in 2014–15, involving about 24% of all homes. The amount of new building in progress at the end of June 2016 was estimated at $2.9 billion compared with $2.1 billion at June 2015. Total spend on building activity in 2015–16 ($4.5 billion) was 18% higher than in 2014–15 ($3.8 billion).

Consumer contributions

Overall, the new means testing arrangements introduced on 1 July 2014 have had a minimal impact on the level of consumer contributions for aged care and on the sustainability of aged care.

In 2015–16, the Commonwealth contributed 66% of provider revenues in **residential care** ($11.3 billion) and residents contributed 27% ($4.5 billion, excluding lump sum deposits). These proportions are virtually unchanged since 2013–14. Income from other sources contributed the remaining 8% ($1.3 billion).

Within this overall figure:

- the Commonwealth contributed 95% of provider revenue for personal and nursing care ($10.9 billion) and consumers contributed 4.2%, an increase of 0.45% or $83 million over 2014–15.
- Non-supported residents contributed 47% ($851million) of provider accommodation revenue, excluding lump sum payments, compared with 45% in 2014–15.

In 2015–16, consumers contributed an estimated $160 million towards the cost of **home care** services compared with a Commonwealth contribution of $1.5 billion.

ACFA noted that because a large proportion of home care recipients are full or part pensioners (82% and 15% respectively at 30 June 2016) who make no or minimal contributions respectively, the impact of the new income testing arrangement on improving sustainability has been limited.

Workforce

Analysis of residential provider GPFRs and Departmental administrative data shows that employee expenses in 2015–16 (wages, superannuation and management fees) increased by 8.6% to $10.9 billion, an increase of $858 million over 2014–15. Employee expenses have increased by 16.6% since 2013–14, but have remained steady at 67% of total expenses.

ACFA estimates that $581 million of the increase in employee expenses in 2015–16 (68%) is attributable to a 6% increase in the amount paid per claim day on wages and management fees, reflecting mainly wage increases but also contributed to by increased hours worked per claim day, increased staffing levels and changes in the mix of staff.

The balance of the increase is largely due to an increase in the number of days of care provided as resident numbers have increased.

Industry consolidation

There has been further consolidation in the **residential** aged care sector, with the number of providers declining from 1,016 in 2013-14 to 949 in 2015-16, despite an increase in the number of operating beds.

There continues to be a large number of single home providers (65% of all residential providers), though they account for only 23% of places.

The proportion of operational places held by for-profit providers has increased from 33% in 2007 to 39% in 2016. Even putting aside acquisitions, this proportion is set to increase further because 63% and 70% of allocated places in the last two ACARs respectively went to for-profit providers.

There were 496 providers of **home care** in 2015-16, little changed since 2012-13 (504 providers), even though the number of home care packages has increased by 31% over that period (from 60,308 in 2012-13 to 78,956 in 2015-16).

However, the number of applications to become an approved home care provider increased significantly since in anticipation of the introduction of funding following the consumer in February 2017. Some 170 new home care providers were approved between 1 July 2016 and 30 April 2017, most of which were existing home support or residential care providers.

The proportion of packages allocated to for-profit providers increased to 11% at 30 June 2016, continuing the steady increase from 5.4% in 2008-09. ACFA will monitor the impact of the February 2017 reforms on market share.

Extra service

There continues to be a decline in the number of extra service status places in residential care. During 2015-16, the number of extra service places decreased to 11,709 compared with 15,280 at 30 June 2015 and 24,281 at 30 June 2013. The extension of market-based accommodation prices and lump sum deposits to mainstream high care largely accounts for this reduction.

Access to care

Supply of services

The target operational provision ratio announced in the 2012 *Living Longer Living Better* (LLLB) package was 125 operational residential places and home care packages per 1,000 per aged 70 and over, to be achieved by 2021-22.

The overall operational ratio achieved has increased only marginally since the LLLB package was announced ie 113.2 in 2016 compared with 111.8 in 2012. Within this overall figure, the home care ratio has increased from 27.4 to 31.9 over the same period (compared with a target of 45 by 2021-22), and the residential ratio has decreased from 84.4 to 79.7 (compared with a target of 80 by 2021-22, which includes two for short-term restorative care).

An additional 62,000 home care packages will need to be released by 2021-22 if the home care target of 140,000 packages is to be achieved, and an additional 49,000 operational residential places created. This compares with about 35,000 residential places commissioned over the previous decade.

As at 30 June 2016, there were 35,124 **provisionally allocated residential places**

that are still to be constructed and commissioned, an increase of 24%. This is about 14% of total allocated residential places and compares with 28,344 at 30 June 2015. About 25% of the provisional places have had this status for four years or longer. Provisional allocations have averaged about 10% of total allocated places over the last ten years.

The increase in the proportion of provisional places partly reflects the increased take up of residential places in recent ACARs following the more favourable investment climate created by the LLLB reforms.

In addition, 7,894 formerly operational places at 30 June 2016 were **offline**. It is thought that the refurbishment of homes with multi-bedded wards triggered by the higher accommodation supplement may be contributing to the number of offline places.

Respite care

Although the LLLB package made no changes to residential respite, recent years has seen a significant increase in the usage of residential respite.

In 2015-16, the number of people using residential respite increased by a further 7% to 56,852, which followed a 10% increase in 2014-15. This ACFA Report includes an analysis of how respite is used and by whom in an attempt to understand what is causing the increase.

The analysis indicates that the number of people entering permanent residential care straight after respite care has increased significantly since 1 July 2014. This suggests that people may be using respite care while they arrange their financial affairs and/or await means testing assessments, further suggesting a shift in the use of respite compared with the original policy intent.

Supported residents

The proportion of supported residents was 47% in 2015-16, the same as in 2014-15, but higher than 44% in both 2012-13 and 2013-14. This indicates that the LLLB changes have not had a negative impact on access by supported residents.

Occupancy

Average occupancy in **residential care** at 30 June 2016 was 92.4%, having hovered between 92% and 93% over the past five years.

Occupancy peaked at 96.7% in 2002 when the operational ratios were 81.9 and 14.8 for residential care and home care respectively. At 30 June 2016, the respective ratios were 79.7 and 31.9.

Not-for-profit providers continue to have higher average occupancy (94%) than for-profit providers (91%).

The utilisation of **home care** packages continues to drop, declining from 92% per cent of package days available in 2012-13 to 82.6% in 2015-16, with utilisation rates decreasing with remoteness. Lower utilisation rates in rural and remote areas are also evident for residential services.

Home care utilisation rates vary significantly across States, from 68% in WA to 93% in Victoria. It will be important to track whether the national prioritisation process for assigning packages to individuals introduced in February 2017 leads to a reduction in geographic variations.

Utilisation rates also vary across package levels (68% for level 1; 81% for level 2: 80% for level 3; 93% for level 4).

It is difficult to draw conclusions about the variation in utilisation rates across the package levels. It may reflect the uneven availability of packages across the different package levels (ie a mismatch between availability and demand), or the impact on value for money considerations stemming from the currently configured income testing arrangements and the generally lower fees applying in home support. It is understood that the 2017 Legislated Review will address these issues.

Who is accessing aged care?

At 30 June 2016, 39% of people aged 70 and over were receiving some form of aged care. This increases to 81% for the 85 and over cohort. About 53% of the 85 and over cohort are using home support, 6% home care packages and 22% residential care.

In home care, the average age of consumers was 82.1 in 2015-16 compared with 84.6 in residential care. The proportion of people aged 85 and over in residential care was 59% (55% in 2009), compared with 43% for home care.

Females have a higher chance of entering permanent residential care than males, though the difference between females and males reduces in older age. At age 70, the probability of an individual entering residential care in their lifetime is 55% for females compared with 40% for males. The probability of a person entering residential care gradually increases up to around age 85 (60% for females and about 48% for males). Thereafter, the chances of dying before entering care reduces the probability of entering residential care.

The current probability of entering residential care reflects the current relative availability of home care and residential care. This also affects the proportions of older people currently using home care and residential care. As home care expands, it could be expected that fewer people will enter residential care.

Length of stay

The average length of stay in **residential care** has been declining gradually, from 3.3 years in 2003 to just under 3 years in 2015-16 (3.3 years for females and 2.4 years for males).

An unexpected development is that the proportion leaving residential care within three months and six months since 1 July 2014 (14% and 22% respectively) has been decreasing, after a sustained period of gradual increase. ACFA will continue to monitor this situation to see if this is just a temporary change.

Length of stay in **home care** differs markedly between package levels.

- For people who enter at level 2, about 50% stay at least 1.5 years and 25% over three years
- For people who enter at level 4, around 50% leave within one year and 25% remain for over two years.

The proportion of home care consumers who move to residential care is currently 58%, after having hovered around 64% between 2009 and 2013. It will be interesting to monitor this figure as the availability of home care increases.

The years ahead

As noted in the introduction, ACFA's financial analysis in this Report does not cover the period since 1 July 2016 when the progressive implementation of the ACFI changes and indexation pauses commenced.

The latest data from the Department of Health shows a significant decline in real growth rates in ACFI revenue since 1 July 2016. Real growth has declined to 2.1% per resident per day for the period 1 July 2016 to 31 March 2017. This compares with real growth rates in 2014-15 and 2015-16 of 7.4% and 5.2% respectively.

In addition, the recent national wage case, which increased minimum wages by an unusually high 3.3%, coincides with the indexation pause. This can be expected to put upward pressures on employee costs, which comprise 67% of operating expenses

The question that arises is whether ACFA's 2017 Report will mark the end, at least for the foreseeable future, of the relatively more benign business environment that has prevailed since the LLLB reforms, as seems likely.

ACFA notes that the ACFI changes, together with the large minimum wage increase, may be expected to contribute to a decline in financial performance over time.

A decline is already evident in recent performance benchmarking by StewartBrown. This shows that in the nine months to March 2017, average results for residential providers have declined by about 8%.

StewartBrown has also commented that their benchmarking shows that cost management is a key differentiator between facilities that continue to show stable results and those whose results have declined. It remains to be seen, however, whether this holds true as the full impact of the progressive implementation of the changes takes effect, or whether we see further pressure to increase revenue from additional services. And of course, the implications for the quality of care cannot not be ignored.

Disclosure statement: The author of this Update, Nick Mersiades, is a member of the Aged Care Financing Authority. The opinions in this Update should not be read as being an expression of the views of the Aged Care Financing Authority.

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