Submission to the Aged Care Royal Commission on capital financing arrangements for residential aged care
Consultation Paper 1

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Made by:

Research Analytics

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Our Perspective

About Us

This submission is prepared by Mark Sheldon-Stemm. Thank you to the Commission for providing this opportunity to make our submission.

Research Analytics is headed by Principal Mark Sheldon-Stemm. Mark brings over 20 years CEO/CFO experience in health aged care services in metro, rural, regional and remote settings. Since 2015 he has worked in the development of new aged care systems with supporting business & financial systems, including MyCDC for both community and residential Aged Care. Mark is also a Senior Australian and is determined to make the aged care system one of excellence. Rather than talk about how it should be done, he does it.

In 2018, Mark was commission by the Department of Health and the Minister for Aged Care to undertake analysis and provide a report on how Consumer Directed Care will work in Residential Aged Care. He currently conducts workshops for Leading Aged Care Services Australia (LASA) on Consumer Directed Care (MyCDC), with over 3,000 staff trained in this area; and in helping organisations meet the Aged Care Standards.

Research Analytics has developed a sophisticated benchmarking database over the past 20 years on the operation of residential care covering both care and accommodation.

Research Analytics consults to residential and home care providers around Australia covering all locations and types of services (in Metropolitan, Rural, Remote, Regional, Indigenous and Special Needs Groups). All of these are successfully operated from both a care and financial perspective.

In terms of credentials, knowledge, and experience to make the comments Mark is a Fellow of the Institute of Public Accountants and has the following Qualifications:

- Master of Management (Strategic Foresight) – 2009
- Graduate Diploma of Agricultural Economics – 2000
- Bachelor of Social Science – 1990 - Majors – Psychology & Sociology
- Diploma in Commercial Data Processing 1982
- Commerce (Accounting Procedures) Certificate 1980

And Experience:

- CFO – American Flange (multinational company)
- CFO (Financial Controller) – United Milk Tasmania:
- Finance Director – Agricultural Developments of Tasmania (and associated companies):
- CFO – Mt. St Vincent's Aged Care;
- CEO – Tandara and Grenoch Aged Care organisations:
- President of Aged and Community Service – Tasmania:
- Chair and Co-Founder of Suicide Prevention program- CORES:
- CFO (Company Secretary/Business Manager) – CRC Forestry Ltd:
- General Manager – CEO Kalyna Care:
- CEO Capecare:
- Consultant in Aged Care:

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Preface

Due to the subject and the nature of the questions it is important the answers to these questions are put into perspective.

Firstly, the Aged Care system in Australia is fundamentally a Commonwealth Government responsibility. While the actual services are outsourced to the private sector (made up on for profit, not for profit organisations and State governments) the Commonwealth Government has full control of the Aged Care system. This is from the allocation of places to funding to regulating to underwriting the accommodation deposits to managing the outcomes for consumers and monitoring the performance of the aged care providers.

Secondly, the Commonwealth Government has overall responsibility on how the aged care system is to be shaped in the future.

The responses provided are based on this perspective and see the use of a mixture of private resources and government funding in aged care as a way of achieving what the Commonwealth Government is ultimately responsible for.

Executive Summary of Submission:

The residential aged care sector currently makes significant loses on accommodation services for the following reasons:

1. The low interest rates offered on deposits from Residential Accommodation Deposits (RAD's).
2. The inability to retain any of the RAD amount, as previously (before July 2014).
3. The continued increase in accommodation costs for operating a residential aged care facility (such as maintenance, power, regulatory requirements, etc).
4. The ability of the consumer to decide, after they have entered, on how they will pay for their accommodation.
5. The continued decline in the amounts paid as RAD's in favour of paying a Daily Accommodation Payments (DAP's) and other combinations. **
6. The requirement of financiers (Banks) to pay any RAD's received against borrowings for building a new aged care facility. This is part of the short-term financing arrangements currently required by the financiers.
7. Overall, the amount earned on accommodation does not cover the cost or provide a return on investment.

** The level of RAD payments for non-supported residents in 2015-16 (as part of the capital contribution) was 51% of the total contributions. This has now dropped to 43% in the 2018-19 financial year (Aged Care Financing Authority Report 2020, page 110).

Added to the above is the fact that the current RAD system mimics a Ponzi scheme (A Ponzi scheme is an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors).

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Whilst there are no promises of increased returns to consumers funds paid out to them require new funds to come in. The security for the contributor is the Commonwealth Government who under-writes the scheme. In the long run the current RAD scheme (which is government guaranteed) is unstainable as the amount of deposits held are likely to continue to decrease and providers become unable to provide the liquid assets to make payments. In the end the government will be forced to pay out the refunds.

The aged care industry is reminiscent of the Forestry industry that collapsed after the Global Financial Crisis in 2008-9. Having been involved on the Creditors Committee of the receivership and wind up of the Great Southern Group I know firsthand how such a scheme ends with billions of dollars lost by investors (in this case the losses will be the Commonwealth Government's). Using new money to pay out old money has been, and will always be, doomed to failure.

Therefore, current Capital funding system for aged care is unstainable for several reasons:

1. The length of stay in residential care is projected to become shorter as entry will be at the later stages of life.
2. The preference for a majority of people will be for services to be received in their home with the rate of entry into residential likely to remain at the current supply levels (as the population ages the percentage accessing residential aged care will fall but the actual number of places is likely to remain stable).
3. It is a myth that a payment of a RAD is a none intertest loan to be used to build aged care places. The RAD is not a loan as there is no loan term and the full amount is repaid on the call of the contributor and can occur at any point in time.
4. Much of the current RAD's are held in non-liquid assets which are new buildings whose worth is determined by the profitability of the aged care operation and which have no other use. Currently the total cash available across the aged care sector is 20.79% of the value of Accommodation Deposits held. The total liquid assets available is 34.72% of the value of Accommodation Deposits held. **
5. The preference for people to pay a RAD is decreasing as the choice moves towards paying a combination for accommodation (refer the earlier comment).

The result of falling RAD deposits in the future will apply significant pressure to current operators and at some point, there will be an inability to repay RAD's as and when they fall due. This will then force the collapse of many aged care providers.

**Aged Care Financing Authority Report 2020 page 115.

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Our database contains detailed financial information from current operations whom we termed “Smart Providers” and below are the benchmarks as an average of these providers.

Benchmarks for Operation - per client per day	Average Benchmarks
INCOME	
Client's Service Fees – (Care)	$52
Client's Accommodation (RAD Interest) – (Accommodation)	$2
Client's Accommodation (DAP/ Supported Payments) - (Accommodation)	$26
Client's Additional Services – (Care)	$1
GOVERNMENT	
Government subsidies – (Care)	$178
TOTAL INCOME	$259
EXPENDITIURE	
Care Management – (Care)	$10
Nursing staff – (Care)	$33
Care Staff – (Care)	$79
Lifestyle Staff – (Care)	$7
Allied health – (Care)	$5
Medical & incontinence supplies – (Care)	$6
TOTAL CARE SERVICES	$140
HOTEL SERVICES	
CATERING	$28
Staff costs, Consumables – (Care)	
CLEANING	$9
Staff costs, Consumables – (Care)	
LAUNDRY	$5
Staff costs, Consumables – (Care)	
UTILITIES	$7
Electricity, Gas, Rates, Other – (Accommodation)	
PROPERTY AND MAINTENANCE	$31
Labour, R&M, Depreciation, MV exps, Refurb- (Accommodation)	
OVERHEADS	$28
Administration charges, Staff Costs, Other – (Care)	
TOTAL COSTS	$249
EBIT - per resident per day	$10
EBITDA - per resident day	$25
EBIT - per annum	$3,723
EBITDA - per annum	$9,198
Care Result per resident per day	$20.60
Accommodation Result per resident per day	-$10.40
Total	$10.20

** These are a mixture of Metropolitan, Regional and Rural aged care providers.

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The average loss on accommodation is $ 10.40 per resident per day.

In a 100-bed aged care facility this represents a loss of $379,600 per annum.

These providers are recording a surplus on Care that is offset by the loss on accommodation.

However, when an aged care providers care income is fully utilised then their loses come from accommodation.

Recommended Solution to capital funding in aged care:

There are four steps that need to be taken so the capital requirements for residential aged care can be met into the future:

1. The current RAD scheme (deposits) is ceased and replaced by government back loans which are required to be repaid over a long period of time based on ability to repay (this could be anywhere between 15 to 25 years).
2. Consumers are to pay the cost of accommodation which includes the cost of maintaining the infrastructure and an average return on investment (estimated to be between $35 -$55 per day depending upon nature of the accommodation). This payment is over and above the $52 per day currently paid by consumers as these funds are used for the living expenses of catering, laundry, and cleaning.
3. Financing of new developments (or refurbishments) are long term investments and should be funded by the private sector over a period of 15 to 20 years paid for from the profitable operation of aged care services.
4. In the case where residential aged care services are required in rural and remote regions then if the returns are insufficient for repayment to the private sector (due to the size of the aged care facility) then the Commonwealth Government should provide funds through the operation of the low interest rates loans scheme previously operated.

The first step will allow the current RAD's to be repaid. Security would be taken for the period of the loan.

The second step will require consumers to fund the daily payment either from their current income or cash or as a drawdown on their assets. In the case where a consumer's only asset is their home then a drawdown against the pensioner loans scheme would be available from the Commonwealth Government.

In the case where the consumer does not have any assets then the cost of accommodation would be covered under the current supported supplement scheme with daily payments from the Commonwealth Government.

The third and fourth steps are how capital funding would be provided in the future.

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The expected outcomes from these steps would be:

1 The government no longer will rely on the aged care provider holding sufficient funds for prudential purposes.
2 The government loans will be repaid over time (with security).
3 The liability for the Commonwealth Government for the RAD's moves from a contingent liability to a long-term liability which will decrease over time.
4 These steps would also provide the "smoothest" transition in funding capital.
5 The consumer no longer must sell their home to pay a RAD, but rather accesses any equity to pay for their accommodation.
6 The government will continue to support those who have no assets by paying the costs of accommodation for these people.
7 The operation of aged care would be based on commercial reality instead of mimicking a Ponzi Scheme. **

** It should also be noted that other Accommodation industries (Hotels, Motels, Commercial rentals, Tourism Accommodation, etc) all operate on a commercial basis with funding from Financiers or through raising capital from the markets. Aged Care should be no different unless the market is too small or not applicable which will require the Commonwealth Government to provide the means for infrastructure.

It should also be noted that previously the Commonwealth Government have provided similar schemes for industries as part of a transition/adjustment period.

Addressing the Points in the Brief:

1 Whether the current capital financing arrangements are appropriate for the aged sector as it exists today, and as it is likely to evolve into the future.

No, they are not as the scheme is not sustainable into the future. Refer to the above four steps as to how it should evolve:

1 The current RAD scheme (deposits) is ceased and replaced by government back loans which are required to be repaid over a long period of time based on ability to repay (this could be anywhere between 15 to 25 years).
2 Consumers are to pay the cost of accommodation which includes the cost of maintaining the infrastructure and an average return on investment (at between $35 -$55 per day depending upon nature of the accommodation). This payment is over and above the $52 per day current paid by consumers as these funds are used for the living expenses of catering, laundry, and cleaning.
3 Financing of new developments (or refurbishments) are long term investments and should be funded by the private sector over a period of 15 to 20 years paid for from the profitable operation of aged care services.
4 In the case where residential aged care services are required in rural and remote regions then if the returns are insufficient for repayment to the private sector (due to the size of the aged care facility) then the Commonwealth Government should provide funds through the operation of the low interest rate loans scheme previously operated.

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2 How the capital financing arrangements might need to change to support a progressive shift in the balance of care from residential to home care.

The point raised is based on a Myth. Whilst the balance moves towards more home care (in people's home) the current number of places available in residential care will be able to cater for the increase in those who will need to this type of care in the future (due to an increase in the ageing population).

These will be people with different stages of dementia and end of life who are no longer able to stay in their homes due to their condition.

However, there will be a requirement to renew infrastructure over time and this is where the four-step proposal put forward will address this need.

Any changes would be in line with the four-step proposal.

3 Whether the current prices for Refundable Accommodation Deposits are appropriate given that the average per bed construction cost of residential accommodation is approximately $250,000.

The question is irrelevant to the way the system current works or needs to in the future. The RAD is not paid for a room as it is fully refundable at the end of occupancy. As mentioned earlier the RAD is not a "Loan".

The only reason the RAD's are of a high value is to try and earn enough interest from them to pay for the accommodation costs. The $250,000 cost has little or nothing to do with the RAD paid.

As interest rates are so low even with a $1m RAD the interest equates to only around $9,500 per year or $ 26.02 per resident per day which is just half the required amount to cover the cost of accommodation.

4 Whether there should be reforms to the existing capital financing arrangements for residential aged care, and if so, the policy rationale for these reforms. Examples of reforms could include:

a. Linking the level of Residential Accommodation Deposits more closely with the value of the accommodation received.

The is again irrelevant as the RAD is not linked to the cost of the room nor the cost of accommodation and should not be. Linking this is meaningless considering the overall daily cost of accommodation (which includes the cost of accommodation and return on investment).

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b. Phasing out Refundable Accommodation Deposits, and if so, whether that would need to be subject to an alternative arrangement and transition period.

Yes, please refer to the four-step process as an alternative arrangement:

1 The current RAD scheme (deposits) is ceased and replaced by government back loans which are required to be repaid over a long period of time based on ability to repay (this could be anywhere between 15 to 25 years).
2 Consumers are to pay the cost of accommodation which includes the cost of maintaining the infrastructure and an average return on investment (at between $35 -$55 per day depending upon nature of the accommodation). This payment is over and above the $52 per day current paid by consumers as these funds are used for the living expenses of catering, laundry, and cleaning.
3 Financing of new developments (or refurbishments) are long term investments and should be funded by the private sector over a period of 15 to 20 years paid for from the profitable operation of aged care services.
4 In the case where residential aged care services are required in rural and remote regions then if the returns are insufficient for repayment to the private sector (due to the size of the aged care facility) then the Commonwealth Government should provide funds through the operation of the low interest rate loans scheme previously operated.

c. Fixing the amount paid to providers by residents as Daily Accommodation Payments, and by the Australian Government through the Accommodation Supplement, to the weighted average cost of capital for aged care providers. In addressing this area, comments can also be provided on the Required return for aged care service providers report prepared by Frontier Economics.

Refer to my earlier comment as the Daily Accommodation Payments (DAP) should be at the $35-$55 per day rate based on the type of accommodation provided. As mentioned previously the DAP is not only to provide a return on investment but to also cover the cost of the maintenance and upkeep of the infrastructure. Currently the only income to cover this is the DAP, interest from the RAD, a combination of both or a government supplement.

Newly built accommodation would be paid more depending upon the level of return on investment required to generate cash to renew the infrastructure and/or to service debt or pay a return on capital.

The weighted average cost of capital is tied to the total rate of return of the investment (total business). The current arrangements with low payment for accommodation results in aged care providers losing money. This is a direct result of regulatory system set by the Commonwealth Government on capital funding for aged care which is no longer adequate.

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Whilst the report for Frontier Economics outlines returns it fails to recognize the difference between care and accommodation costs. There are other ongoing costs for operating residential aged care that does not form part of the report. Unfortunately, this leaves the report short on developing a complete picture on capital and ongoing accommodation costs.

d. Measures to encourage equity investment from a wider range of sources, such as superannuation funds, real estate investment trusts or private equity firms.

Refer to my earlier as part 3 of the proposal:

- Financing of new developments (or refurbishments) are long term investments and should be funded by the private sector over a period of 15 to 20 years paid for from the profitable operation of aged care services.

e. Expanding the Australian Government's capital grants program. This could include a general capital grants program similar to the arrangements that operated from 1954-97, or a more targeted program designed to improve access to residential aged care and support the establishment of providers of last resort.

The current capital grants process could only be termed a farce.

In areas for rural, remote, regional, indigenous and special needs groups (including low socioeconomic areas) the policy should be the recommencement of the low interest rate loan scheme.

Currently many aged care providers outside of the metropolitan areas and those in the low socioeconomic are unable to borrow funds from the commercial market to either renew or refurbish their accommodation.

There should be no capital grants scheme as the amount available and the administration of the scheme has proved to be inadequate.

5 How capital financing arrangements could be used to support the development of innovative or emerging models of accommodation.

My apologies but the point is a contradiction in terms. The determination of what is "innovative" is not able to be determined by anybody independent of the clients/consumers themselves.

There has been a history of Governments and Bureaucracies trying to "pick winners" with failures as a result. It is not the role of Government's to pick winners but rather support the preferences of the consumers/clients.

There are already innovative models operating in the market and these have not been recognised or supported by Government or its agencies. These models have been developed by providers to meet the preferences and demands of their clients.

Therefore, the only innovative or emerging models will be those that elderly people will want to live in. No amount of architectural or so-called design brilliance will entice people to live where they do not want to. The myth of "build it and they will come" should not be encouraged.

6 Whether the current accountability and reporting arrangements around the use of capital grants from government and contributions from care recipients are sufficient.

No, they are not as they are not policed and often abused.

A review of most current residential aged care providers will reveal that funds taken as RAD's are held in the non-liquid form of buildings. This means the ability to repay amounts as residents leave is reliant on new money coming in (a Ponzi scheme).

In the event of RAD's decreasing these aged care providers face insolvency as they are unable to liquidate their assets to repay RAD's and unable to borrow as returns in aged care are insufficient (as they are not recovering their cost of accommodation).

However, change the system to that recommended (where providers receive the current amount for their accommodation costs) and this no longer becomes a requirement.

7 Whether investment of capital grants from government and contributions from care recipients should be restricted strictly to aged care activities.

Regarding capital grants there should be none and replaced by long term low interest rate loans from government.

In terms of the restriction then any contribution should be restricted to those who are approved aged care providers.

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8 Whether there should be different capital financing arrangements for specialist facilities such as for people who are homeless or at risk of homelessness, or Aboriginal and Torres Strait Islander people.

Refer to my earlier comment:

In areas for rural, remote, regional, indigenous, and special needs groups (including low socioeconomic areas) the policy should be the recommencement of the low interest rate loan scheme.

Currently many aged care providers outside of the metropolitan areas and those in the low socioeconomic are unable to borrow funds from the commercial market to either renew or refurbish their accommodation.

9 The management of any transition issues if the existing capital financing arrangements were reformed, including the roles that both government and the aged care sector should play.

The transition should be handled by a group which consists of:

- Consumer representatives:
- Aged Care Providers representatives:
- Ministerial Advisors

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