Sustainable Financing of Aged Care Capital Expenditure: Stakeholder Perspectives

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Costs in residential aged care

• Costs associated with living in residential aged care
  o Care costs - mostly funded by the Australian Government through the Aged Care Funding Instrument (ACFI)
  o Daily living expenses – paid by the residents – mostly from the single aged pension
  o Accommodation costs
    – Residents with low means – supported by the government through accommodation supplement – income and means tested
    – Partially supported and non-supported residents pay themselves
    – housing is the consumer’s responsibility
Accommodation costs

• Australia has a unique capital financing system for residential aged care accommodation

• When a resident enters aged care, they pay their accommodation through:
  o A refundable accommodation deposit (RAD) – lump sum payment
  o A daily accommodation payment (DAP) – a rent styled payment
  o Or a combination of both

• RADs are used to fund capital expenditure
  o Significant refurbishment and develop new facilities
  o Total value held by providers $30.2b (2018-19)

• Capital expenditure is also funded through equity, commercial debt, donations, endowments and capital grants
Background

• 1997: Accommodation bonds introduced to increase investment in nursing home stock

• 2013: Living Longer Living Better (LLLB) reforms

• 80,000 new beds are required to meet demand over the next decade (projected by ACFA)
  o Refurbishment and rebuilding current stock
  o Combined total investment of $51 billion: this will require a substantial increase in RAD balances
In recent years, there has been a shift away from RADs to DAPs. Providers have no choice over whether a resident pays a RAD. This has left them exposed to a reduction in RADs given this shift.
Conflicting views on the role of RADs in residential aged care:

- The Royal Commission into Aged Care Quality and Safety recommended
  - Phasing out of RADs for new residents
  - For government to assist providers to transition away from RADs
  - Establishing an aged care accommodation capital facility

- Aged Care Financing Authority
  - No obvious and immediate alternative funding models to RADs
  - A system offering RADs and DAPs to consumers are appropriate

- Residential Aged Care Accommodation Framework
  - Seek to clarify whether a viable alternative capital financing mechanism exists
  - Framework to commence from 1 July 2024
Research aims

- Previous literature on aged care financing has focused on:
  - Consumer choice between RADs and DAPs (Abiona, Yu, Woods, & van Gool, 2020; Cutler et al., 2021)
  - Care costs (Fine & Chalmers, 2000; Sherris, 2021)
  - Several government initiated inquiries explored specific components of accommodation payments

- Our study aims to evaluate:
  - the role of RADs in the residential aged care sector
  - the potential impact from a significant reduction in RAD balances on the sector’s sustainability
  - Identify possible government policy responses
Method

• Use qualitative methodology
  o Ability to provide rich descriptions of complex phenomena
  o Illuminate the experience and interpretation of event by stakeholders

• Grounded theory
  o Used to develop a theory grounded in the behaviour, words and actions of those being studies (Goulding, 2020)
  o Involves iterative process, interrelated planning, data collection/analysis and theory development (Vollstedt & Rezat, 2019)

• This study follows the general principles of grounded theory (Corbin & Strauss, 2008)
  o Modified practical approach in carrying out analysis
Data

• Purposeful sampling to start the sampling process
  o Identified and recruited a wide range of stakeholders of interest with experience and knowledge

• 14 stakeholder interviews (60 minutes)
  o 6 lenders, 3 peak provider representatives, 2 peak consumer representatives & 3 valuers

• 5 focus groups (90 minutes)
  o 23 providers based on size of RAD balances, number of beds, ownership type

• Provider survey
  o Online survey of 300 providers (representing 35% of all approved providers)
Analysis method

• Used inductive constant comparative method
  o Analysed and coded the transcripts using Nvivo
    – Decomposed into small components to identify categories and concepts
    – Systematically categorised and compared themes to find patterns of data
    – Iterative process until themes became more developed to form unified explanations of the research questions
Themes: Use of RADs

• Access and uses of RADs vary by provider
  o Depends on provider preferences, characteristics, debt and liquidity level, and location of facilities
  o Uses include:
    – Invest into capital to avoid paying commercial debt
    – Repay bank debt and acquire land
    – Generate income through term deposits

• Preferences for RADs vary by providers
  o Preferences are mostly determined by desire to undertake capital expenditure
  o Some prefer a mixture of RADs and DAPs to reduce operational and capital investment risks
Themes: Advantages of RADs

- RADs represent a low-cost loan for many providers
  - Allow providers to access cheaper debt compared to commercial debt
    - at rates lower than the Maximum Permissible Interest Rate
    - MPIR is the government set interest rate used to calculate DAP on a specific RAD value, used to determine equivalence between RAD and DAP
    - MPIR is currently around 4%
  - Increases opportunity for providers to access commercial debt not otherwise obtainable
    - Provider’s ability to attract RADs = capacity to repay debt
  - Allowing them to undertake significant capital expenditure
Themes: Risks associated with RADs

• RADs can create a volatile capital structure
  o RADs are a current liability but are used to finance capital expenditure which is a non-current asset
  o Requires continual monitoring and management
  o Significant reduction in RADs can create solvency risk
  o Provider’s capital expenditure, liquidity and solvency are exposed to shifting consumer preferences away from RADs

• RADs incur administrative costs for providers
  o Smaller operators may struggle understanding prudential and compliance requirements
  o Providers with RAD balances must ensure they remain liquid to repay RADs to exiting consumers
Themes: Disadvantages of RADs

• The choice between RADs and DAPs is not well understood by consumers
  o Complex financial decision – impacts on assets and income
  o Some providers may try to manipulate the choice towards RADs

• RADs may impose barriers to entry for equity investment
  o Limited public information available on how RADs are treated
  o RADs not understood by international investors given they are unique to Australia

• No viable alternative to RADs currently exist
  o Not enough lending capacity from banks to substitute RADs
  o Lack of equity investment due to low profitability and uncertainty in the sector
  o Real estate investment trusts (REITs) are common overseas but current market does not generate enough yield for healthcare REITs to work in Australia
Reduction in RAD balances

• A reduction in RAD balances would impact on providers differently depending on their reliance on RADs
  o Benefit those not undertaking capital expenditure
  o Negatively affect providers mostly using RADs for capital expenditure

• Whether the government should intervene should depend on the size and timing of the reduction

• Any liquidity problems from significant reduction in RADs can lead to facility closures and consumer distress

• Australia government is responsible for consumers accessing residential care
Policy interventions

- Government can enforce liquidity and capital adequacy requirements on residential aged care providers

- Create a more viable market for equity investment or REITs
  - Greater return on investment required

- Remove RADs from aged care financing
  - As recommended by the Royal Commission
    - Phase out by 2025, government establish a capital facility
Policy interventions

• Accommodation capital facility
  o Government to guarantee providers’ commercial debt
    – Increasing a bank’s ability to lend to providers
  o Develop loan facility for providers to access capital
    – If providers cannot obtain commercial debt or equity
    – Funded by government’s access to cheap debt via their AAA credit rating
    – Providers can invest surplus RADs back with higher returns
    – Creating risk pooling amongst providers

• Stakeholders’ view: RADs can only be removed if there is a stable alternative, detailed transition plan and over long period of time
Thank you

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