Finance & Public Administration Committee
Inquiry into Residential and Community Aged Care

Perth Hearing 30 January 2009

Questions on Notice to Grant Thornton Australia

Questions 1 and 2

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Senator CAMERON—Can I put two questions on notice?

CHAIR—You certainly can, Senator Cameron.

Senator CAMERON—Could you give the committee some idea of the declining housing values and how that will affect people's capacity to meet bonds—

Mr Ansell—Yes.

Response:

Whilst I am unaware of specific research undertaken into the impact of the declining property market on residential aged care, there have been two critical impacts for our own clients.

Firstly, the level of accommodation bonds contributed by residents is heavily influenced by the realisable value of their property. In a declining market this relationship is reflected in lower bonds.

Secondly, significant increases in the time required to sell properties has resulted in delays in bond receipts. Most of our clients across Australia are experiencing such delays and many residents are opting for periodic payments in lieu of bonds.

Recent estimates released by the ANZ indicate that the average time taken for residents to pay bonds after admission has extended from around 2 months to 4 months since the markets have deteriorated and periodic payment of bonds has increased from 10% to 20% or residents.

Senator CAMERON—if anyone has done any analysis on that? I think that is something that will be an issue. You spoke about some analysis you have done in Europe. Could you provide the committee with any analysis of best practice government approach in Europe in terms of the care industry?

Mr Ansell—Your first question was in relation to the impact of the condition of the property market at the moment?

Senator CAMERON—Yes.

Response:

The reference to European aged care models was made in relation to the concepts of "Consumer Directed Care" and "Consumer Choice". The most comprehensive research into international models that focus on these principles was released as part of the *Review of Pricing Arrangements in Residential Aged Care 2004 (The Hogan Review - www.health.gov.au/internet/main/publishing.nsf/Content/health-investinginagedcare-report-index.htm)*. The specific section of the report has been attached to this response with additional reference material for more recent international research undertaken by Mr Ian Hardy AM.

The importance of consumer choice and consumer directed care is explored further in the recently released "Productivity Commission research Paper, *Trends in Aged Care Services, September 2008 (www.pc.gov.au/research/commissionresearch/aged-care-trends)* in the context of Australia's ageing population and growing diversity among older people. In the current environment, the over-regulation of residential aged care in this country has a direct and increasing impact on consumer choice. The report concludes that:

> "The ability of older Australians to exercise choice is limited by regulatory and financing arrangements that effectively ration the quantity, and limit the mix, of available services. The ability of providers to differentiate their services in terms of price and quality is also highly constrained."
>
> "It is increasingly recognised that these restrictions combine to limit the scope for effective competition between providers, weaken incentives for innovation in service design and delivery, distort investment decision making, and risk the long-term sustainability of aged care services."

Similar conclusions on the restrictive impact of over-regulation were presented in the *Hogan Review*:

> "First, they diminish the extent of competition between providers and, in particular, make it more difficult for prospective providers to enter the market. Second, they restrict consumer choice and reduce the consumer's ability to bargain over entry conditions. Third, they curtail innovation in service design and delivery. Finally, they adversely restrict enterprise mix and investment in the sector."

More recently, The National Health and Hospitals Reform Commission's *A Healthier Future for all Australians - Interim Report December* 2008 *(refer http://www.nhhrc.org.au/internet/nhhrc/publishing.nsf/Content/interim-report-december-2008)* adopts the consumer directed care principles tested in international communities. The interim report argues:

> "The current program design and administration of multiple community and residential aged care programs distort older people's choice of care, restrict their control over their care, and hinder their continuity of care when moving from one kind of aged care to another."
>
> "The regulation of aged care, and in particular restrictions on the number of aged care places, limits choice for older people, reduces competition between providers, results in high occupancy and correspondingly low vacancy rates, and so limits incentives for providers to be entrepreneurial and responsive to older people and their families."

Question 3

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Senator MOORE—Could you give the committee some detail about the role that your organisation has played with aged care, following on from Senator Humphries' question about how you first got involved, the work you did, the contract arrangements, and what you are doing now in terms of the decision to move into doing it as a public consultancy and then putting it out. I know Senator Adams has questions on notice from Senate estimates, but I am interested in how that links in with the government—just a synopsis of the process so I can understand about the information gathering and the interchange.

Mr Ansell—Certainly.

Response:

Grant Thornton Australia Ltd is one of Australia's largest national accountancy firms and provides services in the aged care industry in two main areas:

1. Provision of professional services to providers of aged care services to enhance efficiency and service quality; and
2. Research into major trends in the sector to assist industry and government to make decisions regarding resource allocation and policy.

In the second component of this work, Grant Thornton Australia Ltd (then Bentleys MRI Perth Pty Ltd) was engaged by the Department of Health & Ageing under Deed of Standing Order No C0860607 in May 2006. We were re-appointed under a new contract in May 2007 for the same services.

The contract required us to review General Purpose Financial Reports furnished by almost all Australian aged care providers, which had been submitted pursuant to the Conditional Adjustment Payment (CAP) requirements of the *Residential Care Subsidy Principles 1997*. The objective was to provide benchmarking data to the industry to facilitate improved financial management and corporate governance across the sector through analysis of financial performance.

The initiative was recommended in the Hogan review and our role was to provide specific reports to individual providers of residential care on their performance. We were also required to provide a broader industry report utilising aggregate trend data derived from the analysis of financial reports.

Our analysis of the three years under review (2004, 2005 and 2006) revealed deteriorating financial results, which was consistent with our experience working directly for clients. (refer www.grantthornton.com.au/files/aged_care_survey_2008_2nd%20report.pdf). We provided a report to the Department of Health & Ageing on these national trends. This report was not released to the public.

During the 2007 financial year, many of our aged care clients experienced continuing declines in financial returns and this was particularly prevalent for operators of modern high care facilities. Although the 2006/2007 financial reports of providers were submitted and analysed by the Department of Health & Ageing, the results were again not released and there was little empirical evidence to demonstrate the problems being experienced in the industry.

With a growing number of our clients now deferring or abandoning redevelopments and new developments, Grant Thornton decided to conduct a major independent analysis of financial performance in the industry and its impact on consumer choice.

The research was undertaken at no cost to the industry or the government and all aspects of the survey were funded internally by Grant Thornton. Professor Warren Hogan, who also led the Hogan Review, contributed his time to the initiative without remuneration.

The survey achieved a much greater response rate than we originally anticipated, with data provided from about one quarter of nursing homes and hostels across Australia. This made it the largest independent study of its kind with representative distribution between Australian regions and sectors. The first report was presented to the Honourable Lindsay Tanner MP, Minister for Finance and Deregulation and the Honourable Justine Elliot MP, Minister for Ageing on 14 October 2008 (refer www.grantthornton.com.au/files/aged_care_survey_2008-final.pdf). A representative of the Department of Health & Ageing was also in attendance.

Grant Thornton extended an invitation to the Ministers and the Department to request any trend information from the survey to assist in directing future policy. The Minister for Finance and Deregulation requested additional information and this was provided in December 2008. There have been no requests for further information from the Department.

Question 4

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Senator BOYCE—My questions are on notice, Mr Ansell. Could you give us an indication of the quantum of bonds—the sort of typical level of a bond and any information that gives us a sense of the variations. Would high-care bonds improve the return on investment for operators in the aged-care industry? The average length of stay in high care would be a useful figure to have. If possible, could you talk a little more about the comments you make on page 10 of the report that we have about unbundling residential care and what that would mean? Who would fund or provide the separate elements that you are talking about and what would it look like?

Mr Ansell—Certainly.

Response:

1. Bond Averages and Length of Stay Information

According to the *Report on the Operation of the Aged Care Act 1997 - 1 July 2007 to 30 June 2008*, the average accommodation bond agreed with a new resident in 2007-08 was an estimated $188,798 and the median new bond amount was an estimated $155,000.

The Australian Institute of Health and Welfare report, *Residential Aged Care in Australia 2006-07: a Statistical Overview*, showed that the average length of stay for permanent residents has increased from 131 weeks a decade ago to 146 weeks (167 weeks for women and 110 weeks for men) in 2006-07.

2. Resident Accommodation Contributions

The findings of the Grant Thornton Aged Care Survey 2008 revealed that the average cost of building new facilities was $176,000 per bed. Including land costs, most operators will need to invest in excess of $200,000 per place built.

As high care residents now represent the majority of residents (a trend that will be will be accelerated through the operation of the Aged Care Financial Instrument (ACFI)), the majority of residents will not contribute a bond to offset the building costs.

The report also demonstrates that modern high care services produce a return of investment of around 1.1% before financing costs and depreciation. The recurrent payments from government subsidies and resident contributions do not provide sufficient revenues to develop viable residential aged care models. Provider investment levels in residential aged care infrastructure is at its lowest since the introduction of the Aged Care Act 1997 at a time when demand for modern high care services is at the highest level in Australia's history.

The issue of sustainability is critical not only from the perspective of providers of aged care, but also for Australian taxpayers who will be required to fund much of the cost of providing aged care services. A sustainable aged care industry will need to facilitate a balanced appropriation of taxpayer and user contributions to ensure that future generations of taxpayers are not unfairly or unnecessarily burdened with the growing care costs associated with an ageing population.

The major research studies referred to in Question 1 &2 above conclude that accommodation bonds in high care would help to address the capital creation challenge. Grant Thornton believes that policy reform in this regard must ensure that consumer choice should be the primary influence on the accommodation payment option. In our opinion, residents should be able to negotiate with the provider as to whether they make a recurrent payment (such as a rental payment), an up-front refundable capital sum or a combination of both. The choice should reflect the accommodation and service options available as well as the financial situation of the person consuming those services.

It is also imperative that safety-net provisions protect those people that are unable to pay for the accommodation they need. If consumer choice is enhanced through deregulated pricing models, limited taxpayer contributions can be better directed to provide access to the financially disadvantaged and people in the non-urban regions of Australia.

3. "Unbundling" Aged Care Services

The Productivity Commission research Paper, *Trends in Aged Care Services, September 2008* promotes the 'unbundling' of residential care service components to ensure that appropriate and consistent public financing principles are applied to each component across different types of care.

The report argues that there is a strong case that those receiving aged care in their home or in a residential facility should be required to meet the cost of their accommodation and every day living expenses from private means. These are fairly predictable expenses of everyday life and are not exclusively associated with increasing frailty or disability.

The *Hogan Review* distinguished between hotel and accommodation services (the equivalent of everyday living expenses and accommodation), personal care and health care. Thus, the Hogan Review identified 'health care' services as separate from 'personal care'. With regards to personal care and health care it argued:

- Personal care services — these should be seen as primarily a personal responsibility, with a limited suite of basic necessary services available at Australian Government expense on a means-tested basis to those who are independently assessed as needing them.
- Individuals should be able to use their private resources to purchase additional personal care services.
- Health care services — basic necessary services should be provided free of charge to all those who are independently assessed as needing them. A specific co-payment is unnecessary as the bundling of services, together with the financing arrangements for hotel and accommodation and personal care services, means that the individual has already made a considerable private contribution. Individuals should be able to use their private resources to purchase additional health care services.

Whilst the principles would need to be developed with reference to the government's broader health and welfare policy framework, the unbundling of residential aged care services would provide the foundation for a system that enhances consumer choice and facilitates sustainability for both providers of care and the Australian taxpayer.

Question 5

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Senator RYAN—My question was about the burden of state taxes, particularly property taxes, on this sector. As I understand it, the application of those will vary between states and will also vary between for-profit and not-for-profit organisations. I would be interested in any information you had on the application of stamp duties and land taxes, particularly around those issues you raised about the high cost of land, particularly in inner urban areas; secondly—and you may or may not have a comment on this—whether or not the current challenges in the financial markets around raising equity would add something to the findings you made in your survey and report.

<u>Response:</u>

A separate paper has been attached concerning the burden of state taxes.

A major impact from the financial crisis has been on provider borrowings. The recent, high profile insolvencies reported in the media reflect a small proportion of providers in financial difficulty and operators are under increasing scrutiny by their financiers in the current economic environment.

Many of our clients have borrowed to redevelop services and have found that their modern services generate significantly less returns than their original facilities, which predominantly operated with shared rooms. The difficulty in servicing debt and the increasingly cautious banking sector is likely to result in many more insolvencies and administrations in the coming years.

A survey of the Not-For-Profit sector undertaken by Grant Thornton in 2004 indicated that approximately 68% of providers interviewed would be borrowing from banks for the first time. Our research indicates that external debt in the industry is now at record levels. In the absence of reform, the combination of poor returns and deteriorating financial markets increase the risk of large operator failures.

<u>Question 6 and 7</u>

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Senator PARRY—I have two quick questions. You mentioned the percentage of bond that is retained. Could you provide some sort of table or indication as to what that minimum percentage is. Also if you have any information about cross-subsidisation—if there are people at the high end of the market subsidising the low end of the market—that would be great. Thank you.

<u>Response:</u>

The maximum annual retention a provider can draw from an accommodation bond is $3,150. This is usually deducted monthly on a pro-rata basis for a maximum of 5 years. A resident that pays a $190,000 bond that exits a facility after 5 or more full years would be returned $174,250.

There is little research available on the level of cross-subsidisation. Historically, many of our larger clients with multiple services have found that their low care services and retirement living have enabled them to absorb poor returns on modern high care facilities. The up–front resident contributions paid for retirement village units and hostels (low care services) are used to offset construction costs and their returns have traditionally been stronger than high care.

The depressed property market has had a major impact on retirement village developments and there is now a reduced capacity to subsidise modern high care facilities that are unviable as stand-alone services. In addition, the introduction of ACFI on 20 March 2008 is already having a significant impact on hostels as subsidy appropriations for low care residents are declining.

Our first survey report highlights the importance of reviewing pricing arrangements in residential aged care and undertaking research into the cost of delivering care to achieve better correlation between subsidy allocation and indexation. This work is now being undertaken by Grant Thornton with the support of the industry.