Aged care survey 2008

Summary Findings October 2008

Welcome to Grant Thornton Australia's 2008 Aged Care Survey.

Contents

Australia's population is rapidly ageing. As a consequence, the challenge of meeting the needs of the elderly must be one of our nation's greatest priorities. The provision of quality and choice in our aged care services is paramount in a developed economy and the models employed to deliver those services must be responsive to demand as well as being economically sustainable.

The Grant Thornton Aged Care Survey examines changing trends in the aged care industry to evaluate the extent to which our current funding and policy models promote service quality and choice for Australia's elderly population.

This study has been undertaken with the invaluable support of Professor Warren Hogan and follows on from his important work in the *Review of Pricing Arrangements in Residential Aged Care 2004* (the Hogan Review). The Grant Thornton Aged Care Survey examines the changes which have taken place since 2004 using the feedback and financial data from almost 700 nursing homes and hostels throughout Australia, making this the largest independent study of its kind. This data has been used to directly interpret the impact of changing trends in demand on the aged care providers responsible for meeting consumer needs.

This preliminary survey report presents some of the key trends from the survey and more detailed data will be released in the coming months. Grant Thornton would like to express our appreciation to those who supported this initiative, with special thanks to Professor Hogan, the Aged Care Association of Australia, Aged & Community Services Australia, Catholic Health Australia and Stewart Brown & Co.

Cam Ansell
National Head of Aged Care Services
Grant Thornton Australia Ltd

Overview and summary of findings

The Grant Thornton Aged Care Survey provides an independent perspective of the impact of changing demand on the aged care industry. Workshops were held with providers of aged care services throughout Australia and members of the Grant Thornton team have consulted with staff and residents throughout the country.

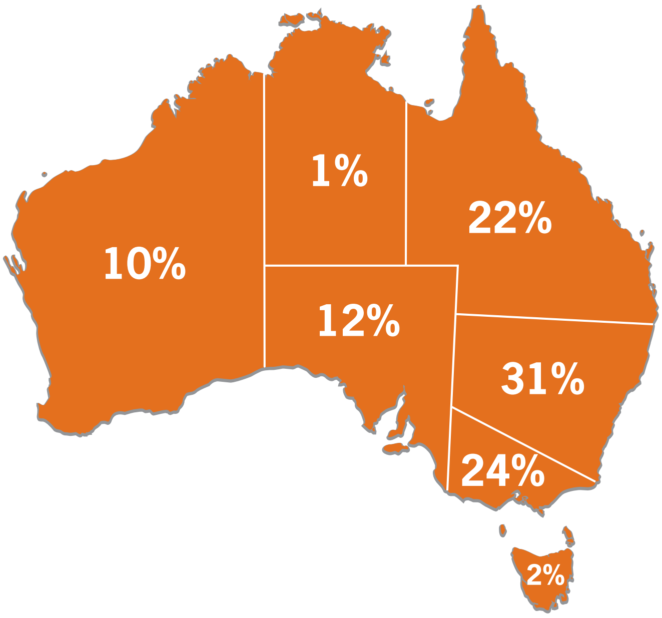
Aged care providers were asked to submit information regarding their financial performance, major influences on their operations and development options for the future. Industry specialists within the Grant Thornton team collated and analysed survey responses to ensure the integrity and objectivity of the information provided. Our staff followed up with survey participants and sought further feedback on critical challenges and opportunities in the sector.

At the time of this initial report, responses had been received from 686 facilities, representing almost a quarter of all facilities. Some late submissions will be presented in subsequent publications. The Grant Thornton Aged Care Survey provides a balanced statistical population analysis of For Profit and Not-for-Profit entities in all major regions.

Key findings were as follows:

- Consumer demand for privacy, dignity and comprehensive care have become the major influences on the design of modern aged care facilities in Australia. As residential care demand moves increasingly toward high levels of care, single bedrooms and extensive services and amenities are preferred.
- Aged care service providers' average earnings before interest, taxation, depreciation and amortisation (EBITDA) in 2008 was $2,934 per bed per annum which is a deterioration from 2007's $3,211.
- Modern high care facilities with single bedrooms reported the worst results, averaging $2,191 compared to $4,233 per bed achieved in older facilities with shared rooms. This represents an average return on investment of approximately 1.1% for modern, single bedroom facilities.
- The increasing costs of construction and low returns were cited as the principal impediments to redevelopment of aged care facilities and much of Australia's building stock remains dated.
- The regulatory and pricing framework now threatens the viability of the aged care sector by suppressing incentives to invest in modern aged care infrastructure. This decline in investment severely limits choice for consumers of aged care services.

Breakdown of aged care facilities surveyed, by state



Industry context

The Australian aged care industry

There are over 2.8 million Australians aged over 65 and approximately half of those require some level of assistance with their every day activities.

The most common aged care services are provided to consumers in their own home and are commonly referred to as "community care programs". State and Federal Government agencies funded community care services for approximately 760,000 people in Australia in the year ended 30 June 2008.

Residential aged care is provided to those aged people with physical, medical or social care needs which are not met in the community. At 30 June 2007 there were around 145,000 Australians in residential aged care services (which are also referred to as nursing homes and hostels). Residential care services represent the most resource intensive aged care service and are the focus of this report.

The two primary forms of residential care are low care and high care. Low level care includes the provision of suitable accommodation and related services (such as cleaning, laundry and meals), as well as personal care services (such as assistance with dressing, eating and toileting). High level care includes accommodation and related services, personal care services and nursing care.

Australia's aged care system is extensively regulated with respect to quality, quantity and price. Residential aged care is highly subsidised by government and provides limited capacity for residents to influence the delivery of their aged care services.

Consumer demand for residential aged care services

The ageing of Australia's population will have an enormous impact on all aspects of aged care services. Over the next four decades, the number of people aged over 85 years will quadruple to around 1.6 million. At the same time, the growing diversity in the care needs, preferences and wealth of elderly Australians is likely to cause major changes in demand.

Over the past decade, such changes have shaped the industry. Some of the key trends are considered below:

Shifts in demand for care services

Between 1998 and 2007, the number of elderly people receiving subsidised care in Australia increased by more than 50%, with a dramatic increase in the demand for community care services.

The vast majority of Australians prefer to remain in their homes as long as possible. Community care is less costly to deliver and the Federal Government's support has greatly reduced the level of demand for residential low care services. This shift reflects the policies of successive governments.

As a result of the expansion of community care programs, the proportion of residents requiring residential low care services has been steadily falling and most residents are entering residential care with higher care needs – 70% of permanent residents were assessed as requiring high care at 30 June 2007, compared to 58% in 1998.

The ageing of Australia's population can be expected to greatly accelerate these trends which will require significant investment in modern high care facilities. Many existing Australian aged care facilities are not designed to support high care residents.

Preferences in accommodation – privacy and amenities

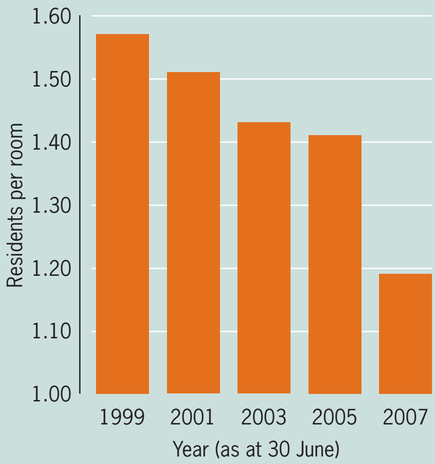
One of the greatest influences in the past decade has been the preference for privacy and personal space. Single room services are a high priority for residents. In response to this demand, the majority of planned facility developments in the survey had single rooms. Government building certification requirements also limit the number of residents per room in new facilities.

Aged care providers have been meeting this demand and the average number of residents per room in Australian residential care facilities has decreased significantly.

Historically, Australian nursing homes were designed to maximise efficiency in the delivery of care whilst containing the cost of their contruction. Higher density facilities maximise utilisation of floor space and greatly reduce construction costs per resident. In contrast, modern facilities are less institutional with resident amenities, recreation and rehabilitation, storage and common areas that are more expansive. These larger facilities generally require greater levels of staffing to operate.

Meeting these demands requires a substantially higher level of investment in buildings, land, equipment and human resources.

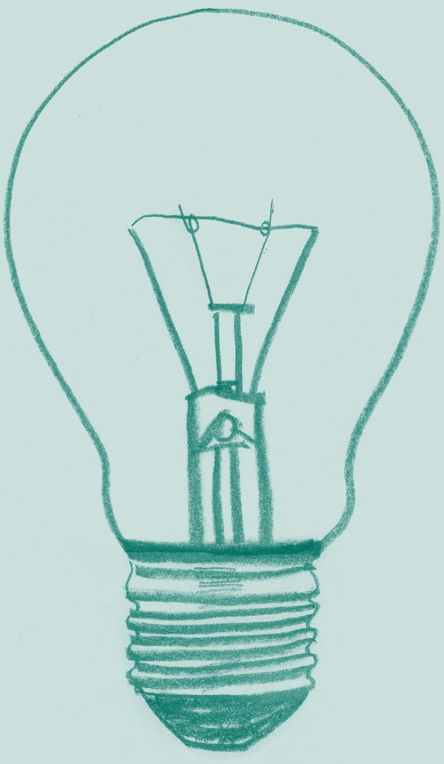
Figure 1: Average residents per room



Service access and location

The growing diversity of consumers of residential care services will necessitate flexibility to meet a wide variety of needs and preferences. Whilst the baby boomers presently represent the wealthiest households in Australia, the aged care sector will need to be able to provide quality aged care services to a large number of people that are reliant on government supported income.

Most elderly Australians prefer to enter residential care services that are near their family home, and their families. Family contact greatly enhances the quality of life for residents and consumers are prepared to go to great lengths to obtain this.

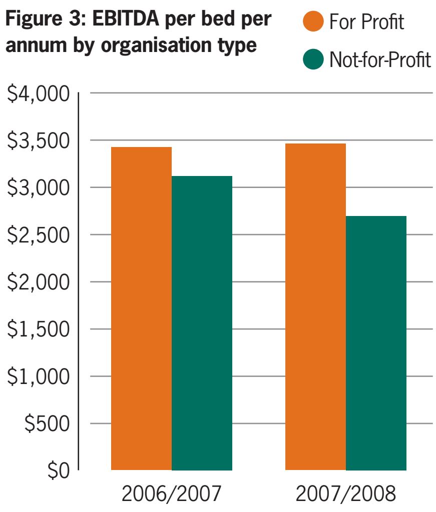


Survey findings

Providers of residential aged care services are experiencing low and deteriorating financial returns at a time of unprecedented demand for high care services. This is particularly the case for the modern, single room facilities most preferred by consumers. Older, institutional facilities with shared rooms consistently outperformed new services. These results reveal a lack of incentive to renovate old facilities, or to build new ones, representing a threat to the viability of the residential aged care sector.

Figure 2: EBITDA per bed per annum

Figure 3: EBITDA per bed per annum by organisation type



Trends in provider performance

Analysis was conducted consistent with measurement principles of the Hogan Review. Because of the great diversity of aged care providers within the industry, the primary analysis has been undertaken using measures of earnings before interest, tax, depreciation and amortisation (EBITDA). This has facilitated the analysis of financial performance in a sector-neutral way without the influence of the differential tax or financing arrangements between the for-profit and not-for-profit sectors.

The average EBITDA for all facilities in 2008 was $2,934 per bed per annum which represents a deterioration of results from the 2007 average of $3,211 (Figure 2).

The most common explanation given for the declining financial performance was that staff and general care costs were escalating faster than increases in Government subsidies.

The average non-government facility EBITDA from the Hogan Review (based on 2003 financial data) was $2,626 per bed per annum. This indicates that, in present day dollars, the overall performance of the industry has declined.

A comparison between For Profit (32%) and Not-for-Profit (68%) indicates that the For Profit sector generates higher returns.

The Not-for-Profit sector indicated that their deteriorating financial position necessitated more 'commercial' policies in relation to resident aged care admissions. This has often come at a cost to the financially and socially disadvantaged people in these programs.

The average anticipated building cost for new facilities was $176,000 per bed excluding land costs. This compares with estimated construction costs of between $74,000 and $85,000 per bed in 2003. The increase represents both a change in the cost of construction as well as the changing expectations of consumers.

Perhaps the most critical analysis from the survey relates to the disparity in returns for modern (single bedrooms) and older (shared bedrooms) facilities (Figure 4). The average EBITDA on shared room high care facilities of $4,233 per bed per annum was almost double the $2,191 average achieved in single room services.

The poor return on single room facilities reflects the greater investment required to operate large, modern facilities that have been built to meet consumer demand and government building certification requirements. Whilst the costs of building and operating these services is greater, the level of subsidy revenue and resident contributions do not change.

Unlike low care services, current legislation prevents high care residents from contributing accommodation bonds upon admission to high care facilities. As a result, most new high care facilities must be financed through external borrowings and the financing costs have a major impact on the viability of providers that operate on such tight margins.

Based on the construction costs referred to previously, and assuming a land cost correlation consistent with the Hogan Review of 10% of building costs, the average return on investment for single room services is estimated at 1.1%.

The impact on consumer demand

Investment in new residential aged care infrastructure

Many operators have deferred or abandoned plans for the redevelopment of their aged care services because of the level of investment required and low returns generated from facilities that meet preferences.

Many of the new aged care places allocated by the Government remain unused or have been returned. There was an under-subscription for aged care places in some States for the first time in the 2007 Aged Care Approval Round. While significant investment has been made to meet demand for modern facilities, the survey results indicate that much of Australia's aged care buildings remain dated.

Figure 4: EBITDA per bed per annum by room type

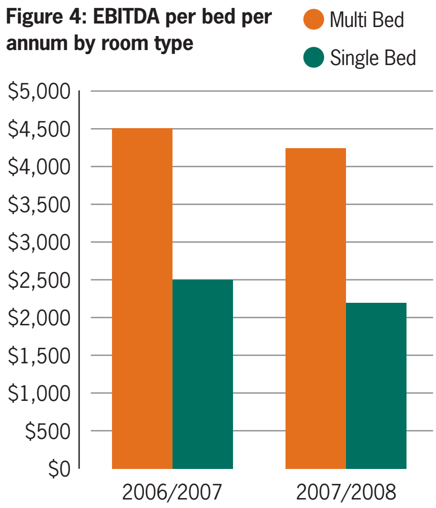
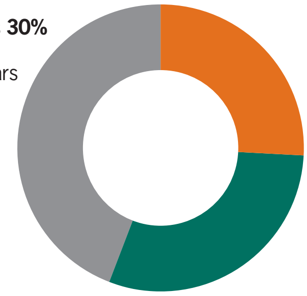


Figure 5: Age profile of facilities in Grant Thornton Aged Care Survey

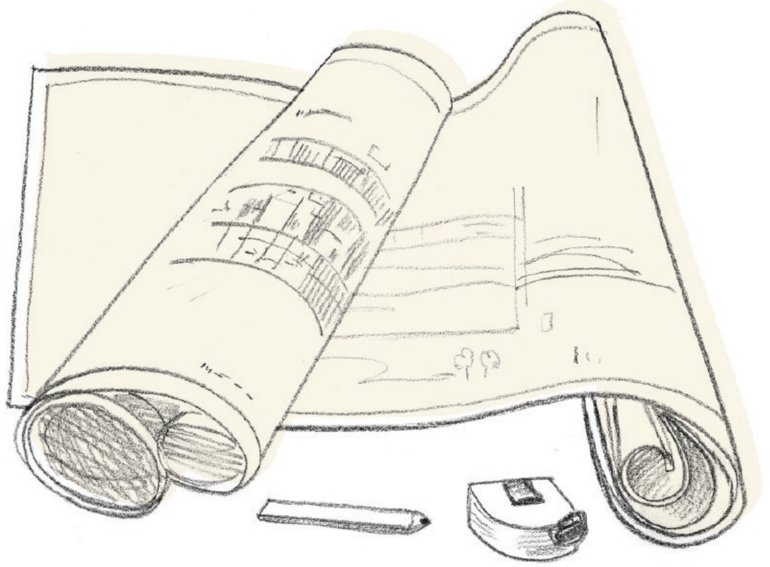


Cost pressures also play a part in the location of new aged care facilities. Increasing land costs and the demand for larger more home-like environments mean many inner city facilities are being relocated to outer suburbs where land is more affordable. This creates a distressing situation for both existing and prospective residents that would be willing to contribute more financially to remain close to friends and family.

Despite the predictability of cash flows from aged care operations and the commercial opportunities associated with a rapidly ageing consumer base, the increase in private For Profit investment has been negligible with their share of residential care beds increasing from around 29 per cent in 1998 to 32 per cent in 2007.

Grant Thornton's work with major investment groups reveals that most hold grave concerns regarding the feasibility of investment in modern aged care infrastructure under current pricing arrangements.

The Government has responded by offering $300 million in interest-free loans. However, a sustainable industry must be able to reward efficient operators with commercial returns. This decline in investment severely limits choice for consumers of aged care services.



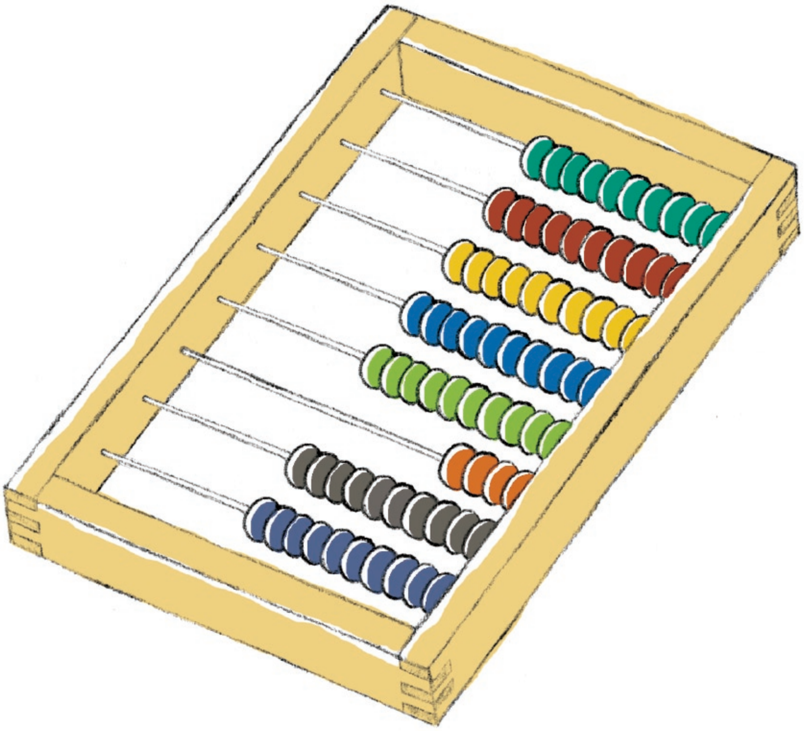
Aged care funding instruments and equity of access

The Government's new Aged Care Funding Instrument (ACFI) came into effect on 20 March 2008. Like the previous Resident Classification Scale (RCS), ACFI allocates government subsidy funding based on an assessment of resident care needs. While the new assessment mechanism is expected to provide a greater weighting towards high care needs, the overall impact of this initiative is only a redistribution of resources under the same basic framework and the net change in subsidy flow will be negligible after grand parenting provisions expire.

Respondents expressed concern about the treatment of people that have valid residential low care assessments. Under ACFI, the level of funding for many potential residents is now so low, that it is not feasible to admit them unless they can afford to pay a substantial accommodation bond. As a result, many prospective residents without sufficient financial resources may be unable to access residential aged care services.

Often these people will not have access to community care services to remain at home or live in conditions where the delivery of community care services is impractical or unsafe. This represents a major challenge to meet a fundamental principle of the Aged Care Act 1997 to ensure that residential care services are accessible to all Australians.

These inequities result from a lack of correlation between the cost of delivering care and the funding provided for that care. ACFI has been developed to address inequities inherent in the previous RCS system between high and low care, however the subsidy allocations under both instruments are largely arbitrary because research into the cost of delivering care and accommodation has not been conducted.



Service quality and resident lifestyle

There is concern regarding the mounting costs of delivering care services and the measures required to operate within increasingly constrained budgets.

Statistics indicate that the number of registered and enrolled nurses in the sector has declined despite the increase in operational places. Participants expressed concern regarding the declining levels of personal contact with residents. Concern was also expressed regarding the budgetary constraints on recreation and lifestyle activities.

Financial performance and position of aged care providers

A number of recent insolvencies represent a small portion of the number of services in financial distress in Australia. The survey revealed concerns regarding the viability of small and large operators. Many operators were incurring unsustainable losses, particularly in modern facilities.

Recent media reports provide an insight into the distress caused by facility closures for residents, staff, families and the wider community. These closures are likely to become more common unless the underlying problems with current pricing and regulatory arrangements are addressed.

Recommendations

The Government's key objectives in aged care focus on quality, equity, efficiency and sustainability in the delivery of quality care.

Sustainability is particularly critical, not only for providers of aged care, but also for Australian taxpayers who fund much of the cost of providing aged care services. A sustainable aged care industry will need to facilitate a balance between taxpayer and user contributions to ensure that future generations are not unfairly burdened with the growing care costs associated with an ageing population.

The following recommendations identify ways in which quality, equity, efficiency and sustainability may be enhanced in the aged care industry. These include:

- Revisiting the key recommendations of the Hogan Report which have yet to be implemented
- Undertaking research into the cost of delivering care to achieve better correlation between subsidy allocation and indexation
- Improving the means through which industry financial information is presented and analysed

i) Review of regulatory and funding arrangements

As outlined in the Hogan Review, the Australian aged care sector is highly constrained by regulation in quantity, quality, location and price. The predominant relationship tends to be one between the Government and the provider of the service, rather than one between the consumer and the provider. The Hogan Review found that these regulatory arrangements create a wide range of economic outcomes:

"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."

The recently released Productivity Commission Research Paper, *Trends in Aged Care Services: Some Implications, September 2008*, highlights several areas for further analysis:

a. assessing the potential for unbundling residential care (separating accommodation, everyday living and personal care costs) to better reflect the underlying costs of services and enable better targeting of public subsidies to those most in need; and

b. considering the feasibility of introducing consumer-centred care arrangements to enhance the potential for older people to influence the nature and scope of the services they receive.

ii) Subsidy allocation and indexation - understanding the costs of delivering care

There exists little correlation between the costs of delivering care services and the subsidies received for providing that care. This has resulted in a mismatched resource allocation which has inhibited investment in core service areas. Recent attempts to address this through a new funding instrument has had limited impact.

In addition to facilitating appropriate subsidies based on actual costs, the determination of the resources will form an integral component of pricing review. It will also support Government planning and budgeting.

Grant Thornton is currently developing methodologies that may help to facilitate this process, paying reference to comprehensive international research conducted in recent years.

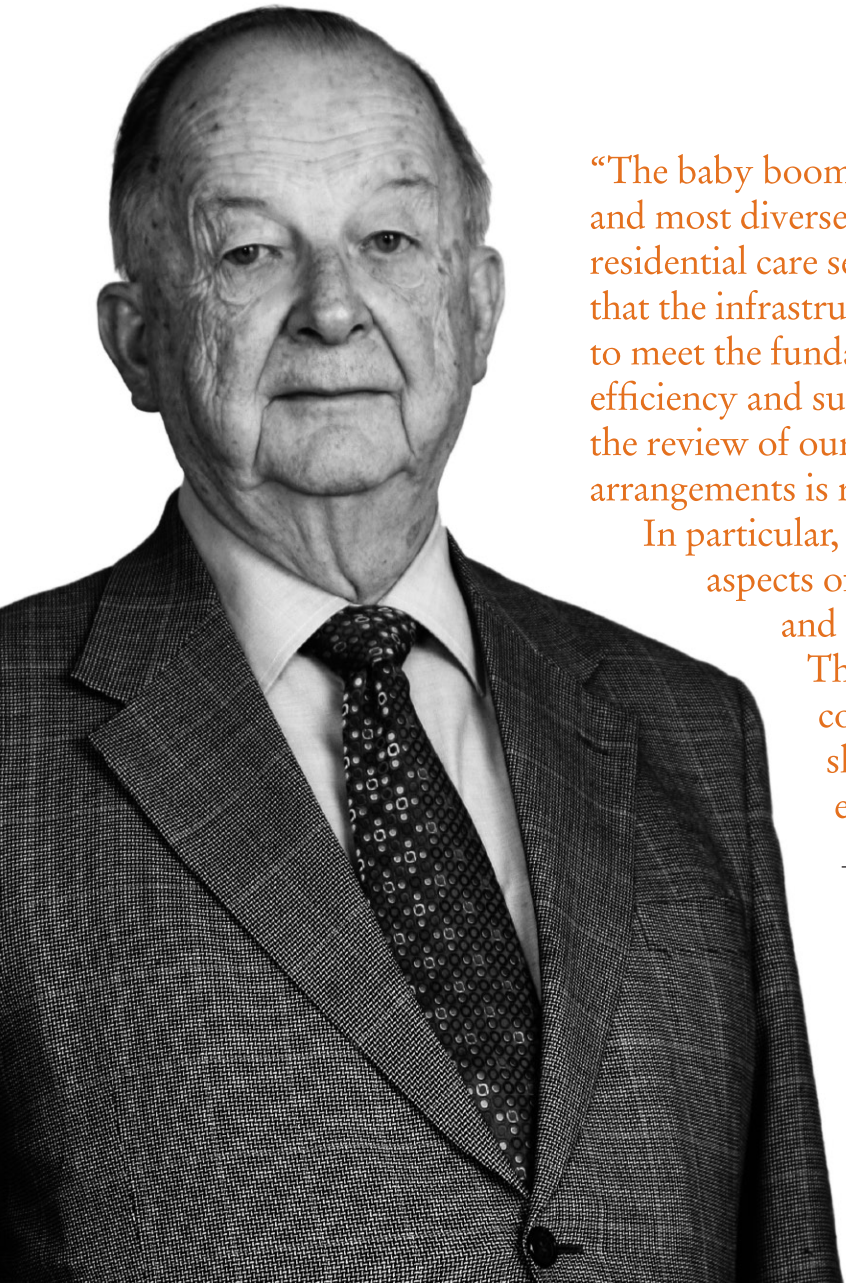
iii) The presentation and reporting of industry performance

A key recommendation of the Hogan Review was that "the existing aged care information infrastructure should be substantially expanded, building on the existing expertise within the Australian Institute of Health & Welfare and should include quality and financial performance data". The Department of Health and Ageing is implementing the recommendation and has required that providers prepare and submit audited general purpose financial reports (GPFRs) which necessitate the application of all Australian Accounting Standards.

The analysis of general purpose financial reports (GPFRs) provides little value to providers as a tool for assessing industry performance or promoting productivity gains through benchmarking. These reports are more appropriate for large publicly listed companies and their preparation is burdensome for aged care providers. The trend information provided in the Grant Thornton Aged Care Survey has enabled comprehensive analysis which is not possible using GPRFs – with less resources – by using data employed by operators to monitor their own performance.

The quality of financial data could be improved by:

a. Discontinuing the requirement to provide GPFRs and replacing them with Special Purpose Financial Reports. This would facilitate the benchmarking of key service costs and revenue drivers as well as support prudential regulation analysis; and
b. Delegation of the responsibility for collating, analysing and publishing results to an agency independent of aged care funding and policy development, such as the Australian Institute of Health & Welfare.



"The baby boomer generation will become the largest and most diverse demographic grouping to access residential care services in Australia's history. To ensure that the infrastructure and service offerings are able to meet the fundamental objectives of quality, equity, efficiency and sustainability, it is imperative that the review of our aged care regulatory and funding arrangements is revisited.

In particular, careful scrutiny must be given to those aspects of regulation which limit consumer choice and investment in modern infrastructure. The initiatives introduced to enhance consumer influence in the aged care sector should not undermine the accessibility, equity and quality of aged care services."

Professor Warren Hogan

If you want to know more, please contact us...

Adelaide
Level 1
67 Greenhill Road
Wayville SA 5034
T 08 8372 6666
F 08 8372 6677
E info@gtsa.com.au

Brisbane
Ground Floor
Grant Thornton House
King George Square
102 Adelaide Street
Brisbane QLD 4000
T 07 3222 0200
F 07 3222 0444
E newsletters.qld@grantthornton.com.au

Melbourne
Level 2
215 Spring Street
Melbourne VIC 3000
T 03 8663 6000
F 03 8663 6333
E info@grantthorntonvic.com.au

Perth
Level 1
10 Kings Park Road
West Perth WA 6005
T 08 9480 2000
F 08 9322 7787
E info@gtwa.com.au

Sydney
Level 17
383 Kent Street
Sydney NSW 2000
T 02 8297 2400
F 02 9299 4445
E newsletters.nsw@grantthornton.com.au

Grant Thornton

www.grantthornton.com.au

This research has been conducted by Grant Thornton Australia Ltd at no cost to the aged care industry or the Government. Aged care provider information submitted to the survey has been managed in the strictest confidence and the views presented in this report should not be attributed to any participant or industry group.