Submission on Capital Financing for Aged Care

October 2020

Note

For the purposes of responding to the Royal Commission's paper on capital financing arrangements for residential aged care, we have taken a broader approach and provided comments on capital financing more generally. UnitingCare Australia considers it is important to look at capital financing as it applies in a system in which service distinctions are less marked.

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About UnitingCare Australia

UnitingCare Australia is the national body for the Uniting Church's community services network and is an agency of the Assembly of the Uniting Church in Australia.

We give voice to the Uniting Church's commitment to social justice through advocacy and by strengthening community service provision.

We are the largest network of social service providers in Australia, supporting 1.4 million people every year across urban, rural and remote communities.

We focus on articulating and meeting the needs of people at all stages of life and those that are most vulnerable.

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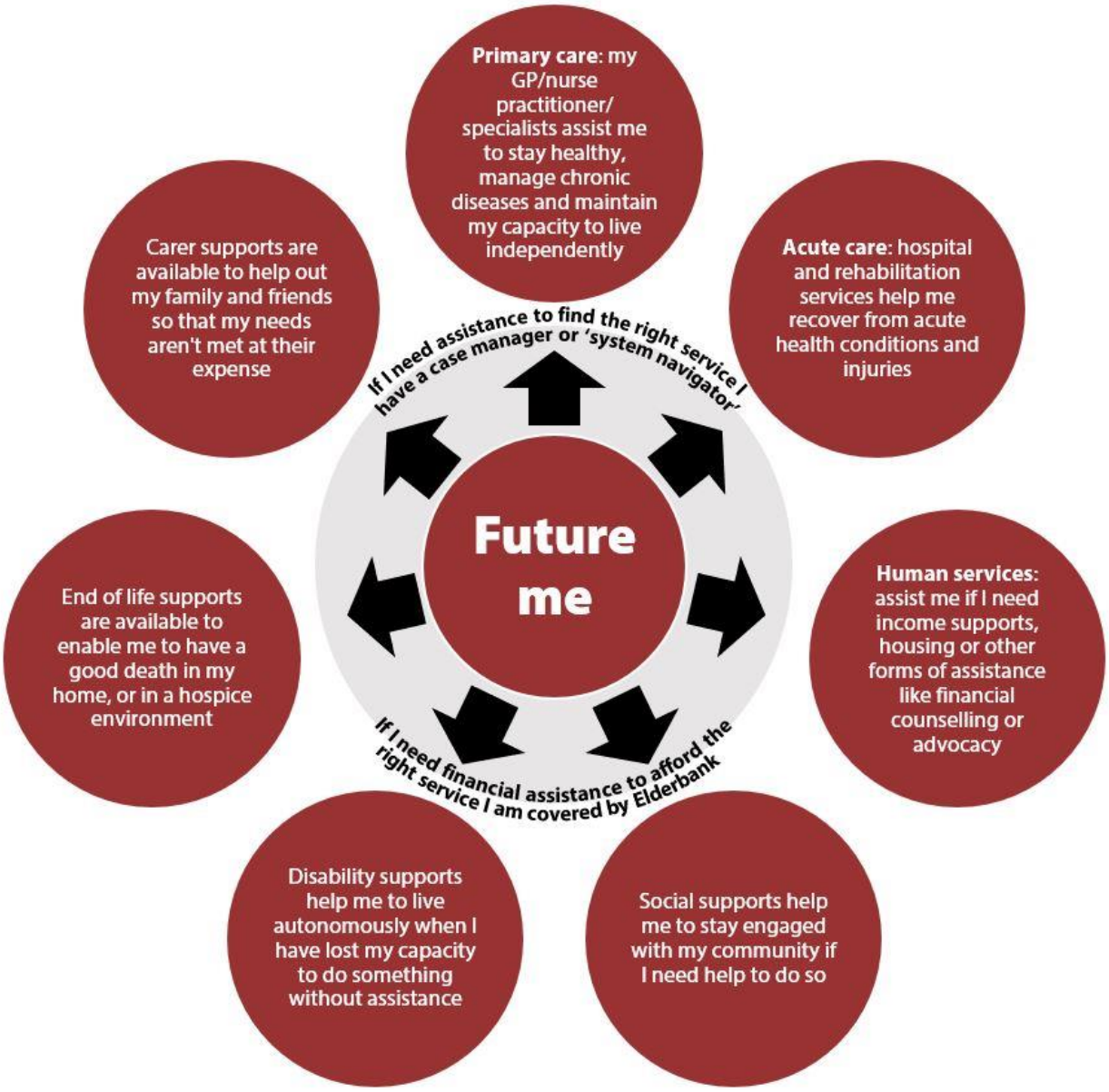
Background

Throughout the Royal Commission process, UnitingCare Australia has advocated for systems in which the sector is able to flexibly respond to the needs of individuals and their circle of support. We believe that to support equity of outcomes for all members of our community, existing concepts need to be challenged. We have, for example, supported the separation of 'accommodation' services from care and support services. This is necessary in our view to promote innovation in service delivery so that user preferences – most importantly the widespread preference to 'age in place' – can be met.



Critical points that UnitingCare believes must be considered in the context of arrangements for capital raising.

Most aspects of services for older people are associated with some form of built or other capital investment. Many types of service are highly capital intensive, notwithstanding the very high cost of labour as a proportion of delivery costs. The capital-intensive nature of the current 'high density' model of residential aged care is self evident. Less 'front of mind' are the capital needs of services ranging from meals-on-wheels to seniors' gyms to day centres and respite services. Likewise, it is well recognised that the cost of new investments is significant, and an important aim of any arrangements to support capital raising must be to increase the capacity of infrastructure in line with population growth. Arrangements must also, however, ensure the availability of capital to support ongoing investment in existing infrastructure required to comply with quality standards for environmental design, which go beyond routine maintenance and ultimately include a perpetual schedule of investment in refurbishment and upgrades.

The current financing arrangements for the capital requirements of the age care system are in need of reform. It is essential however that financing arrangements are considered as part of an integrated package that takes into account:

- the models of service, accommodation and support that exist now and are needed into the future to provide choice and affordability for the service user;
- the confidence of providers/investors to invest the substantial capital required to meet the likely needs of the ageing population;
- the current negative returns that many age care providers are experiencing;
- government regulatory controls over system requirements and funding arrangements that often reflect little credible consideration of associated costs imposed or revenue forgone.

With this in mind, it is difficult for UnitingCare Australia to propose in detail alternative suggestions for capital raising. There are issues with reliance on the Refundable Accommodation Deposits Scheme now and into the future:

- RADs provide a source of capital at lower than market borrowing cost, however the inability of providers to retain part of the RAD to cover depreciation and renovation/replacement of the asset is problematic in an economic environment in which these costs cannot be covered by interest on investments;
- assuming the trend towards use of Daily Accommodation Payments continues, this may increase operating revenue cash flow but could involve a significant shift towards private borrowings, increasing the cost of services to consumers and the Government;
- the COVID-19 pandemic has led to an increasing demand for refunds of RADs (as residents are leaving) while occupancy is decreasing along with deferral of entry by new residents, and correspondingly fewer DAPs or RADs are coming into the system—as this is occurring this is placing considerable liquidity stress on providers that may threaten sustainability of some;

- uncertainty around the Australian Government's commitment to the Accommodation Payment Guarantee Scheme (the Guarantee Scheme) represents an unquantifiable but highly problematic risk to the sector—where providers who manage and maintain sustainability could be required to fund a levy based on liabilities of other providers who were not able to refund RADs as required by legislation.

We believe that there is merit in considering the relative benefits (in terms of system objectives) of changes to the RAD scheme to address these issues, and alternative arrangements to support capital raising. Creation of a capital facility along the lines of (or in connection to) the Australian Affordable Housing Bond Aggregator (https://www.nhfic.gov.au/) or state-based local government financing facilities (for example https://lgfa.com.au/services/) could be an effective way of facilitating borrowing by the sector, and therefore lowering costs of capital-based services for consumers and governments. It is impossible however to assess whether they are attractive alternatives or complements to the RAD scheme without understanding the full package of proposed reforms.

The impacts of any changes to the aged care system on viability of providers must be fully considered and mitigated in a way that supports stability of the sector. The worst case scenario involves exit of a significant number of existing providers, who cannot sell their services as the market for home care increases. Operations running at a loss with considerable RAD debt obligations will not find buyers. The Guarantee Scheme will be heavily called upon. At the same time supply of residential services will drop.

Government must contribute to funding capital investments to ensure that individuals are able to access the services that they need, when and where they are needed. Separating consideration of accommodation services from other types of capital is important in terms of ensuring that public subsidies are provided on the basis of need, and do not interfere with the level of supply in the private market. We note in this context that the government contribution to people with high care needs via Specialist Disability Accommodation places under the National Disability Insurance Scheme is around four times greater than the contribution for care and accommodation costs of Supported residents via the aged care system.

There must be a systemic approach to improved alignment of health, disability, ageing and community services provision, to ensure that capital investment, particularly that which supports services to financially disadvantaged or other special needs groups, is as efficient and effective as possible. There is a pressing need for small, community-run services in remote areas. Arrangements must support the needs of these services, for example by accommodating 'auspicing arrangements' whereby community-based organisations retain autonomy but can reliably access capital, governance and other expertise, back of house services etc. 'at scale'.

Financing arrangements must enhance incentives (for governments, individuals and providers) to take positive steps to improve public health for the future. UnitingCare Australia sees the greatest potential for dramatic improvements in wellness through

- access to re-ablement services and preventive approaches to public health
- more effective allocation of resources to meet consumer preference and optimise care in the community.

A key consideration must be that there is access to capital for developing community services, particularly in 'thin markets', in addition to access to capital for developing mainstream residential services.

The preconditions for certainty of investment must be in place. The sector must be able to respond to demand through business models that create reliable, safe and high-quality services of various types, according to the needs/demands in different communities. Current arrangements do not meet this requirement for a range of reasons, including a number relating to the degree of government control over the range and location of services offered, and the price paid for those services.

UnitingCare Australia believes that if the following conditions (based on those included in the Tune Review recommendations in relation to market deregulation) are met, the sector can invest as it must to meet future demand for services.

1. Government, the sector and related sectors (e.g. VET system) need an accurate understanding of the underlying demand for aged care services.
2. Arrangements must be in place to enable consumers to make equitable and sufficient contributions to the costs of their care and (where relevant) living expenses, without those contributions being so high that they create a disincentive to accessing care.
3. There must be a robust system for assessing eligibility for government-funding for aged care services.
4. Government policy needs to ensure equitable supply of services across different population groups, and in settings where there is limited choice or competition, such as remote locations.

UnitingCare Australia's position is that to meet the fourth condition, there must be

- rigorous costing and funding systems that ensure providers are able to cover the cost of services and reinvestment
- finalisation of the Government's position on whether and how to replace the Aged Care Allocation Round (ACAR) process, with the assurance of demand-driven funding for both residential and community-based services, preferably through a legislated entitlement to services.

The table at Annex 1 sets out principles of funding design previously submitted, now applied to the question of capital financing. This approach reflects the belief that the funding model must cover the cost of capital where appropriate.

Annex 2 responds to the Royal Commissioners' question regarding the current state of capital investment and infrastructure in residential aged care, including whether the sector is undercapitalised and any evidence that the capital stock is not of sufficient quality.

Annex 3 expands on our views regarding the appropriate role for the Australian Government in capital financing for the residential aged care sector.

Annex 1
Funding Principles and implications for future capital funding arrangements

Funding principle/s	Implications for capital funding
1. Outcome Focused The model should be aimed at maximising health and wellbeing, and support re-ablement, prevention and restorative approaches to aged care services. Performance should be measured through the achievement of outcomes (not merely inputs or outputs) while funding recognises the cost drivers, such as workforce demands and required skill levels, in achieving the desired outcomes. **2. Transparent and Simplified** The model should be simple and completely transparent to support trust and engagement between funders, providers and consumers, and to make it easier for consumers to understand and providers to administer.	• Specialised accommodation services (i.e. catering to disability or health needs, as well as special needs groups in the community) should be available as part of a single, universally accessible housing system, with no stigma attached to use of publicly funded services. • It must be possible to demonstrate the viability of construction projects to raise capital investments. Government incentives to integrate affordable housing alongside 'market priced' units must therefore be available, in the form of commitment to adequate accommodation supplements for low means individuals. • Accommodation supplements must be flexible to ensure that individuals' needs are met regardless of social or cultural background, means or locality, and services must be sufficiently flexible and inclusive to cater for the range of individual identities, cultural and social safety needs, and clinical needs that present in older individuals. • Models of financing and funding specialist housing including disability housing exist and do not need to be duplicated. • UnitingCare Australia believes that 'public good' services should be easily accessed by anyone, with the cost of adequate services borne by all taxpayers, not just service users. Subsidies should therefore be sufficient to cover the full cost of accommodation services for fully supported residents, including ongoing maintenance and refurbishment costs. On the other hand, where consumers are able to cover accommodation costs, the provider must be able to recoup all costs including depreciation and refurbishment costs. • The financing model should encourage use of preventive approaches (including safe and appropriate housing) with a view to maximising individual self-reliance and minimising the need for long term, high dependency residential care. There should therefore be constraints on access to accommodation subsidies, to ensure that they constitute an incentive to increase the stock of safe and appropriate housing for older people. • In keeping with the principle that funding should be transparent and simplified, as far as practicable charges and fees should be clear and all inclusive. That is, the necessary return on capital should be built into fees as a legitimate element of the cost of providing a service. **This should apply to both accommodation and other services.**

Funding principle/s	Implications for capital funding
3. Equity Funding should support all consumers based on their assessed needs, including those with special needs. This requires flexible funding allocations, weighted on individual needs to ensure diverse consumers are able to be appropriately supported. The approach should also ensure that specific consumer groups (e.g. rural and remote, LGBTI, CALD, Indigenous, older people living with disability, those with mental health needs or people who are socially isolated) have access to quality support and care. It should further take account of the particular complexities encountered in appropriately supporting consumers with multiple chronic diseases and problematic behavioural patterns.	• The end point for which we should be aiming is full equity of access to services and supports across our society, which means the system as a whole must act as a social safety net. • Where additional resources or pathways to services are needed, or there are insufficient offerings to provide the range of services needed in a community, particularly in regional and remote areas, UnitingCare Australia supports a 'community development' or 'place based' approach to services provision. • In terms of capital raising, reliance on government guarantee of funding to demonstrate security is likely to be greater. Security of funding for income streams on a 'per bed' (for residential services) or 'per client' basis will be necessary to create business models that are able to attract capital investment. In some situations meeting the requirement to provide services may be more achievable through direct funding or government investment models (e.g. social benefit bonds).
4. Consumer Choice and Control The model should support consumer choice and control across the continuum, recognising different cost structures in the delivery of aged care services. The model should also recognise that consumer choice, control and flexibility can be achieved in aged care services through models including, but not limited to, the funding following the consumer model that will be implemented for home care packages.	• We believe that governments have a responsibility to fully meet the cost of providing health and community services and supports necessary for individuals to thrive, however individuals and the broader community have a responsibility to work with health and social systems to minimise, throughout their lives and to their best capability, reliance on formal services. • To a significant extent, the best way to support consumer direction and choice is through giving people access to strong and diverse markets, where this is an option. • In many situations an individualised funding model can enable consumers to access subsidised services alongside commercial offerings, for example where specialised fitness and rehabilitation services are offered alongside general commercial fitness services. In these situations it is possible to create a viable business model that attracts investment and generates an efficient return on capital. • In other cases, services depend on up-front capital investment with limited capacity to recoup the costs of that capital through individual user contributions. This would be the case, for example, for services providing specialised equipment or home modifications. This underlines the importance of alternative options to individualised funding packages, potentially including block funding or pooled funding across services where this is a cost-effective way to provide affordable services to meet a known demand.

Funding principle/s	Implications for capital funding
5. Flexible and Scalable The model should ensure that it can be adapted, where the funding follows the consumer across the continuum of care (home-based, residential and respite etc.), to support longer term planning and goal setting for individuals and to support an integrated aged care system. Regulation and application of funding should enable supplementary resource allocation for episodic, short or medium time periods to provide for very specific needs associated with acute episodes of illness, post-acute periods or for palliative care.	• The current system promotes an institutional approach to residential care. It favours management of the cost of inputs over genuine efforts to improve outcomes for residents. • The lack of resources is coupled with a lack of consumer understanding of the system, which together can make accessing services difficult, stressful and at times traumatic. The challenge of either raising a RAD, or funding a DAP, is not something that individuals plan for, and this situation may be exacerbated for future generations with less home equity (therefore more likelihood that they have considerable ongoing housing costs). • The financing model must allow for the flexibility to respond to situations of need. It must recognise that 'economies of scale' can come at the expense of enabling individuals to live well. It must not signal to consumers that residential services have no purpose beyond 'waiting for the end'. • In a society in which ageing is 'mainstreamed' financing is sufficiently flexible to follow the services model as it evolves over the coming decades, and is not based on the options that are available now.
6. Efficient Minimising red tape should be a key feature of any future funding model. All possible resources should be allocated to direct service delivery. The funding model should support evidence-based practice and discourage practices that do not deliver tangible benefits to the consumer.	• Simplification of administrative systems (funding, financing and regulation) is important to maximising the value of funding in terms of service quality. • System funding that is well constructed will have streamlined external assessment models and objective cost of care studies. Costing of services must address capital inputs, not just labour and other recurrent costs. As we have seen with the current pandemic, there must also be capacity to address extraordinary costs – the sector should not have to rely on political processes to access funding to meet the additional costs associated with extraordinary infection control measures. • Well-constructed funding should also reduce the need/opportunity for providers to act as 'fund managers'. Design of reforms must consider controlled transition away from the current arrangements and implications for cash flow and cost. • System wide 'efficiencies' should be gained by identifying better practice or more cost-effective modes of delivery without compromising outcomes, as well as ways of making capital 'work harder'. For example, reducing the transaction costs incurred when providers must interact with multiple funding points (e.g. disability, health and aged care systems) and regulatory systems will create incentives for multi purpose 'service hubs', potentially resulting in benefits for consumers in terms of both cost and availability of services.

Funding principle/s	Implications for capital funding
7. Certainty and Sustainability The model should ensure the aged care system is financially sustainable and not prone to financial volatility. Investment in service expansion and innovation to achieve positive outcomes for older people and their families will follow stable and predictable baseline funding, which anticipates projected areas of growth in the number and changing profiles of care needs of residents. The model should recognise a commitment to quality, safety and continuous improvement as standard prerequisites for service providers. **8. Value for Money and Affordability** The funding model should represent value for money and affordability for consumers and for government. Those consumers who can afford to pay should contribute to the costs of their care, but Government should provide a safety net for consumers who are unable to make a financial contribution. The funding model should recognise that providers need to generate market-based returns, at an appropriate level to support delivery of effective services and to continue to invest in the sector. The model should also recognise the need to support those providers who deliver aged care for communities where a local market may not otherwise sustain them.	• The most critical aspect of financing is ensuring that the system enables investments in the services that will meet future demand. • Current funding levels are such that previously scheduled capital investments are difficult, if not impossible, to justify on the basis of economic returns. This includes refurbishment projects to bring existing facilities up to standard. • Certainty and sustainability start from the 'fee for service' model, which then sits within a budgetary model. The model that determines fee for service should be equally efficient in identifying needs and the cost of services in residential care and home care, as well as 'hybrids' and respite. • Accurate calculation of the 'unit price' of a service is essential to provide certainty to providers (and potential investors) as to the relationship between projected revenue and costs. • There is considerable uncertainty regarding the resources available to the future cohort of formal service users; options that involve high user contributions and rely on private insurance to mitigate the risk of catastrophic costs to individuals must be considered on the basis of our limited understanding of the 'private' aged care market and how it may evolve. • UnitingCare Australia noted in our January 2020 submission that affordability is a difficult concept to articulate. Value for money implies that the community contribution must be associated with a clear return on their investment. Public funding must be directed to a future system in which they can see themselves, their parents or grandparents experiencing an acceptable quality of life. • 'Value for money' is a consideration that is not transparent in the current system. The financing system for services to older people must be transparent in terms of the value people see in services delivered. There is no transparency in the cross subsidies embedded in the current system, which are necessary due to underfunding. • Likewise, there is no transparency around the cost of underservicing at earlier points in the system, or the genuine cost-benefit of residential care to the community. The community therefore relies excessively on residential aged care, whilst not having the information available to support a public conversation about willingness to fund home care at a higher level.

Funding principle/s	Implications for capital funding
9. Integrated The model should support seamless interactions between the sectors that care for older people, including aged care, primary and allied health, and acute care.	• UnitingCare Australia considers the long-term public policy outcome should be a system in which there is alignment of funding and service outcomes across disability, health and 'aged care' services and supports. • The needs of older people need to be considered as part of a continuum of needs in the context of the impact of lifetime 'health disadvantage'; likewise, sustainability of aged care services must be considered as an aspect of sustainability of other parts of the health and community services systems. • Achieving this goal will require capital investment in infrastructure that supports this goal, including in many regional and remote communities that are severely underserved in each of these areas.

Annex 2
The current state of capital investment and infrastructure in residential aged care, including whether the sector is undercapitalised and any evidence that the capital stock is not of sufficient quality.

The current environment for investment is vastly different than it was [two-three] years ago. The viability of core operations is under threat on many fronts. The negative impact of insufficient indexation has hit our organisation very hard, and as a result, enthusiasm for large capital outlays has dropped significantly. We also predict that many facilities will come onto the market in a "fire-sale" environment", with most organisations hesitant to acquire given the lack of certainty around viability. Key reform items such as the deregulation of bed licences and the [AN-ACC] funding model, heighten concerns about future viability of residential care.

Residential aged care infrastructure requires ongoing maintenance and regular refurbishment, the costs of which are not funded through the current fee structure. The decision to prohibit residential aged care providers from charging 'depreciation' costs against refundable deposits means that they have to recoup these costs elsewhere: this is not possible. It is a simple equation: if a provider borrows $10M and builds a new facility, takes in residents who pay $10M in RADS, and operating costs only are met by ACFI no surplus is available for future investment. If there are no RADS and all DAPS then all income would be used to service the loan.

While ACFI is low, profitability is low, to the point that service providers won't invest in capital infrastructure… even if RAD investments and DAP payments are low service providers would be prepared to use 'operating profits' to pay for capital – clearly demonstrating that the [current] capital financing is flawed.

Although RADs are often characterised as 'interest free loans' given the current environment these funds generate minimal returns via permitted investment strategies. The individual resident's payment for their occupancy is the 'opportunity cost' of the RAD. In the current environment, in which interest rates are projected to remain at very low (if not negative) levels, there is little to no prospect that on average this system will cover the ongoing costs of maintaining beds 'funded' through RADs. DAPs improve income in the short term, but do not meet the long term need to secure capital.

As the Royal Commission has heard, one of the key opportunities to increase efficiency in the provision of residential care is through design of facilities. More importantly, improved

design contributes to the quality of care and the resident experience. UnitingCare Australia is concerned that capital investment must be sufficient to serve two purposes: to increase the stock to the level necessary to meet demand for residential services without excessive waiting periods; and to continually improve the quality of infrastructure as needs and practices change.

Internal surveys last year and in March 2020 asked our network organisations to comment on the [then] current capital investment environment. Most responses indicated that major capital projects were on hold either 'until conditions improved' or indefinitely. As a result, there are limited opportunities for growth, and some contraction of the infrastructure is likely. Some organisations predicted a reduction in the scale of residential care services as non-viable or decommissioned facilities are closed without any strategy for replacement. In at least one state, this prediction is starting to be realised, accelerated by the effects of the COVID-19 pandemic.

Funding is insufficient to generate a return that exceeds the cost of borrowing and providers are operating in an uncertain environment so when an organisation chooses to develop a site it will be in a community where prospects for high occupancy and consumer contributions are relatively good. This is not a scenario under which providers are able to establish facilities in under-serviced markets, where revenue from government subsidies is substantially below the cost of delivery.

Without major change, we expect the ongoing failure to meet home aged care needs will continue to put upward pressure on residential care, and without ongoing investment we are heading for a major shortfall in supply. In the context of consultations on alternatives to the ACAR system, we highlighted that the current system is not needs based: it is based on a population methodology looking at the ageing population and the percentage of people who will most likely need care. This is relevant to the question of whether the sector is adequately capitalised. Answering this question 'on average' does not give an accurate representation of issues in the sector or effectively account for individual characteristics, disease trajectories and other factors impacting people's need for services. While on average pre-COVID occupancy rates were at a reasonable level, this statistic does not account for the 'lumpiness' of supply, in which some communities are underserved and, presumably, there is a high vacancy rate elsewhere.

We believe that Australia's relatively high (internationally) rate of use of residential care represents an underuse of more appropriate services in the community—whether these be services within the system (home care options) or outside, for example housing services. This form of misallocation can be due to lack of diversity in services offered by the sector (for example for higher levels of care in the home) or substitution due to inadequate funding of services such as palliative care or social housing. There is underinvestment in respite, early intervention services and services that promote lifestyle changes that would reduce risk of chronic conditions such as dementia, which could be highly effective in terms of 'return' on investment.

Annex 3
The appropriate role for the Australian Government in capital financing for the residential aged care sector

UnitingCare Australia believes that governments should ensure that optimal investment is directed towards alternative system designs that promote consumer behaviours that maintain independence (for example buyers demanding universally accessible housing designs) and further embedding of reablement approaches and preventive attitudes in the model of services for older people. In this context, there must be coordination of investment between all levels of government.

This might include supply or demand side measures e.g. systemic incentives for uptake of preventive or rehabilitation services by individuals, more support for integration of short term and rehabilitation services with longer term care services, as well as interventions in health and wellbeing—particularly for groups in the community at risk of premature ageing—well before individuals are eligible for 'aged care'.

We believe that it is critical that the approach to investment is designed around the known benefits of early and adequate use of services such as physiotherapy, occupational therapy, hearing and sight services balanced against the potential to 'ration' subsidised services.

The market must be able to operate as freely as possible, responding to demand and setting the price, while recognising that this is a market for essential services. Government contributions to capital financing should be targeted to ensuring service availability or delivered via service payments that factor in capital requirements. In other words, government investment should not crowd out private investment or promote investments that do not respond to community needs.

- It is critical that the sector moves away from a 'supply driven' approach. The government must however monitor and respond rapidly and appropriately to failures of the market. Deep subsidies must be available to those who cannot afford to buy services, with additional incentives if necessary to promote provision in all localities and to meet the cultural and other safety needs of all individuals. Information failures must also be addressed via the public health system, to promote preventive and early interventional responses to avoidable conditions of ageing.
- Prioritisation methodologies and fiscal management mechanisms (including equitable means testing and consumer contributions based on ability to pay) must be considerably more sophisticated and work towards the most beneficial health and social outcomes for the community as a whole. Allocation systems must support the continuum of care approach, including transferability across community and residential care models and appropriate integration of aged care and other health and social services.
- Reforms now need to be consistent with the range of future states that consumers will demand, by not foreclosing options. In remote or low population areas there will often be a 'once in a generation' opportunity to create infrastructure to support services. Reforms must therefore be cognisant of the risks of entrenching 'single

provider' status, for example by requiring locally co-designed responses as a prerequisite for access to publicly-funded capital investment.

In keeping with the Government's responsibility for ensuring a stable and consistent supply of services, consideration must be given to the structural adjustment needs of existing service providers should these new forms of service become a reality. COVID-19 has led to a drop in occupancy of existing residential care places, which we anticipate would be replicated if higher levels of funding for home care packages were to come into play. Measures must be in place to enable residential services that become less viable as a result of system changes to transition to a sustainable model of residential service. For example, targeted investment would be needed to support a transition to a model where permanent places are complemented by time limited rehabilitation/restorative services. With no other change, residential aged care services will continue to operate at a loss rendering expansion of services into new markets impossible.