

30 JUNE 2011

AUSTRALIA'S AGED-CARE LEGISLATION WHAT YOU NEED TO KNOW BEFORE 1 JULY 2011

OVERVIEW

- In response to the forecast demand for aged-care accommodation and services, in recent years the Australian Government (“**Government**”) has introduced a range of regulatory measures, including the integration of high care and low care facilities and Community Common Care Standards (“**Community Care Standards**”)
- As of 1 July 2011, proposed legislative changes will take effect, including a change in the use of accommodation bonds
- In addition, there is the potential for further legislative changes to change the mix of high care and low care and the possible introduction to value accommodation bonds on a cost basis
- There are a range of measures financiers and operators can take to mitigate their risk

INTRODUCTION

Australia’s ageing population poses a significant national challenge. According to the Australian Bureau of Statistics (“**ABS**”) and the Federal Treasury, in the next 40 years the number of Australians aged 65 to 84 years will more than double and the number of people 85 years and over will more than quadruple.

The revenue of Australia’s aged-care sector is expected to increase from \$3.3 billion in 2010-11 to \$3.8 billion in 2015-16 and grow at an average annualised real rate of 2.8 per cent in the five years through 2015-16 (IBISWorld Accommodation for the Aged in Australia April 2011).

This forecast increase highlights the demand for aged-care accommodation and services and underscores the great pressure on the Government to provide adequate care.

As a way to manage this demand, the Government has introduced a number of initiatives that will directly affect lenders, operators and developers, including:

- the implementation of Community Care Standards in March 2011;
- in February 2011, a Heads of Agreement between the Council of Australian Governments (“**COAG**”) announced that the Commonwealth will take full policy and funding responsibility for the Home and Community Care (“**HACC**”) aged-care services from 1 July 2011 and full operational responsibility from 1 July 2012;
- actions taken following the Productivity Commission’s (“**Commission**”) Inquiry into Caring for Older Australians, including addressing changes to the high care and low care distinction, and allocated place limits; and
- amendments to the prudential regulation of accommodation bonds by the Department of Health and Ageing (“**the Department**”), due to come into effect on 1 July 2011. The proposed amendments include changes to the permitted use of accommodation bonds.

THE CHANGES AND WHAT THEY MEAN

The Government has introduced a number of regulatory changes over the past year, with more amendments scheduled for introduction by 1 July 2011.

COMMUNITY CARE STANDARDS

In March 2011, the Government and State and Territory governments issued the Community Care Standards. These Standards set basic principles for community care services for older people under the HACC Program, excluding Victoria and Western Australia where current discussions for HACC continue.

The three Community Care Standards are:

1. effective management;
2. appropriate access and service delivery; and
3. service user rights and responsibilities.

Why is this important?

- cost to upgrade: the introduction of the Community Care Standards means that, in many cases, both facilities and services will need to be upgraded in order to comply with the standards. Operators and owners will be required to outlay the expenditure to cover these upgrades, with little or no increase in revenue;
- skilled staff: in order to comply with the Community Care Standards, facilities may be required to up-skill staff and, if necessary, employ new staff; and
- accreditation: accreditation has now become a significant factor for all facilities. If a facility experiences any failings there is a greater risk that the facility will lose its approved provider status and as a result, remove its access to Government funding.

PRODUCTIVITY COMMISSION'S INQUIRY INTO CARING FOR OLDER AUSTRALIANS

On 21 January 2011, the Commission released a draft report on the Inquiry into Caring for Older Australians. In this report and in an effort to create more supply and enhance the choice for the elderly, the Commissions recommendations included:

1. removing the limits on the numbers of residential aged-care places and community care packages; and
2. removing the distinction between high care and low care.

These recommendations are discussed in more detail below.

1. Limits on allocated places

The Commission proposed the *“progressive relaxation and eventual removal of supply-side limits on bed licences, community care packages and other services, while maintaining quality accreditation.”*

The Commission believes that by removing the present allocation of bed licences, residents will have improved choices through market competition.

At present, the allocated place system governs aged-care in Australia. An allocated place is a licence to operate a bed for a resident of an aged-care facility, subject to complying with all

standard related regulations. Generally, demand for new allocated places has outstripped supply over the past five to 10 years. This has meant that the secondary market, for example the purchase of existing allocated places either by purchasing and operating a facility or purchasing and relocating places, has increased the value for existing allocated places.

What does the proposed change mean?

By limiting and eventually removing the notion of allocated places, the value of the currently issued allocated places will be affected. If, for example, the value of an allocated place falls or disappears, how will current operators recover the investment made when previously purchasing an allocated place?

Additionally, financiers currently rely on the value of allocated places when taking out and calculating security against existing and future loans. This raises the question, how will this change in legislation affect existing banking and asset covenants?

2. Mix of high care and low care

What is the difference between high care and low care?

Broadly, high care is for residents who require 24 hour nursing and personal care, meals, laundry and cleaning services. Low care is for residents who only require accommodation, meals, laundry and cleaning services.

Previously, and as late as 2010, the Government made a clear distinction between high care and low care allocated places. Now however, the Commission has proposed that the current distinctions between high care and low care, and between ordinary and extra-service status, be removed.

What does this mean for an operator?

The removal of the distinction between high care and low care presents great opportunities for operators and owners, such as:

- occupancy turnover will reduce as residents will be able to stay in the same facility regardless of the type of care required; and
- by combining both high care and low care services and scale, operators and owners have the opportunity to increase revenue by providing additional services, such as physiotherapy, exercise, rehabilitation and acupuncture. Furthermore, these additional services give the operator and owner access to increased Government subsidies through extra per-service, per-resident charges.

To facilitate the provision of these additional services, the facility operator and owner will need to analyse the trade-off between the new revenue streams, higher wages and extra capital expenditure requirements needed to provide the space and staff to satisfy regulations and residents. These costs, the majority of which are likely to be upfront, have the potential to erode any increased revenue if not carefully considered, managed and appropriately financed.

ACCOMMODATION BONDS

Permitted use of accommodation bonds

On 12 April 2010 the Government announced changes to the regulation of accommodation bonds as part of the *More Support for Older Australians in the National Health and Hospitals Network* by legislating and strengthening the current prudential arrangements for aged-care accommodation bonds to:

- clearly articulate the permitted uses of bonds, including introducing more limited uses than currently present;
- improve reporting requirements;
- introduce criminal penalties for misuse of bond funds; and
- establish a prudential regime consistent with proposed legislative changes, to apply to aged-care providers who hold accommodation bonds.

These enhancements are due to come into effect from 1 July 2011, although the legislation is yet to be passed in the Federal Parliament 2011 Winter sitting.

If the legislation is passed, in its current form, approved uses for accommodation bonds will be:

- meeting capital works costs where these costs relate to the provision of residential care, or flexible care in a residential setting, by the approved provider, including the retiring of debt related to these costs;
- loans to related parties where the related party uses the loan for a permitted use, subject to certain criteria being met;
- investing in financial products, subject to certain requirements being met; and
- repaying existing accommodation bonds.

Why is this important?

Under the proposed legislation, accommodation bonds may still be used by the approved provider to meet capital work costs related to the provision of residential care. However, they will no longer be permitted to subsidise or otherwise fund operating expenses and interest income from holding accommodation bonds is not captured.

Facilities that have previously relied on accommodation bonds to partially meet operating expenses will experience cash flow pressure. In order to alleviate this pressure, facilities may need to increase fees charged to residents.

Move to cost based value use of accommodation bonds

Although not yet accepted, a key recommendation in the Commission's report is to change the calculation and payment of accommodation bonds. The proposed changes are:

- a move to a cost based approach to the value of accommodation bonds; and
- remove the requirement for accommodation bonds to be paid upfront and instead be payable at intervals over the first few years of residency in a facility.

Why is this important?

Currently, new bonds are often utilised to fund the repayments of exiting bonds. If there is a reduction in the price of new accommodation bonds, or removal of the requirement to pay accommodation bonds upfront, this will impact the ability of an operator to finance the exit of existing bonds as current residents leave a facility.

Additionally, operators and owners which reduce the total value of accommodation bonds held will decrease their funds held for capital expenditure, including the building of new facilities.

HOW CAN YOU MITIGATE RISK?

There are a range of measures lenders, operators and developers can adopt to mitigate risk posed by the ageing population and the proposed legislative changes:

- ensure the facility has the appropriate services by conducting a cost benefit analysis of offering more services to residents, training staff and improving facilities. This ensures appropriate decisions are made in respect to both the operation and funding of the facility;
- maximise facility (and revenue) utilisation by ensuring the full use of skills across venues and the ability to transport staff between multi-facility operations;
- ensure an appropriate ownership structure is employed for the facility;
- analyse the likely future impacts of the current proposed legislative changes on each respective facility;
- given proposed legislative changes, ensure forward projections include realistic amounts for accommodation bonds collected and sensitivity analyses for different regulatory changes;
- insist current borrowers have a plan to deal with existing accommodation bonds, such as interim bank funding;
- take care when looking to allocated places for security; and
- properly evaluate the approved provider to ensure it has the ability to operate and manage all services offered.

HOW TAYLOR WOODINGS CAN HELP

These changes will produce challenges for a number of aged-care operators. Taylor Woodings can assist financiers:

- review the viability of aged-care facilities;
- assess management capabilities;
- identify improvements that can be made; and
- develop and implement formal and informal restructuring, turnaround or exit strategies focused on maximising outcomes for all parties.

Taylor Woodings has developed an excellent understanding of Australia's aged-care sector and the government regulation surrounding it. We have conducted assignments in the aged-care sector for financiers, creditors and operators, including acting as Receivers and Managers and investigating accountants regarding several aged-care facilities experiencing trading difficulties.

We also provide the following services:

- assess creditors security position, identify ways to reduce risk and recommend improvements;
- review business models;
- conduct analysis as to the viability of aged-care facilities;
- conduct assessments of management capabilities;
- conduct pre-lending reviews;
- assist in the sale of assets;

- negotiate with Government bodies regarding asset sales and bed licenses; and
- identify risks and inadequacies regarding financing.

Taylor Woodings is an independent, national Chartered Accounting firm providing clients specialist services in Restructuring, Corporate Recovery, Advisory and Transaction Services and Forensic Accounting. With offices in Sydney, Perth, Melbourne and Brisbane, we offer our clients a truly national service.

To find out how we can help you, please contact one of the Taylor Woodings' Health and Community Services team listed below.

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