



August 2007

INDUSTRY UPDATE

The Aged Care Industry

Is the aged care industry facing a 'baby boomer' boom or is it on the verge of a crisis?

Introduction

With an ageing population it would be fair to assume that the Aged Care Industry in Australia would be booming and aged care centres reporting bigger profits. However, the industry continues to face a number of challenges including increasing operating costs, more government regulation and the knowledge that by 2011 the country's 'baby boomers' will begin to reach the age of 65 years.

Further, in the more immediate future the end of December 2008 looms as a significant 'watershed' for the aged care industry, with some operators facing large capital expenditure costs in complying with specific government regulations relating to space and privacy requirements. Should compliance not be achieved in this regard, facility operators potentially risk losing their government certification.

The Industry

In Australia, aged care services are regulated and partly funded by the Federal Government ("Government"), which controls the size and growth of the industry through a planning ratio for the number of beds in proportion to the increase in older Australians.

The Aged Care Standards and Accreditation Agency is the independent agency that manages the accreditation process. Most facilities, if they meet all requirements, receive three years' accreditation and are then subject to periodic review.

There are two general levels of residential aged care:

- "Low level residential care" - previously referred to as "hostels";
- "High level residential care" - previously referred to as "nursing homes".

Each resident must be assessed (by an Aged Care Assessment Team (ACAT)) before entering an aged care facility and approved for care. The resident is then classified according to the eight tier Resident Classification Scheme.

The majority of Government funding received by an aged care provider is a product of the number of beds, occupancy rates and number of residents in each category.

The aged care facilities charge basic daily care fees to the residents, which are regulated by the Government and are income tested. In addition a daily accommodation charge is levied on those residents with the capacity to pay.

Further, residents in a low level care or extra service place may be required to pay a lump sum accommodation bond, which is essentially an interest-free loan to an aged care facility. The facilities by law must utilise these bond monies to improve the building facilities and the standard of care. Whilst the aged care home is able to deduct monthly amounts from the bond (with the maximum set at \$273.50 per month for up to 5 years), the balance of the bond must be refunded to the resident or their estate when they leave the home.

Current issues and challenges

With continued industry focus on Government regulation and funding and some industry operators being criticised for poorly maintained facilities, the Government has been under pressure to find viable long term solutions for the industry and in recent years has introduced various initiatives to improve the quality of aged care services.

Under a 10 Year Forward Plan agreed with industry groups in 1999, accredited aged care facilities must meet specific privacy and space requirements with respect to the number of residents per room and ratio of toilet and bathing facilities, by 31 December 2008. In addition, an annual Fire Safety Declaration process was also introduced in 2003 to ensure that each facility meets Government fire safety regulations. Failure to meet the above requirements could lead to the suspension or revocation of certification.

The following standards will apply with respect to space and privacy requirements:

For existing facilities:

- An average of no more than two beds in each room with no rooms to have more than four beds; and
- Maximum of six residents per toilet and a maximum of seven residents per shower.

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For new facilities:

- An average of 1.5 beds per room with no more than two beds in each room; and
- Maximum of three residents per toilet and no more than four residents per shower or bath.

With a number of older facilities having up to six beds per room, a number of existing facilities will require substantial capital expenditure in order to meet the privacy and space standards by December 2008. The Government provided a one-off payment of \$3,500 per resident to facility operators in 2004 to assist in meeting capital expenditure costs.

Financial Considerations

Whilst the Government and industry initiatives go some way in addressing the issues, facility operators have continued to face a number of challenges in recent times including:

- Increased staffing and other operating costs putting increased pressure on margins;
- Increases in Government funding trailing the increased operating costs (Government funding rose by 3.5% in 2005, whilst wage costs are estimated to have increased by 4-6%);
- Large capital costs in upgrading existing facilities to comply with regulations regarding quality of the facilities;
- Insufficient number of beds to absorb the fixed operating costs; and
- Low profit levels.

Whilst increases in land values have improved the balance sheet position of many facilities, with high fixed costs and some older facilities facing significant capital expenditure particularly in the lead up to December 2008, short-term cash flow continues to remain a major issue. As the

Government controls the fee structure of aged care providers, the revenue of facilities is also restricted and cost control and minimisation remains a key focus.

Further the fact that not all operators own the land on which their facilities are located can act as a disincentive in committing to significant capital expenditure to improve the quality of the buildings, given the uncertainties in relation to long term tenure and ability to effect a future going concern sale.

A significant push is being made by the industry to make accommodation bonds payable by residents where possible in the high-care facilities. This is potentially seen as an avenue for high-care facilities to fund increased capital costs in the short term. However, facility operators will need to be mindful that at some point, generally when the resident dies, the majority of the accommodation bonds must be refunded.

Industry Review

In the 2001-02 budget the Government provided funding for a comprehensive review of the Pricing Arrangements in Residential Aged Care and the resulting report prepared by Professor Warren Hogan was released in 2004 (the Hogan Report).

The Hogan Report made the following observations about the industry generally:

“The industry can generally be characterised as having a relatively low level of maturity. Financial accountability and reporting is generally undeveloped and prudential arrangements require improvement”.

The Hogan Report also estimated that approximately 66% of expenses incurred in providing aged care services are attributable to labour and associated on-costs and that some operators have difficulty raising capital due to the high level of Government regulation and lack of operator control over operations.

As a result of various recommendations contained in the Hogan Report, the Government has in subsequent budgets allocated further funding for aged care centres which is conditional on providers:

- Preparing audited financial statements which are made publicly available;
- Participating in a periodic workforce census; and
- Encouraging staff training.

The continued provision of conditional funding is seen as imperative in changing industry practices and improving the overall quality of aged care services.

Future trends and direction

Significant consolidation in the industry has commenced and will continue for some time as acquisitions of under performing and sub standard facilities by the established



industry players continues. Operators of multiple facilities may also be able to achieve some economies of scale as the administration functions are able to be centralised and overall fixed costs are reduced.

The Australian Nursing Homes and Extended Care Association has also identified the following as crucial for the future of the industry:

- Removal of unwanted burdens to operations, particularly in the areas of capital raising, unnecessary red tape, accreditation, complaints resolution and taxation; and
- Appropriate funding and capital raising potential to enable the aged care sector to pay competitive wages and therefore attract high end nursing staff to the sector.

It has been suggested that further reforms with respect to the prudential regulation of accommodation bonds is necessary given that an estimated \$2.8 billion are held in this respect by approved aged care providers. As there are very few restrictions on how the bond monies can be held, and as they do not appear to be afforded any specific priority under the Aged Care Act or the Corporations Act, in the event of liquidation, they may only rank as an unsecured claim against the aged care provider. To protect the interests of residents, in these instances the Government currently guarantees the balance of bond entitlements.

Going Corporate?

The corporate sector is becoming increasingly involved in operating facilities in an industry traditionally dominated by charitable and non-profit organisations.

This has included the recent moves by Macquarie Bank and Babcock & Brown to enter the market by directly or indirectly acquiring various facilities including the purchase by a Macquarie Bank controlled entity of 14 'under performing' aged care facilities previously operated by the Salvation Army. Further, St Vincent de Paul Society has announced that it is selling its aged care operations in NSW to an unidentified corporate purchaser, due reportedly to difficulties in funding the compliance costs of 2008 certification requirements at its facilities.

There has also been speculation in the media of the industry following the USA in the use of a franchise model to streamline operations and cut costs whilst continuing to meet the increasing demand in the aged care sector.

Whilst the increasing involvement of the corporate sector has been seen as a negative by some who see it as putting

profits before quality of care, it is certainly likely to lead to maturity of the industry and further rationalisation with greater focus on promoting efficiencies, financial reporting and accountability.

Taylor Woodings Experience

Taylor Woodings has expertise in the aged care industry having advised a number of industry participants in recent times. Assignments have involved advising financiers with respect to under performing facilities and the development of exit and turnaround strategies.

Our experience has highlighted that now is an opportune time to act for both owners and financiers as despite the issues mentioned above the aged care industry will continue to expand given Australia's ageing population and the consolidation process provides an opportunity for under performing assets to be efficiently deployed.

Taylor Woodings has conducted assignments within the aged care industry including acting for financiers as investigating accountants in relation to several aged care facilities experiencing trading difficulties. Our advice included identifying the formal and informal strategies that could be employed to restructure or turnaround operations as well as develop exit strategies and assisting in the sale of assets.

Through our research and experience we have developed a detailed understanding of the legislative and practical issues associated with undertaking assessments of aged care facilities for the purpose of developing turnaround strategies and addressing commercial issues associated with the industry.

Should you wish to discuss this matter or require more detailed advice on a particular situation please contact:

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