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FINANCIAL IMPACT OF FUNDING REFORMS FOR RESIDENTIAL AGED CARE

Executive Summary

The *Aged Care Bill 2024* (draft new *Aged Care Act)* was tabled in Parliament on 12 September 2024 with bipartisan support for Chapter 4 "Funding for Aged Care Services". The *Bill* included the funding reforms resulting from the Aged Care Taskforce Report (Aged care reforms and reviews | Australian Government Department of Health and Aged Care).

StewartBrown has been very supportive of the Taskforce Recommendations and the Governments clear desire to ensure the financial sustainability of the aged care sector to meet the current and future demands of older Australians. Bipartisan support will be strongly welcomed by older Australians and the sector more broadly, and it establishes a strong foundation for the future.

There has been, and will continue to be, considerable public comment as to the nature and extent of the proposed funding reforms prior to the new *Aged Care Act* (as amended) receiving Royal assent.

The StewartBrown Report "Aged Care at the Crossroads" (2024 07 Aged Care At The Crossroads Report (stewartbrown.com.au)) highlighted the urgent need for funding reform to ensure the financial sustainability of the residential aged care sector to address the looming critical shortage of beds to meet the current and future needs of people who will require residential aged care. The challenges facing aged care's fiscal sustainability, provider viability and workforce availability have also been exposed and analysed in the biannual Aged Care Sector Reports published by UTS Ageing Research Collaboration.

In summary, the following facts need to be considered when assessing the essential funding reforms required to be implemented as a matter of urgency:-

- The current estimate of demand for residential aged care is 200,000 places which will increase to 250,000 by 2030; 365,000 by 2040; and to 400,000 by 2043 *(source: Financial Report on the Aged Care Sector 2022-23 (page 127))*
- There are currently around 210,000 places in operation, and many will require refurbishment and renewal
- The residential aged care sector has accumulated over $5 billion in aggregate losses in the last five financial years
- The taxpayer funded subsidy for direct care services represents over 96% of the cost of providing these services
- The current means-testing arrangements for direct care were introduced on 1 July 2014. The previous Income Tested Fee was introduced on 1 March 1998. *(note that the Taskforce Report* ***did not recommend*** *any increase in the means-testing arrangements for direct care services which have remained in place through successive governments)*
- Increased consumer contributions by older people with significant means for their everyday living (catering/cleaning/laundry/utilities) and accommodation services are to cover the **actual agreed cost** of receiving these daily non-care services
- If a resident is financially assessed as not eligible to receive a full or partial taxpayer subsidy, they will be paying the same agreed cost for receiving the daily everyday living services. They will not pay a greater amount, irrespective of their financial means, than the agreed cost, except if they choose to receive additional everyday living services
- It is inequitable to expect the taxpayer to provide a subsidy to residents with financial means to cover part of the cost of receiving these daily everyday living services

Caution must be considered where sweeping statements such as "persons receiving residential aged care (residents) have worked hard and paid taxes all their lives and why should they pay more for aged care". **All residents** receive considerable taxpayer funding for their direct care services (current subsidy averages $269 per day, which is taxpayer funded to over 96%). *The increased consumer contribution applies to the daily non-clinical care services and everyday living services which should be borne by the resident if, and only if, they are not assessed as requiring government financial assistance.*

The proposed increased consumer contributions for accommodation (a 2% annual retention of the Refundable Accommodation Deposit balance capped at 5 years) are **only in relation to residents paying a refundable accommodation deposit** (not a Daily Accommodation Payment) and amount to only 4.13% of the cost of the national average dwelling value if the resident remains in the aged care home for three years (which is currently greater than the average length of stay). This more equitably represents the cost of receiving the accommodation services.

The Daily Accommodation Payment, however, will be indexed twice a year.

All current residents are grand-parented and the proposed reforms will not affect their contributions.

Background

Residential aged care provides 24/7 care, support and accommodation for older persons who are unable to live at home. There are a number of contributory reasons which can include significant frailty, symptoms of dementia, other illnesses, or loss of their primary carer, making it no longer possible to manage at home without help beyond what can be provided under the support at home program. Residential aged care includes personal care 24 hours each day including access to nursing and general health services, allied health, medication, everyday living services and accommodation.

Care Services that must be Provided

Approved Providers must provide care services that are specified in the *Quality of Care Principles 2014* (Federal Register of Legislation - Quality of Care Principles 2014) and that comply with the Aged Care Quality Standards (Quality Standards | Aged Care Quality and Safety Commission).

There are three components of residential aged care services, and each has a separate funding (revenue) stream: -

Direct Care

Direct care includes all of the nursing and personal care, allied health, lifestyle and medication services that an older person needs (comprising clinical and non-clinical care). The funding amount is assessed by clinical specialists according to the person's needs. This is referred to as the Australian National Aged Care Classification (AN-ACC) funding model. Almost all of this direct care is funded by a taxpayer subsidy.

Everyday Living

Everyday living is the ongoing provision of the daily living requirements of residents (catering, cleaning, laundry and utilities). These are the costs that most people have had to pay in full or contributed to during their adult lives. Many older people paid for these costs from their age pension and will continue to do so in residential aged care.

Accommodation

Accommodation is the provision of a standard of accommodation that ensures that the residents' physical requirements are met in a setting that provides comfort, access, recreation and lifestyle. Again, many older people were helped in meeting the costs of their housing through public or social housing or rental assistance and will receive free accommodation in residential aged care.

Current Financial Sustainability

The residential aged care sector is not sustainable. Providers have accumulated **aggregate deficits of $5 billion** for the four financial years 2020 to 2023 (source*: Financial Report of the Aged Care Sector* Financial performance of the Australian aged care sector | Australian Government Department of Health and Aged Care). It is projected by StewartBrown that another deficit will be reported in the 2024 financial year.

Taskforce Report and Recommendations

In 2023 the Australian Government established an Aged Care Taskforce. The Taskforce's December 2023 Report commenced with the statement "Australia's aged care needs are increasing as the population ages, and expectations of quality improvements are high. However, the aged care sector is currently not in a financial position to meet expected demand, deliver on the required quality improvements or invest to meet Australia's future aged care needs".

In summary, the Taskforce supported funding reform that involved a greater level of consumer contribution for everyday living and accommodation services to meet the actual cost of providing those services. This is contingent on the consumer (resident) having the financial means to pay the actual cost.

Funding Reforms Announced

In conjunction with the tabling of the new *Aged Care Bill*, as noted previously, further detail around the funding reforms was announced. A summary is as follows:-

Contributions to Clinical Care

The AN-ACC subsidy is to be split between Clinical Care and Non-Clinical Care. The Clinical Care component will be fully funded by a taxpayer subsidy and no means-testing arrangements will be in place.

Contributions to Non-Clinical Care

- The Means-Tested Care Fee (MTCF) to be abolished and replaced with a Non-Clinical Care Contribution (NCCC) as part of the AN-ACC subsidy. This contribution to be capped at a maximum of $101.16 per day
- No Annual Cap for the means-tested NCCC
- The Lifetime Cap to be increased to $130k (indexed) or 4 years in care whichever comes sooner (includes Support at Home contributions)
- *No financial impact to providers*

AN-ACC Subsidy

- AN-ACC price increased to $280.01 per day
- Price includes uplift to average 215 direct care minutes, FWC "work value" stages 2 and 3, superannuation guarantee increase and inflation adjustment
- Revised Basic Care Tarriff (BCT) weighting for MMM1 (metropolitan) to MMM5 (small rural towns) revised
- National Weighting Activity Units (NWAU) revised for AN-ACC classes
- Remote and specialised base care tariffs revised
- *It is anticipated that the overall average Direct Care (AN-ACC) margin will remain, however this will vary on an individual home basis based on the specific circumstances including staffing, agency costs and resident profile*

Contributions to Everyday Living Costs

- All residents will continue to pay a Basic Daily Fee (BDF) equal to 85% of single aged pension
- Additional/extra services will be replaced with a new Higher Everyday Living Fee (HELF) which will have specific requirements attached, including agreement after entering care, cooling off period and regular review
- From 20 September 2024 the Hotelling Supplement will increase to $12.55 per day. *No financial benefit to providers at this point as $1.09 per day relates to FWC increase (to be fully passed on) and $0.22 per day is indexation of non-labour costs*
- From July 2025 people with sufficient means will pay up to the current value of the Hotelling Supplement
- The Hotelling Supplement will not contribute to the Lifetime Cap
- The Hotelling Supplement will continue to be indexed each six months (March/September)
- A further $1.89 per day increase will come into effect on 1 July 2025 "to help providers meet the cost of hotelling (including critical nutrition and hygiene services). This will increase the Hotelling Supplement to be $14.91 per day (including indexation estimate of $0.47 per day in March 2025)
- IHACPA has been tasked with providing advice on the appropriate level for the Hotelling Supplement, to ensure providers can <u>fully meet</u> the actual cost to supply high quality everyday living services for older people from the BDF and hotelling supplement. *StewartBrown estimates a further $7 per resident bed day for the Hotelling Supplement may be required to meet this requirement. IHACPA released the "Residential Aged Care Pricing Advice 2024-25" on 18 September 2024 (<u>Residential Aged Care Pricing Advice 2024–25 | Resources | IHACPA</u>) which noted that their estimate of the everyday living funding gap is $4.30 per resident per day for the current 2025 financial year*
- The Government is working to finalise the future service list for everyday living, and this will determine the IHACPA pricing advice for the Hotelling Supplement going forward meaning that the actual costs associated with everyday living may vary, however if the costs are fully covered this should not affect the overall financial result

Contributions to Accommodation

- The Price Cap on RADs (accommodation price) is to be increased to $750,000 indexed annually by CPI (effective from 1 January 2025)
- A 2% retention on RADs for up to 5 years will come into effect (on a $550,000 RAD this equates to additional revenue for providers of $11,000 per annum; on a $750,000 RAD equates to $15,000 additional revenue per annum)
- The DAP payments will be indexed twice yearly by CPI
- Caution needs to remain to ensure that the accommodation pricing is reasonable and affordable for residents
- Reference to the local house and unit prices remains relevant as well as market and competition indicators
- The Accommodation Supplement for supported residents to be independently reviewed (possibly by IHACPA)
- *Accommodation funding reform increases revenue to providers*

Consumer Contribution

The Department of Health and Aged Care has provided a succinct summary of how the funding reforms affects consumers (residents) through various case studies (<u>Case studies – Residential care | Australian Government Department of Health and Aged Care</u>)

Financial Sustainability Modelling

The financial modelling of the impact of reforms has been performed using three scenarios based on the StewartBrown Survey detailed operating results for the 2024 financial year (FY24):-

<u>Scenario 1: Operating Result based on reforms as announced</u>

- Hotelling Supplement to be $14.91 per day from July 2025 (refer above) and indexed based on this amount
- RAD retention of 2% pa to be phased in for new residents
- RAD pricing (accommodation price) to be increased by CPI each year
- DAP pricing to be based on 8% pa floor (MPIR)

Scenario 2: Operating Result based on reforms as announced (increased RAD pricing)

- Hotelling Supplement to be $14.91 per day from July 2025 and indexed based on this amount
- RAD retention of 2% pa to be phased in for new residents
- RAD pricing (accommodation price) to be progressively increased by 10% each year (to move toward an average of $700k by FY28
- DAP pricing to be based on 8% pa floor (MPIR)

Scenario 3: Operating Result based on additional Hotelling Supplement (including increased RAD pricing)

- Hotelling Supplement to be $22.41 per day from July 2025 based on meeting the actual cost of providing everyday living services and indexed based on this amount
- RAD retention of 2% pa to be phased in for new residents
- RAD pricing (accommodation price) to be progressively increased by 10% each year (to move toward an average of $700k by FY28
- DAP pricing to be based on 8% pa floor (MPIR)

Figure 1 shows the forecast operating result expressed in $ per bed day based on the three scenarios. In summary, it indicates that the operating deficit for FY24 (deficit of $1.54 per bed day) marginally improves under the current settings for FY25 (due to an increase in current RAD and DAP pricing based on historic trends).

The funding reforms positively impact from FY26 as they are phased in over a three year period (due to existing residents being grand-parented, the funding changes only relate to new residents when they enter the aged care home) and the FY29 forecast is after the full phasing in period is completed.

Figure 1: Projected Operating Results FY24 to FY29 based on 3 scenarios ($ per bed day)

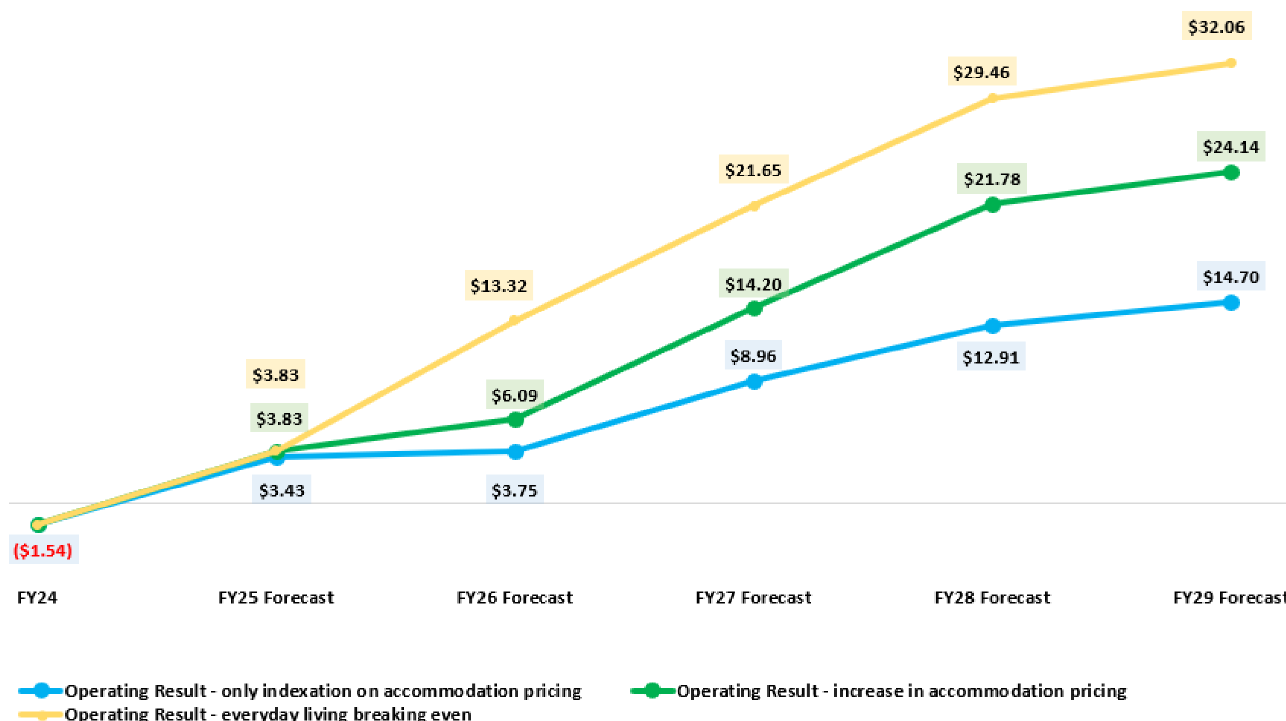
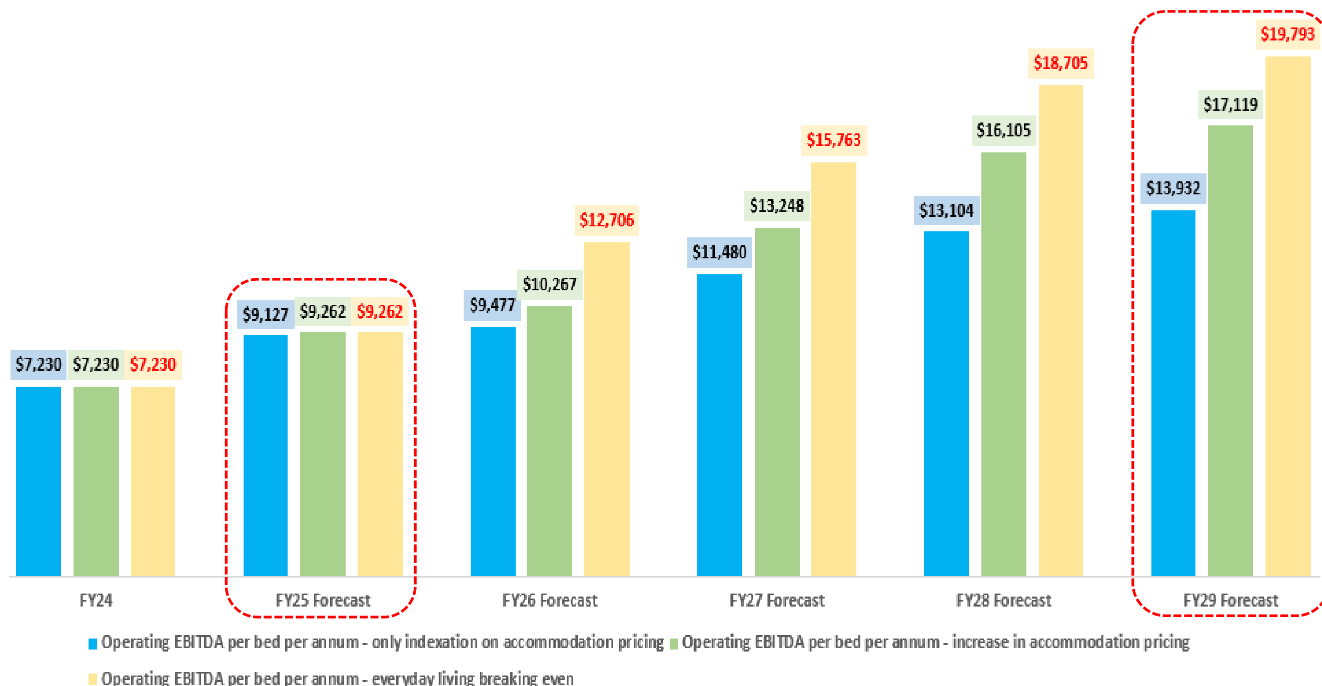


Figure 2 shows the operating results expressed in EBITDA terms for the three scenarios ($ per bed per annum). EBITDA is a common measure when assessing the core cashflow performance of an organisation which is relevant when assessing the future investment and capital requirements needed to meet future expansion and development.

In residential aged care which has a high capital requirement and a lower effective life of buildings than commercial, residential and retirement living, a sustainable EBITDA of between $18,000 to $20,000 per bed per annum would be considered a minimum level of return.

Figure 2: Projected Operating Results FY24 to FY29 based on 3 scenarios ($ per bed per annum)



Everyday Living Analysis

The analysis of the everyday living margin has additional complexity with respect to the overall result (all homes) as it includes those homes that charge additional/extra services fees, and those that do not. Those homes that do charge additional services report additional revenue and expenditure accordingly, which makes it complicated to determine the cost of providing the high level of daily living needs required before any additional services.

The FY23 summary is a comparison of the StewartBrown FY23 Survey (issued October 2023) and the "Financial Report on the Australian Aged Care Sector 2022-23" (Financial Report on the Australian Aged Care Sector 2022–23 | Australian Government Department of Health and Aged Care) which was issued by the Department in August 2024.

Both the Survey and Department of Health and Aged Care (DoHAC) figures include All Homes whether they have additional services fees or not for comparison purposes. This is done as the DoHAC figures do not provide any separation of expenditure for additional services. *Please note that the additional service fee ($ per bed day) is an overall average (ie total $ received for additional services divided by total number of occupied bed days, therefore it is not the average of only homes providing additional services).*

Taskforce Recommendation 10 stated "Funding for daily living needs to cover the full cost of providing these services. It is recommended this be composed of a basic daily fee and a supplement".

When considering the amount required for the Hotelling Supplement, additional services fees and expenditure relating to these additional services should be excluded, as they will form part of the new Higher Everyday Living Fee (HELF) regime.

The FY24 Survey summary shows the revenue and expenses for homes that do not charge additional services (approximately 62% of homes in the Survey). This has been used in the modelling analysis with the deficit of $8.52 per day being included in the Hotelling Supplement, bringing it to $22.41 per day as included in Scenario 3 above.

Please note that this is the StewartBrown analysis of the required Hotelling Supplement and is not the determination of IHACPA. IHACPA will be making their own individual assessment which is likely to be based on the FY24 Aged Care Financial Report and other current data that they will access. Once IHACPA have determined the amount required based on the current data this should be publicly available for scrutiny.

Table 1: Everyday Living revenue and expense summary FY24 and FY23 ($ per day)

	FY24		FY23	
	Survey *No Additional* $pbd	Survey *All Homes* $pbd	Survey *All Homes* $ pbd	DoHAC *All Homes* $pbd
Revenue				
Basic daily fee	60.99	61.08	57.16	56.14
Hotelling supplement	10.88	10.99	9.98	9.99
Additional/extra services fee	-	3.91	3.39	5.52
Revenue	*71.87*	*75.98*	*70.53*	*71.65*
Expenditure				
Catering	39.36	39.98	37.55	37.14
Cleaning	10.52	10.65	10.47	10.72
Laundry	4.51	4.75	4.60	4.64
Other hotel services expense	0.98	1.10	1.13	2.05
Utilities	8.45	8.22	7.73	7.30
Administration	16.57	16.83	15.67	15.33
Expenditure	*80.39*	*81.53*	*$77.15*	*$77.18*
Everyday Living Margin (Deficit)	**($8.52)**	**($5.55)**	**($6.62)**	**($5.53)**

Supporting Notes in relation to FY23 Comparison

Administration Allocation

The DoHAC financial report noted that the Administration cost centre was not allocated between Direct Care, Everyday Living and Accommodation. The StewartBrown Survey allocates administration to each costs centre. For the purposes of this analysis, the administration cost has been allocated to the DoHAC results based on the StewartBrown Survey allocation percentages.

It is noted that IHACPA use the same administration allocation as included in the StewartBrown Survey.

Hotelling Supplement

DoHAC treated the Hotelling Supplement from 1 October 2022 as being a Direct Care subsidy. For the three months (July - September) the former Basic Daily Fee (BDF) Supplement was allocated as Everyday Living revenue ($2.41 per bed day) and for the nine months (October to June) it was treated as being Direct Care subsidy ($7.58 per bed day). This treatment was due to the subsidy being paid with the AN-ACC subsidy from 1 October 2022.

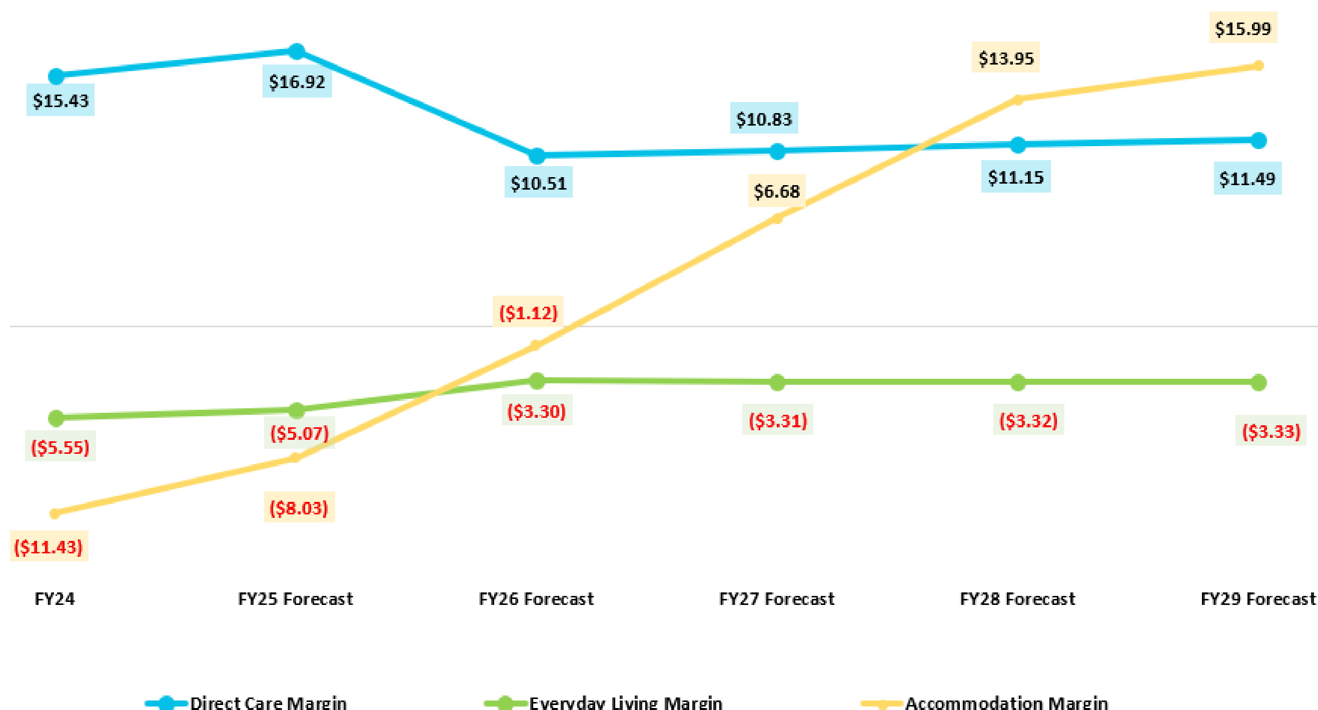
StewartBrown has an alternate opinion, being that the Hotelling Supplement was, in reality, the renamed BDF Supplement (relating to Everyday Living and not Direct Care), and although the mechanism for payment was included with the AN-ACC subsidy payment, it still related to Everyday living. This approach was further emphasised with the later IHACPA advice on the new AN-ACC subsidy to incorporate the FWC interim "work value" award increases, which showed the BDF Supplement as being separate and then replaced by the Hotelling Supplement.

It is further noted that the definitions for the 2024 Aged Care Financial Report have been amended to recognise this supplement under Hotel (Everyday Living) Income.

For the purposes of this analysis, the Hotelling Supplement for the nine month period has been reallocated to the DoHAC everyday living revenue.

Figure 3 shows the everyday living margin remaining in deficit if the Hotelling Supplement is not further increased above the $14.91 per day proposed amount to meet the actual cost. The margin includes homes providing additional/extra services. *This is a theoretical position as to date IHACPA has not yet had access to any FY24 actual data to validate their analysis. StewartBrown strongly support the role of IHACPA in providing the advice in relation to aged care funding.*

Figure 3: Projected Margin for each operating segment FY24 to FY29 based on Scenario 2 ($ per bed day)



Accommodation Supplement

The Accommodation Supplement plays an important role to incentivise aged care providers to provide accommodation to residents that do not have the financial ability to pay a RAD or DAP.

Currently, the maximum Accommodation Supplement payable to providers with a supported resident ratio in excess of 40% is $69.49 per day which, if it was a DAP would equate to an accommodation price of $302,671. The average agreed accommodation price, based on average full RAD taken, is now almost $500K and the equivalent DAP would be $114.79 per day, significantly higher than the maximum Accommodation Supplement. This difference will further increase should the accommodation price cap to $750,000 leads to increased accommodation prices.

The Government has accepted Taskforce Recommendation #14 to conduct an independent pricing review on the amount of the Accommodation Supplement to ensure equity for all residents.

Financial Sustainability

The funding reforms will have a significant positive benefit in ensuring the financial sustainability of the sector for the next generation. The level of the improved operating performance will remain dependent upon a number of factors:-

- AN-ACC subsidy is sufficient to meet the costs of providing the clinical and non-clinical direct care services with a sufficient margin to allow for continual improvement, innovation and diversity in care service delivery
- Maintaining occupancy levels above 92.5% of available beds
- Maintaining the rate used to determine the DAP at being a floor of 8% (this is effectively the Weighted Cost of Capital)
- Increasing the accommodation price in an orderly manner whilst maintaining the affordability for future residents
- Ensuring that the Hotelling Supplement together with the Basic Daily Fee is sufficient to meet the actual costs of providing these services
- Increase the accommodation supplement for financially supported residents if recommended by the independent review to ensure equity between financial and non-financially supported residents
- Ensuring that the “thin markets” are appropriately funded

There will always be a legitimate public concern as to the increasing the profitability of providers may lead to a reduced focus on the standard of care or a lack of accountability or transparency over the taxpayer and consumer funding received. It is important that appropriate governance and accountability guidelines are adopted and monitored.

As noted earlier, an increasing concern will be the availability of beds to meet the increasing demand for residential aged care. This can only be overcome through having a level of financial sustainability that allows this investment to occur, be it from the for-profit, not-for-profit and Government sector.

The cost of building a new aged care home is upwards of $500,000 per bed (land/building/fittings/equipment) and an aged care home has an effective life of 25 to 30 years (including refurbishments in this period to maintain the standard of accommodation).

An EBITDA return of $20,000 per bed per annum (refer *Figure 2* FY29 projections) represents a return on capital invested of 4% per annum, which is low when compared to other commercial sectors. This should be the starting point, not the end point for the residential aged care sector to have long term viability.

For proponents of full taxpayer funding (be it a levy or increased personal taxation) outside the Basic Daily Fee, it will still require the same amount of additional funding and financial return to ensure this viability. In addition to the recurrent funding, the taxpayer would have to fund the cost of building the new places and refurbishing the exiting places to meet the future supply needs of the community as well as meet the demands for the standard of accommodation expected.

A comparison with Government owned facilities (Local/State/Territory) shows that they had an average **EBITDA deficit** of $16,724 per bed per annum for FY23 *(source: Financial Report on the Australian Aged Care Sector, page 83)* after receiving additional State/Territory funding of $223 million for the year. Occupancy based on approved places for Government homes averaged 82.7% for FY23 as compared to 84.1% for-profit providers and 87.8% not-for-profit providers.

Summary

Implementing a major funding policy change such as has been included in the *Aged Care Bill* will always create varying levels of consternation that unintended consequences are avoided. These will need to be addressed when they are identified.

StewartBrown has been a constant advocate for these funding reforms for the past 4 years and continue to be supportive. A significant consultation process has been undergone during the Taskforce period and since the release of the taskforce Report.

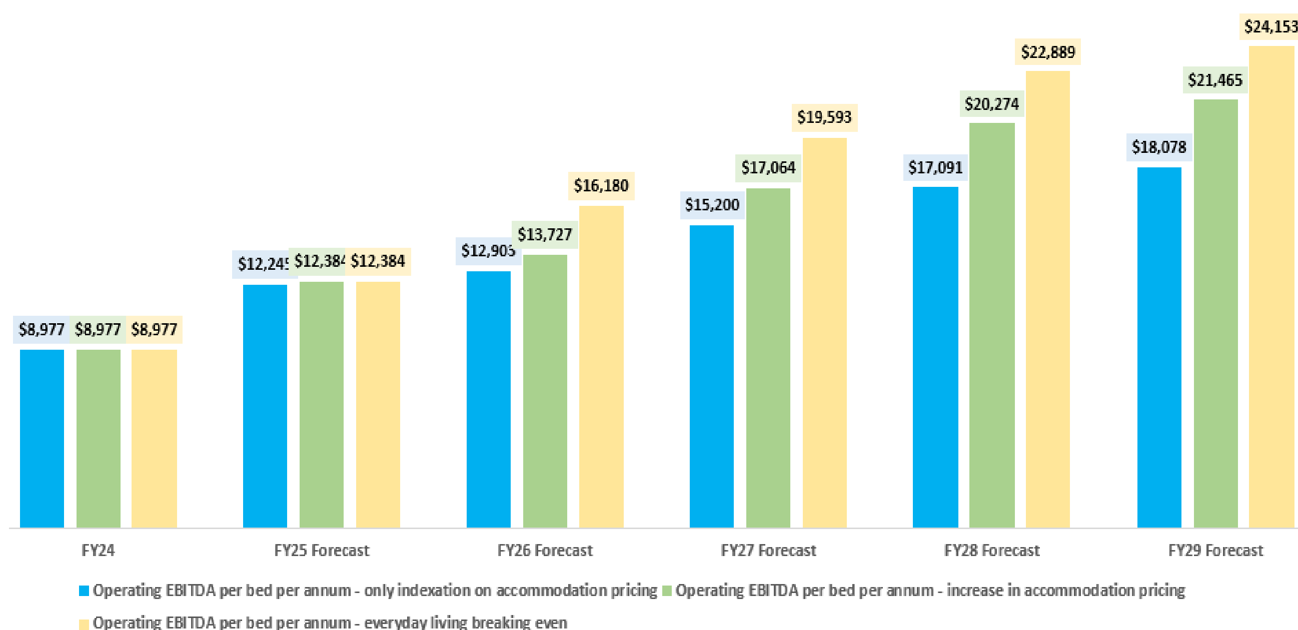
The financial modelling, in an overview sense, supports the reforms to date and after the three year phasing in period there should be a greater level of confidence in the ongoing financial sustainability of the residential aged care sector.

Regional (MMM) Modelling

The following graphs show the modelling for each region MMM1 to MMM5. MMM6-7 (very remote locations) have not been modelled due to the data size and the different funding arrangements within AN-ACC and other remote subsidies.

MMM1

Figure 4: MMM1 Projected Operating Results FY24 to FY29 based on 3 scenarios ($ per bed per annum)

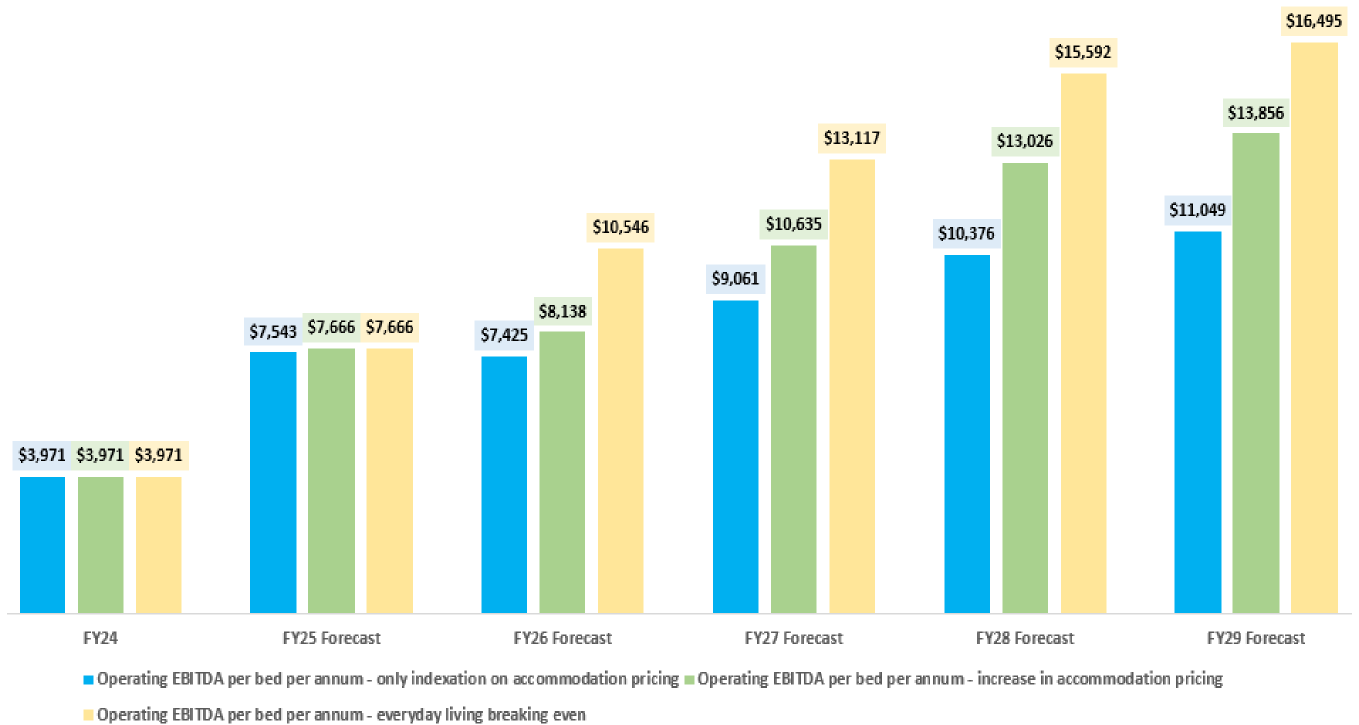


MMM2

Figure 5: MMM2 Projected Operating Results FY24 to FY29 based on 3 scenarios ($ per bed per annum)

MMM3

Figure 6: MMM3 Projected Operating Results FY24 to FY29 based on 3 scenarios ($ per bed per annum)



MMM4

Figure 7: MMM4 Projected Operating Results FY24 to FY29 based on 3 scenarios ($ per bed per annum)

MMM5

Figure 8: MMM5 Projected Operating Results FY24 to FY29 based on 3 scenarios ($ per bed per annum)