

Aged care providers and their financiers could be significantly impacted by changes proposed for the sector



As Australia's ageing population grows, so does the spotlight on our aged care industry. Reforms to the way aged care is funded proposed to the Government by the Productivity Commission could mean a shake-up of the industry; making the market more competitive and giving older Australians greater freedom of choice from an improved selection of providers.

Productivity commission recommendations

The Productivity Commission has made a number of recommendations which if the Government adopts in their entirety could significantly change Australia's aged care industry. Even if the Government does not implement all the recommendations, it is likely that the current barriers to entry will erode over time and the baby boomers will demand improved levels of service and quality and will have the capacity to pay for them. Some of the key recommendations relate to:

Increased transparency through the establishment of a 'Gateway' for older Australians, which will give them access to information and assessment of their care needs and to performance data and prices across all providers in their region

A more open and competitive market with the *removal of key industry constraints* (for example, removal of the distinction between high care and low care and allowing providers to charge market prices for services)

Changes to the way Aged Care facilities are funded as a result of the proposed alterations to the use of accommodation bonds (consumers may opt to pay periodic payments over bonds), the provision of index-linked Government Pensioners savings accounts and a government-sponsored line of credit to help meet care and accommodation expenses without older Australians having to sell their home.



How does this impact aged care providers?

More competition amongst providers would be generated by greater availability and transparency of information leading to opportunities for aged care providers who can re-think their business models in the existing market. For example, the proposed changes appear to encourage polarisation – either into niche providers or *industry consolidation* into Superhomes

Operators will need to look to *commercial sources of finance to replace accommodation bonds* in their capital structures. This will be a big outflow of cash for most operators over time and will fundamentally change their financing models. This will impact liquidity, funding needs and even viability in some cases as new funding will likely be costly compared to the current regime.

Aged care providers can take action now in anticipation that funding models will change. Providers should start making improvements to their funding and capital models (given the changes to bonds) and the suitability of their operating models (niche or large scale) now so they are already in place before any changes happen. It is likely that providers will need to be more structured in their approach to their capital bases.

How are lenders to aged care providers impacted?

Banks and other financiers will need greater clarity from existing customers around both:

- a) ***Operators' future business models and management strength to deliver them.*** There is a risk for some operators that their current business model and their assets are out of fit with the needs of the market going forward. They could be too small to get efficiencies at the lower end or they may be overly dependent on the current market imperfections for protection. Overall, management teams are going to have to sharpen up in terms of their commercial acumen and have a clear view on what their model is. Lenders would be well advised to be challenging management teams to define their competitive advantages and, in less viable cases, they should start to think about how to exit whilst there is still an opportunity
- b) ***Operators' financing models.*** There is both an opportunity and a threat. The opportunity is to provide large amounts of capital to the industry over time. The threat is that for those operators who are already stretched, the prospect of potentially large capital outflows and reduced capex capacity will mean that a proactive response from their lenders is required. This probably starts with scenario modelling to assess the capacity of the business to be viable in the new environment and then to look to transactions to address identified weaknesses. Either way, it requires an active response.

Obtain and challenge robust business plans from operators which focus clearly on the operation model and the funding structures over the next 3-10 years. When reviewing these forecasts, lenders need to get comfortable in a number of scenarios on both competition and capital flows and in essence need to stress test the forecasts and build contingencies into any proposal.

Assess the commerciality of the operator's management team. Heightened competition in the future market will bring increased opportunities only for those who are flexible in adapting to new commercial norms. Lenders need to make sure the management teams of these providers are commercial in the changing market.

Overall impact

The proposed changes to the way aged care is funded present opportunities for both providers and banks who lend to them. More freedom of choice will bring healthy competition and opportunities for providers to tailor their offering and better service their communities, leading to improved levels of care for older Australians. On the funding side, banks should be on the look out for robust customer operating models and strong, commercial management teams to lead the change.

Want to know more?



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