more give, less take

nabhealth

Insights:
Aged services

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"The future for aged care providers is a positive one. It's a future that has the demographics to underpin investment that will provide essential support to a deserving part of our community."

Natalie Smith, Head of NAB Health Corporate

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Introduction

Health represents one of the largest and fastest growing sectors of the Australian economy. This insight paper has been prepared by NAB Health to address current issues and trends emerging in the Australian Aged Care Services sector. In this paper we've touched on some of the current market factors as well as government initiatives aimed at assisting aged care operators.

We're entering a new age of innovation in care. Given ageing populations worldwide are pushing traditional models beyond their capacity, the fundamentals of the sector will require it. In this new era, governments and certain health organisations have recognised the need to refocus on the consumer, thereby delivering a more holistic and coordinated approach to care services. People in care and their families know what they want, and are asking for it.

NAB Health has conducted extensive market research (via its work with Fjord Design and Innovation,[1] an arm of Accenture) that has assisted in formulating fundamental design principles to underpin a future Australian health ecosystem.

These principles are based on an individual's view of health care and include the desire to:

- **make life easier and more convenient for me**
- **respect me in the relationship**
- **provide me with confidence along my journey**
- **have transparent access to information**
- **let me take ownership**
- **empower me**

Governments around the world are encouraging patient-centred, outcome-based operating models intended to drive efficiency. Understanding the demand and supply curve assists us to understand why this model is preferred.

1

The demand and supply curve

Australia's ageing population, together with declining workforce participation and increased health spending, has created the need for health organisations to leverage technology, collaborate and innovate on many levels to meet rising demand for quality care.

The demand curve

The Australian population is expected to grow at a Compound Annual Growth Rate (CAGR) of 1.7% between now and 2020, with growth in the over 75 year old population expected to be 3.3%. In addition, increased life expectancy levels are also likely to increase demand for care in later life. Currently, approximately one million Australians require care, with this demographic shift likely to lead to a significant uplift in this level[2] (see Table 1 below).

Table 1: An ageing population

	Today	2060
Population >85 years old	1.90%	5-6%
Population 75-85 years old	4.50%	7.60%
Life expectancy at birth – Women	93.6	95.1
Life expectancy at birth – Men	91.5	96.6

Source: Australian Bureau of Statistics data and publications

Non-demographic drivers

The Intergenerational Report, March 2015, concluded that non-demographic factors are expected to be the largest contributor to growth in real per person health spending. These include higher incomes, increased burden of chronic disease and co-morbidities, technological advancements as well as increased financial incentives for preventative medicine.

The supply curve

Regulated supply

Despite growing demand, aged care is supply constrained, with cost growth tightly managed by regulated supply through the Aged Care Approvals Round (ACAR).

A declining and ageing workforce

Overall workforce participation is set to fall by around 2% to 62.4% while participation from women is projected to increase to 70% in 2055 from 66% in 2015 and the over 65s by 4.1% to 17.3% in 2055.[3] Rising participation rates in over 65s and women will create the need to shift our culture to accept, hire and up-skill these segments to leverage their experience and capability and reduce the shortfall in participation.

2

The power of the consumer

We're living longer, we want to live better and it makes economic sense to do so.

Unlike trends within the pension and health systems in Australia, where a greater responsibility has been transferred to private individuals, aged care remains firmly a publicly funded domain.

UBS in its 2015 research has identified that residential aged care funding now comprises approximately 74% or $9.5 billion funded by the Federal Government and $5.2 billion from resident contributions.

Table 2 below shows that in FY15, aged care funding will total $14.7 billion, with $9.5 billion being funded by the Federal Government and $5.2 billion from the resident (including RAD's & DAP's). Forecasts over the next three years expect this resident contribution to grow to $7.5 billion or 12.6%.[4]

Table 2: Residential aged care funding

	FY15	FY18	% Growth
Government	$9.5bn	$11.2bn	5.6%
Resident	$5.2bn	$7.5bn	12.6%
Total	$14.7bn	$18.6bn	8.2%

Source: UBSe

Another demand-side strategy is to increase contributions from those who can pay. It is proposed that by 2030, older Australians are expected to own 47% of household wealth, while making up 19% of the population.[5]

As consumers are being asked to contribute more to their care costs, consumer expectations on service and product delivery have, and will continue to evolve. Providers are already trialling and delivering different models of care in order to meet these changing expectations.

These include:

- **Home care** – The government released 1,729 more Level 3 and Level 4 packages than the 2014 ACAR, an increase of 45%, and released fewer lower level home care places. In total, the government released 10,490 additional residential aged care places and 6,045 home care places in the 2015 ACAR round.[6]

  Delivering services in the home is a much more cost-effective way for governments to meet the demand. It also offers the benefit for those who, with choice, prefer to stay in their community and age at home, living as independently for as long as possible in their community.

  Technology will continue to prove an enabler of in-home care with innovations like wearable devices (which can take observations of a patient remotely) without the

patient feeling they are being observed. Or the use of television monitors to enable carers and healthcare practitioners to contact and assess aged people remotely, without the need for the patient to leave their home.

- **Ageing precincts** – This model aims to connect with residents in a genuine way, respecting their right to make decisions and promoting independence. This model challenges established perceptions and includes aged care, retirement village and wellbeing precincts in the one location.

  A number of ageing precincts are based in inner city locations with facilities including a café, social activities, hydrotherapy pool, seniors gym, fitness programs, rooftop garden and cinema, as well as state-of-the-art technology from automatic light sensors to detect movement, to WiFi and Smart TVs that allow residents to Skype and social networks to interact with friends and family.[7]

- **Multi-story aged care services** – Given the increasing cost of real estate in inner city locations, we are also seeing a growing number of multi-story developments. Ensuring operational efficiency is often a challenge with multi-story models of care. Facility design and construction has a wide and direct bearing on operational costs in terms of staff numbers, operations and movements as well as ongoing maintenance costs and durability. Return on investment criteria needs to be considered with multi-story models, given the higher cost to build in these locations.

  The build cost per bed for multi-story facilities is approximately $400,000-$450,000 in comparison to single level, which is approximately $200,000-$250,000.[8]

- **Supporting Cultural and Linguistic Diversity (CALD), lesbian, gay, bisexual, trans/transgender and intersex (LGBTI) communities** – Australia is a cosmopolitan community with people of diverse backgrounds. Aged care operators are being encouraged by government to tailor their services to cater for the individual's needs to ensure inclusion, empowerment, access, equity and quality of care. Consideration needs to be provided when designing facilities to cater, for example, for décor and interior design, orientation of rooms, food preparation, recreational space, gardens and landscaping.

Prior to July 14, many providers were anxious about potential bad debts given the introduction of the 'Daily Accommodation Payment' (DAP) and reliance on the consumer's ability to continue paying it. Bruce Bailey of RSM Bird Cameron has stated that there hasn't been a significant increase in bad debts, noting that this in part is reflected by consumer preference to pay a 'Refundable Accommodation Deposit' (RAD) upfront, rather than meet an ongoing payment.

Bruce recommends three key principles:

- **Make it easy for people to pay** – This means having all payment options covered. When a new resident moves in, make sure you can accept payment via EFTPOS, credit card, BPAY and direct debit.
- **Set the rules from day one** – Advise residents and their families that it's important fees are paid regularly and the best way to do this is to have an automatic payment put in place.
- **Keep the provision of care and administration separate** – This way the administration team is responsible for collecting fees and that doesn't influence or impact on the level of care provided.

In essence, the above principles are about bad debt 'prevention'. Early intervention is critical to managing bad debts.

3

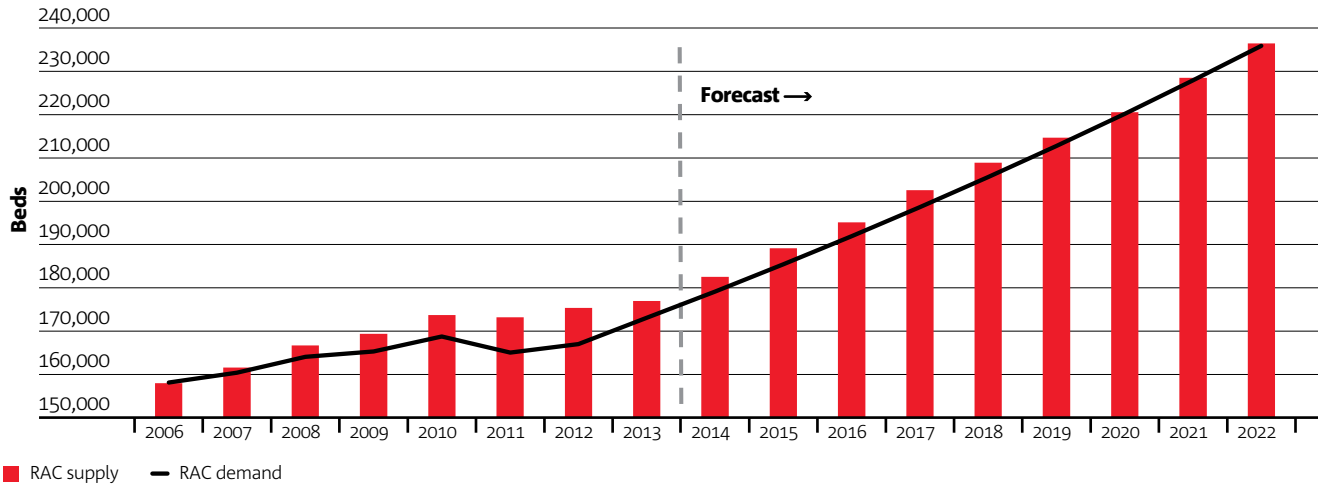
Increasing interest from the broader investment community

The Commonwealth and the states can't do all the heavy 'financial lifting' of aged care services indefinitely – the current funding models are ripe for review and the ideological barriers between public and private modes of delivery must be recognised as barriers to the provision of high quality care at an affordable price.

Not-for-profit operators, such as religious, charitable or community-based groups, comprise the majority of the industry, holding 59% of the market (based on number of places); with governments (state and regional) comprising a further 5%, and for-profit operators making up the balance at 36%.

Graph 1 provides details on the forecast supply of residential aged care beds against projected demand. The Aged Care Financing Authority (ACFA) estimates that by 2023-24 some 76,000 new residential aged care places will be required, an increase of 41% representing a significant need for new

Graph 1: Residential aged care – supply and demand



Source: ABS, AIHW, UBSe

capital spending. That's over six new 100-bed aged care homes each month for the next decade.

With increasing demand and opportunity in aged health care comes increased private sector investment, bringing greater competition across the sector. Older designed facilities are feeling the impact on demand and waiting lists when a new facility is built within close proximity.

We've also seen the rise of equity investment in aged care with the listing of three aged care groups over the last 12 to 18 months. The aged care sector is a highly regulated and attractive market with strong fundamentals and growing demand based upon demographic factors.

All indications are that merger, amalgamation and partnership activity is at unprecedented levels across the aged care sector (including both for-profit and not-for-profit operators).

Based on NAB's merger and acquisition tracking for the industry, over 24,500 beds have changed ownership at an approximate average price per bed of $168,000.[9]

As an example, we're seeing the three listed aged care operators, Japara Healthcare, Regis Healthcare and Estia Health, focus on non-organic expansion including mergers, acquisitions and partnerships as well as developing brownfield and greenfield developments (see Table 3 below). Collectively these three IPOs totalled enterprise value of $2.66 billion, representing a strong new source of capital for the industry. It's noted that all three IPOs were completed with existing debt repaid (that is, no debt outstanding at listing), and have since put in place new, undrawn debt facilities. Given this combination of factors, these players currently have significant amounts of capital available to pursue acquisitive growth. Japara Healthcare Limited has set a target to deliver a further 805 net new places by the end of FY 2019. Estia Health Limited has a plan to grow from 4,441 places as at 12/08/15 to 10,000 places by 2020 through acquisition and organic growth. Regis Healthcare Limited has over 900 places currently under construction to be delivered in 2016.[10]

With the recent legislative changes and current market environment, residential aged care providers are asking themselves: should we stay or exit from residential aged care; should we merge, partner, acquire or build our own; and/or should we expand our service offerings?

Table 3: Listed aged care providers – capital raising

	List date	Offer price ($)	Price ($) 30/09/15	Change (%)	Offer multiple	Implied price/ bed ($'000)
Japara Healthcare Limited (JHC)	17/04/2014	2.81	2.81	37.50%	12.7x	160.9
Regis Healthcare Limited (REG)	7/10/2014	3.65	5.34	44.38%	12.6x	216.7
Estia Health Limited (EHE)	11/12/2014	5.75	6.79	20.52%	14.7x	269.1

Source: Annual Reports FY2015, ASX

4

Social finance as an investment

Countries including Australia face widening gaps between demand for social services and what governments can afford. Governments, businesses and communities are seeking new solutions, as well as effective ways to finance and deliver them at scale.[11]

We're also seeing the emergence of social impact investments as an example of innovative funding. In November 2014 the Government released an 'Expression of Interest', to identify partners and determine the details of a trial involving a way for investors to finance early intervention programs to address social problems.

The Government is also exploring 'payment outcomes' contracts with non-government organisations as a way to trial a reward payment for organisations that demonstrate excellence, to encourage greater innovation in the social services sector.

"We've seen the domestic market for funding evolving; there are definitely markets aged care organisations can tap into in Australia for low risk funding and we are working on developing those markets."

James Waddell, Director Capital Financing Solutions, NAB

James Waddell says NAB is already actively contributing in the area of social impact investment:

"We at NAB are working with organisations on the design and development of social impact transactions. We're happy to work with organisations to develop ideas and programs that can help to reduce government costs by delivering services and measuring outcomes, while the organisation is getting paid by the state."

There are three dimensions to what NAB looks for when a client is looking at social impact investment bonds:

- Traditional risk/return analysis
- Community impact
- Mission/intention focus and how this can be measured.

Australia has an ageing infrastructure relating to healthcare assets including aged care. There's currently a great deal of international interest in the Australian healthcare model. We have an enviable blend of public and private providers and approximately 47% of the population is privately insured.

5

Healthcare in China: opportunities for Australia

The Free Trade Agreement (ChAFTA) announced by Australia and China, finalised in July 2015, provides opportunities for aged care operators.

Free trade agreements create a framework, or a common conceptual space, between trading partners, which promotes greater cooperation in the commercial sphere. They aspire to create a 'level playing field', leaving it up to enterprises from each party to attempt to gain market access or greener market share. China will now permit Australian wholly-owned aged care facilities to be established in China.

As of 2014, China has a population of 1.4 billion, 1.94 million practicing doctors and assistant doctors, 2.24 million nurses, 950,297 medical institutions, including 23,170 hospitals (13,384 public, 9786 private), 912,620 primary health care institutions, 12,083 public health agencies, and 11,514 private hospitals.[12]

"ChAFTA will take investment into Australia to another level, making our economy stronger and creating more jobs for Australians long into the future."

Jennifer Westacott, Chief Executive, Business Council of Australia

6 Strategies for success

Governing all other factors, market and thought leadership with a change management focus will offer the possibility for better health care and prosperity for organisations offering aged care services.

Success in the new aged care landscape will rely on:

- Structure to enable innovation
- Access to funding
- Managing physical and mental wellness as well as illness
- Convergence of services
- Leadership.

"The most profound changes for aged care businesses in the short to medium term are that they must continually evolve and proactively think about how they market their facilities and care for residents. Their success depends on how fast they adapt to changes," says Natalie Smith, Head of Health Corporate, NAB

Other values, such as resilience, adaptability and accountability, will underpin these key themes and will determine an organisation's readiness to take on change in a highly competitive aged health care market.

Does the National Disability Insurance Scheme hold lessons for aged care providers? Are there parallels between disability, community care and aged care services?[13]

Structure to enable innovation

At the crux of innovation is the desire and ability to anticipate needs, find ways of capturing ideas then develop frameworks to filter ideas and bring the best to life. If an organisation is focused towards innovation it will create processes, systems and overall culture to enable innovation to progress from concept to practice. Inputs to innovation include:

- **Proactive board governance** – Ensuring a sound approach to risk management; diversified funding streams around core competencies; determining operational gaps and scope how to fill these gaps.
- **Technology** – Leveraging technology to make decisions around service delivery, sustainability, robust innovation systems and investing in technology to assist in delivery. We're seeing the roll out of telehealth technologies that allow doctors or nurses to monitor and treat patients remotely.
- **Service delivery** – Focusing on the behaviour and skills of the people at the frontline of service delivery, encouraging 'relationship-based care' and setting reward systems in place to reinforce a culture of striving for excellence.
- **Skills** – Building, investing and retaining leadership and change management skills to integrate disparate people, cultures, systems and organisations. The value and importance of voluntary care for older Australians will be acknowledged and built into the way services are developed.

- **Frameworks and culture** – Creating an environment where ideas are captured and fed into functional/ effective decision-making processes.

Access to funding

The investment landscape is rapidly changing and businesses need to adapt accordingly. This is particularly evident in the residential aged care sector, where achieving an appropriate return on investment capital is crucial to the effective and efficient functioning of an organisation. Depending on the strategy, to merge, partner, acquire or build, access to funding is critical.

The Australian Aged Care Financing Authority (AFCA) has advised the future need to not only build new beds to meet the needs of the future, but significant capital expenditure will be required to refurbish or replace existing building stock over the coming years.

Obtaining the right advice and solutions is equally as important, whether this involves cashflow solutions, particularly during the commissioning building and increasing occupancy stage, or obtaining the right structures to meet your, Refundable Accommodation Deposit.

Table 4: Listed aged care providers – payment preferences

Payment preference	Japara Healthcare	Estia Health	Regis Healthcare
Net RAD Receipts	$77.3m	$88.5m	$73.6m
RAD	64.5%	85.7%	69%
DAP	17.3%	4.3%	6%
Combination	18.2%	10%	25%

Source: Annual Reports 2015, ASX

(RAD) strategy needs. We're seeing changes in consumer behaviour around the payment of a lump sum RAD being all or part paid via a Daily Accommodation Deposit (DAP), which could have an impact on businesses balance sheets, liquidity and cash flow position, particularly given the recent ability to collect RAD's for high care. As these high care RAD's flow through the system this will need to be closely monitored along with resident's length of stay.

The listed aged care organisations show a considerable difference between RAD, DAP's and Combination payment options (see Table 4 below).[14]

Risk assessment for the provision of funding for residential aged care includes, and is not limited to: understanding government policy risk which includes government spending in aged care versus budget estimates; the RAD/ DAP mix and combination pricing and liquidity management strategy; understanding means testing thresholds and potential future changes; economic impacts which may impact consumer affordability and capital availability; operator management including the effective management of facilities, quality of care, staff and agency costs, audit and compliance to regulatory requirements; growth strategy including execution and integration risk on developments, mergers and acquisitions.

Managing physical and mental wellness as well as illness

The health landscape is changing with the rise of new diseases and associated treatments. Increasingly, the ongoing future success of businesses in health care will rely on encouraging preventative measures such as the prevention of obesity, diabetes and other co-morbidities.

There's also an opportunity to create incentives around preventative measures and elevating the role of private health insurers in preventative health. For aged care providers, other factors such as mental health, social and

lifestyle needs should be considered to achieve a higher standard of aged care and to gain a competitive advantage. Services that connect individuals in home care are another consideration, offering shared lifestyle services.

"[Managing wellness and prevention] is about supplementing the time our members spend with their GP with other allied health workers who are experts in diet, nutrition and behavioural change and can take the time to ensure the person understands their condition," says Amanda Hagan, Australian Unity Healthcare CEO.[15]

Convergence of services

"We're already seeing the traditional silos between primary, secondary and tertiary healthcare converging, with collaborative partnerships forming across the health sector," says Melissa Timbs, Policy Advisor, NAB. The aged care system needs to support the whole care of each individual person with a focus on streamlining the end-to-end treatment experience across providers, while recognising the different stages of their care journey.

According to Timbs, convergence is already driving new initiatives such as:

- New income or revenue streams by adopting more flexible and innovative business models and partnerships such as with, pharmacy, medical, allied health services and even child care in close proximity to aged care facilities
- Aged care services being able to provide the full spectrum of ageing in place, ie: increased services in the home through the use of technological advancements.

The government is also looking for primary health networks (PHN's) to drive an integrated health care system and one of their key priorities is aged care. PHNs' operational focus is to engage health services and providers to develop service delivery and system improvements to enable innovation and greater integration across the system. For aged care providers, this may include improved coordination and initiatives between public and private hospitals which will assist in better allocating resources and realigning service delivery priorities.

They will also place growing importance on aged care, particularly for those in rural locations where resources for primary care are limited to aged persons. Services are often limited and are expensive where some patients have to be transported at great cost from regional to metro areas for rehabilitation or extended care services.

Leadership

Governing all other factors, market and thought leadership with a change management focus will offer the possibility for better health care and prosperity for organisations offering aged care services. If health organisations commit to an internal cultural shift, enabling employees to 'initiate' new ideas and processes and 'challenge' status quo, everyone can take a role in leadership for positive change.

A change management culture

A change management focus and culture will ensure providers maintain competitive service models that are shaped around future market drivers and what the future aged care customer will be seeking.

With change management, industry leaders should role-model techniques for leading through change, ensuring that complex change is translated into clear priorities and action plans. Leaders should put in place a process to monitor and evaluate the business impacts of change as well as finding sponsors and key stakeholders who can assist to drive change where necessary to deliver the overarching organisational strategy.

"A change management culture is one that encourages constructive contribution to change, as well as clearly understanding how change execution is measured," comments Melissa Timbs.

"The most profound changes for aged care businesses in the short to medium term are that they must continually evolve and proactively think about how they market their facilities and care for residents. Their success depends on how fast they adapt to changes."

Natalie Smith, Head of Health Corporate, NAB

To find out how we can help your business, contact a NAB Health representative today:

nab.com.au/health

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