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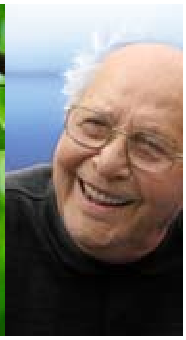
Annual survey into the Australian Aged Care Industry 2010





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1 Background

The purpose of Deloitte conducting a survey (Survey) of Australian Aged Care residential accommodation providers (Providers) is to gauge their views on the current state of the Australian aged care industry (Industry) in relation to a range of issues which have become apparent as our population ages

1.1 Inaugural Aged Care Funding Survey 2010

The most pressing issue is the apparent lack of access by Providers for appropriate levels of funding and how this may impact Providers' ability to meet the growing demand for services for Australia's ageing population.

The funding dilemma has become more prominent in recent times due to:

- Declining profitability and return on investment for Providers
- Increasing costs associated with acquiring land and constructing residential aged care accommodation facilities (Facilities)
- The global economic downturn which has increased the cost of debt finance and restricted Providers' access to increase their debt funding.

1.2 Partnering with the Aged Care Association of Australia

The Survey was commissioned by Deloitte Touche Tohmatsu (Deloitte) and was managed by Deloitte Digital™, the online innovation and technology business of Deloitte. Deloitte partnered with the Aged Care Association of Australia (ACAA) for this Survey as they are the national peak industry body which represents amongst their member base, Providers in the for-profit and not-for-profit sectors.

ACAA assisted Deloitte by distributing the Survey questions to Providers via its extensive member network utilising State based affiliated aged care industry bodies.

Results from the Survey have been electronically collated and the Deloitte Senior Living Group specialists have reviewed and analysed the data.

Deloitte is very appreciative of the support and assistance provided by ACAA and its State based affiliated aged care industry bodies towards this Survey.

2 Executive summary

2.1 What does the Survey examine

The Survey examines key issues which are presently impacting Providers and Australia's aged care industry, and key issues which are likely to emerge in the future and include:

- The intended capital expenditure on new Facilities, measured by dollar and number of Facilities over the next three to five years
- The sources of funding from which Providers will seek to finance their capital expenditure requirements
- The confidence Providers have in securing additional debt funding
- The alternative sources of funding Providers consider to be appropriate to provide more flexible arrangements for funding the aged care industry
- The mix of low and high care beds which Providers currently have and estimate they will have in five to ten years time
- The effectiveness of internal finance and IT functions
- Any significant challenges and opportunities in the aged care industry over the next five years.

2.2 Who was profiled

The Survey profiled Providers in the for-profit and not-for-profit sectors. There were 137 Respondents (Respondents) managing approximately 700 Facilities across Australia which is approximately 25% of the number of Facilities operating in the Industry.

2.3 Summary of results

A summary of the key issues identified by the Respondents in the Survey include:

- The Australian aged care sector is still very much a cottage industry with 80% of Respondents owning/operating less than six Facilities. This is not likely to substantially change in either the for-profit or not-for-profit sectors over the next ten years
- Most Respondents do not intend to make any further investment in their operations over the next five years. Respondents that do intend to grow their operations prefer building their own Facilities rather than making discrete acquisitions
- Access to funding is the single greatest issue for all Respondents at present and this is not likely to improve in the short term. Most Respondents still consider the debt-bond funding model as the most appropriate means to fund their growth. However more than half of the Respondents lack the confidence to secure appropriate levels of increased debt funding
- Industry stakeholders acknowledge that alternative funding methods require consideration in order to create more incentives for Providers and simultaneously ease the burden on the Federal Government to fund the Industry. However due to the delicate nature of this issue it is unlikely to be satisfactorily resolved in the foreseeable future
- The ageing population is likely to result in most Facilities within a period of ten years focussing almost exclusively on catering for high care residents. This will require more specialist Facilities to be built, which in turn means that Providers need to invest more into their operations. At present, there is clearly a lack of funding and a strong reluctance among Providers for this to occur. Consequently a shortage of bed supply and in particular, high care beds, could occur within seven years
- Staffing issues could emerge as the greatest issue for the Industry as the population ages and their expanding care needs will require a greater number of qualified staff to look after them
- Over half of the Respondents regard their finance and IT departments as being less than effective.

3 Survey background and methodology

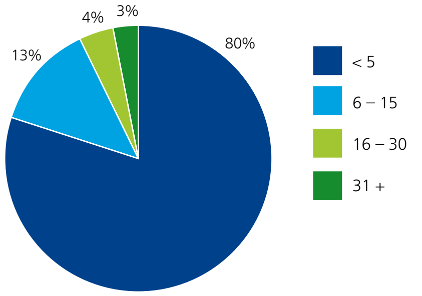
Section one: the Respondents and their Facilities

The Respondents

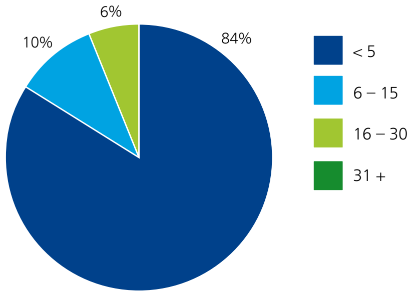
The Survey appears to be representative of the Industry as there were:

- 137 Respondents accounting for approximately 700 Facilities across Australia
- A representative mix of Respondents, with 36% of Respondents operating in the for-profit sector and 64% operating in the not-for-profit sector
- Australia-wide participation including: Respondents' Facilities being predominantly located on the Eastern seaboard (Queensland 16%, NSW/ACT 40% and Victoria/Tasmania 26%) South Australia, Western Australia and Northern Territory comprising 18% of Respondents.

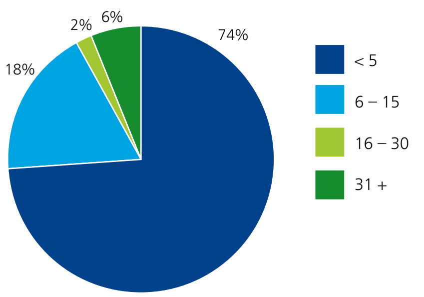
Number of facilities operated by all respondents



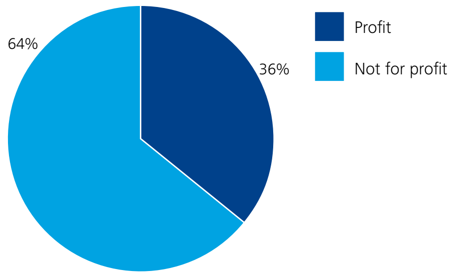
Number of facilities operated by not for profit respondents



Number of facilities operated by for profit respondents



Composition all of Respondents



Deloitte perspective

There is an overwhelming majority of Respondents that own/operate less than six Facilities. This indicates that, despite recent consolidation in the industry over the last five years, Australian aged care is still very much a cottage industry. This statistic is unlikely to decrease significantly in the next ten years for each sector for the reasons outlined below.

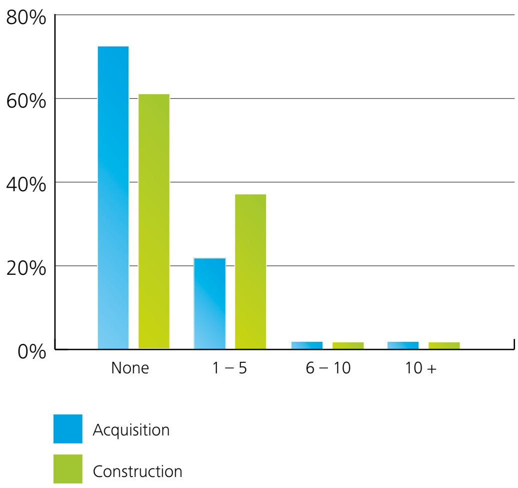
The not-for-profit sector represented 64% of the total Respondents and their operations are typically of a small-scale and run for a particular niche charitable cause. Hence they are unlikely to expand the number of Facilities they operate as the not for-profit Providers will not be able to achieve any economies of scale. Consequently not-for-profit Providers may wish to consider entering into shared back-office arrangements with other similar organisations. This could lead to improved operational efficiencies and performance, provide for greater specialisation of back-office staff and people, which should result in lower administration costs per bed.

The for-profit sector is unlikely to significantly change over that same time frame either because it generally has two categories of Respondents: those with less than six Facilities and a small group of Respondents that operate 15 – 20+ Facilities. This simply reflects the commercial challenges of taking a small operation and growing it into something of greater scale.

It is possible that further consolidation will occur in the medium term which is likely to be driven by listed companies and foreign investors. This is because they have greater access to funding, specialised management experience and a balance sheet to support large scale operations. The remainder of the for-profit Respondents are likely to maintain status quo or marginally increase the number of Facilities under management.

Meeting future demand

Expansion plans of all Respondents over the next five years



The statistics are relatively bleak in terms of growing the capacity of aged care in Australia over the next five years: three quarters of the Respondents have no intention of expanding their operations by acquiring pre-existing Facilities, and 61% have no intention of undertaking any new construction activity on existing facilities or building new Facilities. Only 22% of Respondents are willing to make an acquisition of between one to five pre-existing Facilities in the next five years and 38% of Respondents intend to undertake construction of between one to five Facilities.

Consequently, in terms of additional capital expenditure to be invested into the Industry over the next five years, 29% of Respondents intend to invest between \$10 – 50 million, and 10% of Respondents intend to invest between \$50 – 250 million.

Deloitte perspective

There is a strong reluctance by Respondents to contribute additional capital investment into their aged care operations in the foreseeable future. Alarmingly, the high proportion of Respondents not intending to undertake any new construction of Facilities could possibly result in a shortage of supply in beds in approximately five to seven years. This reluctance is attributable to a number of factors.

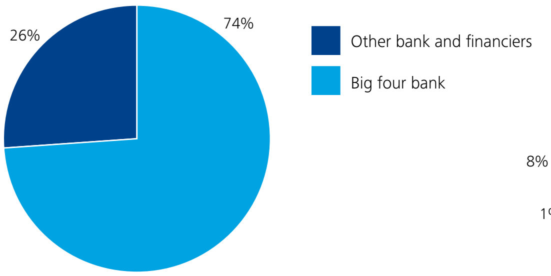
1) Respondents have been experiencing a decreasing return on investment over the past few years which has principally been driven by increases in costs such as infrastructure (land, buildings and bed licenses), wages and dealing with residents expanding high care needs.

2) Respondents are concerned about their ability to access an appropriate level of funding due to the recent economic downturn and the higher returns investors are demanding of their investments, whether it is debt or equity capital.

3) Many Respondents are questioning the long term sustainability of the Industry in the absence of a major overhaul with respect to how it is financed by Government and resident contributions, particularly with an increasing proportion of high care beds relative to low care. This is something which the Government is considering at present with regards to the National Health and Hospital Reform Commission Report released in June 2009.

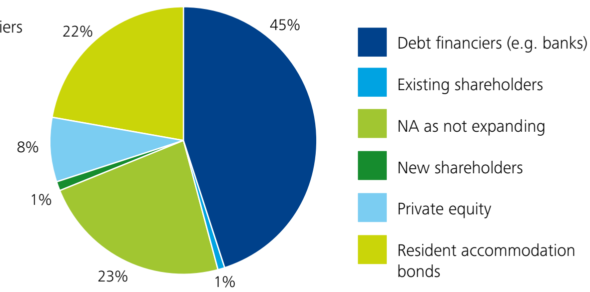
Section two: access to funding

Principal financiers to all respondents



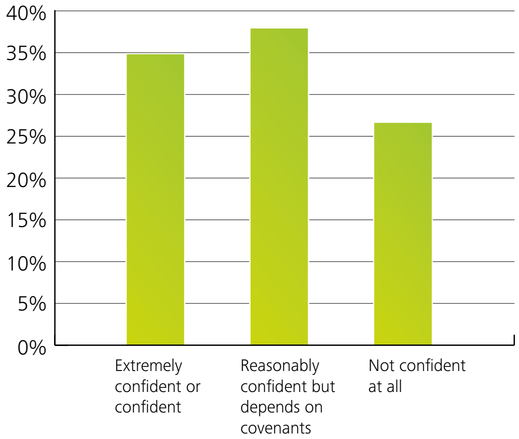
Nearly three quarters of the Respondents have a Big four bank as their principal debt financier, with other banks (24%) and specialist financiers (2%) financing the remaining Respondents.

How do Respondents intend to access future funding needs

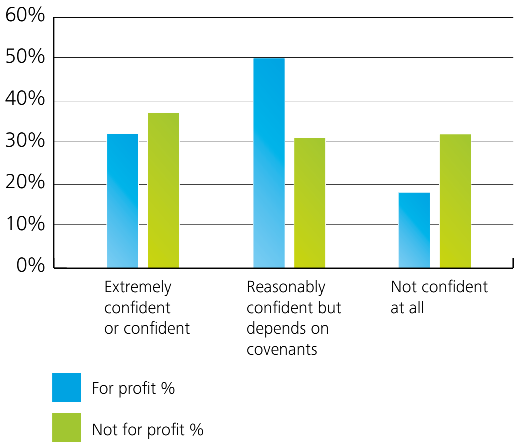


To fund future capital expenditure programs, the Respondents indicated they would seek most of their future funding needs from debt financiers (45%) and accommodation bonds (22%) with the remaining funding to be provided by private equity and to a lesser extent, existing and new shareholders.

Confidence of all Respondents in securing additional funds from current debt financier



Confidence of Respondents in securing additional funds from current debt financier



Notwithstanding the strong need and preference for debt finance, 27% of Respondents have no confidence in their ability to secure additional debt finance and 38% are reasonably confident, however it will depend on the covenant requirements (graph above does not reflect this). This leaves just 35% of Respondents that are confident in securing additional debt finance to grow their aged care operations.

Deloitte perspective

Typically most Respondents use the 'debt-bond' funding model to finance their expansion. That is, the bank debt is utilised to acquire land and build a Facility and upon completion, residents' accommodation bonds are used to refinance the bank debt when the Facility becomes operational. As the cost of debt finance has increased markedly over the past two and a half years, Providers have found it more difficult to access funding. Consequently most Providers have focussed their efforts on improving the financial performance of their existing Facilities rather than acquire or construct of new Facilities.

Not surprisingly, the not-for-profit Respondents were less confident in their views of securing the required level of funds to finance expansion which can probably be attributed to a number of factors. Not-for-profit Respondents:

- *Prefer low gearing ratios and usually have a risk adverse nature so as not to jeopardise their unique position that has taken decades to build*
- *Lack an appropriate economy of scale in their operations, hence they tend to be less profitable on a per-bed basis*
- *Are highly dependent on community support and donations of money to supplement their recurrent operations which are difficult to forecast.*

Section three: alternative sources of funding

With the strong need for funding and the apparent lack of confidence in Respondents to secure additional future debt finance, it is appropriate to consider whether there is any alternate means to fund the Industry.

In this regard, half of the Respondents considered a larger retention of moneys from bonds would provide increased flexibility for them to fund their residents' accommodation and care needs. Additionally, residents who take considerable time to make their required cash contribution for the bond after entry into a Facility should have a larger retention from their accommodation bond to compensate the Operator for the corresponding cost of funds during that period. Respondents also considered there should be more of a 'user pay system' where residents agree an up-front annual fee prior to entry.

Deloitte perspective

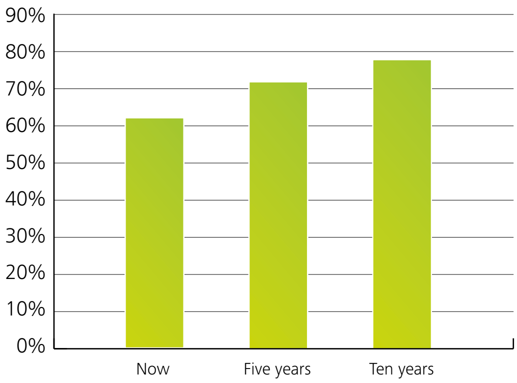
Finding an appropriate balance between what contributions the Federal Government and a resident should make towards a resident's accommodation in a Facility is a delicate issue. This is particularly the case as the average age of elderly residents requiring accommodation and care is swiftly increasing towards 90 and sectors of the community wish to ensure this demographic is not taken advantage of at a time when they are most vulnerable.

On the other hand, the proportion of elderly Australians aged 65+ as a percentage of the total population is likely to double in the next 30 years and accordingly, the community cannot expect the Federal Government to be able to fund aged care to the same extent as they do today so we need to look at alternative sources of funding. Further to this, we have a younger generation maturing with the notion that retirement must be self funded. In this regard, compulsory superannuation savings and better community understanding and education of the need to grow personal savings will assist Australians to save for their retirement. This includes personal care needs as the population ages. However such measures will take decades to ease the burden.

Further growth in the Industry is likely to be measured by an increased number of Facilities, a greater breadth of personal services for residents and improved profitability for Providers. Therefore stakeholders should be encouraged to resolve and agree alternate contribution arrangements for residents to pay Providers. This may be by adopting more of a user pays system for those that can afford it whilst maintaining the same level of safety net for the elderly with less personal wealth.

Section four: high care and low care beds

Expected percentage of high care beds



At present, approximately 63% of the Respondents have a high/low care bed ratio of 60 +/< 40. 72% of the Respondents estimated they will achieve this same ratio within five years and 78% of Respondents will achieve this ratio within ten years. While the Respondents' current high/low care bed mix appears lower than the Industry average of 70% high care beds, Respondents are forecasting a greater proportion of high care beds relative to low care beds over the next five to ten years.

Similarly, Respondents with 100% high care bed operations represented 9% in the Survey with that forecast to more than double to 20% of Respondents within ten years.

Deloitte perspective

The common catchcry associated with aged care in Australia is that we have an ageing population which will require more Facilities to be constructed across the country to meet this demand. There are no easy or short term solutions.

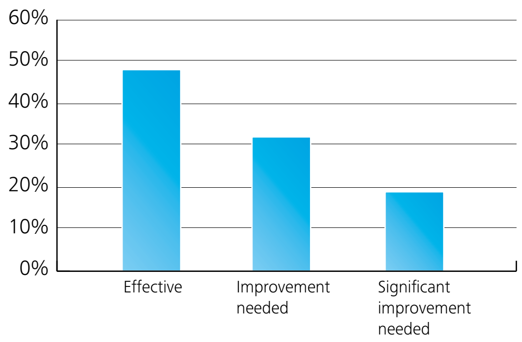
Earlier in this report (refer Section two), it was suggested there could be a shortfall in accommodation supply by around 2015 as it is forecast there will be insufficient construction of new Facilities in the next five years to keep up with the increasing demand. The lead time from inception to completion for a new Facility is usually five years as it requires a significant amount of financial commitment by a Provider as well as planning in conjunction with the Federal Government.

To compound this, the increasing number of high care beds relative to low care beds, could see at least four out of every five Facilities across Australia housing high care residents. This will require an increased workforce and in particular, specialised nursing staff, to care for the residents.

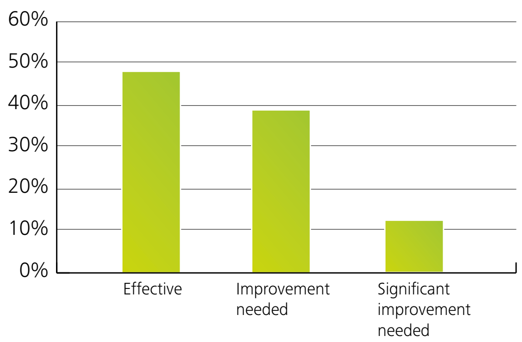
In addition, as costs of housing high care residents relative to low care residents continue to increase (the infrastructure cost of the bed and increased nursing staff assistance), we believe it is time to consider more of a 'user-pays' system where residents contribute more to Providers for their cost of accommodation and care, be it by an accommodation bond in high care or additional daily care fees, or both. A change in these funding arrangements could maintain a system of fairness and considerably ease the burden on the Federal Government to act as the principal funding source in caring for our elderly. Of course a safety net should still exist as it does today for those elderly who do not have sufficient wealth to self fund their retirement living and personal care needs.

Section five: finance and IT departments

Perceived effectiveness of existing finance department for all Respondents



Perceived effectiveness of existing IT department for all Respondents



Finance and IT are not presently core elements associated with provision of aged care services to residents. They are support functions which are of critical importance to Providers in running their operations. At present, only 48% of Respondents consider their finance and IT departments are effective whereas 19% of Respondents consider their finance departments require significant improvement and 13% consider their IT departments require significant improvement.

Deloitte perspective

It is not surprising that more than half of the Respondents do not consider they have an effective finance and/or IT department because the focus for every Provider in the Industry is to ensure they deliver the required level of care for their residents. In addition, as there are high proportions of Respondents that operate five or less Facilities, those Respondents would not have the economies of scale to sufficiently invest in best practice finance and IT departments.

Provider's finance departments have had a more significant role to play in managing aged care operations over the past two years as Providers attempt to ride out the global financial crisis. Financial reporting demands have increased from all stakeholders as managing cash flow has become more challenging and managing financial performance and risks has become a weekly activity. The better performers have highly integrated systems which automate periodic reporting – this permits those Providers to devote more time on analysis and address operational issues in their business as opposed to collating information and re-checking it for any errors or omissions.

IT has traditionally been lagging behind for most Providers, however current and future use of technology is likely to result in IT playing a greater role in Facilities in the future. This may be due to the residents' desire for access to the latest technology as part of their everyday lifestyle or Providers embracing technology to deliver its care services in a more effective and cost efficient manner.

Section six: key challenges and opportunities in a competitive marketplace

Challenges

Apart from funding, Respondents consider their greatest challenge over the next five years will be managing people, reducing Government compliance, improving internal processes and executing expansion plans (for those that have them). This was evident when Respondents identified and considered the risks which they believe may impact their operations in the foreseeable future. These include:

- Lacking the appropriately skilled staff to deliver the required level of care (72%)
- Closing a Facility due to a lack of financial viability (25%)
- Not having continued support from debt financiers (22%)
- Having sanctions imposed on one or more Facilities (21%).

Opportunities

Nearly three quarters of Respondents would consider expanding their aged care services into the community care or retirement living sectors. While this could provide an opportunity to improve financial performance, many Respondents are unsure as to how the delivery model could provide adequate returns and/or believe such a model will require sound Government policy and strategic guidance.

Deloitte perspective

The challenges faced by the Industry over the next five years are not dissimilar to many other industries in Australia; people are critical to success, managing internal processes and having the right management structure to lead and deal with expansion.

Due to lower profitability levels access to funding is undoubtedly the Industry's single greatest issue and requires immediate resolution amongst the relevant stakeholders. If funds do not become more accessible, it is possible that a shortage of bed supply could occur in as little as five to seven years.

There is an increasing demand for aged care and in particular, residents with high care needs. Australia has a large number of Providers who have invested in this industry over the past ten years and previously. Without any significant change in the Providers' ability to access funding in the short to medium term, the Industry will lack the required level of impetus and reward for Providers to continue to invest in and grow to meet the demand which is required in 15 to 25 years time.

Consideration should be given to determining alternate methods of funding a residents' accommodation in Facilities. This should provide incentives for Providers to invest further in the construction of new Facilities and then ease the burden on the Government to act as the principal funding source for residents' accommodation needs.

As the Industry and the Australian community's understanding of how aged care is funded matures, implementation of a 'user-pays' system will become more likely. Until then, the Industry requires a strategic approach in the short term to introduce a more flexible funding platform which can support and develop the Industry over the next two decades.

While aged care is expected to moderately increase over the next five years, the Industry and the Government are well aware that within 20 – 30 years, Australia's ageing population will more than double in size

4 Conclusion

The single greatest issue at present in the aged care industry is Providers ability to access additional funding

Providers need to improve their ability to access debt finance as well as increase flexibility in how residents contribute to their accommodation and care. These issues are crucial because they underpin the Providers' willingness and ability to increase their supply capacity for housing Australia's growing ageing population.

While aged care is expected to moderately increase over the next five years, the Industry and the Government are well aware that within 20 – 30 years, Australia's ageing population will more than double in size. Therefore in order to provide for long term sustainability this is an issue requiring a new strategic direction which needs to be resolved over the next two to three years in order for the focus to return to improving and expanding the provision of aged care services for our elderly citizens.

It is apparent that Respondents observe talent management as an emerging issue and it is not unreasonable to expect that this could become the greatest issue for the Industry in about ten years time. This is particularly relevant for attracting and retaining qualified staff to care for the special needs of an increasing high care bed resident population.

Contact us

For more information, please visit Deloitte's web site at **www.deloitte.com.au** or contact one of our experts:

Helen Hamilton-James
National Leader
Senior Living Group
Tel: +61 (0) 2 9322 7880

Mark Allan
Victorian Leader
Senior Living Group
Tel: +61 (0) 3 9671 7811

James Winter
Partner
Senior Living Group
Tel: +61 (0) 2 9322 7907

Rob Collie
Partner
Senior Living Group
Tel: +61 (0) 3 9671 6135

Feedback
Please email any feedback or suggested improvements to this Survey at **markallan@deloitte.com.au**

Contact us
Deloitte
550 Bourke Street
Melbourne, Victoria
Australia

Tel: +61 (0) 3 9671 7000
Fax: +61 (0) 3 9671 7001

www.deloitte.com.au

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About Deloitte's Senior Living Group
Deloitte's Senior Living Group is a national working group composed of professionals who have significant experience in working with Providers in the aged care and retirement living industries. The team is supported by an extensive national and international network of expertise and knowledge.

We are one of the few firms in Australia to be able to provide fully integrated professional advisory services which include dealing with issues currently facing the industry including:

- Cash flow forecasts and modelling
- Declining profitability
- Debt funding and refinance for capital expenditure programs
- M&A and exit strategy alternatives
- Valuation of key assets such as land, buildings and licenses.

Deloitte's clients involve Providers in the profit and not-for-profit sector, SME and listed entities.

About the Aged Care Association of Australia
The Aged Care Association Australia is a professional, national industry association for providers of quality residential and community aged care services. A federated peak body, ACAA is the only organisation that represents care providers from the private and voluntary sectors on a national basis. ACAA provides a truly representative voice for the residential care industry to the Commonwealth and State governments, all associated agencies and professional bodies, via a structure of autonomous state association, and a national presence in Canberra.

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