

10 April 2017



Ms Lynda O'Grady  
Chairman  
Aged Care Financing Authority

Via email: [ACFA.Secretariat@health.gov.au](mailto:ACFA.Secretariat@health.gov.au)

Dear Lynda,

**Re: ACFA Review of "The Application of the Base Interest Rate"**

Leading Age Services Australia (LASA) welcomes the opportunity to provide a considered response to the ACFA review of the application of the base interest rate (BIR) to the refund of lump sum payments.

The ACFA review of the BIR addresses a matter of importance to the aged care sector, most notably the discrepancy between the current BIR payable on the refunds of any outstanding lump sum accommodation balances (for example, accommodation bonds and refundable deposits) and current market interest rates.

As the ACFA Discussion Paper correctly recognises (in the unnumbered table on page 6) there is a sizeable and widening wedge between the BIR (the interest rate Providers are required to pay on lump sum accommodation balances) and reference market interest rates (implicitly what Providers could earn on the holding of such balances).

The existence and the magnitude of this wedge between the BIR and market interest rates amounts to a flow-of-subsidy between Providers and Consumers: when the BIR exceeds the market interest rate, as is currently the case, Providers are essentially subsidising Consumers, at a cost to their own financial sustainability.

As the table on Page 6 of the Discussion Paper clearly shows, the wedge between the BIR and the reference market interest rate has widened quite considerably over the past three or so years, from 1.05 per centage points (4 per cent less 2.95 per cent, respectively) in the March Quarter of 2014, to 1.70 per centage points (3.75 per cent less 2.05 per cent) in the December Quarter of 2016, where it likely remains now.

In short, Providers are suffering a financial penalty for any delays they may have to deal with (often outside of their control) in the refunding of lump sum accommodation payments.

The Discussion Paper provides (in the second table on Page 7) a useful worked example which illustrates the nature and extent of this financial penalty: a balance of lump sum contribution refundable of \$250,000, over 39 days, with a BIR of 3.75 per cent would produce an interest payment of \$1,001.71.

Had the BIR reflected the reference market interest rate of say 2 per cent which could have been earned by a Provider, the interest payment would have been \$534.25, or a wedge of \$467.46.

The Discussion Paper usefully goes on to point out (in the table on page 8) the quantum of this wedge increases substantially in money terms, with the passage of time. For the same refund amount, a BIR of 3.75 per cent and a market interest rate of 2.05 per cent, the financial penalty for the Provider rises from \$842.47 per refund for a 60 day period to \$1,684.93 per refund for a 120 day period, to \$2,257.40 per refund for a 180 day period.

For many smaller Providers, especially those operating on slimmer margins, the quantum of the wedge is not inconsequential.

A recent survey by Stewart Brown<sup>1</sup>, a consultancy specialising in aged care financial services, found one-in-eight (just over 12 per cent) of residential care facilities had negative EBITDAs (earnings before interest, tax, depreciation and amortisation; a key measure of financial performance), with three-quarters of facilities surveyed having an average care result of \$2.57 or below per bed per day.

The Discussion Paper correctly notes while Providers have some degree of discretion in handling the refund of lump sum accommodation payments, there are potentially serious legal implications (and liabilities) of any missteps in this regard. For all practical purposes, Providers, for good reason, tend to take a careful approach to making such refunds.

In the case of the death of a resident, the Provider is required by law to refund the lump sum payment within fourteen (14) days of receiving probate of the will or letters of administration. Self-evidently, these matters are not within the control of the Provider; rather, they are at the management of a third party (usually the executor, amongst others).

While the Provider has the discretion to make the refund before receiving such formal advisories there is, as the Discussion Paper politely stated (at page 4), “... *some risk is attached to refunding the lump sum balance prior to probate being provided.*”. Sensible risk management would mean most Providers would not execute a refund without receiving such formal notifications

However, the financial costs any such delays in this administrative and legal process are borne by the Provider – that is, they pay a cost for delays outside of their control; over which they have no ability to resolve. And the wider the wedge between the BIR and the reference market interest rate, the greater the financial penalty borne by the Provider.

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<sup>1</sup> StewartBrown (2016) “Age Care Financial Performance Survey – Residential Care Report, September 2016”

Against this background, **LASA supports moving from an administratively determined, largely fixed BIR, to a flexible (say, 'crawling peg') BIR based on a reference market-based interest rate.**

While LASA does not have a formal view on what this reference rate should be, or how it should be constructed from a composite of deposit interest rates, the 'RBA retail deposit rate' used in the examples provided in the Discussion Paper would appear a sound basis for further consultations between industry and regulators.

Should you require any additional information from LASA on this matter, please do not hesitate to contact Dr Brent Davis, General Manager – Policy and Advocacy, at [brentd@lasa.asn.au](mailto:brentd@lasa.asn.au).

Regards

A handwritten signature in black ink, appearing to read 'Sean Rooney', written in a cursive style.

Sean Rooney  
Chief Executive Officer