



Members
Residential Aged Care Accommodation Pricing Review

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Dear Members,

Submission on Consultation Paper

Thank you for the opportunity to make this submission. It is made in my personal capacity, but I disclose the following related interests. I am part time Associate Professor at the University of New South Wales and a member of Actuaries Institute committees with research interests in retirement and aged care. I am also chair of the PPS Mutual Insurance board, and a director of Freshhope Communities, which is an aged care provider. The views expressed are my own and not those of Freshhope Communities nor any other of the organisations that I serve.

1. Preliminary remarks

- I. Research shows that most aged care residents and their families do not have the financial literacy to evaluate RADs, and deciding between RADs and DAPs is stressful.¹ They are also unnecessarily generous financially to residents, disruptive of good financial planning, and not suitable funding vehicles for providers.²
- II. The Review is likely to receive submissions that suggest that providers should receive relatively high returns on capital for their investment in aged care facilities. The evidence suggests that the market return on property investments is of the order of 6% before tax. Property developers may earn more but with greater risk, but holders of commercial property are reported to be earning some 6%.³ Rental yields on residential property are lower – of the order of 5% gross before the deduction of any expenses⁴, but are distorted by tax advantages in that market. The yield on the Mutual Capital Instruments (MCIs) of Australian

¹ <https://theconversation.com/would-you-pass-this-financial-literacy-quiz-many-wont-and-its-affecting-expensive-aged-care-decisions-175063>

² <https://www.businessthink.unsw.edu.au/articles/life-annuity-RAD-aged-care-retirement-income-superannuation>

³ See <https://www.cbre.com.au/insights/reports/australian-cap-rate-outlook> for the “cap rate”. This is an approximation as the yield is measured before depreciation, (See <https://www.investopedia.com/terms/n/noi.asp>) and ignores leasing incentives (<https://www.cromwell.com.au/whats-in-a-cap-rate/>). Rents will however increase with inflation, which has to be added to the return. 6% is probably not far out.

⁴ [https://www.globalpropertyguide.com/pacific/australia/rental-yields#:~:text=The%20average%20gross%20rental%20yield,Prices%20are%20shown%20in%20US\\$](https://www.globalpropertyguide.com/pacific/australia/rental-yields#:~:text=The%20average%20gross%20rental%20yield,Prices%20are%20shown%20in%20US$).

Unity, a significant provider of aged care facilities, is currently just over 6% (fully franked) but was issued at 5%.⁵

- III. There is also research that shows that many providers believe that the RADs provide the finance necessary for new aged care facilities.⁶ This belief is natural in the current circumstances where RADs are exceptionally generous to residents and providers are obliged to offer them. This has created an environment situation where not-for-profits have not needed to access capital markets to expand. However, good financial discipline would be to use long term debt to fund long term investment. The cost of ten-year debt for A rated non-financial corporations is currently 4.7%⁷. A combination of debt and MCIs would therefore be much cheaper than the current MPIR.

Smaller providers would have more difficulty in accessing banking and capital markets, but there would be possibilities of developing financing for them. It should be recognised that their balance sheets are currently explicitly guaranteed by government.⁸ In the short run, as has already been suggested, government could follow the model of the Affordable Housing Bond Aggregator⁹ or alternatively provide banks with a guarantee for the current level of RADs at no additional risk or cost. A number of the property trusts listed on the ASX rely on banks for a significant proportion of their funding¹⁰, and aged care providers should be able to do the same especially with a government guarantee.

In the longer run, government could facilitate the development of a market in aged care property equity and loans. It would need, firstly, to dispel the widespread notion that it is an unreliable funder of aged care and that providers will not be allowed to make a consistent profit. Steward Brown, the major provider of analysis in the sector, sees it thus:

*Aged Care Act 2024 Mindset: Accepting the Government is never going to financially support a public system beyond the minimum requirement. To do so is inconsistent with a 'low tax' agenda.*¹¹

Given political and economic uncertainties, the best way of doing this may well be to guarantee bank loans in the same way that RADs are guaranteed.

In the longer run, government could convene workshops that include the major banks, the ASX and important industry players. A financial vehicle which invests in a range of smaller providers could be constructed to be attractive to institutional investors – perhaps with a more limited government guarantee.

⁵ See <https://www.marketindex.com.au/asx/ayupa?src=search-all>

⁶ Gu, M., Cutler, H., Aghdaee, M., Gu, Y. and Bilgrami, A., 2025. The role of refundable accommodation deposits in financing aged care capital expenditure: Views from the sector. *Australian Journal of Management*, 50(2), pp.390-407.

⁷ <https://www.rba.gov.au/statistics/tables/xls/f03hist.xlsx?v=2025-10-14-09-26-02>

⁸ <https://www.myagedcare.gov.au/aged-care-home-accommodation-refunds>

⁹ <https://cathnews.com/2025/10/30/labor-looks-to-super-funds-to-help-fund-huge-growth-in-demand/>

¹⁰ As an example of long-term bank funding see the balance sheet and note 3.1 at: <https://growthpoint.com.au/FY25-Annual-Report>

¹¹ Taken from James Saunders (2025) “Unpacking Higher Everyday Living Fees”, Steward Brown FY 2025 Aged Care Financial Forum.

2. Consultation questions

1 *Outline how you think the Accommodation Supplement could be reformed to ensure quality accommodation for residents of low means.*

The supplement should logically be based on rent – perhaps the rents of one-bedroom apartments. This incorporates allowances for maintenance, depreciation and a return on investment. Separate calculations for each of these elements are unlikely to add to accuracy. It is similarly unnecessary to agonise over the precise size of accommodation payments because of the significant variability of house prices and rents.¹² In addition, providers' financial viability is based on the total of all their income – from care, everyday living support and accommodation revenue.

2 *Should the value of the Accommodation Supplement be universal or tiered such as by location or proportion of residents or other basis?*

It should be based on rents in surrounding areas because costs, particularly the price of land, differ by suburb or region.

See answer to 4 below for proportion of residents.

3 *Should the Higher Accommodation Supplement be staggered over time, so that as the accommodation facilities age the supplement is reduced (with the full value payable again after a new renovation)?*

It may be helpful to distinguish between building design, which can be difficult to change with extensive alterations, and whether buildings, furnishings and equipment are well maintained. Buildings that cannot easily be altered to meet current design standards present a problem. Buildings should last 50 years or more, and it would seem unfair to current residents to underfund providers for decisions taken decades previously. On the other hand, one would want to incentivise providers to upgrade the buildings – recognising that this often requires demolition and rebuilding. It may be best not to differentiate and rely on the market (and RAD or DAP prices) to drive change.

Current maintenance on the other hand, requires regular inspection and evaluation, and it would be fair and reasonable to penalise residences that fail – by reducing their supplements.

The National Aged Care Design Principles and Guidelines include 31 principles and checklists with some 233 items, which are too complex – and miss the critical issue of maintenance. Of the principles that should apply to all facilities irrespective of age , inspections could perhaps evaluate:

- Acoustic comfort
- Comfortable Temperatures
- Safe floors (and spaces)
- Absence of dereliction – i.e. well maintained, painted and clean.

¹² About a third of house prices will vary by more than 10% from best estimates of the real value. (i.e. be more than one standard deviation from the best estimate.) See table 5 in Shao, A.W., Hanewald, K. and Michael Sherris, A., 2018. House price models for banking and insurance applications: The impact of property characteristics. *Asia-Pacific Journal of Risk and Insurance*, 12(1), p.20170003.

4 *How suitable is the current incentive structure to encourage providers to accept low means residents (a discount on the Accommodation Supplement based on a single threshold of 40% supported residents)? How could those incentives be preserved or enhanced?*

The penalty for fewer “low means care recipients, supported residents, or residents for whom concessional resident supplement” should be on a sliding scale. The current cut-off means that there is no incentive to admit more subsidised residents if the proportion will remain under 40% after they are admitted.

5 *How can the Accommodation Supplement be reformed to support an uplift in the quality of accommodation?*

Figure 1 below suggests that there has been a considerable uplift in the quality of accommodation in recent years, which accords with my understanding. Steward Brown goes further to suggest that the reason has been the availability of RADs. Given that the RADs are only available once a new facility is occupied, I find that an unlikely explanation. There must be other sources of capital – such as bank lending.



Figure 1: Taken from Steward Brown “Unpacking Higher Everyday Living Fees”

As for the answer to 3, the market will probably continue to provide better accommodation without differentiating accommodation supplements.

6 *Outline how the Accommodation Supplement pricing impacts on incentives for capital investment in residential aged care.*

The supplement is currently set too low for some areas and so providers are reliant on subsidies from their other revenue sources and from self-supported residents. It thus offers a disincentive to develop facilities in areas where costs are particularly high or there will be a high proportion of subsidised residents.

7 *In what ways could the Accommodation Supplement be reformed to better incentivise capital investment in residential aged care?*

It would be inappropriate to attempt to make residential aged care more profitable than other investments. Investment flows would be more reliable if they revenue was less

volatile and they were set relative to the median rent on apartments and adjusted regularly with an index on rents.

8 To what extent are the current rates of the Accommodation Supplement sufficient to cover providers' capital and operational costs relating to accommodation?

The HAS appears too low for the major metropolitan areas, and perhaps overly generous for outlying areas.

9 How does the costs of providing accommodation vary across different operating environments, such as differences in location?

It clearly depends clearly on differences in land and construction costs, which can be measured by relative rents, for which data is readily available.¹³

10 What factors should be considered in setting an equivalence mechanism and rationale for each?

The DAP is effectively rent and should provide sufficient revenue to cover maintenance, depreciation and a reasonable return on investment.

The RAD is a loan from resident to provider and the interest rate for the resident should be linked to term deposits. The cost to providers should be related to the interest rate on loans. Banks currently charge an interest rate margin (under 2% currently) between deposits and loans, which is available to share between resident and provider.

A loan from residents does not by itself cover maintenance and depreciation. The current system has therefore – perversely – encouraged providers to push RADs to a level higher than their actual investment in the property. This has enabled them to be able to earn interest on the excess in order to pay for maintenance and depreciation.

A fair rate of return for residents would be that on two-year term deposits.¹⁴ Two years approximates the current average stay. It remains generous because no tax is paid on the notional income – and it does not count for the asset test for the Age Pension. If set at this rate, it would reduce the pressure on residents and their families to find appropriate funding. It would be a sensible investment for spare financial assets, but not worthwhile raising money by borrowing or rushing to sell the home.

The rate on term deposits might appear at first sight to be a cheap loan for the providers, but the difference between it and the likely cost of borrowing would be available for maintenance and depreciation. There would still be an argument for retaining a proportion of the RAD for maintenance and depreciation. The new 2% retention may well be adequate.

11 What is an appropriate rate of return on lump sum for providers? Is this an appropriate level for setting an MPIR?

As above. It is a loan, and the cost should be what a bank would charge them, but see 12 below.

¹³ See for instance <https://www.nsw.gov.au/housing-and-construction/renting-a-place-to-live/rent-check/start-rent-check>

¹⁴ I disclose a conflict of interest in making this suggestion in that Freshhope Communities may potentially benefit – assuming it can find the alternative sources of funds that is likely to become necessary.

12 How does this change with economic conditions? Does the MPIR link to the General Interest Charge represent an appropriate way of adjusting equivalence in line with economic conditions?

It should change with economic conditions – specifically changes to interest rates. It should be noted however that real interest rates (after adjusting for inflation) remain relatively constant over time. Higher inflation leads to higher interest rates, but this should not affect rents immediately because they are anticipated to increase in future. Higher interest rates stemming from inflation present providers with a cash flow problem because they can only increase DAPs/rents after the next scheduled review. When inflation is relatively low, the strain should be manageable in the context of their overall income.

13 Would a Weighted Average Cost of Capital be an appropriate equivalence mechanism? If so, how should this be derived?

No. In addition to the need to provide for maintenance and depreciation, providers need equity capital in addition to loans – whether these are from banks, financial markets or residents. Their equity capital should earn a risk premium. Their Weighted Average Cost of Capital would be an average of the rate they are paying on their loans and the required market Return on Equity. (This is different from their internal targets, which may be entirely unreasonable – see remark III in section 1 above.)

14 Is there a case for an equivalence range rather than a single point of equivalence defined by the MPIR and why? How might this work?

If payment is based on DAPs rather than RADs, providers should be permitted to adjust the rate of return they offer on RADs, depending on their liquidity needs.

15 Should the government introduce a mandated minimum accommodation payment that prevents providers receiving less revenue from non-supported residents than they do from supported residents?

No, but government should monitor what is charged, and if such a practice is widespread it would be an indicator that the supplement was unnecessarily high and should be adjusted.

16 What are the advantages and disadvantages of moving the MPIR-related fluctuations in pricing from the DAP to the RAD?

It would be more logical: residents are renting not buying the room; providers are borrowing from short-term residents, not sharing capital costs with them.

Currently providers enjoy higher DAPs when interest rates are high and vice versa. Changing the relationship but keeping the current MPIR formula would mean that providers would have to access short-term bank loans to make up for lower RADs when in interest rates are already high. This would clearly be difficult and probably more destabilising than the current arrangement.

Changing the base to DAPs would make the providers revenue from DAPs more stable in line with their maintenance costs and depreciation charges. If the interest paid on RADs was based on deposit rates it would also have a narrower range and be more stable. Providers would need to develop access to more suitable long-term capital, but as suggested in the preliminary remarks, this should be achievable.

17 Would setting DAPs as the default make accommodation pricing easier to understand for prospective residents and their families?

Absolutely.

18 Are there other relevant factors to consider in relation to setting the DAP as the default payment type?

Not that I can think of.

19 Do you think the DAP should be set as the default payment type? Why?

Absolutely. As for the answer to 16: more logical, less stress, less destabilising.

