No family house? No inheritance?

Potential impacts from the rising cost of residential aged care

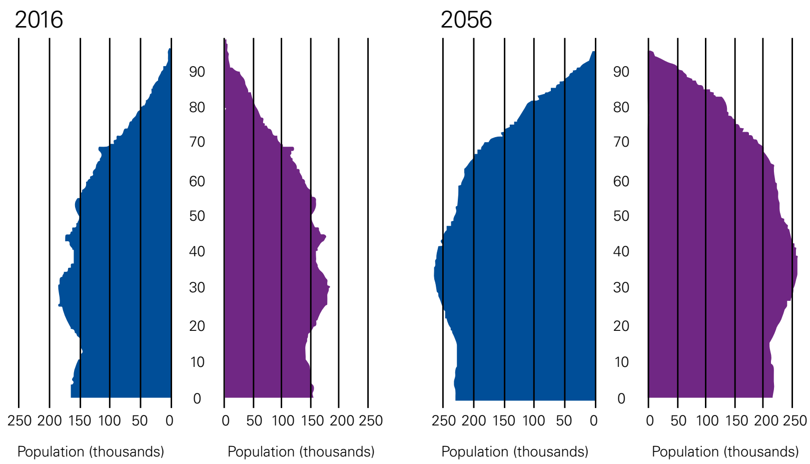
We are all aware of housing affordability impacting younger generations, but there is a real risk that this issue will come back to bite us when we reach the other side of life's journey – our so-called twilight years.

These twilight years may in fact consist of being forced to sell the family home, living apart from our spouse, erosion of inheritance wealth, and compromising on our anticipated quality of life when entering an aged care facility because we cannot afford better.

The dichotomy facing our aged care industry is how we ensure the continued sustainability of a growing sector whilst challenging societal norms about government support and the preservation of wealth for future generations.

Funding pressures

Australian population growth



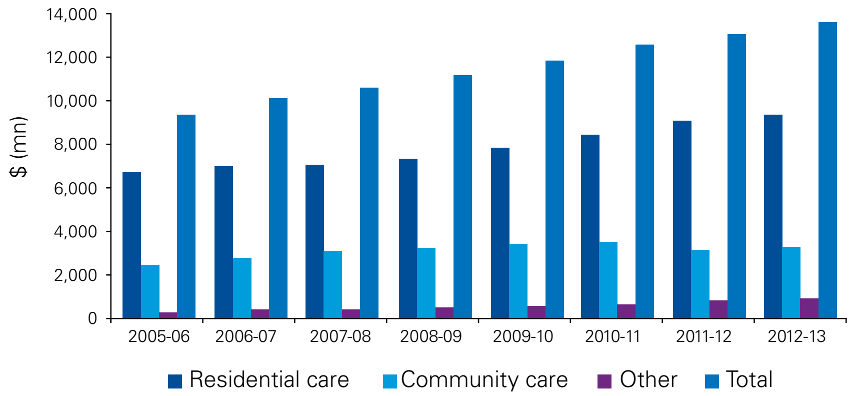
Source: Population Pyramids, Australian Bureau of Statistics

The cost of aged care in Australia is increasing rapidly, and will continue to do so. There are a couple of key factors driving this growth. Advances in health are allowing us to live longer – the average Australian is now expected to live till 80 (male) and 85 (female), whilst a mere 40 years ago, we were hoping for 72 and 79 respectively.[1] Looking forward 40 years, the number of Australians aged 65 years and over is expected to double, whilst those aged 85 years and over is expected to quadruple.[2] Over the same period, the number of working taxpayers to each elderly person will decrease from 4.5 to 2.7[3], placing significant pressure on the Australian workforce, and the government, to support our ageing population. The cost of residential aged care is also being impacted by residents generally being older, frailer, and having more complex care conditions. The increased prevalence of dementia further increases budgetary pressure whilst people's desire for care services in the home, albeit cheaper to provide, is seeing unprecedented demand and growth.

1. Life Tables, 2013-2015, Australian Bureau of Statistics
2. Population Pyramids, Australian Bureau of Statistics
3. 2015 Intergenerational Report, Commonwealth Government

The government faces considerable challenges in tackling this problem. Recent legislative reform and the emergence of Consumer Directed Care aim to build a better and fairer aged care system with greater consumer choice and control, with a key theme being the endorsement to change the way in which people contribute to aged care costs. The 2015 Intergenerational Report indicates that under Australia's current policies, aged care expenditure is expected to increase from 0.9 percent of GDP in 2014/15 to 1.7 percent of GDP by 2054/55. It is likely that Australia will be looking to the policies of other Western countries, who are similarly facing unprecedented costs from an ageing population, to implement international best practice policies to ensure that our aged care industry is financially sustainable.

Government real expenditure on aged care services



Source: Productivity Commission 2014, Report on Government Services 2013 and 2014

Supply pressures

Approximately 76,000 new aged care places will be required over the next decade, with required sector capital investment estimated to be $33 billion[4].

Although the regulation of aged care places is managed by the Commonwealth, there appears to be variations in supply and demand dynamics from one planning region to another, with some areas experiencing a statistical oversupply, and others an undersupply. There is also differentiation between metro and regional/remote areas, thus further extenuating supply pressures.

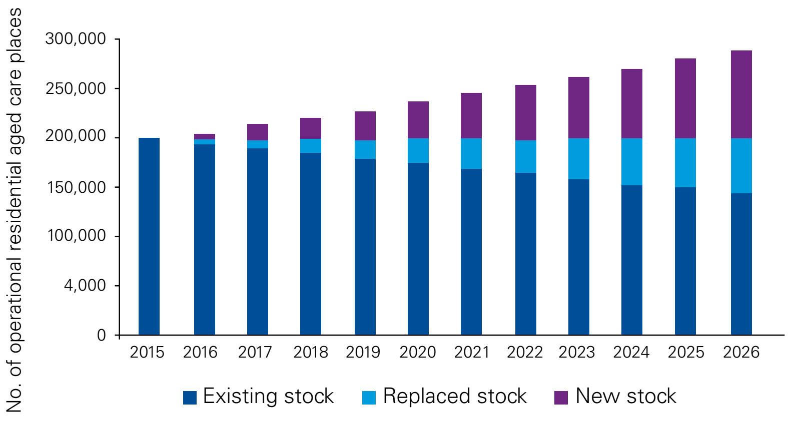
In addition to new stock, a large proportion of existing facilities are quickly losing relevance. The average age of facilities in Australia is believed to be over 20 years, with many originally designed for 'low care' purposes. These facilities will not be able to accommodate the growing proportion of residents with complex care needs, will become less relevant and less competitive
in the marketplace, and will therefore require replacement.

Consumer preferences are also changing rapidly. What was once accepted by previous generations, such as multi-bed rooms and institutional styled facilities, are no longer tolerated. The baby boomers, and beyond, will have much higher expectations in regards to care and accommodation – the question is, will they have the means and impetus to pay for it?

We are already seeing a surge in the development of premium residential aged care facilities across the country. A recent development in Vaucluse is demanding an entry price of $1m to $2m per aged care room.

With supply constraints, rising property prices, and emerging consumer preferences, the cost to develop residential aged care facilities will increase, and so too will the entry price for residents.

Outlook for aged care facilities



Source: Aged Care Financing Authority, 2016

4. Fourth report on the Funding and Financing of the Aged Care Sector, 2016, Aged Care Financing Authority

User pays model

As care costs continue to escalate, further 'innovative' models of accessing funds will be required, with a key facet being a shift towards a 'user pays model'. The Australian government has made it clear that it will continue to support those who are unable to pay for their own care needs, but that responsibility needs to shift to consumers who have the means. We have already seen the introduction of means testing for residential aged care recipients, but in comparison to other countries, we seem to be treading softly.

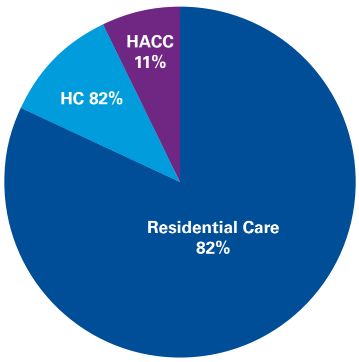
Residential care makes up the lion's share of the cost of aged care services in Australia. In 2014/15, it represented $15.8b (or 82 per cent) of the total $19.3b across residential care, home care (HC), and Commonwealth home & community services (HACC)[4].

Of the $15.8b cost of residential care, consumer contributions represented 26 percent or $4.2b. The government contributed 66 percent, whilst the remaining 8 percent is obtained from other sources such as interest income and trust distributions[4]. In comparison to the UK aged care sector, 45 percent of care costs are self-funded by consumers.

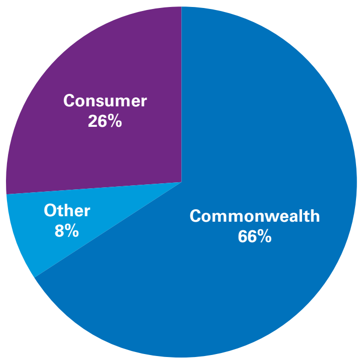
As sector costs continue to grow, and the pressure on government intensifies, a shift to a user pays model will gain momentum. Government will look to alternative methods of accessing consumer wealth to self-fund aged care costs and relieve budgetary stress.

More stringent means testing rules will undoubtedly be applied. With the majority of consumer wealth currently held in the family home, it seems likely that this asset class will be a major element of reform. With around $6 trillion of household value in Australia, one would imagine that the government is keen to procure a portion of it to share the burgeoning cost of aged care.

Aged care services revenue



Residential care contributions



Source: 2016, Aged Care Financing Authority

The family home and inheritance

The 'Great Australian Dream', or rather, the desire to own one's home, is ingrained into the psyche of most Australians. It is perceived by most to be a mark of security and success, as evidenced by our comparably high levels of home ownership. We have little experience or willingness in 'drawing down' this equity for other purposes, and generally have a strongly held belief in preserving this capital for future generations.

Therefore, the notion of 'dipping into' the family home to cover the cost of getting old is a relatively foreign concept. For those nearing the pension, the family home is fully exempt, which further perpetuates our expectations of being provided for.

It is likely that the average Generation Y has not benefited from the property boom, and is currently experiencing housing affordability problems. From this Generation, we will undoubtedly see a cultural shift that sees much less tolerance in allowing older generations to retain their 'million dollar' plus residences, whilst receiving support from the government.

Under current legislation, if a person enters residential care the family home is either exempt or at worst, capped at $159,631 for means testing purposes. Noting that most wealth resides in the family home, and that the elderly generally have low levels of income, it is highly likely that the government will subsidise a proportion of residential aged care costs under these circumstances.

By way of example (see Table 1), for a resident currently in receipt of the aged pension, although accommodation costs will be negotiated with a preferred provider (and be fully refundable if a Refundable Accommodation Deposit is paid), regardless of the value of the family home, the government will not impose a means tested care fee.

With the average home price in Australia currently sitting at $623,000[5], and the current cap well below this amount, one must ask how sustainable this position is in light of increasing care costs, and the future inability of government to pay for them.

Many other countries, including the UK and New Zealand, include the full value of the family home when determining a resident's ability to pay for care costs. Both of these countries have or are planning to introduce a deferred payment scheme. Instead of forcing people to sell their homes, payments are deferred until equity is accessed, but nonetheless the expectation to pay for care costs remains.

Australia also has a cap on the cost of residential aged care paid by an individual, being $26,041 per annum, and $62,498 per lifetime. This means that regardless of wealth and income, the government will subside care costs when these caps are reached.

To illustrate this (see Table 2), let's use the example of a resident with a family home valued at $1m. As previously indicated, an individual on the aged pension (~$20,745) will not be assessed for means tested care fees. As income increases to $75,000 per annum, the resident will be required to contribute means tested care fees of $24,670. Although slightly under the annual cap, the resident will only have to pay these fees for 2.5 years until he reaches the lifetime cap of $62,498. Thereafter, the government will fully subsidise these costs regardless of ongoing income earned by the individual. For residents on a higher income bracket, say $150,000, they will only be required to contribute an additional $1,371 per annum to reach the annual cap, albeit having significantly higher levels of income.

Table 1

Value of the family home	Accommodation contribution	Means tested care fee
$350,00	Per provider	$0
$1,000,000	Per provider	$0
$10,000,000	Per provider	$0

Table 2

Income	Means tested care fee	Years to attain lifetime cap
$20,745	$0	n/a
$75,000	$24,670	2.5
$150,000	$26,041	2.4

5. Residential Property Price Indexes, June 2016, Australian Bureau of Statistics

Potential impacts

Our current approach will become increasing unsustainable, and as we shift further towards a User Pays Model, our typically 'asset rich-income poor' ageing population will have to look to the wealth that they have accumulated in their family homes to cover the cost of aged care. For some, this will involve the sale of the family home to access capital. The expectation, and even perceived entitlement, of children to claim the family home, may be nearing extinction for the middle classes.

One might also expect an increase in the popularity of reverse mortgages and other equity release products. Although currently uncommon in Australia, these may gain traction as access to capital is required to ensure that the elderly can afford the level of care that they require.

Spouses and families will have to face the prospect of increased debt levels and depleting wealth. There are sure to be associated social and psychological flow on effects. The notion of achieving a debt free position in one's later years may only be short lived, and our current expectations of intergenerational wealth will surely be challenged.

And what of those who do not have enough equity, or have only enough equity for one spouse? Will they endure a sub-optimal residential facility located far from family and friends? Or will responsibility rest with their children? There is a growing trend for parents to support their children through the current housing affordability crisis, so when the tables are turned, will these children have the capability and desire to support their parents?

The transition into residential care is usually a challenging and emotional decision to all involved, including the resident, their spouse, and immediate family. The inclusion of greater financial obligations will almost surely make the transition a more complex and difficult one. On the other hand, the sector is rapidly becoming unsustainable, with a growing cultural shift on the inequities of government support whilst intergenerational wealth is maintained. The way in which government manages this shift to a User Pays Model will require detailed consideration on the impact to individual, families, and the wider community.

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