Aged care providers

Time for a strategic shift?

Aged & Community Services Australia

In 2022, the earth is shifting under the feet of the Australian Aged Care sector. Changing government policy, difficult economics, labour market shortages and waves of Covid response are all putting providers under pressure. In this white paper, Aged & Community Services Australia (ACSA) and investment and advisory group Perpetual/Fordham assess the issues and outline the importance of a deep strategic analysis process for providers.

The Australian Government describes its $17.7 billion Aged Care reform package as a "once in a generation" reform of Aged Care.[1]

For the Aged Care sector and its leaders, enacting these reforms is a once-in-a-generation challenge. They will be forced to make major decisions about their long-term strategy, staffing, funding, operations and much more. For some providers these will be *existential* decisions.

Most organisations in the sector support fundamental reform and want to see the Australian community's confidence in the sector improved. However, the need to respond to Covid has exhausted both working and human capital.

In the first section of this white paper we look at the mix of factors that will drive major strategic decisions in the sector. In Sections Two and Three, we look at how the sector is likely to change and how Aged Care providers can manage this change – the strategic approach they can take to achieve first stability and then sustainable growth.

"The bottom line – for everyone – is that reform should deliver high quality person-centred care. All stakeholders realise how important that goal is, especially as we face a growing aged population."

Paul Sadler, CEO, ACSA

[1] https://www.health.gov.au/initiatives-and-programs/aged-care-reforms

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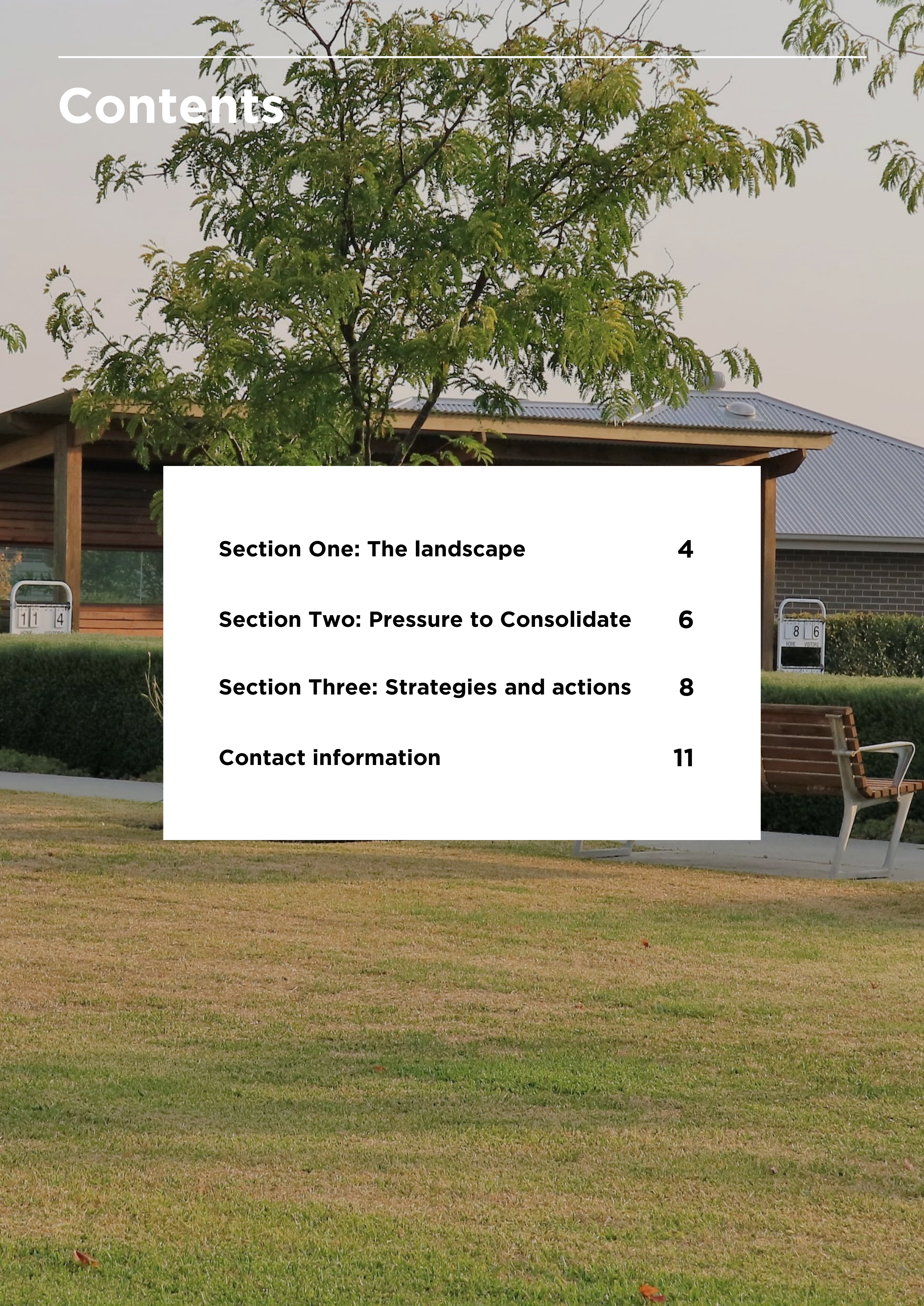

Section One
The landscape

For many leaders in the Aged Care space, the current environment is deeply stressful. The volume and pace of reform – plus the disruption and the operational stresses caused by Covid – has set many back on their heels at a time when they need to be leaning into the reform challenges.

Compliance burdens

Post Royal Commission, with a new Australian Government 'Five-Year, Five Pillars' plan and some 70 pieces of legislation in play, many Aged Care providers are swamped by the compliance burden.
That compliance burden is not going to ease – it will grow.

ACSA's experience in the field attests to this challenge. "We're working with providers, engaging with them on the reform agenda and its implications," says Derek Dittrich, Executive Director Government & Public Relations at ACSA. "But many are currently working through major operational reform and pandemic-related challenges with new operational, reporting and payment arrangements to be embedded. We're dealing with reform challenges in a sector where the leaders are incredibly time poor."

People pressures

Aged care is a people business, and right now, there is a shortage of people.

- Covid and the initial approach taken by public health units to furloughing staff have shrunk the pool of available workers, exacerbating workforce pressures.
- Closed international borders removed a key cadre of workers – immigrant workers and student visa holders. Even as borders re-open, filling the staffing backlog caused by two years of lockout will take some time.
- After two years of Covid and continuing growth in the disability sector, Aged Care providers are competing for in-demand staff and if they're lucky enough to get them, need to pay higher wages and provide better conditions to keep them. This is particularly problematic in the health functions, where requirements for complex healthcare services in Aged Care are butting up against more competition for trained health staff.

Anecdotal evidence - real life shortages

- According to one very large specialist staffing agency, on any given day, they're currently able to fill only around half of their requests for staff.
- For one operator, the inability to recruit registered nurses means they've been forced to close one of their two centres. In other centres, there is not enough staff to deal with new admissions. Already, some centres are closing beds due to staffing shortages.
- In broader terms, staffing stresses are creating higher costs and higher operational and compliance risks. Care delivery is at risk from the acute workforce shortages and operators face the risk of compliance actions including sanctions.

Retaining their workforce, rather than the professionalisation of the workforce, has become the issue. For the residential Aged Care sector, the current low unemployment rate makes it incredibly challenging to meet market forces with competitive pay or bring on staff to prepare for the reform target of a minimum 200 minutes of care per resident per day. Reform comes with the expectation of increased training in areas such as dementia and palliative care – creating further staffing pressure.

"Human capital acquisition – via targeted immigration and additional funding to address rising wage pressures – needs to be addressed or the Five Pillars timeline will blow out. CEOs are already calling for a slow-down in the timeline to allow the remaining resources to be prioritised on sustaining BAU."

Julie Hough, Partner, Fordham

Balance sheet pressures

In addition to the labour supply problem, Aged Care providers confront a challenge that's quite common in heavily regulated industries. The price they can charge is fixed. The prices they pay – for all their inputs – are not fixed and are increasing. Whether for-profit or not-for-profit, that structural imbalance damages the balance sheet by eroding margins and working capital.

According to Derek Dittrich, ACSA Executive Director Government & Public Relations, the cost pressures affect different providers differently. Those with low debt can, for the moment, manage those rising costs if they have sufficient uncommitted reserves. For those with significant debt – in terms of Refundable Accommodation Deposit liabilities or bank loans – these rising costs create a significant liquidity problem. And a viability problem.

The fact that administrative overheads are an emotive subject highlights the pressure the sector is under. The media is sometimes keen to 'name and shame' providers, without objectively exploring the issue, perpetuating negative community perceptions and affecting consumer confidence.

The other key issue affecting Aged Care balance sheets is the vacancy rates in residential homes. This crisis is biting in two ways, neither of which will be quickly resolved.

Consumers will now delay entry to residential care to take up expanded home care options

The immediate ability to accept admissions is being affected by Covid precautions and a lack of clinical staff to carry out onboarding.

These problems are currently causing widespread viability concerns, particularly as the Government sees this as a residential-care over-supply situation and have scheduled a cessation of allocations of new bed licences. Whilst providers welcome a future of fair and competitive market conditions, the current stresses are absorbing the resources needed to manage such change.

Section Two
Pressure to consolidate

One part of the Government's reform package is the Business Improvement Funding Grants under the Structural Adjustment Program. They're aimed at improving governance and operations in small and medium providers, particularly those located in regional, rural, and remote areas.

Why are they required? To reduce the risk of business failure amongst the most vulnerable Residential Aged Care providers as they adjust to changes in the sector. They lead some to infer that the intent and funding structure developed by the Government, as it laid out its Five-Pillar Reforms, are a deliberate consolidation strategy.

Michael Sutherland, a Lead Partner at accounting and advisory firm, Fordham, says; "From 1 July 2024, residential Aged Care places will be allocated to residents instead of providers. Providers will now compete for customers. This is the real turning point which providers must prepare for now. I can't put it too boldly. It will be the ability to attract customers which will drive the value and viability of any Aged Care provider going forward."

According to Fordham, this has the following implications:

- Unless they're in a strategically superior location with proven high demand, provide a superior accommodation option, or meet a specific need, most Residential Aged Care businesses are likely to be operating under capacity and hence are under-valued. Despite all the stress in the sector, it's therefore a buyers' market for organisations who understand the market, its economics and governance and can manage the risk as they capitalise on the opportunity. For efficient buyers, there is substantial upside in well-executed strategic acquisitions.
- Paradoxically, some high-quality, well-located residential Aged Care businesses will now be susceptible to competition in their catchment areas. Previously these businesses were protected via bed licensing. Providers in areas of over-supply will struggle to maintain asset values unless they can find a way to gain or maintain market share whilst delivering their services cost-effectively within their local market.
- While the legislative environment imposes uncertainty about the economics and outlook for Aged Care operators, it's unlikely new investors (private equity, Real Estate Investment Trusts, property companies) will buy in. As a result, most transactions will occur between existing operators for whom there is strategic alignment.

According to the annual Report into the Operation of the Aged Care Act commissioned by the Government the past five years have seen a contraction in the number of residential Aged Care providers (by 12.5%). [2] Similarly, the Commonwealth Home Support Packages have been declining at a comparable rate. It is interesting to note that after the 2017 reforms, Home Care Package numbers had an uplift which has since stalled over the last two years.

The team at Fordham believe the need to access economies of scale will drive further consolidation via strategic mergers, acquisitions or alliances.
The removal of supply side constraints via the cessation of bed licensing in residential Aged Care underpins consolidation; this results in fewer but larger operators in a transformed Aged Care industry.

[2] https://www.gen-agedcaredata.gov.au/www_aihwgen/media/ROACA/21520-Health_Report-on-the-Operation-of-the-Aged-Care-Act-2020%e2%80%932021.pdf

New offerings

These forces may also change the strategy behind residential offerings. Economic incentives for seniors to consider alternatives to the traditional family home will drive further change in consumer preferences. The experience of Covid isolation – plus lifestyle advantages, tax incentives, security of tenure, certainty about ongoing costs, priority access to assisted living options and end of life care – are enhancing consumer appetites for retirement village living.

Innovative, scaled-up and master-planned communities that connect to co-located businesses and healthcare services (plus new rental-style models) could deliver the integrated social infrastructure seniors want and need.

Social costs

While the above summary covers the business implications of consolidation, ACSA's Derek Dittrich highlights some of the social implications. Simply put, some smaller providers – faced by the overwhelming weight of regulatory change, higher staffing costs, rising staff vacancy rates and more intense competition – will be forced to fold or merge.

Though increasing competition will be good for some consumers – driving down prices and broadening services – those who live in regions where services cannot be economically sustained may lose access to facilities that suited their needs. There is no guarantee that regional and rural centres will remain viable in the new marketplace in the long-term unless they form part of a broader campus of community offerings.

"We have to ensure that in the rush for a more efficient sector, we don't leave consumers behind – especially in rural and regional centres."

Derek Dittrich, Executive Director Government & Public Relations, ACSA

Structural Adjustment vs Transformational Change

We are already seeing transactions within the Aged Care sector that show organisations undertaking transformational change thanks to forward-thinking leadership.

The acquisition of Japara (one of 3 listed entities in Australia) by Calvary (a faith-based NFP) gives Calvary an attractive geographic footprint, more scale, more diversification and a better occupancy pipeline – and all at low point in market valuations.

Bolton Clarke's acquisition of Allity – another NFP provider acquiring a for-profit sector operator – doubles Bolton Clarke's size and makes them the 2nd largest provider (alongside Estia) in the market.

Aveo's decision to focus on home care delivery and sell its Aged Care facilities and undeveloped sites to Opal is a similarly future-focused strategy. Aveo addresses risk mitigation by partnering with a specialist provider to deliver high-care needs whilst focusing on its retirement village and home care core competencies.

Section Three Strategies and actions

Given the scale of the regulatory and economic challenges facing the Aged Care sector, even the most experienced boards and executive management teams may lack the required skills in whole of business strategic planning and buy/sell/merge transactions to respond appropriately. That's why support from external experts can be so valuable when it comes to planning and evaluating all options, and it is the small to mid-size operators that need support the most.

The Fordham team has extensive experience in advising businesses – including Aged Card providers – on how to deal with industry disruption and be successful in the aftermath. In this section we look at a strategic roadmap Aged Care leaders can follow to maximise their chances of surviving – and then thriving.

Assess your fitness – and flexibility

According to Fordham, leaders of Aged Care providers first need to conduct a thorough appraisal of their current business situation and, crucially, of their ability to adapt. That means an assessment of the financials and of systems and processes – how flexible are they when faced with changing rules, inputs and metrics? It also requires an assessment of the leadership team – is it adaptable to change in functions around compliance and competition?

This assessment extends to the customer level. Fordham helps Aged Care organisations assess the marketability of their services within the context of their local demographies and then assess the providers' ability to achieve profitable, sustainable occupancy. This process typically involves input from the sales and delivery teams to understand each site's unique dynamics and the relevant customer experience.

This analysis underpins the identification of potential 'growth and sustainability solutions' – product and service offerings that future consumers will want to buy. This is a core part of actionable and achievable plans for transformational change.

Understand your assets

A deep understanding of organisational assets – the balance sheet, working capital, infrastructure, staffing etc – is valuable but not sufficient. Aged Care providers must assess those resources against the challenges they face – the consolidation agenda, a heightened regulatory environment and consumers' shifting expectations.

Risk tolerance also needs to be reassessed. When board tolerance for investment and liquidity risk is too low, the risk of failure is heightened. For example, if more cash than necessary is being held on the balance sheet, inflation risk is amplified and opportunity costs exist. In times where profit margins are razor thin, aged care leaders need to use the levers available to them to improve financial performance.

Decision analysis

At this point, providers need to make the big calls. Fordham assists businesses with what they call 'stay and grow – or go' analysis. This involves using the strategic thinking above, plus forecasts of what will happen from 2025 onwards, to define crucial decisions. It means identifying and modelling the upside in staying in the market and the organisation's ability to grow organically or by way of acquisition or merger. Alternatively, it's time to measure the value of alternate uses of capital and to seek divestment.

Long-term planning

Decisions to stay and grow – or to divest all or part of existing operations – usually become clearer through analysis and exploration of the strategic options.

That strategic planning usually encompasses:

- Examination of the current resources available to the provider, their position within their market, the competitive landscape – both risks and opportunities given known threats, their ability to manage BAU and the reform agenda as outlined
- Examination of strategies to diversify income streams and/or redeploy capital to new business models (retirement village, homecare, NDIS, specialisation within Aged Care etc)
- Examination of specific strategies for acquisitions, mergers or strategic alliances to achieve critical economies of scale
- Analysis of the potential benefits of divesting non-core activities to allow for deployment of resources towards more focussed growth
- Facility plans including required refurbishments and targeted redevelopments
- Capital funding plans including all forms of financing
- Workforce plans for attracting, retaining and developing quality personnel
- IT strategies to ensure systems are reliable, integrated and scalable
- Succession and recruitment plans to embed high calibre leadership and enhanced governance capabilities so the organisation can manage increased accountabilities and risk
- Deployment of any excess capital, in line with codified investment and liquidity management strategies
- Current valuations and future valuations (in the current stakeholders' hands) at the end of each period

The numbers

All this planning needs to be underpinned by detailed financial modelling in the form of 3-way financial forecasts. In this analysis, balance sheets are important – not just earnings and cash flow. These forecasts might include assumptions around capital investments and financing facility usage. They should also include monthly performance metrics that can be assessed against required bank covenants, industry benchmarks or expected return on investment metrics from planned activities.

Importantly, these longer-term plans must then be brought back to actionable initiatives.

The data imperative

Looking at this strategic re-appraisal, it becomes clear that information is a currency almost as important as cash. Providers need data – and data management systems – that meet two objectives:

1. They deliver – via automation – data and information flows to regulators and do it efficiently and effectively
2. They gather, analyse and present management data in an integrated way so that leaders of Aged Care providers can make highly informed decisions

"This modelling and data analytics work is a crucial part of any strategic re-alignment," says Fordham's Julie Hough. "It's business intelligence, but it also supports compliance, stewardship and governance and helps an organisation manage risk."

What's next?

The frameworked approach outlined above can help Aged Care providers lean into the challenges posed by reform. However, this analysis is only part of the solution. Organisations have to think very deeply about the communities they serve and how any strategic change may affect them.

Forward-thinking providers will examine their ownerships and operational structures and how they might work in any buyout, merger, acquisition or wind-up scenario. Expert advice is crucial.

Similarly, providers will benefit from assessing the investment landscape within the sector. Who will wish to fund Aged Care providers? What will attract their capital and on what terms? And how can this capital be optimally deployed? An understanding of those issues will help providers attract new capital - and deploy the capital they already have.

Expert advice makes the difference

Fordham works with Aged Care providers and understands the complexities faced by operators. Their highest value service offerings are focused around:

- Advising operators on how to improve performance against industry benchmarks
- Working with operators on projects that enhance management of BAU, manage the increased compliance burden and optimise the financials
- Prepare businesses for consolidation – whether as merger partners, buyers or sellers
- Liaise with funding providers to ensure providers can access capital on suitable terms

This strategic analysis is underpinned by Fordham's experience on all sides of buy/sell/merger transactions and their work providing independent expert valuation reports for a whole range of corporate actions in the Aged Care sector.

Fordham also works with board and management teams as advisory board members providing external insight and/or preparing them for the whole gamut of merger and acquisition discussions.

Fordham can also bring Perpetual's investment expertise into play to meet the needs of providers. Perpetual works with some of the country's largest not-for-profit organisations, as trustee, investment manager and/or advisor. In this context, Perpetual already works with numerous providers to assist them in the formulation of their investment strategies and ultimately with the investment of excess funds and to ensure all assets on their balance sheet are put to work to optimise risk-managed financial returns. Perpetual also manages the funds extracted by operators looking to divest all or part of their operations.

"For Aged Care providers dealing with major reform, consolidation and a more competitive marketplace, getting the most out of your assets is crucial. Those assets include customer knowledge, human capital – and financial capital. All need to be optimised to support the strategic shifts required."

Anthony Hamawi, Manager, NFP and Aged Care, Perpetual

The bigger picture

Aged Care providers must continue engaging with government and working with other stakeholders to optimise their place within the evolving Aged Care landscape and contribute to a future for Australians that sees them receive high quality care as they age. ACSA is currently lobbying government to develop a robust and comprehensive sector transition plan.

The time is now

Whilst this white paper has outlined an array of challenges to providers, the teams at ACSA, Fordham and Perpetual are close enough to the industry to see the many attractive opportunities available to Aged Care organisations that are financially strong, attuned to consumer needs and geared up to manage disruption in the sector. It will be the organisations that are prepared to do deep strategic analysis – and do it now – that will succeed.

If you would like to know how Perpetual and Fordham – working with ACSA – can help your organisation manage the challenges of compliance, reform and consolidation please contact Anthony, Michael or Julie using the details on the following page.

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