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DISCUSSION PAPER

AGED CARE FINANCIAL AND PRUDENTIAL STANDARDS 2025

Abstract
The Aged Care Quality and Safety Commission (Commission) sought public consultation on the draft Financial and Prudential Standards (Standards) from 18 February 2025 to 14 March 2025. Following this consultation, the Commission released the consultation report (Public consultation summary report: The new Financial and Prudential Standards | Aged Care Quality and Safety Commission) and an overview of the development of the liquidity standard (Overview of the development of the Liquidity Standard | Aged Care Quality and Safety Commission).

The new Financial and Prudential Standards will commence on 1 November 2025 together with the *Aged Care Act 2024* (New Financial and Prudential Standards | Aged Care Quality and Safety Commission).

The Commission has stated that new Standards "aim to strengthen the financial governance and sustainability of aged care providers, so they can deliver high-quality care and services and maintain continuity of care for older people."

This Discussion Paper is to provide commentary and analysis of the new Standards, in particular the Liquidity Standard. For context, the Paper should be read in conjunction with *Appendix A* which was the StewartBrown submission to the Commission's public consultation.

The Liquidity Standard only applies to residential aged care providers (registration category 6).

StewartBrown fully supports the development and implementation of a phased approach to risk management and financial monitoring from the Commission, as recommended by the Royal Commission, and acknowledges the consultation and transparency process that the Commission has followed in this regard in formulating the new Standards.

Liquidity Standard
The Commission amended the proposed liquidity formula ratio from the pre-consultation draft as follows:-

- Reduced the ratio for retirement village refundable deposits to from 10% to 2%
- Included trade receivables as forming part of liquid assets

The Commission provided guidance as to the methodology and risk assessment and stated that "they did not want to increase the liquidity risk across the sector." The Commission further stated that:

- Just under 84% of all residential aged care providers already hold a liquidity amount equal to or above the amount they would need to comply by using the original formula (35/10/10)
- About half of those providers that do not already hold the minimum liquidity proposed under the new Standard, should be able to comply using other arrangements based on a review of provider profiles
- Estimated that about 10% of providers will have a financial viability risk that they can manage by:
  - lifting their liquidity amount to comply by using the formula
  - having other liquidity arrangements

Liquid Assets
For the purposes of the Liquidity Standard and liquidity formula, liquid assets include:-

- Cash - as defined in AASB 107 "Statement of Cash Flows"
- Cash equivalents - as defined in AASB 107 "Statement of Cash Flows"
- Financial assets - as defined in AASB 9 "Financial Instruments"
- Trade receivables (less provision for doubtful debts) - as defined in AASB 9 "Financial Instruments"

We note that financial assets for the Liquidity Standard do not make a distinction between fair value through profit or loss and fair value through other comprehensive income.

The liquidity calculation does **not** include the following:-

- Loans receivable (related entity and non-related entities)
- Capital work in progress
- External borrowings (related entity and non-related entity)

- Loans payable (related entity and non-related entities)
- Government subsidy acquittals owing (HCP unspent funds, CHSP grants, capital grants, other grants)
- Lines of credit (unused)
- Capital expenditure pipelines

The stated aim of the Liquidity Standard is "to improve aged care providers' financial governance and financial sustainability" in addition to providing a financial monitoring and risk assessment process by the Commission. To achieve these aims effectively, adopting such a restricted definition of what is included as liquid assets and to not include other cash flow related balances is simplistic and not contemporary.

Residential Sector Viability

The Commission's risk assessment and approach appears to suggest that the current minimum levels of liquidity as required to be calculated by providers through their respective Liquidity Management Strategy (LMS) and included in the Annual Prudential Compliance Statement are not sufficient to meet the prudential requirements and form part of the risk framework.

Table 1 is a summary of the net asset (equity) position of the residential sector based on the detailed financial analysis and modelling conducted as at 31 December 2024 by StewartBrown for the consultation submission (refer *Appendix A*).

The following observations from this analysis were noted:-

- The underlying financial equity (net assets) of residential aged care providers as at December 2024 remains stable, with a low risk profile in aggregate for all cohorts based on size of revenue and assets employed
- The resultant effect of over five years of aggregate operating deficits, combined with the effects of COVID-19 and a critical staffing shortage, has caused a resultant change in provider behaviour with a greater emphasis on cost management and a low appetite for expansion of accommodation and service delivery
- The effective "capital strike" together with positive net inflows from resident refundable loans (RADs and Entry Contributions) has caused the sector to have excess liquidity in comparison to assets employed
- Policy settings must be designed to provide the necessary balance between financial sustainability, financial risk mitigation, required investment returns for the sector to be "investable" and to encourage new accommodation builds and major refurbishment of existing accommodation
- There have been consistent net cash inflows from refundable resident loans (incoming loans exceeding outgoing loans) since the 2014 financial year with the introduction of the "*Living Longer Living Better*" legislative reforms. For the 2024 financial year, net cash inflows exceeded net cash outflows by an average of 33% (compared to 28% for 2023 financial year)

Table 1: Summary of net assets (equity) KPIs by provider size cohort

	All $'000	Small $'000	Small/ Medium $'000	Medium $'000	Medium/ Large $'000	Large $'000
Assets	494,948	75,055	189,369	489,782	715,815	2,216,982
Liabilities	394,212	50,542	146,380	371,296	499,515	1,877,219
Net assets	100,736	24,513	42,989	118,486	216,300	339,763
Liquid assets	81,572	22,669	46,448	81,229	157,617	283,151
Property assets	309,528	43,874	112,388	332,111	535,221	1,311,542
Refundable loans	299,091	41,832	124,796	271,072	416,088	1,383,946
Liquid assets % refundable loans	*27%*	*54%*	*37%*	*30%*	*38%*	*20%*
Refundable loans % assets	*60%*	*56%*	*66%*	*55%*	*58%*	*62%*

** Refundable loans include RADs and ILU entry contributions*

Accommodation Payment Guarantee Scheme

The Accommodation Payment Guarantee Scheme (Guarantee Scheme) was established under the *Aged Care (Accommodation Payment Security) Act 2006*. The Guarantee Scheme ensures the Commonwealth refunds residents their accommodation deposits, with interest if applicable, if an approved provider becomes bankrupt or insolvent. The residents' rights to pursue the defaulting provider for recovery of the accommodation deposits transfers to the Commonwealth.

At 30 June 2024, the Guarantee Scheme had been activated 17 times since its introduction (2006), with refunds of approximately $180.2 million (including interest) made to 541 residents. The Guarantee Scheme was not activated in 2023–24 and received a recovery of $422,169 from the liquidation of a provider that activated the Guarantee Scheme in 2019 *(Source: 2023-24 Report on the Aged Care Act 1997).*

With an average total residential refundable loan liability in the period since inception of (say) $20 billion, the refunds made under the Guarantee Scheme represent less than 0.01% of the resident refundable loan liability. Whilst the current total resident refundable loan (RAD) liability is in excess of $42 billion, liquid asset coverage represent 47% of this amount which could be considered to be a conservative level on a going concern basis, rather than representing a significant risk of default.

Financial Risk Assessment

The Commission considered a number of specific design principles when developing the Liquidity Standard and risk matrix. A key principle was "balancing over and under-regulation" which stated that "the standard should ensure providers are sufficiently protected by the standards without requiring the sector to hold excessive amounts of liquid assets."

The Commission analysis included two predominant stress testing assumptions, being a 7.7% drop in occupancy and a 1.3% rise in inflation. The analysis was based on financial years 2018 to 2022, which included the significant impact of the COVID-19 pandemic.

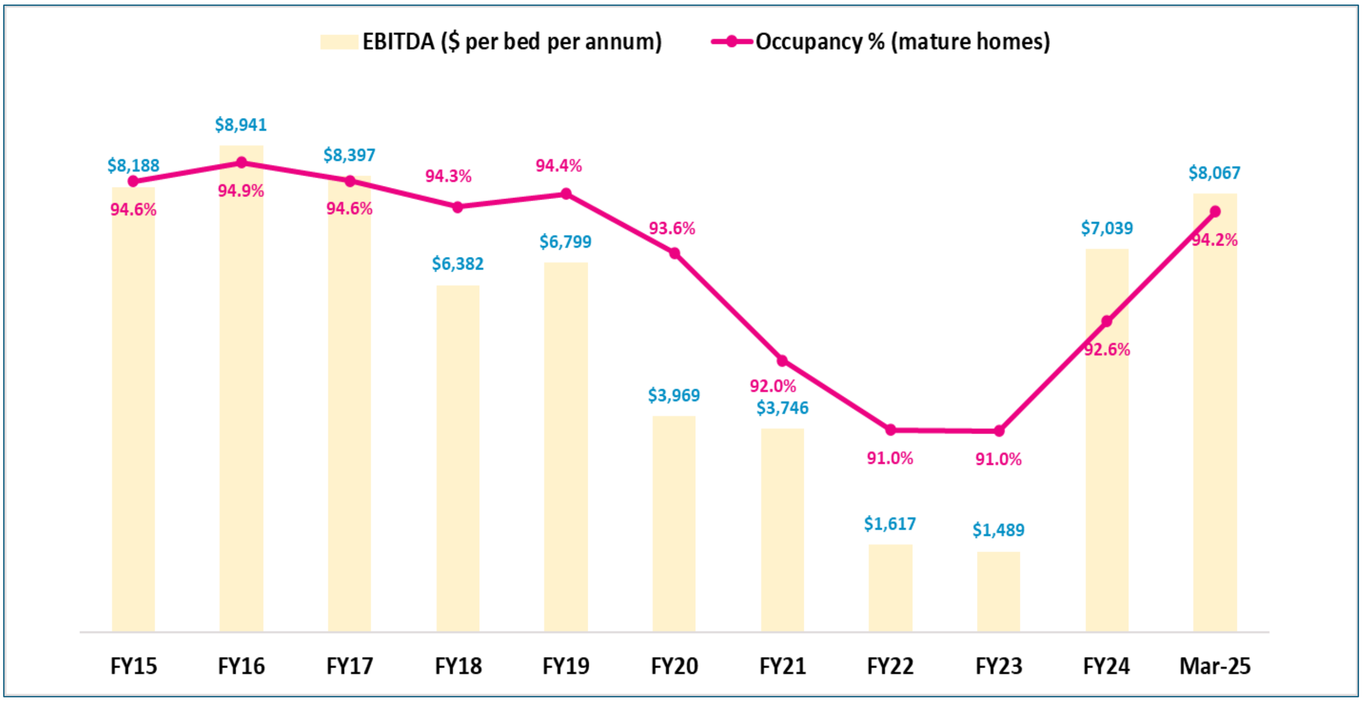
The Commission further noted that "alternative models recommending lower liquidity requirements exposed the sector to higher levels of risk" (lower liquidity levels referring to the amended 35/10/2 liquidity ratios). The analysis document made no reference to the current levels of liquidity maintained by providers as included in the audited LMS and what financial risks are considered to require an increase in these current liquidity levels. This comment by the Commission seems to assume that there are currently "higher levels of risk" which appears to be an unsupported contention.

Occupancy

A key component of the Commission's risk analysis was to model an occupancy drop of 7.7%. The Commission further noted "occupancy drops around 7-8% are realistic for providers, including pre- and post-COVID, and can reasonably be justified as a stress assumption for the sector" and additionally "drops of this nature are a 1 in 5-year event for 46% of the sector using data from the latest 5-year period." The 5-year period was in relation to the latest available data.

Figure 1 shows the occupancy percentage and EBITDA result ($ per bed per annum) for each financial year from 2015 to 2024 (FY15 - FY24) and for the nine months ended 31 March 2025 (Mar-25) for mature homes. Mature homes excludes homes under sanction, new builds, homes being refurbished, or beds/places not operational. The occupancy percentage is calculated by the actual number of resident occupied days divided by the number of available beds (places) aggregated for each home, so the occupancy percentage accurately reflects the actual position *(source: StewartBrown Aged Care Financial Performance Survey)*.

Figure 1: Occupancy % and EBITDA result FY15 to Mar-25



The occupancy percentage range was 3.9% for the 10-year period (94.9% to 91.0%) and the drop in occupancy for FY20 to FY23 was as a direct result of the COVID-19 pandemic, which is a highly abnormal event rather than a 1 in 5-year event.

Based on future demand as estimated by the Department ("*Financial Report on the Australian Aged Care Sector 2022-23 (page 127)*" there will be a requirement for 253,000 places by 2030 and 368,000 by 2040. As at 30 June 2024 there were 223,691 approved places, however the actual number of available places is likely to be in the range of 208,000 to 212,000.

The total number of projected additional beds required as noted above are very unlikely to be built and, increasingly over time, demand for aged care beds will exceed supply. The occupancy percentage is rising to now virtually equate to the historic levels up to FY19 and will shortly exceed this level with no indication of any drop in occupancy for the foreseeable future.

Relationship of Occupancy to Financial Performance

The residential aged care sector, as is the case with any business reliant on revenue, the absorption of fixed costs through increased turnover (revenue) has a direct effect on the financial performance. *Figure 1* highlights the decline in EBITDA as occupancy dropped in the FY20 to FY23 period.

However, the sector is unique in that the major revenue stream derives from the direct care subsidy (formerly ACFI and replaced by AN-ACC) which is directly relational to the assessed resident acuity. In this regard, the previous ACFI subsidy year-on-year increase to cover award wage increases and inflation was calculated by a formula known as COPE. For context, the COPE increase did not cover the actual increased costs, and in FY18 there was no COPE increase.

The resultant effect was that the direct care margin, being the difference between the ACFI subsidy and the actual direct care costs (predominantly staff costs) declined substantially.

Figure 2 shows the operating result (includes depreciation), direct care, everyday living and accommodation margins since FY15 (all expressed in $ per bed per annum) together with the respective occupancy percentages. The operating result has the same trend line as the EBITDA result in *Figure 1*.

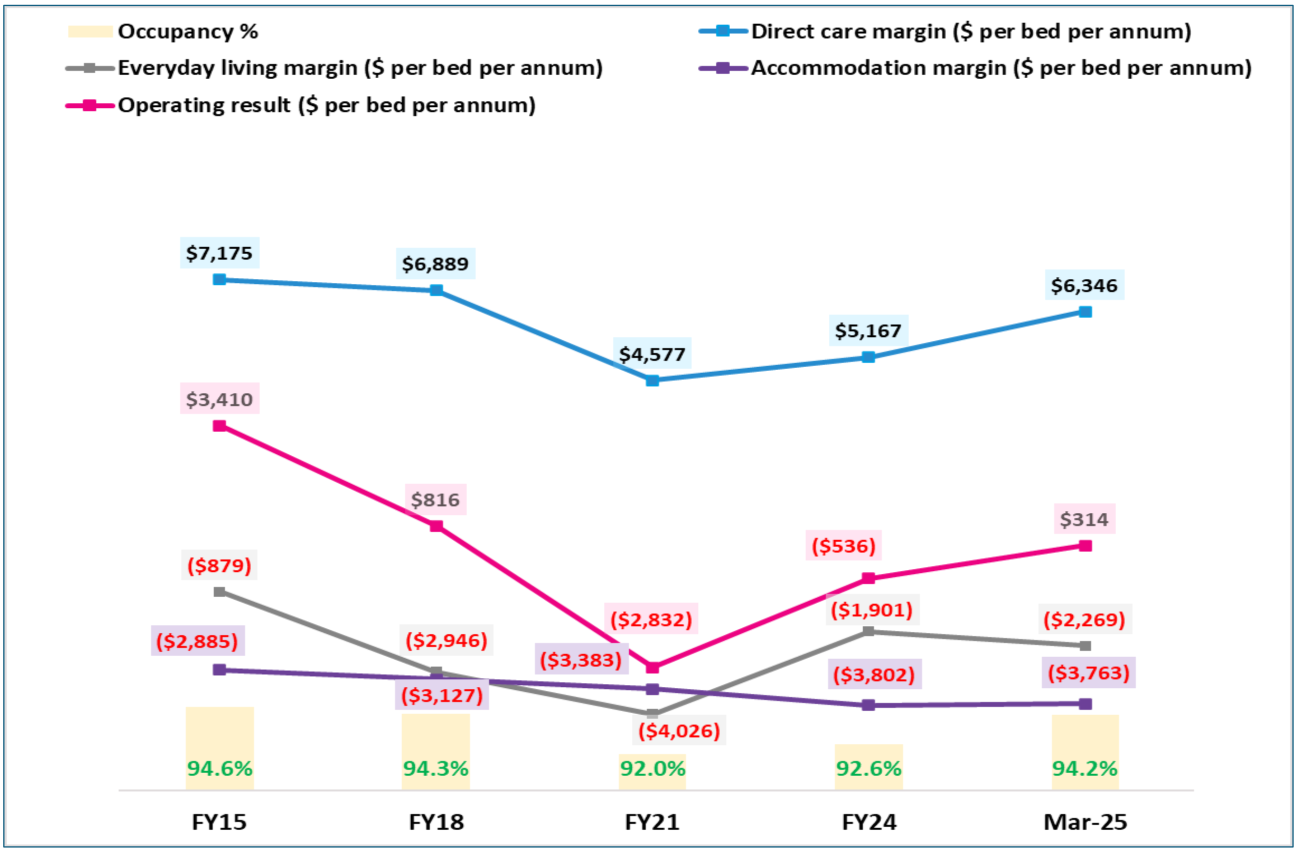
The impact of the declining direct care margin from FY18 under the previous ACFI subsidy was a major contributor to the reduced operating result, in addition to the drop in occupancy percentage. Everyday living and accommodation margins were directly affected by the drop in occupancy levels.

The introduction of the AN-ACC direct care subsidy from 1 October 2022 together with the subsidy now being determined by the Independent Hospital and Aged Care Pricing Authority (IHACPA) has resulted in the direct care margin increasing and, accordingly, the operating result improvement.

Further significance when considering future financial performance is that IHACPA is charged with recommending that the AN-ACC subsidy levels be sufficient to meet the direct care costs with an implicit margin.

Whilst it is acknowledged that a drop in resident occupancy will reduce financial performance, the overall impact needs to be assessed in relation to the direct care margin which is less influenced by reduced occupancy.

Figure 2: Occupancy %, operating result, direct care, everyday living and accommodation margins from FY15 to Mar-25



Liquidity Risk due to Outflow of Refundable Accommodation Deposits (RADs)

A significant liquidity risk will exist with a substantial change in resident behaviour which leads to the percentage of RADs held being reduced and replaced by a greater percentage of daily accommodation payments (DAPs) for those residents who are not supported. A drop in occupancy levels (such as what occurred in the FY20 to FY23 period may also cause a liquidity risk by having fewer incoming RADs to replace outgoing RADs.

Table 2 shows that for the FY24 and FY23 years, net RAD inflows exceeded net RAD outflows (with RAD outflows representing 67% and 72% of RAD inflows respectively). From a liquidity perspective this represents a net cash injection which has been the case since 2014 when the policy changed in relation to accommodation pricing.

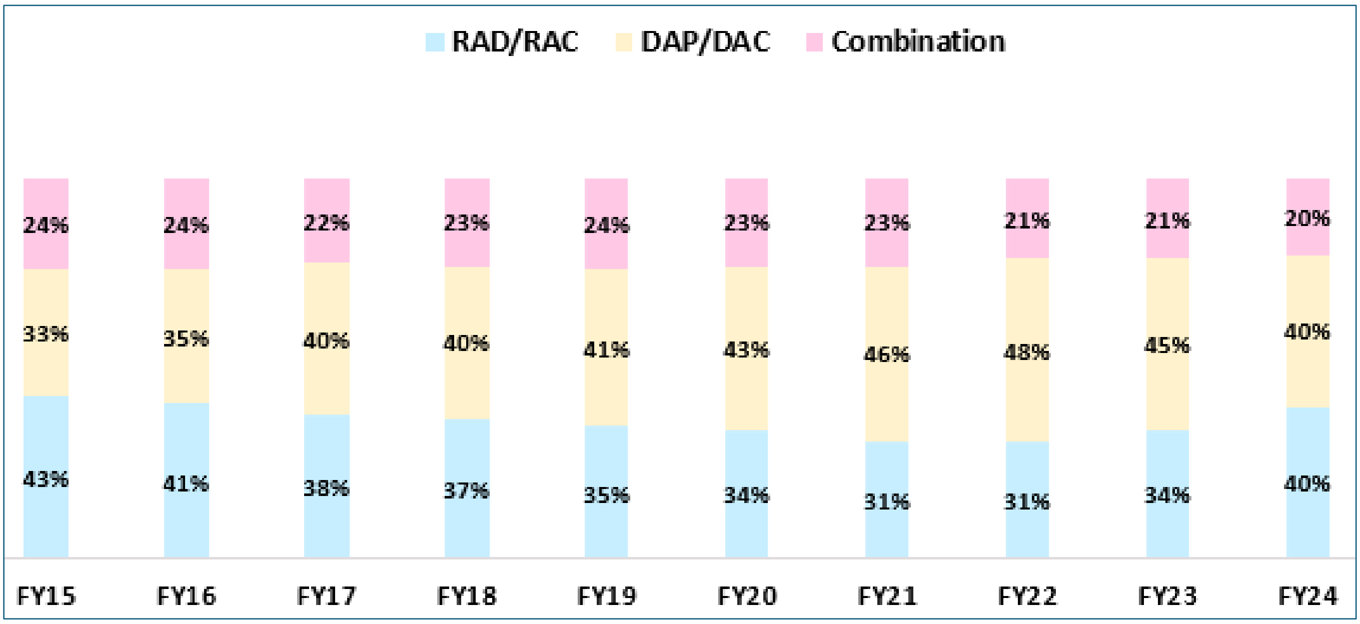
Table 2: Summary of RAD inflows and RAD outflows for FY24 and FY23 *(Source: Statement of Cash Flows by provider)*

	FY24				FY23			
	Liability $'000	Received $'000	Refunded $'000	Net $'000	Liability $'000	Received $'000	Refunded $'000	Net $'000
Total Provider Data Set	30,662,921	7,976,133	5,375,570	2,600,563	26,293,596	6,461,948	4,677,982	1,783,966
			67%				72%	

Figure 3 shows the percentage of RADs/DAPs/Combination RADs/DAPs held within the sector since FY15 to FY24. For the years significantly affected by COVID-19 (FY20 to FY23) there was a reduction of 3% in RADs received (34% to 31%) which was primarily due to the DAP being a lower cost as a result of the reduction in the Maximum Permitted Interest Rate (MPIR) from 5.96% (FY19) to 4.01% (FY21) and 4.07% (FY22).

It is worth noting that the RAD percentage increased significantly to 40% in FY24 due to the MPIR progressively increasing to 8.42%. This is due to a RAD payment remaining an overall cheaper option for the resident. This further emphasises that it is unlikely that RAD outflows will exceed RAD inflows and therefore avoiding a major shift in liquidity for the sector as a whole.

Figure 3: Accommodation payment choices for the period FY15 to FY24



Source: Department of Health, Disability and Ageing "Financial Report on the Australian Aged Care Sector 2023-24"

Funding Reforms

Effective from 1 November 2025, the new *Aged Care Act 2024* will legislate significant funding reforms that were recommended by the Aged Care Taskforce. The reforms will provide more revenue flows to providers and improve the financial performance of the residential aged care sector.

A summary of the funding reforms are as follows:-

- Hotelling supplement to fully cover the costs of normal everyday living services
- Additional clarity and guidelines to encourage additional (extra) everyday living services and related fees
- Retention of 2% of RADs per annum (maximum of 5 years and 10%)
- Indexation of DAPs for CPI twice yearly
- Increased cap for accommodation pricing from $550,000 to $750,000 before requiring approval

Scenario Analysis

The scenario analysis in *Figure 4* has been prepared based on the actual financial performance as at Mar-25 and including the funding reforms on a progressive basis as they are only applicable to new residents entering residential aged care after 1 November 2025. In summary the respective scenarios are as follows:-

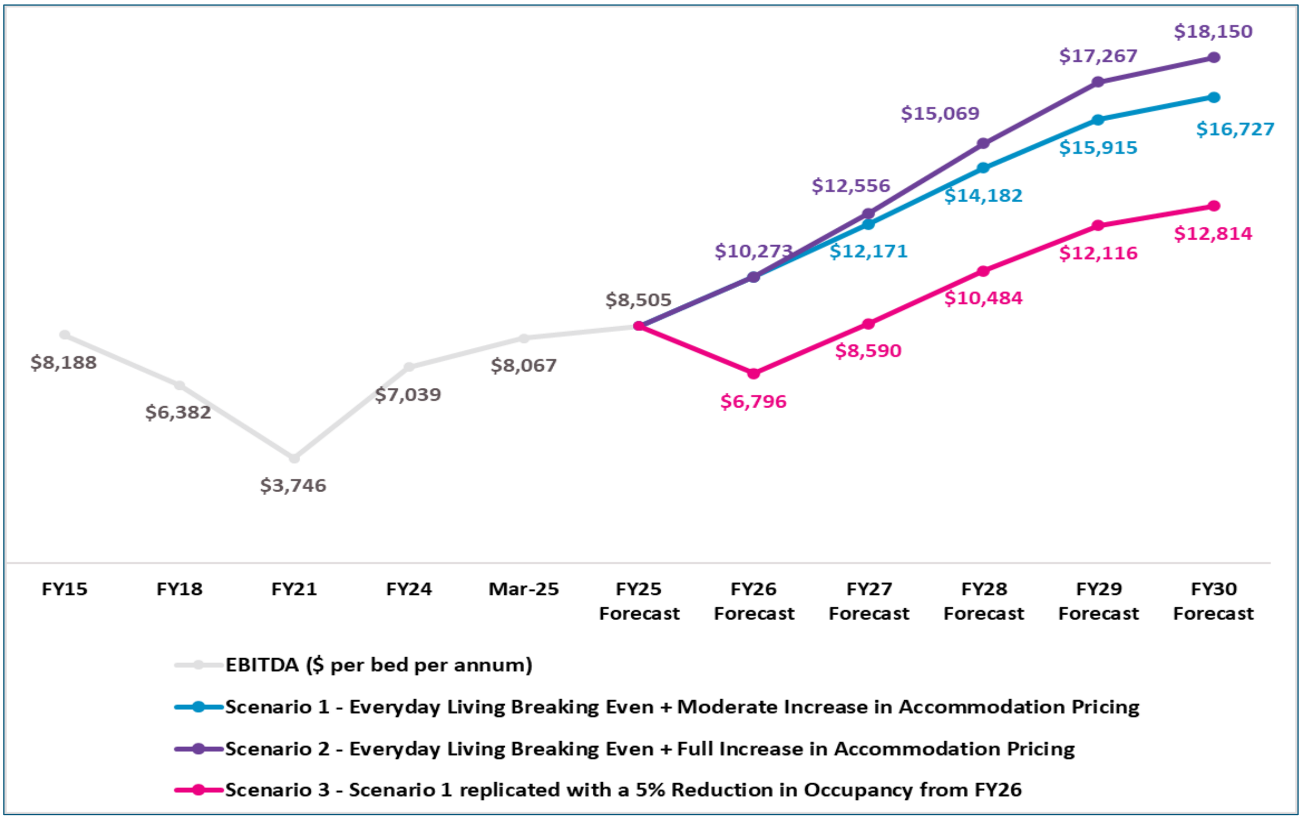
Scenario 1: Increased hotelling supplement, 2% RAD retention, moderate increase in accommodation pricing

Scenario 2: Increased hotelling supplement, 2% RAD retention, more aggressive increase in accommodation pricing

Scenario 3: Same as Scenario 1 with 5% reduction in occupancy from FY26 (a very conservative scenario)

Each scenario indicates a significant and continuing improvement in the operating result up to FY30 (which is in accord with the intent of the funding reforms). On the basis of the scenario analysis, it would be expected that the liquidity risk will be progressively lower than the current risk and would therefore suggest that any increase in the current levels of mandated liquidity are not required.

Figure 4: EBITDA residential operating result scenario analysis ($ per bed per annum)



Analysis of Liquidity Ratios on Liquidity Levels

The enforceable minimum liquidity amount aims to manage two risks:-

1. The risk that a residential provider won't be able to refund refundable deposits when they're due
2. The risk that a residential provider isn't able to manage periods of financial stress resulting from a shortfall in their expected cash inflows, or an unexpected increase in their cash outflows. These can cause providers to make spending decisions that affect the quality and safety of care

The Commission has stated that the revised liquidity ratios will be met by 84% of providers and a further 6% will be able to be met through alternate assurance. This is not in dispute, however, meeting the Liquidity Standard mandated calculated amount and having an enforced liquidity are separate issues when considering that sufficient liquidity must remain for investment and necessary residential aged care builds and major refurbishment of existing homes.

The Commission has estimated that about 10% of providers will have a financial viability risk which seems high, and the comment "that they can manage by lifting their liquidity amount to comply" or "by using the formula having other liquidity arrangements" does not seem practical, particularly for not-for-profit and small for-profit providers who do not have access to additional equity funding, and if additional lines of credit are excluded from the assurance measure.

Table 3: Summary of RAD inflows and RAD outflows for FY24 and FY23 *(Source: Statement of Cash Flows by provider)*

	All $'000	Small $'000	Small/ Medium $'000	Medium $'000	Medium/ Large $'000	Large $'000
Liquid assets (A)	81,572	22,669	46,448	81,229	157,617	283,151
Current LMS %	*24%*	*24%*	*20%*	*24%*	*22%*	*25%*
Current LMS amount (B)	18,331	5,270	9,139	18,470	32,349	66,004
Available liquid assets (C = A - B)	63,241	17,399	37,309	62,759	125,268	217,147
ACQSC Proposed liquidity % (35/10/2)	*48%*	*22%*	*31%*	*38%*	*32%*	*61%*
ACQSC Proposed mandated liquid assets (D)	36,761	5,005	14,517	30,711	51,057	173,818
Available liquid assets (E = A - D)	44,811	17,664	31,931	50,518	106,560	109,333
Difference proposed mandated and current LMS amount (C - E)	18,430	(265)	5,378	12,241	18,708	107,814
Capital pipeline (all business segments) (5 years) *	260,861	37,750	37,211	249,212	179,262	691,360
Capital pipeline (residential segment) (5 years) *	65,590	11,637	8,200	88,783	70,594	190,708

Table 3 shows the effect of the Commission mandated liquidity calculated requirement (being 48% of available liquid assets and the current levels as included in the respective audited LMS (being 24% of liquid assets). When considering the proposed capital pipeline (which is still conservative and not sufficient to meet future demand) this increased mandated liquidity will restrict the capital development and, at the very least, increase the cost of capital.

When considering the RAD retention funding reform, the Aged Care Taskforce was advised that the Department undertook specific modelling that concluded that a RAD retention of 3% would not affect resident behaviour in paying a DAP instead of a RAD. The retention amount was subsequently amended to be 2% which even reduces any material risk in this regard, and the indexation of DAPs will also likely maintain current accommodation payment preferences.

The Commission stress testing accompanying the modelling was based on financial years 2018 to 2022, which included the COVID-19 peak period. As detailed in this discussion paper, the financial circumstances for residential aged care have changed significantly since that period, with higher margins through the AN-ACC subsidy, occupancy percentages increasing substantially and the impact of the funding reforms commencing from 1 November 2025 will further improve the financial performance. It should be noted that the provider failure as a result of the COVID-19 pandemic was not much greater than before or since, which highlights the underlying equity strength of the sector.

Allowing providers to submit alternate liquidity assurance is a very positive initiative. The basis required for alternative liquidity assurance needs to eliminate subjectivity as much as possible. As this is a liquidity based assessment, the alternatives should be based on cash flow forecasts supported by reliable assumptions over a period of no more than 12 months. Additional lines of credit should be included in providing alternate liquidity assurance.

Cost of Compliance

Initiatives such as the introduction of the Quarterly Financial Report (QFR) has increased the transparency and accountability of registered aged care providers. The QFR has provided an important resource to the Department and Commission in risk management and financial monitoring of those providers who may be experiencing liquidity difficulties. This has led to important early interventions to provide support to providers at risk.

Whilst providing important information for the Department and Commission, the additional compliance through reporting such as the QFR has significantly increased the cost of compliance for providers. This can often be to the detriment of their own important internal management reporting, which can in itself lead to operational difficulties.

Where the Commission seeks further liquidity assurance, this may be provided by the independent auditors, noting that the audited annual financial statements already include a declaration by the governing body that the provider can meets their obligations as and when they are due and payable.

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AGED CARE FINANCIAL AND PRUDENTIAL STANDARDS 2025

Abstract

The Royal Commission into Aged Care Quality and Safety issued the Final Report *"Care, Dignity and Respect"* on 26 February 2021. Chapter 19 "Prudential Regulation and Financial Oversight" included the following Recommendations:-

- Recommendation 130: Responsibility for prudential regulation
- Recommendation 131: Establishment of prudential standards
- Recommendation 132: Liquidity and capital adequacy requirements

The Aged Care Quality and Safety Commission (Quality Commission) has been charged with the financial and prudential monitoring responsibility as included in the above Recommendations. The Quality Commission released the Exposure Draft of the "Aged Care Financial and Prudential Standards 2025" instrument and have provided explanatory guidance on the following link New Financial and Prudential Standards | Aged Care Quality and Safety Commission.

The Quality Commission has stated that new Standards aim to strengthen the financial governance and sustainability of aged care providers, so they can deliver high-quality care and services and maintain continuity of care for older people.

The Liquidity Standard only applies to residential aged care providers.

Executive Summary

StewartBrown fully support the development and implementation of a phased approach to risk management and financial monitoring from the Quality Commission as recommended by the Royal Commission.

Currently, all registered providers who provide residential aged care services are required to submit an audited Annual Prudential Compliance Statement (APCS) with specific reference to the Liquidity Standard which requires providers to "maintain sufficient liquidity to ensure that they can refund (in accordance with the Act and the Fees and Payments Principles) refundable deposit balances and bond balances (including entry contributions) that can be expected to fall due in the following 12 months".

The APCS provides guidance in determining the minimum level of liquidity that must form part of the Liquidity Management Strategy (*refer Appendix*).

The proposed calculation for the mandated minimum level of liquidity by the Quality Commission moves from each provider making an assessment based on the factors as included in the current APCS guidance, to a formulaic calculation based on the Quarterly Financial Report submissions.

The implied benefit of this approach is that it will provide more clarity and consistency of calculation and enable the Quality Commission to monitor the liquidity of providers on a quarterly basis and engage with providers who do not meet the minimum level of liquidity to assess the circumstances and possible remedy.

This submission is specifically based on an assessment of the Quality Commission's proposed minimum liquidity calculation formula.

The modelling and analysis performed by StewartBrown includes the following observations:-

- The underlying financial equity (net assets) of residential aged care providers as at December 2024 remains stable with a low risk profile in aggregate for all cohorts based on size of revenue and assets employed
- The resultant effect of over 5 years of aggregate operating deficits, combined with the effects of Covid-19 and a critical staffing shortage, has caused a resultant change in provider behaviour with a greater emphasis on cost management and a low appetite for expansion of accommodation and service delivery
- The effective "capital strike" together with positive net inflows from resident refundable loans (RADs and Entry Contributions) has caused the sector to have excess liquidity in comparison to assets employed
- Based on future demand as estimated by the Department of Health and Aged Care ("*Financial Report on the Australian Aged Care Sector 2022-23 (page 127)*" there will be a requirement for 250,000 places by 2030 and 360,000 by 2040. As at 30 June 2024 there were 223,691 approved places, however the actual available places is likely to be in the range of 208,000 to 212,000
- Policy settings must be designed to provide the necessary balance between financial sustainability, financial risk mitigation, required investment returns for the sector to be "investable" and encourage new accommodation builds and major refurbishment of exiting accommodation

- There have been consistent net cash inflows from refundable resident loans (incoming loans exceeding outgoing loans) since the 2014 financial year with the introduction of the "*Living Longer Living Better*" legislative reforms. For the 2024 financial year, net cash inflows exceeded net cash outflows by an average 33% (28% for 2023 financial year)
- There has been no disclosed reason provided by the Quality Commission to indicate that the current minimum levels of liquidity as required to be calculated by providers and included in the APCS are not sufficient to meet the prudential requirements and form part of the risk framework
- StewartBrown agrees with the implied benefit, as stated previously, in having a consistent methodology in calculating the minimum level of liquidity required based on operating cash flows and refundable loans. Consideration of other factors, including current capital developments, future liquidity requirements, related entity support, secured lines of credit and equity (net asset) strength of the provider need to also be considered in any risk management framework matrix
- The current average minimum liquidity percentage as calculated by each provider represents 24% of liquid assets (cash and cash equivalents plus financial assets)
- The proposed minimum liquidity percentage by the Quality Commission represents 58% of liquid assets, a significant increase in this requirement
- In the case of the large provider cohort, who will likely be the major developers of accommodation expansion, the proposed calculation increases their percentage of liquid assets to be quarantined from 25% to 77% which is an extreme adjustment

Conclusion

- ➢ Whilst an attractive option for clarity, a "one size fits all" approach also will have inherent complexity. StewartBrown does not favour a tiered approach as this becomes subjective in order to establish the relevant tiers, and accordingly, recommends additional complimentary criteria be included:-
  - o Net asset (equity) backing to support refundable loans
  - o Current capital work in progress in the calculation
  - o Unused line of credit in the calculation
  - o Provision of a 12 month cash flow forecast (operating and capital) to be updated annually together with actual movements for the previous quarter to assist the Quality Commission to monitor risk and financial performance
- ➢ The Quality Commission proposed liquidity calculation settings (35/10/10) is likely to increase cost of capital for providers, discourage the proposed (and critical) planned capex for new construction in both residential aged care and retirement living at a time when this investment in new builds and renewal of existing building stock is essential
- ➢ On the basis of the modelling and analysis conducted, StewartBrown recommends that the liquidity calculation settings be amended to be a sector average level similar to the current LMS minimum liquidity amount. The recommended settings are 25% quarterly cash expenses; 5% of RAD liability and 2% of ILU liability. The ability for providers who do not meet this calculated requirement to submit an alternate liquidity management strategy must be included in the Standard.

Financial Modelling and Analysis

Minimum Liquidity Amount

The enforceable minimum liquidity amount aims to manage two risks:-

1. the risk that a residential provider won't be able to refund refundable deposits when they're due
2. the risk that a residential provider isn't able to manage periods of financial stress resulting from a shortfall in their expected cash inflows, or an unexpected increase in their cash outflows. These can cause providers to make spending decisions that affect the quality and safety of care

Part 3 "Liquidity" Section 11 "Registered provider must determine minimum liquidity amount on a quarterly basis" of the draft instrument defines the liquidity calculation (clause 3) as being:-

(i) the amount equal to 35% of the provider's cash expenses for the previous quarter
(ii) the amount equal to 10% of the deposited amount balances held by the provider at the end of the previous quarter
(iii) the amount equal to 10% of refundable independent living payment amounts (if any) held by the provider at the end of the previous quarter
(iv) the amount equal to 10% of refundable retirement village payment amounts (if any) held by the provider at the end of the previous quarter

The liquidity calculation does not include the following:-

- Loans receivable (related entity and non-related entities)
- Capital work in progress
- External borrowings (related entity and non-related entity)
- Loans payable (related entity and non-related entities)
- Government subsidy acquittals owing (HCP unspent funds and CHSP grants)

- Lines of credit (unused)
- Capital expenditure pipelines

Methodology
StewartBrown has prepared a detailed financial model of the proposed liquidity calculation in conjunction with Ageing Australia and concurrently with a number of large registered providers.

Data inputs supplied by each provider (in commercial confidence) and used for the modelling and analysis included:-

- Quarterly Financial Return (QFR) for the December 2024 quarter for the Provider Balance Sheet and Summary Profit & Loss (being 6 months year-to-date)
- Additional line items as required for the analysis
- Cash Flows for refundable resident loans (residential and retirement living) for 2024 and 2023 financial years (sourced from audited general purpose financial reports)

All data inputs received were checked and cleansed by StewartBrown for consistency, omission and unusual amounts. This involved communication with the respective provider to confirm the amendments if required.

Timeline
- December 2023: preliminary consultation with Quality Commission with respect to proposed new Standards (Financial and Prudential Management; Liquidity; Investment)
- May 2024: completion of on-line survey and consultation with Quality Commission with respect to proposed Standards from a conceptual perspective and in advance of the public consultation process
- 26 February 2025: Request from Quality Commission for an informal meeting to discuss issues raised from release of draft Liquidity Standard and liquidity calculation
- 27 February 2025: Discussion with Quality Commission as to issues raised (in concept); concerns in relation to 10% requirement for retirement living refundable loans (a major area of concern); requirement (or not) for a risk matrix; consideration of effect of 35% ratio for non-cash expenses and 10% for RAD loans; advised that StewartBrown will be preparing a detailed model to assess the implications of the proposed ratios as included in the proposed liquidity calculation
- February/March 2025: numerous discussions with providers (in formal meetings and individually); discussion sand meetings with Ageing Australia (including formal meetings with provider representatives); verbal discussions and clarifications with Quality Commission

It is important to state at this point, that the tone and content of discussions with the Quality Commission have been very professional and they have shown a strong commitment to work closely with the providers and not cause any undue financial stress on the sector.

Data Set
54.4% of approved beds (places) (being 215,984 places as at 30 June 2024) *(excludes government providers)*
57.1% of available places (based on 206,000 estimated actual available places) *(excludes government providers)*

Table 1: Summary of modelling data set by provider size cohort

Benchmark Band	No. of providers in the data set	No. of beds in the data set		% of total beds
All Providers	**119**	**117,663**		**54.4%**
Total Assets Below $25M	8	435		0.2%
Total Assets Between $25M and $50M	18	2,153		1.0%
Total Assets Between $50M and $150M	35	6,332		2.9%
Total Assets Above $150M	58	108,743		50.3%
Operating Revenue Below $25M *(Small)*	63	8,659		4.0%
Operating Revenue Between $25M and $50M *(Small/Medium)*	12	4,611		2.1%
Operating Revenue Between $50M and $100M *(Medium)*	16	13,562		6.3%
Operating Revenue Between $100M and $200M *(Medium/Large)*	12	15,012		6.9%
Operating Revenue Above $200M *(Large)*	16	75,820		35.1%

Summary of Analysis

Table 2: Summary of net assets (equity) KPIs by provider size cohort

	All $'000	Small $'000	Small/ Medium $'000	Medium $'000	Medium/ Large $'000	Large $'000
Assets	494,948	75,055	189,369	489,782	715,815	2,216,982
Liabilities	394,212	50,542	146,380	371,296	499,515	1,877,219
Net assets	100,736	24,513	42,989	118,486	216,300	339,763
Liquid assets	77,342	22,360	45,025	77,099	144,813	267,710
Property assets	309,528	43,874	112,388	332,111	535,221	1,311,542
Refundable loans	299,091	41,832	124,796	271,072	416,088	1,383,946
Liquid assets % refundable loans	26%	53%	36%	28%	35%	19%
Refundable loans % assets	60%	56%	66%	55%	58%	62%

Table 3: Summary of modelling by provider size cohort

	All $'000	Small $'000	Small/ Medium $'000	Medium $'000	Medium/ Large $'000	Large $'000
Current LMS %	24%	24%	20%	24%	22%	25%
Current LMS amount	18,331	5,270	9,139	18,470	32,349	66,004
Available liquid assets	59,011	17,090	35,886	58,629	112,464	201,706
ACQSC Proposed liquidity % (35/10/10)	58%	27%	41%	50%	45%	77%
ACQSC Proposed mandated liquid assets	44,498	6,086	18,338	38,557	65,148	205,783
Available liquid assets	32,844	16,274	26,687	38,542	79,665	61,927
Difference proposed mandated and current LMS amount	26,167	816	9,199	20,087	32,799	139,779
StewartBrown proposed % (25/5/2)	29%	14%	20%	24%	22%	39%
Proposed mandated liquid assets	22,411	3,042	9,009	18,786	32,334	105,365
Available liquid assets	54,931	19,318	36,016	58,313	112,479	162,345
Capital pipeline (all segments) (5 years) *	260,861	37,750	37,211	249,212	179,262	691,360
Capital pipeline (residential segment) (5 years) *	65,590	11,637	8,200	88,783	70,594	190,708

Commentary

- There are already several protections in relation to ensuring that RADs are refunded on time and providing recourse to consumers and government
  - o Directors have to sign off on general purpose financial statements that the entity can pay their debts (including RADs) as and when they fall due as well as separately both to the APCS and ACFR
  - o Auditors have to sign an audit report attesting to the financial statements, including that Director's declaration, forming a true and fair view as well as seperately the APCS
- There has been little call on the Support Scheme within the *Aged Care (Accommodation Payment Security) Act 2006* over its duration of its existence (estimated as approximately $160 million) At 30 June 2023 total RAD balance was 38.1 billion and increased by $2.6 billion in that year indicating positive cash inflows from RADs sector wide
- In the case of the residential aged care segment, 76% of revenues to providers are provided by government subsidies with 24% of revenue sourced from residents. In relation to home and community care, government subsidies represents 94% of total operating revenue
- Direct care staff costs represent 88.9% of the direct care subsidies (AN-ACC and supplements)
- Total staff costs represent 103.7% of government subsidies for direct care and everyday living
- Reforms implemented based on the Aged Care Taskforce recommendations will mean that in the future a lower amount of RAD will be refunded compared to that collected (2% pa retention each year over 5 years) and financial viability of providers, including increased revenue streams, will be improved and the sector more financially sustainable
- There is greater likelihood of RADs being paid (similar to current mix of RAD/DAP) due to high MPIR where a floor is required to relate to the weighted average cost of capital
- RADs are by majority replaced <u>before</u> they have to be refunded due to providers having to wait for probate before refunding whereas new resident enters prior to that date

- In most of the State legislation for retirement villages, there is a six month period before an operator must in essence purchase the unit back from an outgoing resident. Prior to that, the unit has to be sold and in majority of cases entry contribution paid to the provider <u>before</u> the entry contribution has to be refunded to outgoing residents or their estate
- In majority of cases, even if capital gains form part of contract, the incoming entry contribution is higher than the outgoing refund due to DMF being retained by operator
- There are no supported residents in retirement living. Individual providers may set aside some units as low cost accommodation on a rental basis, but this is a managed process
- The fact that the sector lost a cumulative $5 billion over a period of 4 - 5 years and there was little or no call on the government to refund RADs is testament to the fact that the sector can withstand financial stress, and current arrangements may be assumed to therefore be adequate
- The Quality Commission has provided comment that with the proposed liquidity calculation ratios (35/10/10) over 80% of providers would currently meet (or exceed) the minimum liquidity amount required to be held
- StewartBrown, however, considers that meeting the proposed calculated liquidity amount and then having to maintain the calculated liquid assets have entirely different consequences. To this extent, the proposed minimum liquidity amount, in our opinion, will significantly inhibit the use of excess liquidity for essential capital investment (including acquisition) purposes and investment in innovation and technology
- Essentially, it is our opinion that the consequence of 5+ years of aggregate operating losses has created a virtual "capital strike" and providers have been very cautious in maintaining liquid assets at the expense of development. This has led to the current situation where the sector has a high amount of excess liquidity, which is another reason why the proposed settings will be theoretically met
- Accordingly, StewartBrown advocates that the excess liquidity needs to be used for capital development and not quarantined by setting a minimum liquidity level greater than that actually required

Summary of Modelling Analysis

- The current LMS amount represents 24% of average liquid cash assets per provider
- The proposed liquidity calculation would increase the liquidity requirement to be 58% (a significant additional requirement)
- All categories of providers (small/medium/large) will be negatively impacted by the proposed liquidity settings
- Large providers will provide the majority of the essential development pipeline (residential and retirement) and the proposed settings will likely delay or reduce the ability to meet the expected demand for aged care services
- 35% of one quarter (3 months) non-cash expenses is conservative being cognisant of the specific financial revenues of the aged care sector, where staff costs represent 68% of total non-cash expenses and are supported by over 95% of government subsidies
- The average capital works pipeline over the next 5 years (average for providers who provided this data) is estimated as being $260 million per provider (residential $65 million) which is an approximate average of over 140 beds per provider
- Net cash flows from resident liabilities (RADs and Retirement) were positive for both 2023 and 2024 financial years with outflows exceeding inflows by 33% in FY24 and 28% in FY23 (*refer Tables 10 and 11)*
- 10% retention of resident refundable loans would represent an average of 6.84 months average cash outflows without recognition of any cash inflows (2023 6.74 months) which is very conservative (*refer Table 10)*
- 5% retention of resident refundable loans would represent in an average of 3.42 months average cash outflows without recognition of any cash inflows (2023 3.37 months) (*refer Table 11)*
- The current financial sustainability of the aged care sector remains highly vulnerable with the following metrics being applicable for the six months ended 31 December 2024:-
    - Operating result as a percentage of assets employed (ROA) - 0.3%
    - Operating result as a percentage of operating revenue - 1.7%
    - Operating EBITDA as percentage of assets employed - 0.9%
    - Operating EBITDA as percentage of operating revenue - 5.4%
    - Capital Adequacy Ratio (CAR) - 0.16
    - Liquid Cash Assets as % of debt (refundable loans + borrowings + HCP/CHSP liability) - 24%

Summary of Liquidity Calculation Modelling

Table 4: Summary of modelling for ALL Providers (119 in data set)

External Lines of Credit						
Drawn	12,283,146					
Undrawn	20,243,575					
Percentage linked to refundable loans refunds	10.8%					
Capital work in progress	9,700,939					
Capital works pipeline		Residential	Home Care	Community	Retirement	Other
Within 12 months	42,259,945	12,485,499	940,507	2,428,029	21,383,371	5,022,539
Within 5 years	260,861,206	65,590,290	2,524,045	33,078,697	138,982,686	20,685,489
Liquidity Management Strategy		Residential				
Current amount	18,331,202	18,331,202				
% LMS to Liquid Cash Assets	24.0%					

Liquidity Calculation - Quality Commission Proposed		% Change from Current LMS	No. of Providers Passed	% of Providers Passed	% Liquidity to Liquid Cash Assets
35% of Cash Expenses, 10% Residential RAD balances, 10% ILU Resident Loans	44,498,400	143%	100	84.0%	58.0%
Liquidity Calculation (Dynamic)	22,472,221	23%	111	93.3%	29.0%

% of Cash Expenses	25.0%
% of Residential RAD Balance	5.0%
% of ILU Resident Loans Balance	2.0%
Include WIP in Liquidity Position	0
% Undrawn Credit included in Liquidity Position	0.0%

Table 5: Summary of modelling for SMALL Providers (63 in data set)

External Lines of Credit	
Drawn	244,181
Undrawn	911,791
Percentage linked to refundable loans refunds	10.2%
Capital work in progress	1,538,476

Capital works pipeline		Residential	Home Care	Community	Retirement	Other
Within 12 months	9,673,809	3,549,033	78,215	-	3,194,929	2,851,632
Within 5 years	37,750,249	11,636,513	-	-	23,158,400	2,955,337

Liquidity Management Strategy		Residential
Current amount	5,269,506	5,269,506
% LMS to Liquid Cash Assets	24.0%	

Liquidity Calculation - Quality Commission Proposed		% Change from Current LMS	No. of Providers Passed	% of Providers Passed	% Liquidity to Liquid Cash Assets
35% of Cash Expenses, 10% Residential RAD balances, 10% ILU Resident Loans	6,085,742	15%	59	93.7%	27.0%
Liquidity Calculation (Dynamic)	3,042,417	-42%	61	96.8%	14.0%

% of Cash Expenses	25.0%
% of Residential RAD Balance	5.0%
% of ILU Resident Loans Balance	2.0%
Include WIP in Liquidity Position	0
% Undrawn Credit included in Liquidity Position	0.0%

Table 6: Summary of modelling for SMALL/MEDIUM Providers (12 in data set)

External Lines of Credit						
Drawn	1,067					
Undrawn	615,600					
Percentage linked to refundable loans refunds	0.0%					
Capital work in progress	4,762,501					
Capital works pipeline		Residential	Home Care	Community	Retirement	Other
Within 12 months	14,783,137	2,761,126	-	29,000	6,672,417	5,320,595
Within 5 years	37,210,595	8,200,000	-	750,000	15,240,000	13,020,595
Liquidity Management Strategy		Residential				
Current amount	9,138,799	9,138,799				
% LMS to Liquid Cash Assets	20.0%					

		% Change from Current LMS	No. of Providers Passed	% of Providers Passed	% Liquidity to Liquid Cash Assets
Liquidity Calculation - Quality Commission Proposed					
35% of Cash Expenses, 10% Residential RAD balances, 10% ILU Resident Loans	18,388,176	101%	12	100.0%	41.0%
Liquidity Calculation (Dynamic)	9,008,512	-1%	12	100.0%	20.0%

% of Cash Expenses	25.0%
% of Residential RAD Balance	5.0%
% of ILU Resident Loans Balance	2.0%
Include WIP in Liquidity Position	0
% Undrawn Credit included in Liquidity Position	0.0%

Table 7: Summary of modelling for MEDIUM Providers (16 in data set)

External Lines of Credit	
Drawn	4,544,982
Undrawn	24,969,384
Percentage linked to refundable loans refunds	15.2%
Capital work in progress	8,742,766

Capital works pipeline		Residential	Home Care	Community	Retirement	Other
Within 12 months	28,591,102	12,617,181	351,500	432,000	10,964,212	4,226,209
Within 5 years	249,212,084	88,782,864	715,500	4,130,167	144,663,167	10,920,386

Liquidity Management Strategy		Residential
Current amount	18,469,809	18,469,809
% LMS to Liquid Cash Assets	24.0%	

Liquidity Calculation - Quality Commission Proposed		% Change from Current LMS	No. of Providers Passed	% of Providers Passed	% Liquidity to Liquid Cash Assets
35% of Cash Expenses, 10% Residential RAD balances, 10% ILU Resident Loans	38,556,878	109%	10	62.5%	50.0%
Liquidity Calculation (Dynamic)	18,785,737	2%	12	75.0%	24.0%

% of Cash Expenses	25.0%
% of Residential RAD Balance	5.0%
% of ILU Resident Loans Balance	2.0%
Include WIP in Liquidity Position	0
% Undrawn Credit included in Liquidity Position	0.0%

Table 8: Summary of modelling for MEDIUM/LARGE Providers (12 in data set)

External Lines of Credit						
Drawn	5,668,355					
Undrawn	19,607,085					
Percentage linked to refundable loans refunds	4.6%					
Capital work in progress	17,065,836					
Capital works pipeline		Residential	Home Care	Community	Retirement	Other
Within 12 months	24,821,901	10,360,365	1,271,854	4,049,430	7,650,134	1,490,117
Within 5 years	179,261,676	70,593,886	1,420,313	21,450,021	73,194,881	12,602,575
Liquidity Management Strategy		Residential				
Current amount	32,349,128	32,349,128				
% LMS to Liquid Cash Assets	22.0%					
Liquidity Calculation - Quality Commission Proposed		% Change from Current LMS	No. of Providers Passed	% of Providers Passed	% Liquidity to Liquid Cash Assets	
35% of Cash Expenses, 10% Residential RAD balances, 10% ILU Resident Loans	65,147,879	101%	10	83.3%	45.0%	
Liquidity Calculation (Dynamic)	32,334,058	0%	12	100.0%	22.0%	
% of Cash Expenses	25.0%					
% of Residential RAD Balance	5.0%					
% of ILU Resident Loans Balance	2.0%					
Include WIP in Liquidity Position	0					
% Undrawn Credit included in Liquidity Position	0.0%					

Table 9: Summary of modelling for LARGE Providers (16 in data set)

External Lines of Credit						
Drawn	81,597,387					
Undrawn	106,835,011					
Percentage linked to refundable loans refunds	21.8%					
Capital work in progress	40,978,968					
Capital works pipeline		Residential	Home Care	Community	Retirement	Other
Within 12 months	133,724,011	43,381,085	1,532,778	900,000	77,037,517	10,872,631
Within 5 years	691,359,620	190,708,255	5,201,383	99,937,037	337,741,467	57,771,478
Liquidity Management Strategy		Residential				
Current amount	66,003,879	66,003,879				
% LMS to Liquid Cash Assets	25.0%					
Liquidity Calculation - Quality Commission Proposed		% Change from Current LMS	No. of Providers Passed	% of Providers Passed	% Liquidity to Liquid Cash Assets	
35% of Cash Expenses, 10% Residential RAD balances, 10% ILU Resident Loans	205,785,323	212%	9	56.3%	77.0%	
Liquidity Calculation (Dynamic)	105,364,966	60%	14	87.5%	39.0%	
% of Cash Expenses	25.0%					
% of Residential RAD Balance	5.0%					
% of ILU Resident Loans Balance	2.0%					
Include WIP in Liquidity Position	0					
% Undrawn Credit included in Liquidity Position	0.0%					

Summary of Refundable Loan Cash Movements

Table 10: Summary of Resident Loans liability, cash inflows and outflows by provider size cohort for 2024 and 2023 financial years based on 10% RAD Liquidity Requirement

	2024				2023				2024			2023		
	Liability $'000	Received $'000	Refunded $'000	Net $'000	Liability $'000	Received $'000	Refunded $'000	Net $'000	Liability $'000	Refunded $'000	Refunded Coverage	Liability $'000	Refunded $'000	Refunded Coverage
Total Provider Data Set	**30,662,921**	**7,976,133**	**5,375,570**	**2,600,563**	**26,293,596**	**6,461,948**	**4,677,982**	**1,783,966**	**3,066,292**	**447,964**	**6.84**	**2,629,360**	**389,832**	**6.74**
			67%				72%							

	2024				2023				2024			2023		
	Liability $'000	Received $'000	Refunded $'000	Net $'000	Liability $'000	Received $'000	Refunded $'000	Net $'000	Liability $'000 *10.0%*	Refunded $'000 *per month*	Refunded Coverage *# months*	Liability $'000 *10.0%*	Refunded $'000 *per month*	Refunded Coverage *# months*
Resident Liability Balance Above $800M	816,471	153,139	106,777	74,418	727,202	135,264	99,210	46,473	81,647	8,898	9.18	72,720	8,267	8.80
Resident Liability Balance Between $250M and $800M	318,062	92,185	66,560	25,624	274,188	72,130	57,983	14,147	31,806	5,547	5.73	27,419	4,832	5.67
Resident Liability Balance Between $100M and $250M	123,831	34,496	21,907	12,589	115,455	31,575	23,109	8,466	12,383	1,826	6.78	11,545	1,926	5.99
Resident Liability Balance Below $100M	768,109	201,840	135,421	66,419	659,407	163,690	118,315	45,375	76,811	11,285	6.81	65,941	9,860	6.69

Table 11: Summary of Resident Loans liability, cash inflows and outflows by provider size cohort for 2024 and 2023 financial years based on 5% RAD Liquidity Requirement

	2024				2023				2024			2023		
	Liability $'000	Received $'000	Refunded $'000	Net $'000	Liability $'000	Received $'000	Refunded $'000	Net $'000	Liability $'000	Refunded $'000	Refunded Coverage	Liability $'000	Refunded $'000	Refunded Coverage
Total Provider Data Set	**30,662,921**	**7,976,133**	**5,375,570**	**2,600,563**	**26,293,596**	**6,461,948**	**4,677,982**	**1,783,966**	**1,533,146**	**447,964**	**3.42**	**1,314,680**	**389,832**	**3.37**
			67%				72%							

	2024				2023				2024			2023		
	Liability $'000	Received $'000	Refunded $'000	Net $'000	Liability $'000	Received $'000	Refunded $'000	Net $'000	Liability $'000 *5.0%*	Refunded $'000 *per month*	Refunded Coverage *# months*	Liability $'000 *5.0%*	Refunded $'000 *per month*	Refunded Coverage *# months*
Resident Liability Balance Above $800M	816,471	153,139	106,777	74,418	727,202	135,264	99,210	46,473	40,824	8,898	4.59	36,360	8,267	4.40
Resident Liability Balance Between $250M and $800M	318,062	92,185	66,560	25,624	274,188	72,130	57,983	14,147	15,903	5,547	2.87	13,709	4,832	2.84
Resident Liability Balance Between $100M and $250M	123,831	34,496	21,907	12,589	115,455	31,575	23,109	8,466	6,192	1,826	3.39	5,773	1,926	3.00
Resident Liability Balance Below $100M	768,109	201,840	135,421	66,419	659,407	163,690	118,315	45,375	38,405	11,285	3.40	32,970	9,860	3.34

APPENDIX

Annual Prudential Compliance Statement (APCS) Guidelines *Extract*

COMPLIANCE WITH THE LIQUIDITY STANDARD

Any provider holding at least one refundable deposit or bond balance (including entry contributions) during their financial year must comply with the Liquidity Standard, which requires providers to:

- maintain sufficient liquidity to ensure that they can refund (in accordance with the Act and the Fees and Payments Principles) refundable deposit balances and bond balances (including entry contributions) that can be expected to fall due in the following 12 months (see section 43, Fees and Payments Principles), and

Implement and maintain a written Liquidity Management Strategy (LMS), which identifies:

- the amount expressed as an amount of **whole dollars** required to ensure that the provider has sufficient liquidity to refund bond balances and refundable deposits (including entry contributions) as they fall due, and
- the factors that the provider considered in determining the minimum level of liquidity, and
- the form in which the provider will maintain the minimum level of liquidity (see section 44(1), Fees and Payments Principles).

The provider must then:

- maintain the minimum level of liquidity in the form specified in the LMS, and
- ensure that the LMS is kept up-to-date, and
- ensure that it complies with the requirements of the Liquidity Standard.

A provider must modify or replace its LMS if the provider becomes aware that it no longer meets the requirements of the Liquidity Standard.

At any point in time, a provider must meet the requirements of the Liquidity Standard (see section 42, Fees and Payments Principles).

The provider must maintain the minimum level of liquidity identified in the LMS necessary to meet refunds over the following 12 months (see section 43, Fees and Payments Principles).

Determining the minimum level of liquidity

Each provider should identify and assess the factors used in determining its minimum level of liquidity, based on their individual circumstances and experiences.

While some factors might be common to many providers, their relative importance can differ for individual providers. Factors that providers could consider in determining their minimum level of liquidity include:

- cash requirements for operating and capital expenditure,
- their historical pattern of refundable deposits and bond balance refunds,
- characteristics of the residents in their care, such as Australian National Aged Care Classification (AN-ACC)categories, ages, genders and length of time spent in care, which can affect the timing of refundable deposit and bond balance refunds,
- the average value of refundable deposits and bond balances held,
- the average time taken to replace departing residents,
- the expected number and value of refundable deposits and bonds that will be paid by new residents, and

- the time taken for new residents to make refundable deposits and bond payments.

A provider should consider a range of different approaches in assessing their liquidity requirements, to determine the most appropriate approach for their circumstances. Possible approaches that providers could consider include the following:

- in some cases, the minimum level of funding which is readily accessible may be the difference between the expected refundable deposits and bond balance refunds and the expected deposits and bond payments over the next 12 months,
- the need to refund several of its largest deposits and bonds in the next 12 months,
- for its minimum level of liquidity, a provider could use the likely value of refundable deposits and bond balance refunds that will be required over the coming 12 months, by identifying residents who are likely to leave the service in the coming 12 months and the size of their refundable deposits and bonds. For example, a provider could decide to maintain as its minimum level of liquidity the total value of refundable deposits and bonds held on behalf of residents with a greater than 50 per cent likelihood of leaving over the coming 12 months, less expected payments from new residents.

A provider can also maintain a prudent margin to provide a buffer against unexpected developments. A prudent margin could be incorporated into the minimum level of liquidity in various ways. For example, providers may choose to adopt conservative estimates for key parameters or include an explicit additional buffer to their level of liquidity.

Factors that could be considered include conservative assumptions for:

- the average size of payments expected to be received from new residents in the region given market conditions, and
- the rate of replacement of exiting residents.

Identifying forms in which the minimum level of liquidity is maintained

To ensure that a provider can refund refundable deposits and bond balances as they fall due, it is important that the minimum level of liquidity for a provider is maintained in readily accessible forms.

It is the responsibility of the provider to determine the appropriate form(s) in which their minimum level of liquidity will be maintained. Many financial instruments have a high level of liquidity, including:

- cash,
- bank bills,
- stand-by lines of credit, and
- guarantees.

Letters of comfort do not provide a form of liquidity suitable to meet the Liquidity Standard.

In considering the form(s) in which they hold their minimum level of liquidity, providers may also wish to consider cost issues. The cost to providers could be considered in terms of both the actual cost of accessing the funds (that is, the actual cost of the transaction) and the economic cost (the difference between the purchase price and the price realised on disposal). For example, liquid instruments such as cash and financial products like term deposits have relatively low costs as the fee for accessing them is not significant and they can be redeemed at their face value.

APPENDIX

Review of Liquidity Management Strategy

The Liquidity Standard requires providers to:

- ensure that the LMS remains up-to-date and complies with the requirements of the Liquidity Standard, and

Providers should review the LMS at least annually. This review should include an assessment of whether the factors used to determine the minimum level of liquidity are still appropriate. Providers should consider:

- whether changes in services they operate or the profile of their residents require variations to the factors included in the LMS,
- whether parameters or assumptions such as the size of refundable deposits and bonds received from new residents should be adjusted,
- whether to include events in the LMS that would trigger a review outside of an annual review cycle. These events may increase the risk that they would not have the liquidity to meet refundable deposits and bond balance refunds over the coming 12 months. They include:
  - the acquisition or divestment of residential services,
  - a significant change in the allocated places within a residential service,
  - a significant change in the profile of residents,
  - a significant change in the size of refundable deposits and bonds received,
  - changes in legislative requirements, and
  - changes in the corporate structure of the provider.

Things you need to know

The approach to documenting the LMS is a matter for individual providers. In determining their approach, providers should consider:

- that they must be able to demonstrate their compliance with the Liquidity Standard to their auditor, and
- that the provider may be requested to provide its LMS to the Commission for monitoring and compliance purposes at any time.

Your response in the APCS

After considering the information provided under Compliance with the Liquidity Standard, did you comply with all requirements of the Liquidity Standard for the full financial year?

Respond Yes or No and enter the date that your LMS was last reviewed, updated or replaced. If you answered 'NO' you must submit a separate statement explaining why you have not complied with the Standard.

Minimum Liquidity Level

Enter the dollar amount that you have identified in your LMS as being the minimum amount of liquidity that you are required to maintain over the next 12 months.