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Will the current aged care means testing arrangements fit the bill?

While accepting that taxpayers will inevitably meet the majority of aged care costs, successive Australian Governments have applied various forms of means testing arrangements and price controls to make aged care services affordable for taxpayers and individuals. The question is whether in their current form these arrangements are relevant for a future aged care service industry which is consumer-driven and more market-based.

The current policy context

The 2012 Living Longer Living Better (LLLB) package, drawing on principles developed by the Productivity Commission, adopted the following principles to guide policy:

- accommodation and everyday living expenses should be the responsibility of individuals, with a safety net for those with limited means; and
- individuals should contribute to the cost of their personal and nursing care according to their capacity to pay, but annual and lifetime caps should 'insure' consumers against excessive costs.

This policy approach has been largely accepted by recent governments.

However, determining what is an appropriate level of contribution by individuals towards their personal and nursing care costs, who should receive an accommodation subsidy and which assets and incomes are taken into account in determining capacity to pay within this policy framework, is another matter entirely. This decision is one for government having regard to social, economic and political considerations, balanced against other national priorities, current and prospective, that influence the formulation

of Commonwealth Budgets. Governments will also take into account the interplay with income support for older people and health care funding arrangements, especially Medicare.

For consumers, attitudes will be influenced by perceived fairness, including views about inter-generational transfers and the role of government, and the simplicity of the arrangements (ease of comprehension). Consumer views could also be expected to be influenced by the quality of the services for which they are being asked to pay a fee, and how much choice, control and flexibility they have over services.

All told, a complex range of sensitive issues have to be weighed and balanced.

Some history

The current means testing arrangements have their roots in government policies in residential aged care that applied many decades ago, before home care packages[1] were introduced. Because government policy at the time, and for many years, did not require a consumer contribution towards personal and nursing care costs, the means test that was developed for residential care was designed to determine only if a resident qualified for a government subsidy towards accommodation costs. The expectation was that most Australians would meet their accommodation costs using an entry contribution or accommodation bond financed through the sale of their former residence.

For everyday living expenses, on the other hand, there has been a longstanding expectation that these costs are met by residents, including through use of any age pension entitlement. However, governments have applied price controls whereby all residents (except those living in extra service facilities) contribute 85% of the single age pension towards the cost of a list of services specified in legislation. Residents can agree to pay for additional or higher quality services, but there have been ongoing issues about what constitutes 'additional'.

Thus, with a focus on who should qualify for an accommodation subsidy, an asset test was developed for residential care that did not have regard to a person's total assets or wealth, but solely focussed on determining whether a person had the minimum level of assets considered necessary to meet their accommodation costs. In effect, to determine whether the resident had sufficient assets to be able to pay at least the same amount as the government was prepared to pay on behalf of a person with limited means. So a nexus was drawn between the Commonwealth accommodation subsidy and whether a resident was expected to look after their accommodation costs themselves.

When home care packages were introduced in the early 1990s, the assets test in residential care was not considered relevant because personal and nursing care is

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delivered in a person's own home, and therefore no changes were made to the existing accommodation-focussed means testing arrangements. Instead, borrowing from the policy applying to the former hostels (whose level of care the Community Aged Care Packages delivered in a person's home were the equivalent of), the government gave home care providers discretion to charge a fee linked to the age pension. However, this arrangement did not enable fees received by providers to be deducted from the Commonwealth subsidy.

Fees for home support services, when eventually introduced under the former Home and Community Care Program, were similarly set and charged at the discretion of each provider operating under loose government guidelines.

In 1998 the government extended fees to personal and nursing care in residential care. In doing so, it introduced a separate income test in order to offset fees against its care subsidy. However, the government kept the separate assets test dedicated to determining each resident's capacity to pay for their accommodation costs.

The Living Longer Living Better package

The use of separate tests for accommodation and personal and nursing care costs in residential care created the situation where income-rich, asset poor residents contributed to their care costs but nothing towards their accommodation costs, whereas asset-rich, income poor residents paid for all their accommodation and nothing towards their care.

The LLLB package introduced in 2012 addressed this inequity by introducing a combined income and assets test for care and accommodation, which is the means test used currently. This was achieved by grafting an income test on to the assets test that was originally designed to establish whether a resident had sufficient assets to pay for their accommodation.

The combined operation of the income and assets tests generates a 'means tested amount' for each resident, and maintains a nexus with the accommodation supplement.

A resident qualifies for a full or partial accommodation subsidy (ie. becomes a supported resident) if the 'means tested amount' is less than $54.39, which equates to the maximum daily subsidy[2] that the government will pay for a person who does not have the capacity to pay for all of their accommodation costs. The new combined test was calibrated to result in no change in the proportion of supported residents.

The means test then assumes that anyone who cannot afford to meet their accommodation costs also cannot afford to contribute to their personal and nursing care costs. Any amount in excess of the 'means tested amount' becomes the care fee, subject

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to the fee not exceeding the cost of the resident's care as determined by the ACFI assessment.

The LLLB package also introduced a formal income tested fee for home care packages administered by the government which enabled the government to reduce the subsidy payable by the amount of any income tested fee.[3]

To this day, means testing and fee arrangements across residential care and home care packages remain quite separate, as do fees for home support services which remain at the discretion of each provider operating within recently promulgated national fees policy guidelines.

How much funding do the current means testing arrangements contribute to aged care?

In 2014-15, consumers contributed $4.2 billion (or 27%) of total residential provider revenue of $15.8 billion. The bulk of this amount ($3.6 billion) was for everyday living expenses and only $377 million was for personal and nursing care fees (3.8% of Commonwealth care subsidies and care supplements paid to providers on behalf of residents).

Under market-based accommodation prices that now apply across all residential care, consumers meet the bulk of accommodation costs. Refundable lump sum accommodation deposits contributed by consumers totalled $22 billion as at December 2015 and consumers contributed $680 million in daily accommodation payments in 2014-15. The accommodation subsidy paid by government on behalf of supported residents in 2014-15 was $827 million.

Home care recipients contribute about 10% of total home care provider revenue, as do home support recipients.

Where do these arrangements leave us?

Compared with the principles outlined earlier, the upshot of the above is that consumers are contributing the bulk of accommodation costs and everyday living expenses, but are contributing relatively modest amounts towards personal care and nursing costs in either residential or home care settings.

The following sets out sustainability and equity issues that arise from the current arrangements.

Sustainability issues

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The 2015 Intergenerational Report projected, based on current policy, that Australian Government aged care expenditure will almost double as a share of the economy by 2055, from 0.9% to 1.7% of GDP. This projection does not take into account the cost of removing the rationing of services under a more consumer-driven market-based aged care system envisaged under the Roadmap[4].

In part, the legislated review of the LLLB reforms currently in progress will go some way towards estimating the extent of unmet need and the potential cost of removing service rationing. However, the fact remains that there is a big question mark over the affordability of a consumer-driven market-based aged care system.

Affordability for taxpayers will not only depend on the level of unmet need, but also on other factors such as the extent of savings by having more care provided in people's own homes, the effectiveness of the eligibility assessment processes, productivity gains through increased competition, greater attention to early intervention and reablement services and service quality expectations. Affordability will also depend on increased contributions by those who can afford to pay in return for greater choice and control of services in a more consumer-driven system.

Any significant policy change to increase affordability for taxpayers by increasing consumer contributions would need to target personal and nursing care. Accommodation costs are already substantially met by consumers, as are everyday living expenses, and any additional revenue from 'additional services', assuming the vexed issue of what constitutes 'additional' services can be sorted out, will not improve taxpayer affordability as there is no scope to use this revenue to offset Australian Government subsidies.
Currently, some 75% of households aged 75 and over rely on government pensions and allowances as their main source of income. On the other hand, 80% of 75 plus households own their homes outright, and home equity per household in the population is highest for households aged 65-74 years, averaging $480,000 in 2011-12[5] (considerably more in 2017), but with values varying considerably by region.

This indicates that the main scope for increasing contributions for personal and nursing care is to draw on the wealth represented by the equity in the former principal residence, noting that all but $159,631 of the value of the former residence currently is excluded from the means test in residential care, and only an income test applies in home care.

It is also relevant in this context that the value of bequests grew from $18 billion to $24 billion between 2003 and 2013 (in 2013 dollars)[6] and continue to grow. This compares with estimated Australian Government funding of $17.4 billion in 2016-17 and care fees paid in 2014-15 of $377 million, though it is expected that this amount will increase a little more as the impact of grand-parented arrangements reduces. There is no data available as yet on how many consumers have paid care fees that have reached the

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annual and lifetime caps on care contributions. However, a very rough calculation suggests that on average, the 125,900 non-supported residents who received permanent residential care in 2015-16 paid on average about $3,000 each in care fees (compared with a lifetime cap of $60,000).

Equity issues

The current treatment of the former residence, which excludes all but $159,163 of its value, results in considerable inequity in contributions towards personal and nursing care costs when considered in the context of capacity to pay when total wealth and the operation of lifetime care contribution caps are not taken into account.

As the Productivity Commission points out, if a primary motivation of individuals is to preserve the value of the former residence for a bequest, it should not be at the expense of shifting the cost of their aged care to taxpayers. In effect, this amounts to taxpayers subsidising the bequests of those holding wealth (noting that the value of homes and bequests vary widely).

Treating all residents with a 'protected person' living in the former residence as supported residents also raises equity issues, noting how aged care needs present differently across households due to differences in each person's frailty trajectory.

There is also no discernible policy basis for the different means testing and care fee arrangements that apply in home care and residential care for individuals with the same assessed care needs, nor the level of government subsidy paid on their behalf. Similarly, the means testing and fee arrangements in home care bare no relationship to those that apply in home support where a set of policy guidelines exist to guide fee policies developed and administered by each provider.

The conclusion to be drawn from the above is that, from both a sustainability and equity point of view, there is scope to increase care contributions by those who can afford to pay, in return for choice and control over the services they purchase, while still leaving the vast majority of personal and nursing care funded by taxpayers. Such a move would go a long way towards making consumer-driven market-based services more affordable for taxpayers.

Where to from here?

One option to help address these sustainability and equity matters is to increase the proportion of the value of the former residence that is assessable under the current combined means test in residential care. The deeming of the first $159,163 in value as assessable under the current test seems to give precedence to the nexus with the maximum amount of the accommodation subsidy as a means of determining residents

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with the capacity to meet their own accommodation costs, rather than establishing a resident's capacity to contribute to their care costs based on their total wealth.

This approach, however, would not deal with equity issues concerning care contributions across residential care, home care and home support. These service types would continue to be subject to separate program-specific means testing and fee arrangements.

The Productivity Commission sought to address these issues in its report *Caring for Older Australians* by proposing an alternative approach based on the following:

- Consumer contributions towards personal and nursing care costs and support costs, whether delivered in a person's home or in a residential setting, would be determined by a comprehensive means test that incorporates income and assets.

The definition of income would be consistent with the age care pension income test, but only assets excluded from the age pension test would be included ie each resident's share of equity in the principal residence and any lump sum contributions paid.

Contributions would be proportional to the actual cost of the care being provided, and contributions would be subject to annual and lifetime caps.

- The eligibility of a resident for an accommodation subsidy would be determined by an assets test which includes all of a resident's share of total assets.

More comprehensive means testing arrangements along the lines suggested by the Productivity Commission that would apply across all aged care services, and which would take account of total wealth as an indicator of capacity to pay, would require most consumers to monetise equity in their former residence, either through sale or use of an equity release product.

However, the vast majority of older Australians are highly reluctant for a variety of reasons to monetise equity by tapping into the wealth in their homes. The reasons include not wishing to dilute the value of their bequest, debt aversion especially in older age, attachment to the security of the family home, perceptions of equity release being exploitative and high cost, and low awareness of equity release products. There is also a reluctance on the part of many financial institutions to offer equity release products. This being the case, any policy changes designed to increase consumer contributions for personal and nursing care for those that can afford to pay would need to address this reluctance if sale of the house (perceived as forced) and use of drawdowns from a lump sum deposit is not to be the only option for consumers.

Conclusion

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A rational analysis of the current means testing arrangements and what reforms are required to achieve an aged care service industry which is consumer-driven and more market-based, and yet be affordable for taxpayers, can only lead to the conclusion on sustainability and equity grounds that reform of the current means testing arrangements has to be one of the key reform steps.

Without reform in this area, the quality of personal and nursing services and availability of aged care services will remain completely hostage to government budgetary constraints and priorities, the consequences of which we have already experienced and which will be amplified as Australia confronts the trifecta of more modest economic growth in the post resource boom era, rapidly increasing aged care needs as the population ages and rising community expectations for quality and choice in aged care services.

Of course, the policy choices become considerably more complex if ever proposals to include the residence in the age pension assets test gain any traction, especially with regard to home care.

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[1]First introduced as Community Aged Care Packages or CACPs (equivalent to former hostel or low level residential care) and subsequently expanded to Extended Aged Care at Home or EACH (equivalent to nursing care or high level residential care).

[2] This amount (which is indexed) is considered sufficient to encourage investment in renewing and expanding services.

[3] Provider discretion to charge a basic daily fee up to 17.5% of the single pension was continued.

[4] The Aged Care Reform Roadmap prepared by the Minister for Aged Care's Aged Care Sector Committee.

[5] Productivity Commission *Housing Decisions of Older Australians* December 2015

[6] Ibid

Disclosure statement: The author of this Update, Nick Mersiades, is a member of the Aged Care Financing Authority. The opinions in this Update should not be read as being an expression of the views of the Aged Care Financing Authority.

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