Investing effectively starts with a reassessment of risk

By Emily Barlow
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Profit margins in the residential senior living sector continue to decline as the covid response continues to bite. Indeed, as at 31 December 2021, residential care providers were running an average deficit of $10.31[1] per resident, per day. This deficit is including the additional $10 per resident per day government funding.

This has a clear knock-on effect on the ability of providers to protect their balance sheets and ultimately grow and enhance their facilities.

Whilst improving the care of older Australians is a priority for the new Labor Government, there is still a lot of uncertainty around the future of funding. We do know continuous change is on the horizon and this is expected

to lead to a more competitive marketplace which could increase pressures on revenue further. That is why action needs to be taken now, as small changes can make meaningful differences over the longer term.

As we wait for further clarification on policy, one area that can and should be prioritised by boards is investment and liquidity risk. Whilst cash rates are increasing, inflation remains high and so now is the critical time to review your Investment Management Strategy (IMS) and Liquidity Management Strategy (LMS) to ensure it is fit for purpose. It is also a time to test whether the risk framework in place is still appropriate in this new and changing environment.

Risk tolerance and liquidity needs will be unique to each provider but the approach across the industry has tended to be highly conservative. Whilst this will remain appropriate for some when the tolerance for investment and liquidity risk is too low, the risk of failure is heightened. In some cases it could even be the difference between being loss and profit-making.

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 or non-existent, senior living leaders need to use the levers available to them to improve financial performance. This is particularly important in the NFP sector where the levels of cash held as a percentage of debt was on average 39% as at December, 2021

Even incremental investment gains can make a meaningful difference. For example, an organisation with $10M of excess cash in term deposits could have made $1.9M extra if it had been invested in a conservative portfolio with 40% in growth assets (such as equities) over the past five years. Increase the growth weighting to 60% in a diversified portfolio and the difference grows to $2.5M[2].

5 years invested 03/17-03/22	**Capital Growth**	**Income**	**Total Return**	**The difference it would have made**
Term Deposits	$ 0	$ 677K	$ 677K	-
Conservative	$ 1,558K	$ 969K	$ 2,527K	+$ 1,860K
Diversified	$ 2,025K	$ 1,129K	$ 3,154K	+$ 2,477K

It is important to note that investing effectively is only one piece of a very complex puzzle. In order to be successful in this shifting landscape, senior living providers need to consider an array of strategic options including examining current resources available, strategies to diversify income streams, acquisition and/or merger strategies, divesting non-core activities, and redevelopment projects, workforce planning and IT strategies.

After all, it will be the organisations that are prepared to do deep strategic analysis – and do it now – who will succeed.

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[1] StewartBrown Senior living Financial Performance Survey December 2021

[2] StewartBrown Senior living Financial Performance Survey December 2021

[3] The is just an example and is no guarantee of future market performance. Investing can result in positive or negative returns

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