Australian Government
Aged Care Financing Authority

Report on the
Base Interest Rate Study

June 2017
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Executive Summary

ACFA was asked by the Minister for Aged Care, the Hon Ken Wyatt in November 2016 to undertake a short study examining the application of the Base Interest Rate. The Base Interest Rate applies to the refund of outstanding lump sum accommodation balances, after the departure of residents from the provider’s care. The study included an assessment of alternative options as well as the implications of any change.

There is a legislated timeframe for repaying lump sum accommodation balances. The provider is required to pay interest on the lump sum deposit, from the day following the date of the resident’s departure from care. This compensates the resident or their estate for the time that the lump sum deposit is held while care is no longer being provided. The Base Interest Rate can apply for up to 14 days after the date of the resident’s departure from the facility, or if the resident has passed away, up until 14 days after the approved provider is shown the probate of the will or letters of administration of the estate. If the lump sum deposit is not repaid within the legislated timeframe for repayment, the higher Maximum Permissible Interest Rate applies.

Providers are not required to wait before refunding the lump sum deposit. However, allowing providers to confirm the legal arrangements relating to probate or the letters of administration provides important legal protection to the provider from potentially refunding the lump sum to a person who is not the proper legal representative of the estate.

ACFA recognises that the process and time taken in obtaining probate differs in each situation and can be impacted by a range of circumstances that are unique to each resident or their estate. This can result in aged care service providers needing to pay the Base Interest Rate for a period of time that they have no ability to influence. Concern has been raised about the rate of interest that is payable by aged care service providers when the Base Interest Rate applies.

During March 2017 ACFA performed a short round of targeted consultation with a number of consumer and peak provider organisations to further explore this issue. Provider organisations were generally in favour of a reduction in the current Base Interest Rate requirements whereas the consumer organisation felt that there was no strong case for change.

If viewed in isolation, ACFA recognises that additional costs can be faced by aged care service providers compared to a lower rate as summarised in the following table of alternate interest rates and the estimated premium above the RBA Retail Deposit Rate.
Summary of options

<table>
<thead>
<tr>
<th></th>
<th>Option 1</th>
<th>Option 2</th>
<th>Option 3</th>
<th>Option 4</th>
<th>Option 5</th>
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<tr>
<td>Retaining the Base Interest Rate</td>
<td>3.75%</td>
<td>3.25%</td>
<td>2.75%</td>
<td>2.05%</td>
<td>1.75%</td>
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<tr>
<td>Above Threshold Rate</td>
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<td>Below Threshold Rate plus 1 per cent</td>
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<td>RBA Retail Rate (all terms)</td>
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<td>Below Threshold Rate</td>
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Applicable interest rate

- Difference from the BIR (3.75%)
  - Option 1: 0%
  - Option 2: -0.5%
  - Option 3: -1.0%
  - Option 4: -1.7%
  - Option 5: -2.0%

- Difference from the RBA Retail Deposit Rate (2.05%)
  - Option 1: 1.7%
  - Option 2: 1.2%
  - Option 3: 0.7%
  - Option 4: 0%
  - Option 5: -0.3%

- Incremental (cost) / benefit
  - Option 1: ($3,324)
  - Option 2: ($2,346)
  - Option 3: ($1,369)
  - Option 4: $0
  - Option 5: $587

This however needs to be viewed in the context that when a resident pays a lump sum accommodation deposit to a provider, it operates like an interest free loan, accruing no interest income for the resident during their time in care.

Given the average length of stay of a resident in a residential care facility is approximately 3 years, and with the average maximum lump sum accommodation price of $391,000, this can provide interest income to the provider at 2.05 per cent of at least $24,000 during the term of the resident’s stay. Many providers could receive a higher rate of return, for example if the lump sum was used to offset higher borrowing costs.

As shown in the table above, the applicable cost to a provider for holding the lump sum deposit for 6 months following the departure of a resident from care would be approximately $3,324 ($391,000 x (3.75 per cent payable less 2.05 per cent earned)) x 6/12 months, noting again that the BIR may still be lower than the interest cost of borrowings.

While the Base Interest Rate issue was referred to ACFA in the context of provider perspectives, this analysis highlights that there will be different perspectives regarding the

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1 This amount reflects the applicable differential in cost to a provider for holding an average lump sum deposit of $391,000 for 6 months following the departure of a resident from care. For example, retaining the BIR under option 1 would cost the provider approximately $3,324 ($391,000 x (3.75 per cent payable less 2.05 per cent earned)) x 6/12 months).

2 ACFA’s Fifth Report on the Funding and Financing of the Aged Care Sector, July 2017

3 RBA Retail Deposit Rate - RBA Series ID: FRDIRBTD10KAR which shows the ‘average rates (all terms)’ on a $10,000 deposit across the five largest banks
appropriateness of interest rates used in aged care. Rates can often be a balance between provider and consumer interests and consideration of adjustments to any rates needs to be deliberated in the overall context.

Whilst any decision to change the base interest rate rests with government, the results for ACFA’s study may better be considered in the context of the full findings of the Legislative Review and any recommendations to Accommodation Payments and lump sums rather than as a separate action.
1. Introduction

1.1 Scope of the study

The Aged Care Financing Authority (ACFA) is an independent statutory committee and their role is to provide independent and transparent advice to the Australian Government on financing and funding issues in the aged care industry. ACFA considers matters in the context of maintaining a viable, accessible and sustainable aged care industry that balances the needs of consumers, providers, and other important stakeholders.

In November 2016, ACFA was asked by the Hon Ken Wyatt AM MP, Minister for Aged Care to undertake a short study examining the application of the Base Interest Rate (BIR) that applies to the refund of outstanding accommodation deposit balances (including refundable accommodation deposits and accommodation bonds) following the permanent departure of a resident from the provider’s care.

Lump sum deposits operate like an interest free loan to residential aged care providers, accruing no interest income for the resident during their time in care. When the resident departs care, the lump sum deposit begins to attract interest, providing a benefit to the resident or their estate whilst the lump sum deposit is still held by the provider, and care services are no longer delivered.

Two provider organisations wrote to Minister Wyatt and ACFA requesting the consideration of a reduced rate of interest applicable to outstanding lump sum accommodation deposits held in the period after a resident passes away or otherwise leaves care. Given that any changes to this interest rate have the potential to impact both providers and consumers, ACFA performed a targeted round of consultation to further explore the issue.

ACFA developed a short discussion paper outlining the current requirement for payment of the BIR as well as outlining some of the issues that have been raised. The discussion paper was released to a number of consumer and provider peak organisations on 3 March 2017 to ensure that the views of stakeholders could be considered. Responses to the discussion paper were due to be submitted by 7 April 2017.

The key questions the stakeholders were asked to consider were:

1. Should the base interest rate change?
2. What should the rate change to?
3. What impact will this have?

Whilst the discussion paper did not survey the average time period to which the BIR is applicable, anecdotal data suggests that 6 months may be a reasonable average when comparing straightforward and complex probate processes. ACFA sets out in this report the results of this “short study examining the application of the BIR to the refund of lump sum accommodation payments including an assessment of options and implications of any changes”. Any decision to change the BIR rests with Government.
2. Application of the Base Interest Rate

Interest rates are used to calculate the cost of accommodation payments made by non-concessional residents upon their entry to care. Interest rates also apply to the residential aged care service provider on the return of the lump sum accommodation deposit made by a resident when their care ceases. A higher rate of interest (the Maximum Permissible Interest Rate (MPIR)) applies to aged care service providers where the lump sum accommodation deposit is not refunded within the legislated timeframe for repayment.

2.1 Accommodation costs upon entry to residential aged care

From the date of entry to residential aged care, and depending on the level of income and assets that the person holds, a resident may be asked to make a payment for their accommodation costs. If a resident is required to pay for their accommodation costs, based on the result of the Income and Assets Assessment, they will have 28 days from the day they enter the residential care facility to decide on their preferred method of payment for their accommodation costs.

If an accommodation payment is required, the resident will pay a Daily Accommodation Payment (DAP) for their accommodation costs, including the day the resident enters care. If the resident decides to pay a Refundable Accommodation Deposit (RAD) for their accommodation costs within those 28 days, the resident has 6 months to pay the lump sum deposit and they will continue to pay the DAP until the RAD is paid. So from the date of entry to care, a resident will pay the DAP (equivalence to the RAD is calculated using the MPIR) either on an ongoing basis or until the RAD is paid.

Once the lump sum accommodation deposit is paid to the aged care service provider, it operates like an interest free loan, accruing no interest income for the resident during their time in care. The average maximum lump sum accommodation price of $391,000 if invested as a term deposit can provide interest income to the provider of at least $24,000 at 2.05 per cent during the term of an average 3 year stay.

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4 Approved providers of residential aged care must ensure there is equivalence between the refundable accommodation deposit amount and the daily accommodation payment amount. Under section 20 of the Fees and Payment Principles (No 2), the daily accommodation payment amount is worked out by multiplying the maximum permissible interest rate for the relevant day by the refundable accommodation deposit amount, and then dividing this amount by the number of days in the year.

5 ACFA’s Fifth Report on the Funding and Financing of the Aged Care Sector, July 2017

6 RBA Retail Deposit Rate - RBA Series ID: FRDIRBTD10KAR which shows the ‘average rates (all terms)’ on a $10,000 deposit across the five largest banks
2.2 The Base Interest Rate

The BIR definition is set out in the *Fees and Payments Principles 2014 (No. 2)* made under subsection 96-1 of the *Aged Care Act 1997* and is defined as being the sum of:

1. the ‘below threshold rate’; and
2. two per cent.

The ‘below threshold rate’ is determined under the *Social Security Act 1991* and is used to calculate the income which is assumed to be earned from the financial assets that a person holds for the purposes of assessing their entitlement to pensions and allowances under this Act, as well as the Income and Assets Assessment for Aged Care. Deeming was first introduced in 1991 to encourage income supported residents to maximise their investment income and derive returns at least equal to the deeming rate. Further commentary on deeming rates is provided at Appendix A.

2.3 Accommodation refund upon departure from residential aged care

If the resident has paid a refundable accommodation deposit or an accommodation bond for their accommodation costs, approved providers are required to pay interest on the lump sum accommodation deposit for each day following the date of the resident’s departure from the service, until the date the lump sum accommodation deposit is refunded. Interest is not paid for the day of the resident’s departure, but is payable for each day thereafter, including the date of repayment of the lump sum deposit, at two different rates.

1. The Base Interest Rate (currently 3.75 per cent) is applied to the refund of the balance of a lump sum deposit, until the date the lump sum deposit is actually refunded or the legislated timeframe for repayment expires, whichever is earlier; and
2. If the lump sum balance is not refunded within these timeframes, additional interest at the Maximum Permissible Interest Rate (currently 5.78 per cent) is applied until the lump sum is actually refunded.

There is a legislated timeframe for repaying lump sum accommodation payments. Approved providers are required to refund lump sum accommodation payments within the following timeframes:

- Where the resident passes away, the provider must refund the lump sum payment within 14 days after being shown the probate of the will or letters of administration;
- Where the resident moves to another service and the resident gives:

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8 The MPIR for the relevant day is defined under section 6 of *the Fees and Payment Principles (No 2)* as being (1) the general interest charge rate for the relevant day under section 8AAD of the *Taxation Administration Act 1953*; (2) this rate is multiplied by the number of days in the calendar year in which the relevant day falls; and then (3) subtract 3 percentage points from the amount worked out at step 2. The result is the maximum permissible interest rate for the relevant day.
• more than 14 days of notice, the provider must refund the lump sum payment on the day the resident leaves the service;
• notice within 14 days of departing, the provider must refund the lump sum payment within 14 days of the day the resident gave notice;
• no notice before departing, the provider must refund the lump sum payment within 14 days of the day the resident leaves;
- Where the resident leaves the service to return home, the provider must refund the lump sum payment within 14 days after the resident leaves the service;
- Where the service ceases to be certified, the lump sum payment must be refunded within 14 days of the date the service ceased to be certified.

The BIR can apply for up to 14 days after the resident’s date of departure, or if the resident has passed away, up until 14 days after the approved provider is shown the probate of the will or letters of administration of the estate. If the approved provider does not refund the lump sum payment within the legislated timeframes for repayment, the approved provider must pay interest at the Maximum Permissible Interest Rate for the period commencing from the day after the date the lump sum payment should have been refunded, and ending on the day the lump sum payment is repaid.  

Allowing providers to request probate or letters of administration before refunding the lump sum balance provides important legal protection to the provider from refunding the lump sum to a person that is not the legal representative of the estate. Providers are not required to wait for probate or letters of administration however, and they may choose to make the refund earlier if they prefer. Providers can face risks in refunding the lump sum balance prior to probate being provided, such as refunding the lump sum to the wrong beneficiary, or in circumstances where the Will of the deceased resident is contested or the resident has died intestate.

The requirement to pay interest on the lump sum deposit from the date following the resident’s departure ensures that the resident or their estate is compensated for the time that the lump sum deposit is held by the provider whilst care is no longer being provided. Whilst providers are required to pay interest on the balance of the lump sum deposit held during this period, the provider is able to earn interest income on the amount owing during the whole time the deposit is held which can be used for service provision.

The provider’s ability to earn interest needs to be balanced with the requirement for maintaining sufficient liquidity to enable the provider to repay lump sum accommodation balances as and when they fall due for repayment.

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9 Fees and Payments Principles (No 2) 2014, Part 7, Division 1, section 69
10 The resident has died without a legally valid will, so the relevant state laws will apply to determine how the estate should be distributed.
11 Fees and Payments Principles (No 2) 2014, Part 5, Division 2, section 43 requires that where an approved provider holds one or more refundable deposit balances, accommodation bond balances or entry contribution balances, the approved provider must maintain sufficient liquidity to ensure that the approved provider can refund, in accordance with the Aged Care Act 1997 and the Fees and Payments Principles (No 2) 2014, any of those balances that can be expected to fall due in the following 12 months.
3. Changing the Base Interest Rate

3.1 The concerns that have been raised

From the provider’s perspective, concerns have been raised in relation to the disparity that exists between the current cash rate\textsuperscript{12} and the BIR that needs to be paid. Providers have highlighted the issue of the BIR being too high in comparison to the cash rate and other funds kept on call. This results in interest costs to providers that are higher than the earnings a provider could be expected to achieve on the lump sum if invested so the cash rate was payable, whilst waiting for the deposit to be repaid. ACFA however has no evidence on the rates of return that providers generally benefit from.

Some providers have noted the process and time taken in obtaining probate can sometimes be lengthy and this can incentivise providers to refund lump sum balances more quickly, undermining the legal purpose of allowing providers to wait for probate or letters of administration.

From the consumer’s perspective a reduction in the BIR will impact residents that are transferring between different aged care facilities, in instances where the resident intends to pay for their accommodation costs by lump sum deposit. The resident will pay a DAP at the new aged care home whilst waiting for the lump sum to be refunded by the previous aged care home. The MPIR used to determine the DAP payment on entry to the new aged care home is higher than the amount of BIR interest received on the outstanding lump sum payment that is held by the previous aged care home and this is an extra cost for the resident. Transfers between facilities generally only occur to approximately 2 per cent of consumers.

ACFA developed a short discussion paper that outlined the current requirement for payment of the BIR as well as highlighting some of the issues that have been raised. The paper included a worked example as well as a table that compared the below threshold rate to the base interest rate, the above threshold rate and the maximum permissible interest rate. As a comparison, the Reserve Bank of Australia term deposit rate\textsuperscript{13} for all term lengths across the five largest banks was also shown. An extract of the current rates is shown in the table below. The example illustrated in the discussion paper and table of rates for the last three years are set out in Appendices B and C respectively.

\textsuperscript{12} The cash rate, effective 3 May 2017 is currently 1.5 per cent
\textsuperscript{13} RBA Series ID: FRDIRBD10KAR which shows the ‘average rates (all terms)’ on a $10,000 deposit across the five largest banks
Table 1 – Current rates of interest

<table>
<thead>
<tr>
<th>Rates of interest</th>
<th>Below Threshold Rate</th>
<th>RBA Retail Rate (all terms)</th>
<th>Below Threshold Rate plus 1 per cent</th>
<th>Above Threshold Rate</th>
<th>Base Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.75%</td>
<td>2.05%</td>
<td>2.75%</td>
<td>3.25%</td>
<td>3.75%</td>
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As part of this short study a targeted round of consultation was performed through the release of the discussion paper to a small number of consumer and provider stakeholders for comment. The key questions the stakeholders were asked to consider were:

1. Should the base interest rate change?
2. What should the rate change to?
3. What impact will this have?

3.2 Should the base interest rate change?

Feedback from the provider stakeholders was supportive for a reduction in the BIR.

Providers noted that using the below threshold rate of 1.75 per cent, rather than the BIR of 3.75 per cent, would align the interest payable on lump sum deposits more closely with the cash rate, thereby reducing costs for providers. It should be noted that following the departure of a resident from care:

1. there is an immediate loss of ownership of income for the provider applying from the day after the date of the resident’s departure. From this date, the interest received on the lump sum is accrued at the interest rate earned by the provider but the interest is paid for the benefit of the resident or their estate; and
2. the financial impact experienced by the provider is the difference between the rate of BIR paid and the rate of interest earned (or saved) by the provider.
   - Where the provider accrues 2.9 per cent in interest revenue on the lump sum deposit for example, the provider would face an additional cost of 0.85 percent (3.75 per cent payable less 2.9 per cent received) applying from the day after the date of the resident’s departure.
   - Where the provider used the lump sum for capital expenditure at a borrowing rate of 5 per cent, the benefit received would reduce to 1.25 percent (5 per cent saving less 3.75 per cent payable) applying from the day after the date of the resident’s departure.

Any difference between the current cash rate and the BIR may create incentives for some consumers or their estates to delay the probate process longer than needed.
Leading Age Services Australia noted that:

“for many smaller providers, especially those operating on smaller margins, the quantum of the wedge [the difference between the BIR and the market interest rate] is not inconsequential”

Aged and Community Services Australia acknowledged that:

“requiring approved providers to pay interest on lump sum balances due for refund is appropriate as it compensates the resident or their estate for the time the lump sum is held by the provider after the resident ceases to receive care. However, we believe that the interest amount payable by an approved provider should be commensurate with what the approved provider could reasonably be expected to achieve on their investment of these funds whilst holding them as working capital”.

Providers also noted that lowering the BIR would better support them by allowing them to wait for probate or letters of administration before refunding lump sum deposits. Residents or their estates could still receive income on the lump sum deposit held by a provider that is broadly commensurate with the interest that could otherwise have been received by depositing the lump sum with an authorised deposit-taking institution.

The Aged Care Guild noted that:

“The amount ultimately refunded to residents, or their estates, should be an amount equivalent to the initial bond amount (less agreed deductions), plus the equivalent interest that would be earned on that amount by the resident, from when the resident leaves care until such a time that the bond is ready and able to be refunded, noting that any delays are most likely due to probate or otherwise outside the control of providers.”

Some providers noted that they have observed instances where Executors have taken advantage of the difference in the interest rate payable by the provider.

Uniting Care (NSW-ACT) acknowledged that:

“There are examples of Executors avoiding or delaying seeking probate or providing evidence of probate to a provider to take advantage of the higher interest rate payable by the provider”

The use of a cost neutral rate equivalent to a rate that can be earned on similar investments would enable providers to wait for probate as the legislation allows, ensuring protection of the resident’s estate.

On the other hand, the view from the consumer stakeholders did not support any change in the BIR, noting any reduction in the rate would disadvantage consumers or their beneficiaries.

Lowering the BIR can negatively impact residents transferring to another aged care home. The MPIR used to determine daily payments is higher than the BIR, meaning the resident would likely be paying a daily payment (this is effectively interest on the outstanding lump
sum) that is higher than the amount of interest they would receive on the outstanding lump sum. However, given that the lump sum balance must be refunded within 14 days (or less, depending on when the resident notified the provider) when the resident is transferring to another service, it is likely the impact would be relatively small.

It was noted that aged care providers may earn interest at rates well over the base interest rate. COTA Australia noted that:

“the cash rate is a floor on which many rates are calculated for many purposes”

COTA Australia noted that providers could reasonably expect to earn higher rates of interest:

“this could be because they have a secure investment facility that is paying them higher than published term deposit rates. It can also be because they have borrowings for current or past developments and are using these funds held as either a formal “offset” with the financing institution, or as the means of having to borrow less than they otherwise would have to. On that basis the effective rate of earnings on the funds held is likely to be in the vicinity of 5.5% to 6.00%”.

Consumer stakeholders indicated that there was no substantial need for any change to the BIR.

3.3 What should the rate change to and what is the impact?

The submissions from all provider organisations indicated that a reduction in the rate of the BIR was required. This change would better align the BIR with the current cash rate, thereby eliminating the extra cost that is faced by some providers, and supporting providers by allowing them to wait for probate or letters of administration before the lump sum deposits are refunded.

Catholic Healthcare recommended adopting the use of the Below Threshold Rate:

“The rates determined under subsection 1082(1) [of the Social Security Act 1991] reflect the returns available in the market for a range of financial investments. It is reflective of earnings that could be achieved on funds held for short periods of time.

Catholic Healthcare believes that the holding of refundable deposit balances or accommodation bond balances, whilst waiting for probate to be granted, is no different to situations where Executors of Estates are accumulating assets prior to administration of the Estate. In other words, the amount expected to be earned by an Executor during the probate period is the below threshold rate.”

The Aged Care Guild recommended that:

“the RBA Retail Rate is a more appropriate rate, being that which a resident could earn on a term deposit with a major bank. The Guild considers this a fairer and more equitable approach.” “ACFA might therefore consider using:

- the RBA term deposit rate (RBA Series ID: FRDIRBTD10KAR) which would result in a 1-1.5% saving for providers; or
the deeming rates plus 1% (instead of plus 2%), which would result in a 1% saving for providers”.

Leading Age Services Australia commented that they supported a reduction in BIR:

‘from an administratively determined largely fixed BIR, to a flexible (say a crawling peg) BIR based on a reference market based interest rate’.

The view from the consumer stakeholder however did not support any change in the BIR, noting a reduction in the rate would negatively impact residents’ families and their estates.

COTA Australia noted that:

“At worst, there is a ‘swings and roundabouts’ element to the current BIR....However on balance, we think the BIR is a reasonable compromise between provider and consumer interests”.

Whilst any significant changes in market rates is mitigated through the regular review of the deeming rates, there may be a perception amongst consumers that lowering the interest rate paid during the initial refund period would reduce the incentive for providers to refund lump sum deposits in a timely manner, especially if the general market rates improve substantially above the below threshold rate. The MPIR, a higher rate of interest, applies for the resident’s benefit if providers do not refund lump sum balances within the legislated timeframes outlined in section 2.3 above.
4. Assessment of Options

4.1 Alternative options

Concerns from providers related both to the time taken in some instances to obtain probate, as well as the difference in rates that exists between the BIR and the current cash rate.

As part of this short study, the range of options identified, through targeted consultation with respect to the BIR are set out below.

1. **Retaining the BIR, currently 3.75 per cent**

This option involves continuing the existing arrangements with no change being applied to the current method of calculating the BIR. The difference between the BIR and the cash rate can provide an incentive to aged care service providers for the prompt return of the deposit. Providers can be financially disadvantaged when delays in the probate process are experienced.

It’s possible for consumers to also be financially disadvantaged when transferring to another aged care home. The resident may need to pay a DAP (MPIR, currently 5.78 per cent) for the new home whilst waiting for the lump sum to be refunded by the previous home. The resident will receive BIR interest (at 3.75 per cent) on the balance of funds held by the previous provider, however the legislated timeframes for payment (refer section 2.3 of this report) operates to impose a higher interest rate, providing protection to the consumer to ensure the timeframe is not protracted.

2. **Replace the BIR with the ‘Above Threshold Rate’, currently 3.25 per cent**

The Above Threshold Rate is a legislated deeming rate determined by the Minister for Social Services under the *Social Security Act 1991*. The Above Threshold Rate is applied to the value of assets exceeding the deeming threshold, reflecting the rate of return available to pensioners across a range of financial investments.

While the rate is used to calculate the income a person is assumed to have earned, it seems reasonable that this rate could also be used to determine the income that a person is to be paid.

For consumers, whilst the use of the Above Threshold Rate in place of the BIR would result in a 0.5 percent loss in interest income (3.75 per cent less 3.25 per cent), the rate of return generated at 3.25 per cent is still higher than the RBA Retail Deposit rate (currently 2.05 percent).

For providers, the use of the Above Threshold Rate will continue to provide a financial incentive for the prompt return of the deposit whilst resulting in a 0.5 per cent saving in interest paid on lump sum deposits upon a resident’s permanent departure from care. Where delays in obtaining probate are experienced, providers can still be financially
disadvantaged if the rate of return that is earned is less than the rate of interest they need to pay.

3. **Replace the BIR with the ‘Below Threshold Rate’, plus 1 per cent totalling 2.75 per cent**

The Below Threshold Rate is also determined by the Minister for Social Services under the *Social Security Act 1991*. This option involves retaining the existing formula for calculating the BIR, but reducing the additional interest component to 1 per cent.

For consumers, reducing the additional interest component would result in a 1 per cent loss in interest income derived during the time after the resident has departed care, however the rate of return generated is currently higher than the rate that could otherwise be achieved through depositing the lump sum with one of the largest banks.

For providers, this rate would provide a saving from the BIR. At the same time, as the rate is higher than market based interest rates, it will provide an incentive for the prompt return of the deposit upon a resident’s permanent departure from care. Where delays in obtaining probate occur, providers may still be financially disadvantaged if the rate of return that is earned is less than the rate of interest payable on the lump sum deposit.

4. **Replace the BIR with an investment deposit rate such as the Reserve Bank of Australia Retail Deposit Rate, currently 2.05 per cent**

This option involves adopting a market based rate, fluctuating on a monthly basis in line with market movements.

For consumers, adopting a market based rate such as the RBA Retail Deposit Rate would mean that greater interest equivalency is provided, with consumers generating the same rate of return that could otherwise be generated in the market place. A market based rate would provide greater cost neutrality between providers and consumers, however this would result in a loss of interest income to consumers in the order of 1.7 per cent compared to the current BIR. Any reduction in rate could be viewed by consumers as diminishing the incentive for the provider’s prompt return of the deposit, however the MPIR would still apply if providers fail to refund the lump sum balances within the legislated timeframes.

For providers, adopting a market based rate will result in interest savings in the order of 1.7 per cent from the current rate and ensure providers are not penalised for any delays that are experienced when time is taken to obtain probate.

5. **Replace the BIR with the ‘Below Threshold Deeming Rate’, currently 1.75 per cent**

This option involves retaining the existing formula for calculating the BIR, and removing the additional interest component of 2 per cent.

The Below Threshold Rate would not provide the same cost neutrality between providers and consumers. Consumers would be disadvantaged, receiving a 2 per cent loss in interest income as well as receiving a rate of return that is lower than rate that could otherwise be generated in the market. Consumers may view this as providing an even greater incentive
for providers to delay the return of the lump sum deposit, however the MPIR would again apply if the funds are not repaid within the legislated timeframe.

For providers, removing the additional interest component will result in a 2 per cent saving in interest paid on lump sum deposits upon a resident’s permanent departure from care. At the current market rates, providers would be able to earn a higher rate of interest on the lump sum deposit than the rate of interest they need to pay.

4.2 ACFA’s observations

The options explored above are summarised below:

Table 2 – Summary of options

<table>
<thead>
<tr>
<th></th>
<th>Option 1</th>
<th>Option 2</th>
<th>Option 3</th>
<th>Option 4</th>
<th>Option 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retaining the Base Interest Rate</td>
<td>Retaining the Base Interest Rate</td>
<td>Above Threshold Rate</td>
<td>Below Threshold Rate plus 1 per cent</td>
<td>RBA Retail Rate (all terms)</td>
<td>Below Threshold Rate</td>
</tr>
<tr>
<td>Applicable interest rate</td>
<td>3.75%</td>
<td>3.25%</td>
<td>2.75%</td>
<td>2.05%</td>
<td>1.75%</td>
</tr>
<tr>
<td>Difference from the BIR (3.75%)</td>
<td>0%</td>
<td>-0.5%</td>
<td>-1.0%</td>
<td>-1.7%</td>
<td>-2.0%</td>
</tr>
<tr>
<td>Difference from the RBA Retail Deposit Rate (2.05%)</td>
<td>1.7%</td>
<td>1.2%</td>
<td>0.7%</td>
<td>0%</td>
<td>-0.3%</td>
</tr>
<tr>
<td>Incremental (cost) / benefit14</td>
<td>($3,324)</td>
<td>($2,346)</td>
<td>($1,369)</td>
<td>$0</td>
<td>$587</td>
</tr>
</tbody>
</table>

The table at Appendix C shows the amount of interest payable on a lump sum payment of $250,000 using the above-mentioned interest rates across different timeframes.

If the Commonwealth wishes to reduce the difference that exists between the BIR and current cash rates, then a change from current requirements is required.

ACFA recognises that the process and time taken in obtaining probate differs in each circumstance and can be impacted by a range of circumstances that are unique to each resident and their family arrangements as outlined in Appendix D.

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14 This amount reflects the applicable differential in cost to a provider for holding an average lump sum deposit of $391,000 for 6 months following the departure of a resident from care. For example, retaining the BIR under option 1 would cost the provider approximately $3,324 ($391,000 x (3.75 per cent payable less 2.05 per cent earned) x 6/12 months).
ACFA acknowledges that it is possible that the process and time involved in applying for a grant of probate could be extended by the Executor. This could occur for a range of reasons including through causing delay, in order to benefit from the higher interest rate applying to lump sum deposits in comparison to market rates\textsuperscript{15}, however the extent of any such action is unclear. At a practical level, it should be noted that beneficiaries are likely to be keen to finalise the distribution of an estate. ACFA investigated an option of applying a timeframe to the probate process, to limit the time period for which the BIR is paid, however this was found to be too complex because of the number of situational variants.

As a result, ACFA’s analysis focused on exploring the option of changing the rate of interest that applies to lump sum payments, following the permanent departure of a resident from care. ACFA notes that based on the results of the short study that was conducted, providers favoured a change from the current BIR requirements noting a preference for Options 2-5. The consumer organisation did not support the case for any change and supported Option 1.

ACFA’s analysis identified that Option 5 offers the greatest saving for providers, however it does not create the same cost neutrality between consumers and providers. The interest rate payable is 0.3 per cent lower than could otherwise be earned when compared against the RBA Retail Deposit Rate highlighted in the table above.

Option 4 provides the greatest cost neutrality with consumers able to generate the same rate of return that could otherwise be derived in the market place. This option is also likely to be appealing to residential service providers. ACFA’s analysis noted that where providers are able to achieve the same rates of return as the interest they need to pay, consumers may view this as removing the financial incentive that exists (through the use of different rates) for providers for the early return of the lump sum deposit. As noted in the Conclusion section, all options also need to be considered in the broader context, noting for example that providers would have likely have had higher effective rates of return while holding the lump sum while the resident was in care.

Options 2 and 3 provided different levels of savings for providers, whilst still retaining a financial incentive for the prompt return of the lump sum deposit. Consumers receive a rate of interest on their outstanding lump sum deposit of 1.2 per cent and 0.7 per cent respectively than what could otherwise be generated when compared against the RBA Retail Deposit Rate shown in the table above.

It should be noted that where delays in obtaining probate are experienced, providers could face a level of financial disadvantage where the rate of interest earned is less than the rate of interest they need to pay.

\textsuperscript{15} The Base Interest Rate is currently 3.75 per cent compared against the RBA retail deposit rate of 2.05 per cent
5. Conclusion

ACFA’s study focused on the comparative impact of a change to the base interest rate applying to lump sum payments, following the departure of a resident from a provider’s care.

The study revealed support from providers to reduce the rate of interest applying to lump sum payments, resulting from the difference that exists between the BIR and the current cash rate. ACFA recognises that the process and time taken in obtaining probate differs in each situation and that this results in aged care service providers needing to pay the Base Interest Rate for a period of time that they have no ability to influence.

Providers noted that a reduction in the BIR rate would reduce the extra costs they face whilst waiting for a grant of probate or letters of administration to be provided. The study also revealed that consumers supported the continuation of the existing rate and noted there was not a strong reason for change. A reduction in the rate would negatively impact residents and their estates through reducing the amount of interest that is earned following the resident’s departure from care.

From the four alternative options that were investigated, ACFA found that Options 2 and 3 provided a level of savings for providers from the current BIR rate whilst the differential in the rates of interest could provide a financial incentive for the prompt return of the deposit to the resident or their estate. Options 4 and 5 did not include the same financial incentive for providers for the early return of the lump sum payment, with the interest rate payable equal to or lower than market rates, which disadvantages consumers.

If viewed in isolation, ACFA recognises that additional costs can be faced by aged care service providers. This however needs to be viewed in context with the fact that when a resident pays a lump sum accommodation deposit to a provider, it operates like an interest free loan, accruing no interest income for the resident during their time in care.

Given the average length of stay of a resident in a residential care facility can be approximately 3 years, and with the average maximum lump sum accommodation price of $391,000\(^{16}\), this can provide interest income at 2.05 per cent\(^{17}\) of at least $24,000 during the term of the resident’s stay. Many providers could receive a higher rate of return, for example if the lump sum was used to offset higher borrowing costs.

As shown in table 2, the applicable cost to a provider for holding the lump sum deposit for 6 months following the departure of a resident from care would be approximately $3,324 ($391,000 x (3.75 per cent payable less 2.05 per cent earned)) x 6/12 months.

\(^{16}\) ACFA’s Fifth Report on the Funding and Financing of the Aged Care Sector, July 2017

\(^{17}\) RBA Retail Deposit Rate - RBA Series ID: FRDIRBTD10KAR which shows the ‘average rates (all terms)’ on a $10,000 deposit across the five largest banks
The lump sum deposit pool increased from $18.2 billion at 30 June 2015 to $21.9 billion at 30 June 2016. Interest income earned on the average balance of funds held by the sector at a rate of 2.05 per cent or higher provides interest income of at least $407 million\(^{18}\) per annum on the average pool balance of $19.9 billion.

Given the average length of stay of residents, one third of the average pool balance, being $6.66 billion is likely to be refunded to residents or their estates during the year. The cost to the sector for holding these deposit balances for 6 months following the date of departure of the residents would be approximately $124 million per annum, providing a net gain to the sector which is estimated at $283 million per annum.

While the Base Interest Rate issue was referred to ACFA in the context of provider perspectives, this analysis highlights that there will be different perspectives regarding the appropriateness of interest rates used in aged care. Rates can often be a balance between provider and consumer interests and consideration of adjustments to any rates needs to be deliberated in the overall context.

Whilst any decision to change the base interest rate rests with Government, the results for ACFA’s study may better be considered in the context of the full findings of the Legislative Review and any recommendations to Accommodation Payments and lump sums rather than as a separate action.

\(^{18}\) ACFA considers this to be a very conservative estimate and that providers have the opportunity to earn far greater returns on investments, or equivalently through debt reduction
Appendix A – Deeming Rates

Under the Social Security Act 1991 deeming rates are used to calculate the ordinary income that a person or couple is taken to have earned based on the financial assets that they hold. Section 1081 of this Act sets out different levels of deeming threshold that apply to a single person, a pensioner couple and member of a couple who is not a pensioner couple as follows:

(1) The deeming threshold for a person who is not a member of a couple is $30,000;
(2) The deeming threshold for a pensioner couple is $50,000;
(3) The deeming threshold for a member of a couple, other than a pensioner couple, is an amount equal to one-half of the amount fixed by subsection (2).

In determining the income which is deemed to be derived from the financial assets held, the total value of the person’s financial assets up to their deeming threshold is subject to the ‘below threshold rate’ which is currently 1.75 per cent. The remainder of their assets above the deeming threshold is subject to the ‘above threshold rate’ of 3.25 per cent. The deeming threshold rates are determined by the Minister for Social Services, by legislative instrument under section 1082 of the Social Security Act 1991.

Deeming rates reflect the returns available to pensioners across a range of financial investments in the market. Deeming rates are subject to regular review to ensure they reflect the returns currently available in the market to people for their financial investments. The deeming rate is reviewed through the analysis of the medium to long term trends in a wide range of investment indicators such as term deposit rates, cash management account returns, changes in share prices, share dividend yields, managed investment returns, and data and analysis from the Reserve Bank of Australia and the Department of Treasury19.

Any changes made to the deeming rates are usually made to coincide with the indexation of pensions, to reduce disruption to pensioners and minimise the number of changes to their payments. Changes to the rates can be made at any time however, if there are significant movements in returns from financial investments.

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19 Explanatory Statement for Social Security (Deeming Threshold rates) Determination 2015 (No 1)
Appendix B – A worked example (as tabled in the consultation Discussion Paper)

If we assume a resident entered care on 1 July 2014 and agreed to the average accommodation price at this time of $296,400\textsuperscript{20} with their preferred aged care service provider. The resident will pay the equivalent daily payment of $54.33 upon entry to care, based on the MPIR applying at this time of 6.69 per cent. The resident had 28 days from the date of entry to the facility to decide on their preferred payment method and elected to pay by lump sum, paying this amount within the 6 months allowed for payment. The resident paid $54.33 per day until the lump sum payment was made, equating to approximately $1,652 per month.

Assume the resident agreed in writing to draw down the DAP as well as other costs from the RAD payment, totalling $46,400 during the course of their stay in the facility. The resident passed away a few years later, departing care on 31 December 2016 and leaving a balance of lump sum payment of $250,000. The provider must refund the lump sum payment within 14 days after being shown the probate of the will or letters of administration.

It is important from a legal perspective for the aged care facility to ensure the lump sum payment is refunded to the correct person. The granting of probate provides the required evidence that the person named in the probate is authorised to manage the affairs of the deceased person. The first part of this process is for an online notice to be published to notify that the executor of the estate intends to apply for probate of the last will of the deceased person.

The application for probate cannot be lodged with the Supreme Court until 14 days have passed from the date of publication of this online notice. In granting the application for probate, the Supreme Court in the relevant state validates and registers the deceased person’s will, and names the executor, enabling the management of the deceased person’s estate so the assets can be distributed in accordance with the will. If the deceased person does not have a valid will, the validation of their estate and beneficiaries is performed through a letter of administration. Given these timeframes, evidence of the granting of probate could take up to 20 days or longer to obtain.

Assume that evidence of probate for the deceased resident is provided to the aged care service on 25 January 2017, the aged care service must refund the lump sum payment within 14 days from this date, being 8 February 2017. Assume there was a delay in payment to the estate, with the aged care service refunding the lump sum payment on 13 February 2017.

The following table shows the balance of the lump sum payment held at the end of the resident’s care period which is repayable to the executor of the estate.

---

\textsuperscript{20} The average accommodation bond agreed with a new resident in 2013-14 was $296,404, 2013-14 ROACA p55
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lump sum payment</td>
<td>$294,400.00</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Written agreement for drawdowns made between 1 July 2014 and 31 December 2016</td>
<td>- $46,400.00</td>
</tr>
<tr>
<td><strong>Balance of lump sum contribution refundable</strong></td>
<td><strong>$250,000.00</strong></td>
</tr>
</tbody>
</table>

The following table shows the total funds, including the lump sum contribution which is repayable to the executor of the estate.

<table>
<thead>
<tr>
<th>Description</th>
<th>Applicable dates</th>
<th>Amount applied to</th>
<th>Term</th>
<th>Rate</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance of lump sum contribution refundable</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$250,000.00</td>
</tr>
</tbody>
</table>
| Base interest rate amount                        | 1 Jan 2017 to 8 Feb 2017 | $250,000 | 39 days | 3.75% | $1,001.71  
| Maximum permissible interest rate amount         | 9 Feb 2017 to 13 Feb 2017 | $250,000 | 5 days  | 5.76% | $196.72   |
| **Total amount repayable**                       |                  |                   |       |       | **$251,198.43** |

21 The interest of $1,001.71 calculated at the BIR is $534.24 higher than if the interest was calculated using the BTR of 1.75%.

22 The MPIR applying between 1 January 2017 and 31 March 2017 was 5.76 per cent.
Appendix C - A comparison of interest rates

The amount of interest payable on a lump sum payment of $250,000 using the different rates applicable and for different timeframes is set out in the following table.

<table>
<thead>
<tr>
<th>Time</th>
<th>Option 1</th>
<th>Option 2</th>
<th>Option 3</th>
<th>Option 4</th>
<th>Option 5</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Base Interest Rate</td>
<td>Above Threshold Rate</td>
<td>Below Threshold Rate plus 1 per cent</td>
<td>RBA Retail Rate (all terms)</td>
<td>Below Threshold Rate</td>
</tr>
<tr>
<td></td>
<td>3.75%</td>
<td>3.25%</td>
<td>2.75%</td>
<td>2.05%</td>
<td>1.75%</td>
</tr>
<tr>
<td>per day</td>
<td>$25.68</td>
<td>$22.26</td>
<td>$18.84</td>
<td>$14.04</td>
<td>$11.99</td>
</tr>
<tr>
<td>21 days</td>
<td>$539.38</td>
<td>$467.47</td>
<td>$395.55</td>
<td>$294.86</td>
<td>$251.71</td>
</tr>
<tr>
<td>30 days</td>
<td>$770.55</td>
<td>$667.81</td>
<td>$565.07</td>
<td>$421.23</td>
<td>$359.59</td>
</tr>
<tr>
<td>60 days</td>
<td>$1,541.10</td>
<td>$1,335.62</td>
<td>$1,130.14</td>
<td>$842.47</td>
<td>$719.18</td>
</tr>
<tr>
<td>90 days</td>
<td>$2,311.64</td>
<td>$2,003.42</td>
<td>$1,695.21</td>
<td>$1,263.70</td>
<td>$1,078.76</td>
</tr>
<tr>
<td>120 days</td>
<td>$3,082.19</td>
<td>$2,671.23</td>
<td>$2,260.27</td>
<td>$1,684.93</td>
<td>$1,438.36</td>
</tr>
<tr>
<td>180 days</td>
<td>$4,623.29</td>
<td>$4,006.85</td>
<td>$3,390.41</td>
<td>$2,257.40</td>
<td>$2,157.54</td>
</tr>
<tr>
<td>per annum</td>
<td>$9,375.00</td>
<td>$8,125.00</td>
<td>$6,875.00</td>
<td>$5,125.00</td>
<td>$4,375.00</td>
</tr>
</tbody>
</table>
Appendix D – Probate

Following the death of a person, arrangements need to be made to manage the affairs of the deceased. This can involve collecting the assets of the estate, paying any outstanding liabilities, and distributing the estate in accordance with the wishes that are set out in the Will.

The Executor is responsible for applying for a grant of probate, but must first obtain a death certificate, locate a copy of the Will as well as determining the balance of the deceased resident’s assets and liabilities, usually through the location of relevant documents and a process of writing to each institution\(^{23}\). The Executor can then arrange to publish an online notice of their intention to apply for probate or administration of the estate.

Probate is the legal process that occurs when there is a valid Will and an application has been made by the Executor to administer the estate. The Supreme Court in the state in which the resident held assets can issue a grant of probate, enabling the Executor to collect and distribute the assets of the estate, following payment of any liabilities in accordance with the terms of the Will. A grant of letters of administration (where there is no Will or a valid Will cannot be located), or a grant of administration with the Will annexed (where there is no Executor, or the Executor named in is unable to act) can also be applied for.\(^{24}\)

Delays in obtaining a grant of probate can occur for a variety of reasons, with some actions being within the control of the Executor and others such as related party processing times\(^{25}\) that are outside the Executor’s hands.

Additional time may be required to obtain a grant of probate when complications arise including\(^{26}\):

- the deceased owning assets in multiple states or different countries;
- the named Executor is deceased or dies shortly after the death of the resident;
- the named Executor is unwilling or unable to take on the role;
- the Will has not been properly executed or the validity of the Will is questioned;
- a caveat applies (a challenge of proceedings that prevents the relevant state court from issuing a grant of probate for the estate for 6 months or until the caveat is removed); or
- a family provision claim is made within 12 months of the date of death (a challenge made by an eligible person that has been left out of the Will or believes they have not received an appropriate share of the estate).\(^{27}\)

\(^{23}\) Rest Assured: A legal guide to wills, estates and funerals – R Long and T Coffey Aug 2016
\(^{24}\) Supreme Court of NSW factsheet – Applying for a grant of administration, Applying for a grant of administration with the Will annexed
\(^{25}\) For example, processing times of the courts, banks, solicitors, registry of births, deaths and marriages
\(^{26}\) Supreme Court of NSW factsheets – ibid
Appendix D – List of submissions received

<table>
<thead>
<tr>
<th>Base Interest Rate Submissions Received</th>
<th>Preferred Option Highlighted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aged and Community Services Australia</td>
<td>The Below Threshold Rate, as a starting point for consultation with the sector</td>
</tr>
<tr>
<td>COTA Australia</td>
<td>No change from the existing rate</td>
</tr>
<tr>
<td>Catholic Healthcare</td>
<td>The Below Threshold Rate (removal of the additional interest penalty)</td>
</tr>
<tr>
<td>Leading Aged Services Australia</td>
<td>A flexible (crawling peg) BIR based on a referenced market based interest rate</td>
</tr>
<tr>
<td>The Aged Care Guild</td>
<td>A market rate such as the RBA retail deposit rate</td>
</tr>
<tr>
<td>Uniting Care (NSW – ACT)</td>
<td>The Below Threshold Rate</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Option 1</th>
<th>Option 2</th>
<th>Option 3</th>
<th>Option 4</th>
<th>Option 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retaining the Base Interest Rate</td>
<td>Above Threshold Rate</td>
<td>Below Threshold Rate plus 1 per cent</td>
<td>RBA Retail Rate (all terms)</td>
<td>Below Threshold Rate</td>
</tr>
<tr>
<td>Applicable interest rate</td>
<td>3.75%</td>
<td>3.25%</td>
<td>2.75%</td>
<td>2.05%</td>
</tr>
<tr>
<td>Difference from the BIR (3.75%)</td>
<td>0%</td>
<td>-0.5%</td>
<td>-1.0%</td>
<td>-1.7%</td>
</tr>
<tr>
<td>Difference from the RBA Retail Deposit Rate (2.05%)</td>
<td>1.7%</td>
<td>1.2%</td>
<td>0.7%</td>
<td>0%</td>
</tr>
</tbody>
</table>