How do you finance development without RADs?

2 October 2025

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Take pride in your success

Bruce Bailey
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Residential aged care is uninvestible

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Australia

We have population growth, good sales and high levels of occupancy across the shopping centre industry. But very little development as the costs do not currently allow for an attractive initial yield.

The aging population presents a powerful investment theme

US and Canada

Demand is running at 4% growth, supply growing at 1%. Such a clear mismatch between demand and supply, means occupancies and rents are surging.

Why is supply muted?

The average cost increase for a new senior housing facility in Toronto at 50%. Banks and other financiers require substantially higher yield on the higher which means rents have to rise a further 20-30% to justify new development.

What it takes to be investible

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REIT measures of Investability	Definition	Normal metric
FFO Funds From Operations	Measures of cash flow from operations (includes ongoing capex)	$
NOI Net Operating Income	Property-level income before debt and capital costs	$
WACR Weighted Average Capitalisation Rate	Rent divided by value of the asset	5.31%
Debt-to-EBITDA	Measure of a REIT's financial health and dividend capacity	< 6* 2/3 equity 1/3 debt
Payout Ratio	% of FFO paid as dividends	> 90% of NOI
Leasing Spread	The difference between old and new tenancy rates	3%
Rent escalation	The Y-on-Y increase in rent	4.5%

RAD verses Debt

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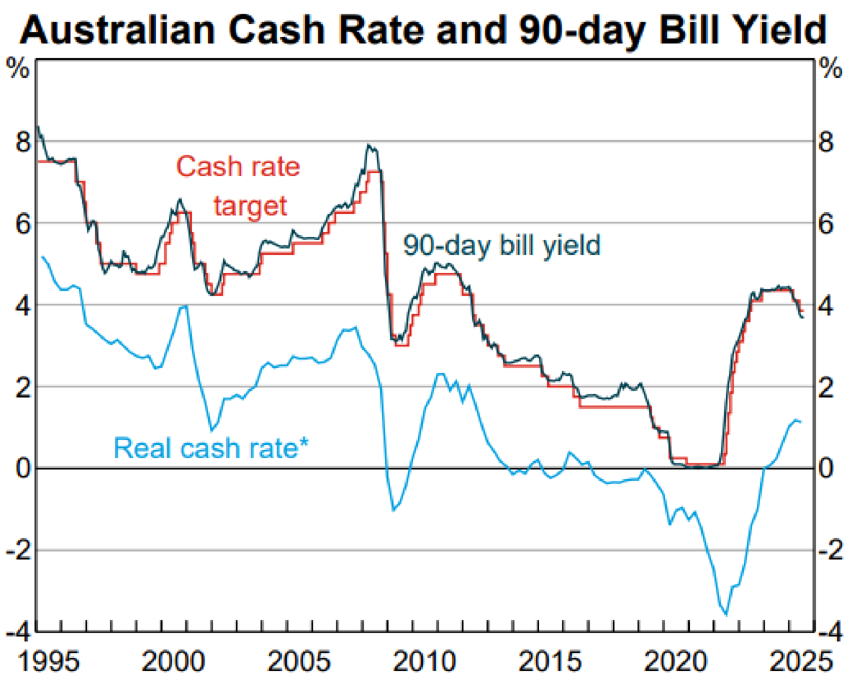
Bank borrowing rates
Bill rate plus 2 - 2.5%

MPIR
90 Day rate plus 7% minus 3%
= 90-day rate plus 4%

$10M of RAD reduces:
NOI by $765,000
FFO by $Nil (2% retention creates equivalence)



* Calculated using average of year-ended weighted median inflation and year-ended trimmed mean inflation.

Sources: ABS; AFMA; ASX; RBA.

Difference between MPIR and Bank lending is 1.75% - 2%

RAD retention is 2%

Was this the agenda in the RAD retention policy?

The invisible cross subsidy in accommodation

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Accommodation supplement	RAD equivalent (7.61%)	Supported development cost @ 7%	Current cost of development	Shortfall/Cross subsidy from self funded	Supplement required
> 40% $70.94	$340,250	$369,900	$500,000	$130,100	$95.83
< 40% $53.21	$255,212	$277,500	$500,000	$222,500	$95.83

A self funded resident is paying an extra $130,000 to $222,500 in RAD to cover the shortfall in government funding of the accommodation supplement – **equity goes both ways!**

Takeaway:

The 40% hurdle does not make sense in an investible model of residential aged care.

What investment yield is required

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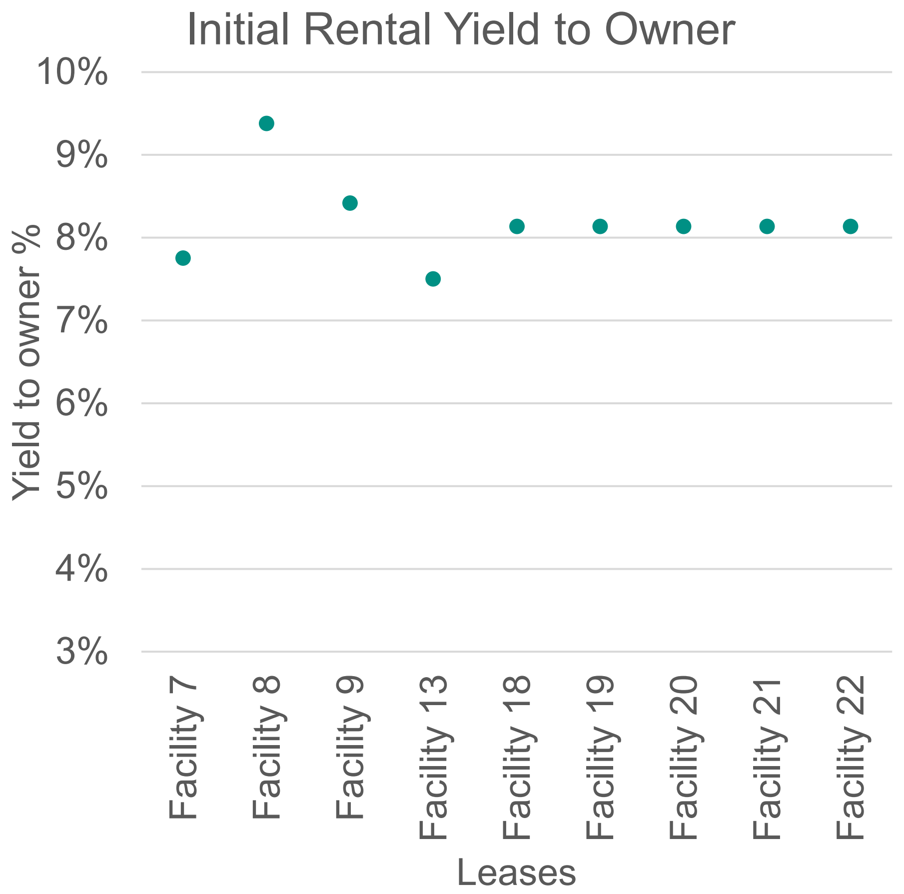
Westfield destinations 2024 annual report

Developments have a target yield of 6% to 7%

Some real Propco yields RAD/DAP 7% - 8%

Current supplement regime requires more than this

Recent transaction supported by us



Measuring the right things

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Stewart Brown benchmarks

Administration cost is:

35.4% of accommodation revenue (rent)

16.5% of revenue with imputed DAP

Industry benchmark is 4% - 7% of revenue

Takeaway:

We need a robust assessment of accommodation performance.

Case Study existing facility with an extension

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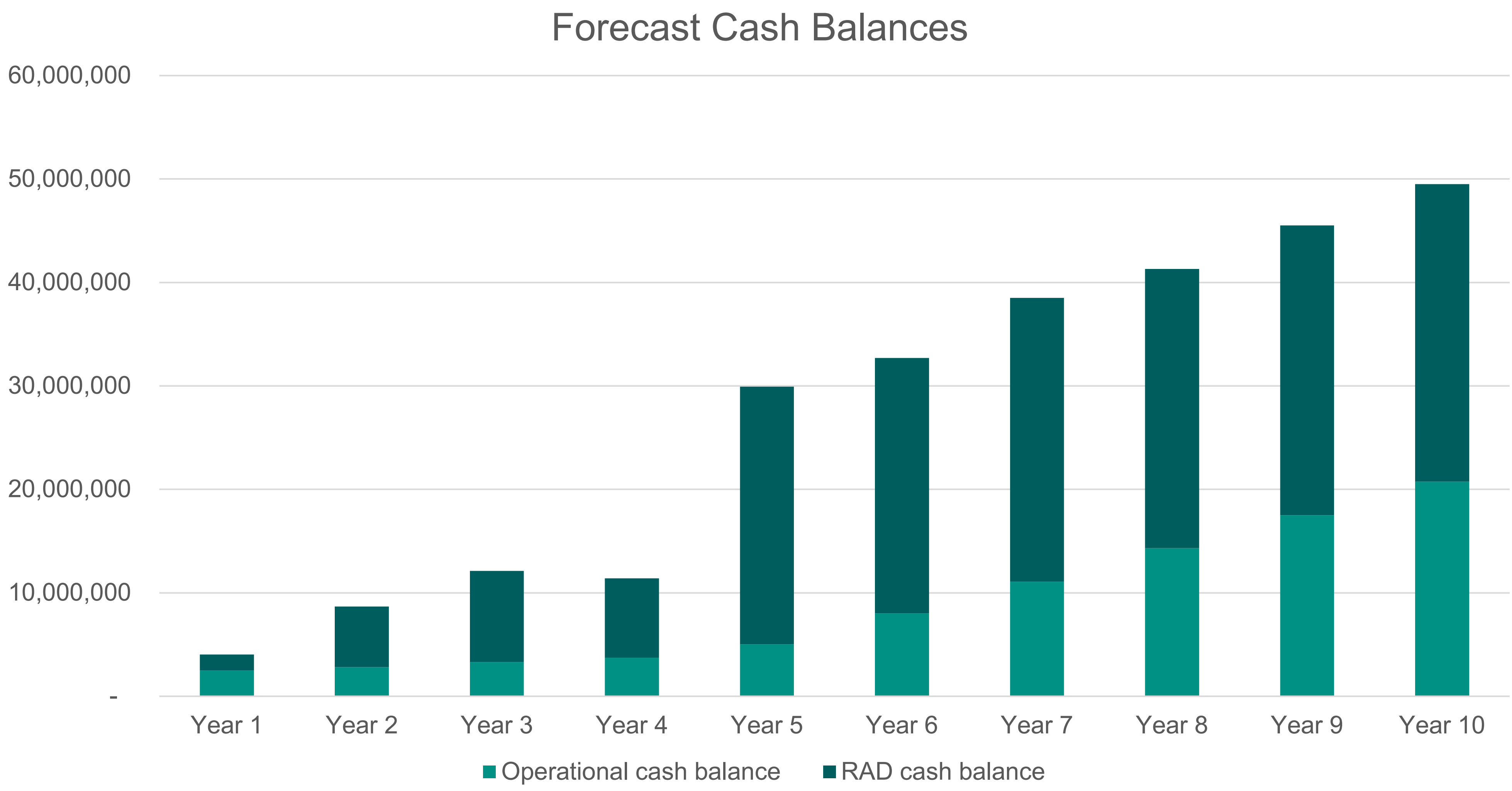

The upside of RAD

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1. Hassle free finance to providers

2. Potentially inflates values of facilities

3. Risk free capital – Bond guarantee scheme

The downside of RAD

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1. Reduces profitability - Provider borrows at 7.61% and invest at 4% - cost 3.61% (less 2%)
2. RAD growth amplifies the economic cost/discourages increasing prices
3. Permitted Use means excess RAD has limited utilisation
4. RAD is nominally more expensive than traditional debt
5. Complicates decision processes for stressed consumers
6. Paying RAD exposes residents to – CGT, higher means tested fees, increased stress
7. Reduces providers’ capacity to manage balance sheet/optimise returns make Resicare Investible
8. Potentially inflates values of assets
9. Increases risk to Government
10. Distorts the market

Making RACF investible

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To make RACF investible requires	
A commercial supplement – Government	✗
FFO of 7% of capital cost – assuming $0 RAD – manage CAPEX	✓
RAD with retention equivalent to bank debt	✓
Allow for ongoing capex (FFO)	✓ ✗
Allow for periodic refurbishment	✓ ✗
Use RAD and Debt to increase the return to investors ROI/IRR	✓ ✗
Eliminate excess RAD to create capital efficiency and boost EBITDA	✗
Actively manage accommodation pricing (DAP spread and DAP escalation)	✓ ✗

Takeaways

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1. If you don’t need RAD, stop asking for it
2. Implement a robust accommodation pricing strategy that aligns with Investability
3. Be commercial
4. Implement an asset management plan
5. Maintain the quality of your assets

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