Technical Update – Aged Care

What to do with the family home when entering aged care?

By Mark Teale, AAP Technical Manager – Retirement Strategies and Solutions on 28th April 2016

This is a crucial question for those people about to enter residential aged care, especially in light of the change to the treatment of the rental income for new aged care residents after 1 January 2016. With the median price of homes in Sydney now around the $1 million mark, many people looking to enter aged care will be faced with a difficult choice on what to do with the family home. Many of these homes were built over 50 years ago, and are in varying states of repair. Often they are still occupied by the original owner/s and based on demographics, this will quite likely be an elderly widow in her mid to late 80's.

For a significant number of these people, as they age further, are widowed, and their health declines, they will need to enter residential aged care – often a highly daunting prospect for them, and their families. On top of the emotional issues, further changes to the legislation that took effect on 1 January 2016, have added to the complexities. For new aged care residents, this change will see any rental income from their recently vacated home now being included in their resident's income for the purpose of calculating their Means Tested Care Fee. For those people who entered residential aged care before to 1 January 2016 and whose former home has been retained and rented out to help pay a Daily Accommodation Payment, the rent will continue to be exempt.

This situation then raises an interesting question. When it comes to entering aged care, is the strategy of partially paying the Refundable Accommodation Deposit (RAD) and renting the former home, still viable? I would suggest that for many widowed age pensioners living in a million dollar home in Sydney or elsewhere, the answer may well be yes.

Take the following scenario:

Moira is a widowed lady aged 85, has $135,000 in cash and term deposits, $5,000 in personal effects, her home is valued at $1 million, and she is in receipt of a full age pension. Moira's family become concerned that she is no longer able to look after herself and needs to enter residential aged care. An Aged Care Assessment Team (ACAT) assessment is completed, and a suitable aged care home is located which requires a RAD of $350,000. The first reaction for a lot of families is to sell the home and pay the RAD of $350,000. Moira's position after the sale of her home and payment of the RAD is as follows:

Cash & term deposits	$785,000
Personal effects	$ 5,000
Total	**$790,000**

For the purposes of her age pension, Moira's assets total $790,000. She is now classified as a non-homeowner, and her age pension is reduced to $210 per fortnight, or $5,460 per annum. If her asset position does not change, she will lose her age pension entitlement on 1 January 2017 as a result of the upcoming change in the assets test. Her assets, for aged care purposes, total $1,140,000 because the RAD of $350,000 is included. Her aged care fees are:

Basic daily fee	$47.86
Means tested care fee	$52.73
Total	**$100.59 per day ($36,715 pa)**

Moira's annual income, based on an age pension of $5,460, and interest of 3% on the cash, would be $29,010. This represents a cash-flow shortfall of $7,705 per annum. This is not a lot when you have $785,000 in the bank, but nevertheless, it is still must be drawn down from her bank account or funded by her family. So, let's look at what happens if the family do not follow their first reaction and instead of selling the family home, they rent it out and partially pay the RAD?

The RAD is $350,000, and they decide to pay $100,000, the balance being paid as a Daily Accommodation Payment (DAP). If we assume the home is rented, after expenses the annual net rent is $31,200 per annum. As far as her aged care fees are concerned, the net rent of $600 per week will be taken into account. More importantly, the value of the home remains capped at $157,987.20 as at 1 January 2016. Based on her changed circumstances the Means Tested Care Fee is $41.76 per day or $15,242 per annum. The aged care fees now look like this:

Basic daily fee	$47.86
Daily accommodation payment	$42.60 ($250,000 x 6.22% ÷ 365)
Means tested care fee	$41.76
Total	**$132.22 per day ($48,260 pa)**

While her aged care fees have increased, Moira's income also has increased significantly now that she is receiving rent from her former home. For age pension purposes the value of her home, and the rent she receives, are both exempt from the income and the assets test. The changes to aged care legislation which took effect from 1 January 2016 did not change this. As a result, she will retain her full age pension of $867.00 per fortnight ($22,542 per annum). The total fees payable in this scenario, including the basic daily fee, the means tested care fees and the daily accommodation payment, equal $48,260 per annum.

However, her total income from the age pension and the net rent has increased to $53,742 per annum, providing her with surplus income of $5,181 per annum. Given the level of income Moira is now receiving, she will go very close to having to pay income tax. However the current Medical Expense Tax Offset, which takes into account aged care fees and the Low Income Tax Offset, are sufficient to reduce her tax liability to zero. She may also have to pay capital gains tax on the eventual sale of her home. However, if the home was purchased prior to September 1985, which is often the case in these situations, capital gains tax will not be an issue. It should be noted that the Medical Expense Tax Offset is due to cease from 1 July 2019.

So, in conclusion, despite the recent aged care legislative change that removes the exemption of the rental income from the calculation of aged care fees, it may still prove worthwhile to consider the home retention strategy in the future, especially for those age pensioners whose homes are valued at close to $1 million. To find the optimal financial outcome, you have to 'do the numbers'. Obviously, there is a lot to weigh up in these situations and not just financial. The following table points out some of the advantages and disadvantages associated with the home retention strategy, which I have not discussed but should also be considered.

Retaining the family home when entering aged care

Advantages	Disadvantages
Age pension not affected, provided part of accommodation fees are paid periodically. Home is retained – • sentimental reasons • level of comfort for person entering aged care that the home is still there if they decide to return • future capital growth and/or redevelopment potential • family inheritance Value of home capped for means tested care purposes Outgoings tax deductible May qualify for principal residence exemption on sale (six years). Defers costs of marketing and selling the property.	• Costs to make home ready to rent • Ongoing repairs and maintenance • Rent may give rise to income tax liability • Time and commitment to manage a rental property • Loss of rent if home is unoccupied • Capital gains tax liability on sale, unless pre-Sept 1985.

In their Mid-Year Economic and Fiscal Year Outlook 2015 – 2016, the Government proposed that, from 1 January 2017, net rental income earned on the former principal residence of new entrants into residential aged care, be treated the same way under the pension income test as it is under the aged care means test, regardless of how the resident chooses to pay their accommodation costs (either through a full or partial lump sum or periodic payment). The current exemption of the former principal residence from the pension assets test, where the property is rented and aged care accommodation costs are paid on a periodic basis, will also be removed. This is only proposed at this stage however if the legislation does change then new entrants post 1/1/2017 will require a rethink on the strategies mentioned in this paper.