How massive rate hikes have made aged care less affordable

When people enter aged care they have a choice: they can either pay for their room up-front by way of a Refundable Accommodation Deposit (RAD, formerly known as a bond) or they can part-pay the RAD (or not pay it at all) and, instead, pay interest on the outstanding RAD via what's known as a Daily Accommodation Payment (DAP).

The RAD is a government-guaranteed lump-sum payment that can range from as low as $200,000 to more than $2 million. The RAD is refunded when the resident dies or leaves the facility.

DAPs are not refundable.

The interest rate that applies to the DAP is set by the government based upon the movement in the 90-day Bank Accepted Bill rate and is reviewed every three months.

On July 1 this year the DAP interest rate jumped from 8.34% to 8.36%. This means that for an outstanding $1 million RAD, the annual DAP payment is now $83,600.

Two years ago, the DAP interest rate was 4%, so payment on an outstanding RAD of $1 million was $40,000.

DAPs, like many things in today's economy, have more than doubled in two years.

Why is the DAP so high?

Higher DAPs benefit aged-care facilities, whose fees to residents are capped.

Half of Australia's aged-care facilities are running at a loss, and normal cost-of-living overheads for them are rising.

The result is that many aged-care facilities are being squeezed. Australia needs aged-care facilities to be healthy and profitable, so they continue to offer rooms to Australians in need.

How big is the aged care industry?

As Australians live longer, more and more of us will end up in aged care.

The number of people in permanent aged care in Australia is expected to nearly triple in the next 30 years, from 250,000 today to 700,000 in 2050.

Should people pay a RAD or a DAP?

Two years ago, when DAP interest rates were 4%, many people entering aged care chose to pay the DAP. Many were happy to pay a $40,000 annual payment rather than find $1 million for a room.

This is an easy decision to make when your investments - shares, property, even fixed interest investments - are earning more than 4%. Under these circumstances, selling investments to pay a RAD didn't make commercial sense.

Today it is not so easy.

Not many people earn more than 8.36% on their investments, so it makes more sense today for many to sell investments/property/shares, or to cash in their term deposits, to pay the RAD in full.

What about selling the family home?

The biggest asset for most people is their house and many will think that selling a house to pay for a RAD is the smart thing to do. However, selling a house has implications for pensions.

Under today's rules, a person's home is exempt when assessing a pension, whereas cash is not.

If a person sells a house for $2 million to pay a RAD of $1 million, they will have $1 million cash left over. This cash could well negatively affect their pension.

How might selling the family home impact the means-tested fee?

One of the many monthly fees that people may be required to pay in aged care is the means-tested fee, which is set by the government and collected by the aged care facility based on an assessment of each resident.

It is an attempt by the government to ask residents with the financial capacity to contribute to the cost of care.

This fee can range from nothing to a maximum $416 per day, capped at $33,309 per annum or $79,942 over a lifetime (just over two years of payments).

Selling a home will have implications for the means-tested fee; home values are capped at $200k for the means-tested fee. If you sell your home and have money left over your means-tested fee could increase.

The importance of financial modeling

Everyone's financial circumstances are different.

Because DAPs are now so expensive, the importance of modelling for an individual's circumstances has become more important.

An advisor will look at all scenarios, taking into account many aspects

including pensions and their impact on the means-tested fee.

This is a complicated area, with large amounts of money at stake. It is not a DIY exercise.

Some examples

- If a resident has $300,000 in the bank earning, say 4%, those funds clearly should be used to pay a RAD. Foregoing interest of 4% to avoid paying at a rate of 8.36% is an easy decision to make.
- For a resident who has a family home that they or their family wishes to keep, and they have sufficient income and savings, they may prefer to pay a DAP, which would allow them to keep the family home.
- If a resident has a share portfolio or other financial investments that generate an annual income of, say 6%, they may be happy to sell those investments and pay the RAD, but they need to take into account potential capital gains tax from disposing of the investments.
- If a resident's income provides sufficient cash flow to cover the various aged care-fees, then DAPs can be a better option (for instance, they may have a healthy defined benefit superannuation pension if they had a long career with one employer).

Of course, residents can change their minds as time passes.

If the resident has not paid the full RAD up front and decides they would like to pay more, they can top it up at any time and the DAP will be adjusted downwards.

Conversely, if they have paid a RAD and cash flow gets tight, they can elect to have some or all of the monthly fees deducted from the RAD lump sum.

Source:

https://www.moneymag.com.au/how-massive-rate-hikes-have-made-aged-care-less-affordable

https://www.moneymag.com.au/tough-conversations-christmas-estate-planning

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