HEART Financial Advisers

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What to consider when paying for a nursing home

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BY ANAM BILGRAMI

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Moving yourself or a loved one to a nursing home can be emotional and difficult. While some have their nursing home accommodation costs fully covered by the government (based on a means test), most will have to pay their own way.

The average lump sum room value is A$334,000. Choosing how to pay can make this time even more challenging, particularly for those with low financial literacy.

This is an important and complex decision. It can affect your income, wealth, means-tested aged care fee, and bequests. Here are some things to consider before you decide.

BEFORE YOU GET STARTED

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“One advantage of choosing a lump sum is it’s considered an exempt asset for pension purposes; some people may get more pension if they pay the lump sum.”

Three ways to pay

You can pay for a nursing home room in three ways.

You can pay the entire room price as a one-off, refundable lump sum (a “refundable accommodation deposit”, sometimes shortened to RAD). This lump sum is refunded to the resident or their estate when the person leaves the nursing home (if they move or pass away).

The refund is guaranteed by the government, even if a provider goes bankrupt.

People who don’t want to pay a lump sum can instead choose rent-style, “daily accommodation payments” (sometimes shortened to DAP).

These are fixed, daily interest-only payments calculated on the total room price. The rate at which they are calculated is known as the “maximum permissible interest rate” or MPIR.

The maximum permissible interest rate is set by the government and is currently 7.9% per annum. The formula for a daily accommodation payment is (RAD × MPIR) ÷ 365.

Unlike lump sums, daily accommodation payments are not refunded.

The third option is a combination payment. This means paying part of the room price as a lump sum, with daily payments calculated on the remaining room amount. On leaving the home, the part lump sum is refunded to the resident or their estate.

With a combination payment, the consumer can choose to pay whatever amount they like for the lump sum.

The table below shows three different ways someone could pay for a room priced at $400,000.

Three different ways to pay for a nursing home room priced at $400,000

	Option A: Full lump sum payment	Option B: Daily payments	Option C: Combination payment
Lump-sum paid on entry:	$400,000	$0	$100,000 (a)
Daily amount paid over the stay (b):	$0	$86.58 per day	$64.93 per day
Refund received on leaving the home:	$400,000	$0	$100,000

Notes: a). A $100,000 part lump sum payment is only given as an example. Any lump sum amount is possible when choosing a combination payment. b). Daily payments are calculated using the current MPIR (7.9% per annum) applied to the owing lump-sum. For Option B, the daily payment is calculated as ($400,000 x 7.9%) ÷ 365 = $86.58 per day. For Option C, the daily payment is calculated as ($300,000 x 7.9%) ÷ 365 = $64.93 per day.

Table: The Conversation • Created with Datawrapper

So which is best? It’s impossible to say. It depends on a person’s circumstances, family situation, finances, preferences and expected length of stay.

Why do some people choose a lump sum?

One downside of a lump sum (or part lump sum) is that choosing this option means this money is not invested elsewhere.

By handing over the lump sum, for example, you forgo returns you could have made by investing this same money into property or stocks over the period of your nursing home stay.

On the other hand, paying lump sum means you get to avoid the daily interest payments (the 7.9% in the table above).

So you could potentially be better off paying a lump sum if you think there’s no way you could make investment returns on that money that are substantially higher than the interest you’d be charged through daily payments.

One advantage of choosing a lump sum is it’s considered an exempt asset for pension purposes; some people may get more pension if they pay the lump sum.

The lump sum, however, does count as an asset in determining the means-tested care fee.

And if you sell your house, remember any money leftover after you pay the lump sum will be counted as assets when you’re means-tested for the pension and means-tested care fee.

Why might some people prefer daily payments?

Not everyone can can afford a lump sum. Some may not want to sell their home to pay one. Some may want to hold onto their house if they think property prices may increase in the future.

Daily payments have recently overtaken lump sums as the most popular payment option, with 43% of people paying this way. However, recent interest rate rises may slow or reverse this trend.

And if a spouse or “protected person” – such as a dependant or relative that meets certain criteria – is still living in the house, it’s also exempt from assets tests for the pension and other aged care fees.

If the home is vacated by a protected person, its value is still excluded from the pension means test for two years (although rental income is still assessed).

"The recent Royal Commission into Aged Care recommended phasing out lump sums as a payment option, leaving only daily payments. While that would reduce the complexity of the payment decision and remove the incentive for providers to sway decisions, it would also reduce consumer choice."

If you do not anticipate a lengthy nursing home stay, daily payments may potentially be the easiest option. But it's best to consult a financial adviser.

What does the research say?

My research with colleagues found many people choose the lump sum option simply because they can afford to.

Those owning residential property are more likely to pay a lump sum, mostly because they can sell a house to get the money.

People who consult financial advisers are also more likely to choose lump sums. This may be due to financial advice suggesting it's tough to earn investment returns higher than what you'd save by avoiding the interest charged in the daily payment option.

Some aged care providers prefer lump sum payment since they use these to renovate or refurbish their facilities. But providers are not allowed to influence or control your decision on how to pay.

The recent Royal Commission into Aged Care recommended phasing out lump sums as a payment option, leaving only daily payments. While that would reduce the complexity of the payment decision and remove the incentive for providers to sway decisions, it would also reduce consumer choice.

Is there anything else I should know?

Some 60% of people we surveyed found the decision complex, while 54% said it was stressful.

It is best to seek professional financial advice before you decide.

Services Australia also runs a free Financial Information Service that can help you better understand your finances and the payment decision. But it does not give financial advice or prepare plans.

You have 28 days to choose a payment method after admission, and six months to pay if you choose a lump-sum payment.

In the interim, you will be charged daily interest payments on the room price.

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Firstlinks (formerly Cuffelinks) is a publishing service providing content written by financial market professionals with experience in wealth management, superannuation, banking, academia and financial advice.

Oliver's Insights – recessions versus Goldilocks

BY SHANE OLIVER
Republished from amp.com.au

Key points

- Rapid monetary tightening points to a high risk of recession and, given lags in the way it impacts the economy, just because it hasn't happened yet does not mean it won't.
- However, a combination of falling inflation, a lack of excesses beyond inflation, excess household saving, the possibility of rolling sectoral recessions & strong population growth (in Australia) mean we could still avoid recession.
- We remain of the view that shares will do well on a 12-month horizon, but the risks around recession and higher bond yields mean that the risk of a correction is high.

Introduction

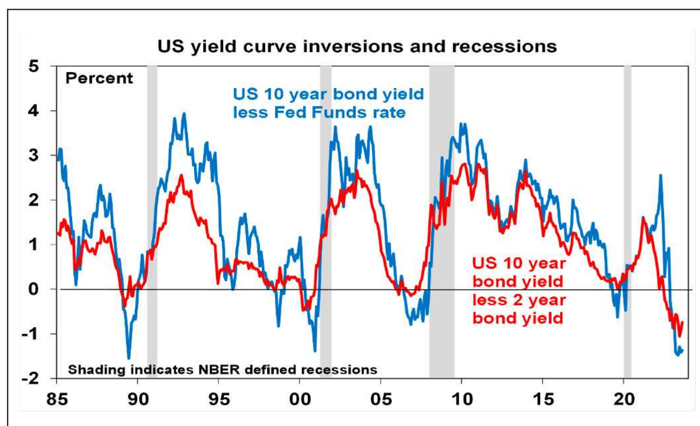
Over the last 18 months there has been much talk of recession globally and more recently in Australia. But, despite mild technical recessions (ie, two consecutive quarters of falling GDP in a row) in the US and Europe in the last 18 months, growth has generally been more resilient than expected and now with inflation falling many have started to give up on recession with increasing talk of Goldilocks (ie, where growth is okay and inflation is falling). So, have we dodged the recession bullet?

The case for a recession

The basic argument is that the most rapid monetary tightening in major countries in decades and cost-of-living pressures have set the scene for recession. This is supported by various signs that precede recessions:

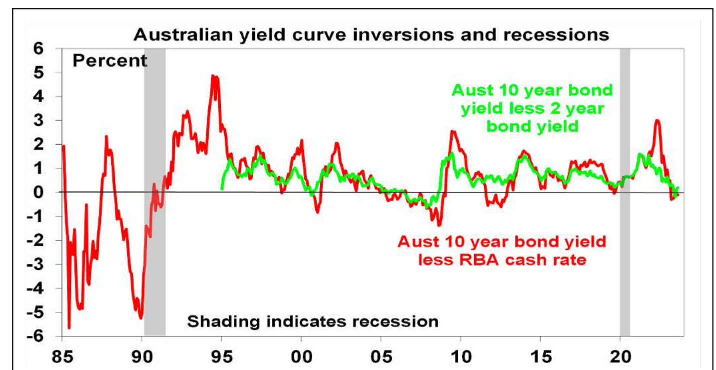
Monetary conditions as measured by bank lending standards have tightened significantly and this normally leads to a collapse in lending. And in Australia a record level of household debt servicing costs to - income add to the local risk of recession which we put at 50%.

- The US yield curve started to invert, with short term interest rates rising above long-term rates, last year. And this has preceded all US recessions over the last 60 years.



Source: Bloomberg, AMP

- More positively though US yield curve inversions have given false signals in the past, eg, in 1998.
- Inverted yields curves have been a poor indicator of recession since 1991 in Australia and right now it's not decisively inverted anyway.



Source: Bloomberg, AMP

- Leading economic indexes – which combine things like building permits and confidence – are at levels that often precede recession.
- Monetary conditions as measured by bank lending standards have tightened significantly and this normally leads to a collapse in lending.And in Australia a record level of household debt servicing costs to - income add to the local risk of recession which we put at 50%. But after "predicting" 4 of the last two recessions in Australia - one of which was the pandemic recession which flowed from lockdowns so shouldn't really count - and seeing lots of incorrect forecasts of global doom over the years, I am all too aware of recession calls turning out to be wrong. Which partly explains my reluctance to go beyond 50/50 at present for Australia.

Can recession be avoided?

The first point to note is things like yield curves and leading indicators can get it wrong in forecasting recession. Yield curves have several issues:

- The lag from yield curve inversion in the US can be 18 months. Various versions of it first inverted between July last year and January this year. So given normal lags it may not eventuate until next year.

There are in fact several ways a recession might still be averted.

First, inflation could fall fast taking pressure off rates

This could occur in several ways: easing goods supply pressures and transport costs could continue to reduce goods inflation; falling job vacancies and an easing in reopening demand could take pressure off wages growth and services inflation; and a productivity surge as Artificial Intelligence is deployed in services industries could do the same. In other words, today's low unemployment levels could turn out to be consistent with "full employment" and only a marginal cooling in demand may be necessary to return labour and product markets to balance. And so central banks may soon be able to move towards lowering interest rates.

Recently the news on this has been good. US inflation has fallen from a peak of 9%yoy to 3% and Australian inflation has fallen from 8% yoy to 6%. And this has occurred without a rise in unemployment. Our US and Australian Pipeline Inflation Indicators continue to point down. However, there are several reasons to be cautious here.

- First, services price inflation may prove a bit sticky as in some countries wages growth is still picking up. This is clearly a risk in Australia with a faster rise in minimum

> **Recessions are normally preceded by imbalances that are unwound and lead to a sharp fall in economic activity. For example, in the US prior to the tech wreck there was an investment boom and prior to the GFC there was a boom in home building.**

and award wages this year resulting in a renewed surge in labour costs in the latest NAB survey.

- Second, AI will take years to enhance productivity growth.
- Third, it assumes that central banks can fine tune the economic cycle - the RBA has done this well in the post 1991 period but the Fed not so well. This is made hard by lags in the way monetary policy impacts the economy which risks central banks raising rates too much. Having lost credibility last year in assuming inflation was "transitory", central banks are likely to err on the side of caution to make sure the inflation dragon is back in its cave before easing up. And of course, this time around RBA tightening has been faster than at any time since the 1980s and the household debt/income ratio is 3 times higher now.

But fortunately, there are also other ways recession may be avoided.

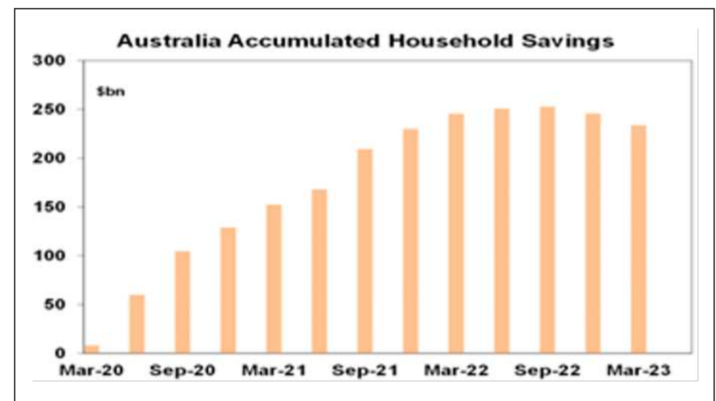
Second, there is a lack of excess to unwind

Recessions are normally preceded by imbalances that are unwound and lead to a sharp fall in economic activity. For example, in the US prior to the tech wreck there was an investment boom and prior to the GFC there was a boom in home building. However, this time around beyond the problem with inflation there are little in the way of similar excesses: there has been no business investment boom; there has been no home building boom and housing vacancy rates are low; household debt has fallen from its pre-GFC high; and inventory to sales ratios are low. So given the absence of excess, recession may be avoided or if not it's likely to be mild.

It's similar in Australia with the exception that household debt to income ratios are nearly double US levels leaving the Australian household sector as an obvious increased source of recession risk here – particularly with household debt servicing costs now pushing around record levels.

Third, households still have pandemic savings buffers

Through the pandemic people were constrained from spending but most still received an income. The result was that household saving rates rose above normal levels resulting in excess saving. See the next chart. In Australia it has been run down but remains high at around $230bn. My concern has been and remains that it is not distributed equally and that for many younger (25-45 year old) households with high debt levels it has been rundown such that it's no longer of any support in the face of the surge in interest payments. And for older households they are unlikely to use much of it for spending anyway. Nevertheless, at an average level it is a source of support that wasn't around prior to past downturns.



Source: ABS, AMP

Fourth, we could have rolling sectoral recessions

Different sectors of the economy are impacted at different times by shocks like tighter monetary policy. So various sectors of the economy may have "recessions" but at different times such that the overall economy never actually contracts. Something like this happened through the 1990s and 2000s to varying degrees providing support for the view that the environment back then was characterised by micro instability but overall macro stability and hence milder economic cycles.

In the US, in this cycle home building and technology, and more recently manufacturing, have arguably already had recessions but they are now starting to find a floor so if consumer spending on services turns down it may be offset by an improvement in home building, technology and manufacturing. Similarly in Australia, home building and retailing have been in recession for a while and conceivably could start to recover as consumer spending on services top out.

> We remain of the view that shares will do well on a 12-month view, but the risks around recession and higher bond yields mean that share market volatility will remain high with a high risk of a correction.

So far so good but the risk is high that currently weaker sectors don't recover in time to offset weakness in lagging sectors like services.

Finally, strong population growth may mask recession

Strong population growth boosts demand and hence GDP growth and could enable a recession as defined as a fall in GDP to be avoided. In this regard it's notable that while both the Australian Government and RBA are forecasting positive GDP growth this financial year on a year average basis at 1.5% and 1% respectively, this is expected to be below the rate of population growth at around 1.7% or more which means that both are forecasting a per capita (or per person) recession, but this is masked by strong population growth. Of course, what matters for living standards is per capita GDP growth but arguably for investors overall growth is more important as this is what will drive company profits.

Bottom line

Each of these considerations has qualifications but together they suggest recession can still be avoided. But it's a high risk with the lagged impact of rate hikes still feeding through - particularly in Australia where we put the risk of recession at 50% given the vulnerability of the household sector. Weak growth in China is also adding to the risks of recession.

But what if growth is too strong?

Of course, the flipside is that we get too much of a good thing - growth takes off again before inflation has fallen back to earth. This would be a problem as it would likely mean a further fall in unemployment and so even tighter jobs markets, more upwards pressure on wages growth, higher for longer inflation and central banks keeping interest rates high for longer or even raising them further (to the point where recession comes anyway). This has been concerning investment markets in the last week or two with bond yields rising which has in turn has pressured share markets as higher bond yields make investment in shares look less attractive. This in turn has been made worse by:

- Japan taking another mini step towards removing its ultra easy monetary policy and allowing a further rise in its bond yields which in time may reduce Japanese investment in US/global bonds; and
- Fitch's downgrade of US debt which has refocused attention on US' high public debt and worsening budget deficit.

But while recession could still be avoided, a rebound in global & especially Australian growth seems unlikely until after central banks cut rates.

Implications for investors

We remain of the view that shares will do well on a 12-month view, but the risks around recession and higher bond yields mean that share market volatility will remain high with a high risk of a correction.

Shane Oliver is Head of Investment Strategy and the Chief Economist for AMP. This article is general information only.

How to navigate difficult markets and create long term wealth

BY CAMERON GLEESON

Republished from betashares.com.au

Asset allocators face three key challenges in portfolio construction. Namely, how to:

1. achieve diversification over the market cycle
2. minimise ongoing fees, turnover, transaction costs and tax impacts
3. deliver strong, long-term performance.

Many active managers fail to address these points, pursuing investment strategies that are high conviction or skew to a particular style or risk premia, charging fees that are sometimes many multiples above passively managed funds and/or failing to deliver outperformance.

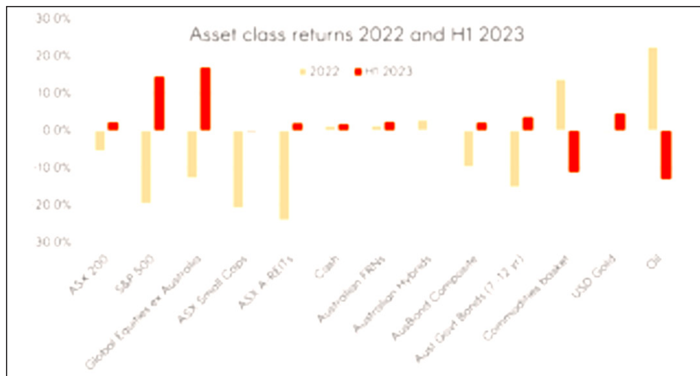
A core portfolio constructed using low-cost index tracking funds, including broad market exposures, together with 'smart-indexing' exposures, has the potential to solve these issues and provide a strong core over the long term.

Building a core portfolio in a world of uncertainty

So far, the economic backdrop for 2023 has looked like a continuation of 2022:

- inflation persistently high despite central bank rate hiking
- leading indicators of activity and sentiment pointing towards elevated recession risk
- yet surprisingly robust "hard" economic data, particularly in the labour market.

Where this year has been very different to the last has been in the turnaround in performance of various asset classes. Among the worst drawdowns in 2022 were in global equities and fixed rate bonds, but so far this year those asset classes have provided some of the highest risk-adjusted returns.



Source: Bloomberg. H1 2023 figures are as at 30 June 2023. Past performance is not an indicator of future performance. 'Global Equities ex Australia' is Solactive GBS Developed Markets ex Australia Large & Mid Cap Index, 'ASX Small Caps' is S&P/ASX Small Ordinaries Index, 'ASX A-REITs' is S&P/ASX 200 A-REIT Index, 'Cash' is Bloomberg AusBond Bank Bill Index, 'Australian Hybrids' is Solactive Australian Hybrid Securities Index, 'AusBond Composite' is Bloomberg AusBond 0+ Yr Index, 'Australian Government Bonds' is Solactive Australian Government 7-12 Year AUD TR Index, 'Commodities Basket' is Bloomberg Commodity Index, 'USD Gold' is XAU Currency Index, and 'Oil' is Bloomberg WTI Crude Oil Subindex Index. You cannot invest directly in an index.

Yet despite these reversals of fortune, significant challenges exist for asset allocators.

- Equity markets remain 'priced for perfection', despite elevated recession risk.
- The recent rally in global equities has largely been driven by an incredibly narrow group of perceived AI 'winners', underwritten primarily by multiple expansion rather than earnings growth.
- As a result, some global exposures, and the US market in particular, appear concentrated, and broad market beta may not offer the diversification it once did.
- Factor or investment style leadership has flipped again, with quality switching from the doghouse to the penthouse.
- Fixed rate bonds are now offering income, but uncertainty on rates has led to continued volatility this year.
- Markets appear to be trending towards a world of shorter, sharper cycles.

So, given the economic outlook and these challenges in markets, how should investors approach portfolio construction?

Key principles for building a robust core portfolio

The core of a portfolio is, by definition, the 'anchor' of any investor's portfolio. We believe the investments used to construct such a core should have the following characteristics:

- Provide diversified exposure to the specific asset class, to help ensure the strategic asset allocation can be achieved across the portfolio as a whole
- Be able to be held for the long run, to reduce turnover and transaction costs, and to avoid the temptation to try to time markets
- Demonstrate compelling 'value', usually reflected in strong, long-term, net-of-fee performance, before and after tax
- Contribute to the overall risk characteristics of the portfolio from a volatility and drawdown perspective.

Selecting the core of your portfolio to best match the asset allocation objectives is likely to result in a more efficient portfolio with desirable risk and return outcomes.

What type of investment strategies can deliver on the requirements above?

Many investors start with a choice between broad market index funds (essentially low-cost broad market beta exposures) and actively managed funds that attempt to outperform their chosen benchmark (such as a broad market index).

Despite the opportunity to generate outperformance in a volatile market from careful security selection, historical evidence shows there have been very few active managers that have actually managed to deliver on that promise of outperformance. It's hard beating the market on a risk-adjusted basis, especially after fees and costs.

It's generally proven to be even harder to do this consistently over long periods of time, amid greater competition among active managers. Active manager alpha or outperformance is overwhelmingly transient. This means that, for an investor using active funds to stay ahead, they need to successfully time switches into the minority of active funds that actually outperform in the subsequent period. Ignoring the challenge of successfully timing manager selection, such an investment process violates a number of key principles of 'core' as outlined above, as it increases turnover and potential performance drag through transaction costs and tax impacts.

For many investors, including at least some allocation to broad market beta within a core portfolio at the lowest possible cost is an effective long-term investment strategy.

Cameron Gleeson is Betashares Senior Investment Strategist. Supporting all Betashares distribution channels, assisting clients with portfolio construction across all asset classes, and working alongside the portfolio management team. Prior to joining Betashares, Cameron was a portfolio manager at Macquarie Asset Management, Head of Product at Bell Potter Capital, working on JP Morgan's Equity Derivatives desk and at Deloitte Consulting.

BetaShares is a leading Australian fund manager specialising in exchange traded funds (ETFs) and other Funds traded on the Australian Securities Exchange (ASX). Since launching their first ETF more than a decade ago, BetaShares has grown to become one of Australia's largest managers of ETFs.

Q&A: Ask a Question

Question 1

Which superfund is best for me?

The “best” superannuation fund varies based on your specific needs and priorities. Thorough research should be conducted to make an informed decision that aligns with your long-term financial objectives. Consider these steps:

1. Assess Your Needs: Identify your financial goals, risk tolerance, investment preferences, and insurance needs. Determine if you want a fund with specific features like low fees, ethical investments, or diverse investment options.
2. Fees: Consider fees associated with the fund, including administration fees, investment management fees, and insurance premiums.
3. Investment Options: Evaluate the range of investment options offered by the fund. Look for options that align with your risk tolerance and investment goals.
4. Insurance Coverage: Check the insurance coverage provided by the fund, including life insurance, total and permanent disability insurance, and income protection insurance.
5. Member Services: Assess the quality of member services, online tools, and educational resources offered by the fund.

Consulting your financial adviser who can provide personalised guidance based on your individual circumstances and goals.

Question 2

What is a reversionary pension?

A reversionary pension is a type of pension arrangement in which the income stream continues to be paid to a nominated beneficiary (reversionary beneficiary) after the original owner passes away. This arrangement allows for a seamless transition of pension payments to the beneficiary upon the original owner’s death.

Reversionary pensions can offer financial security to surviving beneficiaries and simplify the process of transferring pension benefits. However, it’s crucial to carefully consider the implications, taxation, and individual circumstances before setting up a reversionary pension. Consulting with your financial adviser will assist with making informed decisions based on your specific situation.

Question 3

Do I have to access my super at preservation age?

No, you are not required to access your superannuation at your preservation age. Your preservation age is the age at which you become eligible to access your superannuation benefits, but you have the flexibility to decide when and how you want to access those funds.

You can choose to leave your superannuation untouched and continue contributing to it if you’re still working and don’t need the funds immediately. Many people use their superannuation as a long-term savings vehicle for retirement and accessing it at preservation age is just one option.

You can access your superannuation benefits under various conditions, including retirement, reaching age 65, or meeting specific criteria like total and permanent disability. It’s important to carefully consider your financial situation, retirement goals, and any potential tax implications before deciding when to access your superannuation. Consulting with your financial adviser can help you manage your superannuation as you approach retirement.

If you have a question that you would like to see answered in **Wealth Adviser**, please send it through to **centraladvice@wtfglimited.com.**

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