Using rental income to pay for aged care is set to get harder from next year.

Q We are about to rent out our principal place of residence and will be renting for six months before moving into a new home, which will then become our new PPR. Should we obtain a valuation when we move out, or move into the new house, as values may have increased in that time? Do we need to use an official valuer, or will a local real estate agent's valuation be sufficient?

A The cost base of a property which has previously been your PPR will reset to market value on the date it is made available for rent. In my view, you are better to use a registered valuer as this may be more favourable to the ATO than an opinion from a real estate agent. I think the cost would be well worth it.

Q How do I build on my super if I choose to reduce/quit my job due to lifestyle choices, that is, offspring or looking after parents? Would I need to invest my partner's money from his job or even borrow money to increase the amount of money needed for our retirement?

A The key to building wealth is to invest using funds you have generated from surplus income, or create a pool of investment by using excess income to borrow. Unfortunately if you are reducing your income the wealth building process becomes much more difficult as you are reducing the amount of resources available. In your situation I think you should start from scratch and consult a financial adviser to discuss exactly when you would like to retire and how much you believe you will need then. The adviser can then help you design some strategies that are appropriate for your goals. These could include borrowing for investment, or salary sacrifice.

Pensioners feel the pinch

NOEL WHITTAKER

THE squeeze on our senior citizens continues. One element of last month's budget that has received little publicity is a new measure to remove the rental exemption on the former home when a person is living in aged care.

This exemption currently applies to people who pay towards the cost of their aged care accommodation by daily payment. The exemption applies to the rent for the purpose of calculating the means-tested care fee; it also applies to both the rent and the asset for the purpose of calculating pension entitlement. The exemptions for pension purposes are being maintained.

The changes are due to come into effect on January 1, 2016, and are projected to save the government just $26.2 million over five years. Obviously it's small bickies right now, but the number will grow exponentially as baby boomers reach an age where aged care may be necessary.

The government has called it a way of "improving the fairness and equity of aged care means-testing arrangements for new residents entering aged care from 1 January 2016" – in reality it makes it hard for people to use their former home to generate income to meet the cost of care. Those hit hardest of all will be people with few assets outside the home and limited income sources – in other words, pensioners.

Shirley is a full pensioner, with a house that produces $400 a week rent, $60,000 in the bank and $2000 in personal effects. She's paying a Daily Accommodation Payment of $69.70 a day (which is equivalent to a $400,000 Refundable Accommodation Deposit).

Under the current rules, Shirley's means-tested care fee is $1.70 a day and her cash flow shortfall is around $2000 a year. If Shirley moved into care after January 1, 2016, her means-tested care fee would rise to $26 a day and her cash flow shortfall would increase to around $11,000 a year.

Contrast this with Betty, a part-pensioner, who receives $600 a week in rent, has $250,000 in the bank and $20,000 in personal effects. Betty has paid $650,000 by Refundable Accommodation Deposit and is paying a Daily Accommodation Payment of $8.71 a day.

Under the current rules, Betty's means-tested care fee is $45 a day, giving her a cash flow surplus of $14,170 a year. Under the new rules, Betty's means-tested care fee would be $88 a day, and she would have a cash flow shortfall of $1500 a year instead of a healthy surplus.

The new rules mean that pensioners are going to have to change their attitudes about keeping and renting their home as a way of funding aged care costs, particularly if there is not a lot of capital outside the house.

While this sounds simple, and may look like a fair and reasonable outcome at a quick glance, there are other factors that come into play. Since the aged care reforms were introduced on July 1 last year, the amount someone can pay to an aged care facility has been capped at a "market price", making it hard to exchange an exempt asset (their home) for an exempt asset (their refundable accommodation deposit).

The money "left over" reduces their pension, and will most likely reduce it even more, after the new asset test changes take effect in 2017. The sting in the tail is that ANY amount paid as a refundable accommodation deposit is included in the assets for the aged care means-tested care fee, along with the money "left over", thus pushing up the price of aged care. It is a complex system and not getting simpler.

Noel Whittaker is the author of *Making Money Made Simple* and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any decisions. Email: noelwhit@gmail.com.

Balancing risk against returns on your investments

By **JOHN COLLETT**

IT'S one of the most frequently asked questions: how can I get a decent return without taking on risk?

A cash rate at record lows leaves those living off their savings in a tight spot.

Most term deposits are paying interest of less than 3 per cent, which is only a tad more than inflation – the biggest enemy of those living on their savings.

Interest rates will return to normal levels, but with economic growth still weak they could remain low for some time.

Anyone seeking a higher return has to take on some risk. But it is very hard for someone who has always been very conservative with their money to start over with a new investment strategy.

But the shares of the big banks, for example, can be bought on yields, after franking credits, of more than 7 per cent.

Then there are managed funds. Some managed funds invest only in Australian shares and others invest only in global shares.

Some have what is called a "balanced" strategy, where the money is invested in the major asset classes in Australian and overseas.

These are unlisted "unit trusts" where the fund manager, for a fee, decides how much of the money should be invested in each asset class and selects the best individual investments in each market.

Some balanced managed funds have only 30 per cent in so-called "growth" investments, such as shares and property, with the remainder in cash and fixed interest.

Over the medium term they should be able to produce more income than a term deposit. They should also be able to grow the capital to protect against inflation.

The capital value may go down, but the downside risk should be limited if only 30 per cent of the money is in growth assets.

If the investor can live off the investment income and does not need to draw-down the capital, is that such a big deal?

There is another way of looking at this. A full age pensioner is really receiving an income for life, which has been adjusted for inflation and guaranteed by the government.

That should leave them with more tolerance for taking on a bit more risk with their savings if it will make life a little easier.

Financial planners often talk about a "bucket strategy". This is where the growth investments are earmarked as a longer-term investment.

Some of the money could be in high-yielding Australian shares, for example, with the intention of not touching the money for a couple of years. Another portion of savings would be invested in cash and fixed-interest investments that pay a steady income.

Another point to bear in mind is that the highest-paying online saver accounts are paying about the same as term deposits, or a little more, without the money having to be locked away.

The higher interest rates for online saver accounts includes a "bonus" interest rate, that typically last for four months for new customers before reverting to the lower "base" interest rate.

And like term deposits, online savers are covered by the government guarantee for the first $250,000.