Homesafe
Wealth Release®
Change nothing. Change everything.

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Tax White Paper Taskforce
The Treasury
Langton Crescent
Parkes ACT 2600

Dear Sir/Madam

Homesafe Solutions Submission

Thank you for the opportunity to contribute to the Tax White Paper review, and for explicitly inviting submissions on "*how policy settings can better encourage more productive use of savings to optimise retirement incomes, in simpler and more effective ways, not simply restricted to superannuation. This will include issues such as equity release and comprehensive retirement income stream products.*"

This submission has a focus on equity release.

Initiatives to encourage as many Australians as possible to self-fund their retirement must take into account the substantial housing wealth owned by retirees. Mechanisms to encourage release of this wealth are needed.

The home equity release market in Australia is small, with only a handful of product providers. Homesafe Solutions offers the only product currently in the market which enables senior homeowners to access the equity in their homes without taking on debt.

This submission considers some of the issues surrounding home equity release today and suggests solutions which could facilitate home equity becoming a more meaningful pillar of the Australian retirement income system than it is currently.

For a more detailed overview we refer you to Christine Brownfield's paper to the Actuaries Institute in May 2014 which explores the concept of home equity as a "fourth pillar" in more in detail[1].

Please do not hesitate to contact us if we can provide further input to the Tax White Paper review.

Peter Szabo
Managing Director

Christine Brownfield
Company Actuary

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[1] Brownfield (2014) 'The Fourth Pillar – The Role of Home Equity Release in Retirement Funding', Actuaries Institute Financial Services Forum, Sydney May 2014 at http://actuaries.asn.au/Library/Events/FSF/2014/BrownfieldFourthPillarPaper140505.pdf

1. Executive Summary

For many Australians, their main form of savings over their lifetime is their home. Directing savings towards a home provides two benefits:-

- A place to live, with security of tenure. This security of tenure is a major advantage of home ownership over renting, regardless of financial considerations.
- A store of wealth.

It does not make sense for initiatives to encourage as many Australians as possible to self-fund their retirement to ignore this store of wealth. In considering a holistic framework for retirement funding going forward, we must stop overlooking home equity as current policy settings do, and view it as a pillar of the retirement income system.

Retiree housing wealth is largely untapped. There are wide ranging reasons for this, both around public policy settings and the complexities of accessing home equity to fund retirement.

Despite these issues, as Australia's population ages we cannot afford to remain on our current retirement funding trajectory due to the implications for the public purse and for future generations. Solutions to tapping into home equity to fund retirement are required. There are a range of ways in which this might be undertaken, but they can broadly be considered as either "compulsion" or "soft encouragement."

A compulsion approach could have a meaningful fiscal impact although there does not appear to be the political will for this sort of an approach at the current time. A number of public policy papers in recent times have outlined how such an approach might work.

A soft encouragement approach could have a meaningful impact on retirees, allowing many to enjoy a more comfortable retirement than they could otherwise afford.

This submission considers some of the issues around encouraging more senior Australians to access their housing wealth to supplement retirement funding, and suggests mechanisms which might help to achieve this. Areas considered include the impact of the age pension asset and income tests, financial literacy, the regulatory framework and the supply of funding.

2. Home Equity – A Substantial Asset for Retirees, Largely Untapped

For many Australians, their main form of savings over their lifetime is their home. These savings provide homeowners with two benefits:-

- A place to live, with security of tenure. This security of tenure is a major advantage of home ownership over renting, regardless of financial considerations.

- A store of wealth.

This wealth is, for the most part, untapped. The reasons for this are complex and include:-

a) Public policy settings, in particular:

   - the family home exemption from the age pension assets test;

   - the Capital Gains Tax free status of the family home; and

   - a lack of compulsion or even soft encouragement by Government.

b) The difficulties in accessing housing wealth to fund retirement. Owner-occupied residential property is a unique asset in that it is both a home and an illiquid and concentrated store of value.

3. A Holistic Retirement Income Framework

Our retirement income system is often viewed as comprising three pillars. These are the age pension, compulsory superannuation savings and a retiree's voluntary savings for retirement.

Home equity, when explicitly considered, is generally grouped with other forms of voluntary savings which include voluntary superannuation savings and savings held outside the superannuation system.

It makes more sense to consider home equity separately, as a "fourth pillar" of the retirement income system. It forms a substantial "stand alone" pillar because of:

- The high level of home ownership amongst retirees with around 85% of Australians aged 75 and over owning their own homes;

- The significant proportion of senior Australians' wealth that is tied up in their homes with around 55% of retirement asset holdings for those aged 75 and above being tied up in home equity. This is a mean value and does not provide insight into the distribution of wealth – the significance of owner occupied housing would vary significantly across the population with it being the sole asset for a substantial cohort of retirees[1]; and

- The "place to live" attributes that it holds in addition to its "store of wealth" attributes, rendering it a unique asset with particular challenges in accessing.

There is a lot of commentary today around the importance of superannuation being the preferred vehicle for Australians' retirement savings. Superannuation is certainly important but it is unrealistic to expect that the average Australian will prioritise voluntary superannuation savings over home ownership, given the significant "place to live" attribute of owner-occupied property investment. And as housing gets more expensive, it becomes a more significant store of wealth likely to draw a greater proportion of household income to purchase, or to service the debt entered into in order to purchase it fully prior to retirement.

A holistic approach to our retirement income framework would consider the wealth tied up in the family home as a fourth pillar with unique mechanisms required to access it.

[1] The recent Productivity Commission Research Paper on "Superannuation Policy for Post-Retirement" provides useful insight here. Section 2.1 of the Supplementary Papers provides total wealth by quartile, with housing wealth split out. The analysis is broken down into age bands for single males, single females and couples and highlights the significance of housing wealth for many senior Australians

4. How Can Housing Wealth Be Released? Can't Retirees Just Downsize?

This section outlines the range of mechanisms that can be used to release housing wealth.

Selling the Home

The most obvious way to access housing wealth is to sell the home, but this creates the problem of "where to live." It could also impact age pension eligibility due to the wealth transfer from an asset that is exempt from the age pension asset and income tests into a form that would be counted in the tests.

Downsizing

Downsizing is an option often put forward as the solution for retirees who are asset rich and cash poor. Whilst this is a suitable option for some retirees, it is not a solution for others, for a range of reasons. The costs of downsizing can be significant – stamp duty is particularly problematic but there are other costs such as sale and relocation costs. It is often very important for seniors to remain a part of their community; there may not be suitable housing stock in the vicinity of the family home to downsize into.

There can also be a problem when the price of recently developed units/ townhouses, for example, may be similar to the amount that can be realised from the sale of a family home that has not been renovated for many years and may have most of its value in the land. There is a risk that the house size is downsized but not the market price. Little equity may in fact be released.

Finally, where downsizing can be utilised to release equity, there is again the risk of age pension eligibility being impacted as the wealth released from downsizing is in a form that is no longer exempt from the age pension asset and income tests.

Home Equity Release Products

Utilising a home equity release product is another possibility; these products facilitate the separation of the 'place to live' and 'store of wealth' attributes of the home and can help to manage the "lumpiness" of the asset. A home equity release product enables home equity to be accessed whilst the homeowner continues to live in the home. Products can be either debt or equity based. As with selling the home and downsizing, there is a risk of age pension eligibility being impacted.

Debt Products

In Australia, debt products which release equity to senior homeowners are known as "reverse mortgages". A reverse mortgage is currently the most common equity release product used by seniors in Australia.

A reverse mortgage involves a loan being taken out with a home as security. The principal accumulates with interest until settlement, which occurs no later than when the home is sold either by the homeowner or the estate. The loan can be taken as a lump sum, an income stream, a line of credit or a combination of these.

Unlike a "normal" home loan, there are no regular repayments; homeowners do not require an income to qualify. All reverse mortgages written in Australia today must include a "no negative equity guarantee" meaning that the loan provider takes on the risk that the outstanding amount when the loan is repaid is higher than the sale price of the home. This protects against negative equity but there remains uncertainty about how much equity, if any, will be left at the end of the contract.

Equity Products

There are also equity or "home reversion" products which involve a proportion of the home equity being sold and the senior homeowner retaining the right to continue living in the home. The homeowner sells a share of the "reversionary interest" in the home, but retains 100% of the "life interest." It is the life interest which provides the absolute security of tenure as it is the right to use the home (or the income produced by the home) until the homeowner(s) die or sell the home.

Under a home reversion product, the homeowner has certainty about the share of the home equity that will be retained when the house is sold. For example if a contract relates to 60% of the home then when the house is sold, the homeowner/estate will be entitled to 40% of the sale proceeds.

Home reversion products are not widespread in Australia. There is currently a single established product available, which is the product offered by Homesafe Solutions. This product has strict eligibility criteria, including that homeowners must reside in specified postcodes in greater Melbourne and Sydney, which limit its availability.

Government Backed Equity Release Schemes

There is no Government backed equity release scheme that is widely available to Australian retirees, although there are some existing schemes with limited accessibility.

A small number of homeowners have accessed home equity via the Pension Loan Scheme but this is not widely known about and is strictly targeted.

There are also rates postponement schemes operating in some States.

5. Releasing More Home Equity – Compulsion versus Soft Encouragement

As Australia's population ages and the ratio of workers to retirees continues to fall, we cannot afford to remain on our current retirement funding trajectory. Solutions to tapping into home equity to fund retirement are required. There are a range of ways in which this might be undertaken, but they can broadly be considered as either

- "Compulsion" – along the lines of removing some or all of the family home exemption from the pension asset test, to ensure that home equity is drawn on for retirement funding before the age pension can be accessed. This could be achieved via a Government run loan scheme, or using private product providers. (Some form of Government scheme might still be required to cover retirees not meeting private provider eligibility criteria, as is would be important that all impacted retirees could release home equity.) Whilst logical, there does not appear to be the political will for this sort of an approach at the current time;

  or

- "Soft Encouragement" – by making changes to public policy settings to encourage senior Australians to tap into their home equity to supplement other sources of retirement funding. This type of approach will not have the same fiscal impact as compulsion, but would allow senior Australians to live a more dignified retirement. It could also start to change the Australian public's mindset around using home equity to fund retirement.

There have been a number of publications in recent years that outline and model how a "Compulsion" approach might work, and we have not gone into further details of this in our submission. We note key references relevant to this topic as including:-

- The April 2015 report from the Centre for Independent Studies entitled "The Age Old Problem of Old Age: Fixing the Pension";

- The Australia Institute's Technical Brief No. 34 "Boosting retirement incomes the easy way: Extending the Pension Loan Scheme to all retirees" released in September 2014; and

- The November 2013 paper "Balancing budgets: tough choices we need" released by the Grattan Institute – see Section 6.4 headed "Age pension asset test".

The next section of this submission considers how public policy settings could be adjusted with a "Soft Encouragement" objective to increase the extent to which senior Australians tap into their home equity to supplement retirement income.

6. Encouraging Retirees to Release Home Equity

As outlined above, barriers to increasing voluntary home equity release include:-

- the family home exemption from the age pension assets test;
- the Capital Gains Tax free status of the family home;
- a lack of compulsion or even soft encouragement by Government; and
- difficulties in accessing housing wealth to fund retirement.

This section briefly outlines initiatives which would help to encourage retirees to access some of the wealth stored in their homes to supplement retirement income.

- ❖ Home equity release could be encouraged by "deeming" funds released to still be treated as part of the family home for a certain period e.g. for 5 years from release, for purposes of the age pension asset and income tests. Effectively this retains the same advantages for the cash released as when it was invested in the home, for a period of time.

- ❖ Inadequate Financial Literacy about home equity release by both homeowners and advisers is an impediment to a wider take-up of home equity release products. An information campaign by ASIC would significantly assist educating homeowners and advisers, including both legal and financial advisors.

- ❖ There are significant supply side constraints in the home equity release market today. Government could take a pro-active role in ensuring that investment markets participate in an investment which has a socially desirable outcome.

  The shortfall in funding applies to both reversions and reverse mortgages. In many respects the fundamental issue facing both product types is a lack of willingness of major financial institutions to develop funding solutions. A 2011 article[2] in The Australian newspaper by economist Ian Harper concluded:

  > *"The government needs to consider how best to encourage private investors, including superannuation funds, to invest in diversified claims on the future sale proceeds of people's houses. It may simply need to prime the pump, as it has done in the market for residential mortgage backed securities, to encourage the private sector to step in.*

[2] See http://www.theaustralian.com.au/opinion/unlock-home-savings-to-fund-old-age/story-e6frg6zo-1225993848749

> *An active market in debt-free equity release offers greater choice to older Australians in retirement and advanced age, as well as creating a new asset class for Australian institutional investors. The government stands to gain from a reduced call on public funds, which is why the Productivity Commission calls on it to make the first move."*

Significant growth of home release offerings to retirees seeking to release equity from their homes may not be possible if the supply side failures are not addressed.

- There is a need for regulation which unambiguously protects the right of the senior homeowner to remain in the home for life – a key benefit of owner-occupied residential property is the security of tenure and its protection is critical. This is considered in further detail in Section 7 below, along with some other points relating to regulation.

7. <u>Regulation</u>

This section considers regulatory impediments to encouraging a wider take up of home equity release as part of retirement funding.

Principles Based Versus Product Based

There are currently only a handful of product providers operating in the home equity release market. For the market to flourish, new entrants will be needed and as part of this it is likely that new products would be released.

The existing legislative and regulatory framework is inadequate. The current National Consumer Credit Protection Act regulates at the product level, which risks being the regulatory equivalent of "*shutting the stable door after the horse has bolted*". Regulation at an individual product level will not prevent the introduction of "rogue" products that could lead to adverse outcomes for a subset of retirees and consequently erode confidence in home equity release.

A principles based approach to regulation will provide appropriate protection to senior homeowners accessing new types of products as well as for senior homeowners accessing established types of products.

Security of Tenure

The principal aim of regulatory and policy frameworks for home equity release products should be to ensure that the homeowner has the legal right to remain in their home for the remainder of their life, i.e. absolute security of tenure. In this way the greatest reservation of homeowners considering home equity release will be removed.

The Homesafe Solutions product already provides this guarantee for retirees in accessing equity in their home, but having the product sitting within an appropriate regulatory and policy framework would validate and guarantee these product offerings.

The absence of a legislative framework and regulation is a fundamental impediment to the wider acceptance of home equity release. Specifically a legislative framework should include the legal right to reside in the home.

No Negative Equity Guarantee

The peak industry body for equity release, SEQUAL, required members to include a No Negative Equity Guarantee in product offerings, and this was enshrined in legislation in the most recent National Consumer Credit Protection Act. This guarantee is good policy and protects homeowners with reverse mortgages, or their estates, from having to repay more than the home is worth when the home is sold and the loan is extinguished.

This is an example of legislation that has been introduced in relation to a specific product (reverse mortgages) – and which should continue to be reflected in more generalised legislation.

State versus Federal

Operating in the home equity release market today is complicated due to the fact that property law in Australia is State based. This can create inefficiencies for providers seeking to offer products in multiple jurisdictions. Issues impacting on home reversion product providers include stamp duty and differences in the structure of real estate contracts.

To take Homesafe Solutions as an example, our product is today offered only in Victoria and New South Wales. Two contracts and sets of business processes are required which is inefficient. To expand our product into a third State would take significantly more resources than it should, as the State based property legislation leads to a lack of synergy.

The solution would be for all regulation in relation to home equity release products to be at the Commonwealth level.