Retirement Income Review

Submission from

Household Capital

February 2020

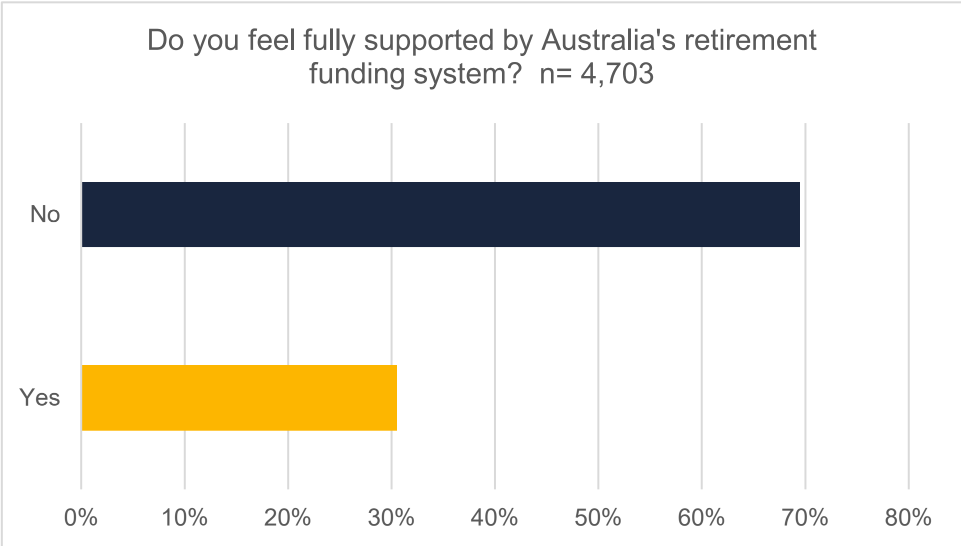
Live Well At Home

SUMMARY

Retirees do not feel fully supported by Australia's retirement system (figure one). The three pillars of retirement funding have not, to date, adequately supported all Australians for several reasons:

- Australians are living longer, a fact that's communicated with rhetoric around this being an economic burden or threat
- Australia's retirement system was not designed to support retirees for 20-30 years of life beyond work
- Superannuation came in too late for most baby boomers; accordingly, the median account is $200,000 at retirement (less for women), which provides income for around 10-15 years
- The Age Pension is inadequate as the sole source of retirement funding
- Home equity, the largest pool of savings for most retirees, has not been appropriately and effectively made available to improve retirement funding.

Figure one: Do you feel fully supported by Australia's retirement funding system?

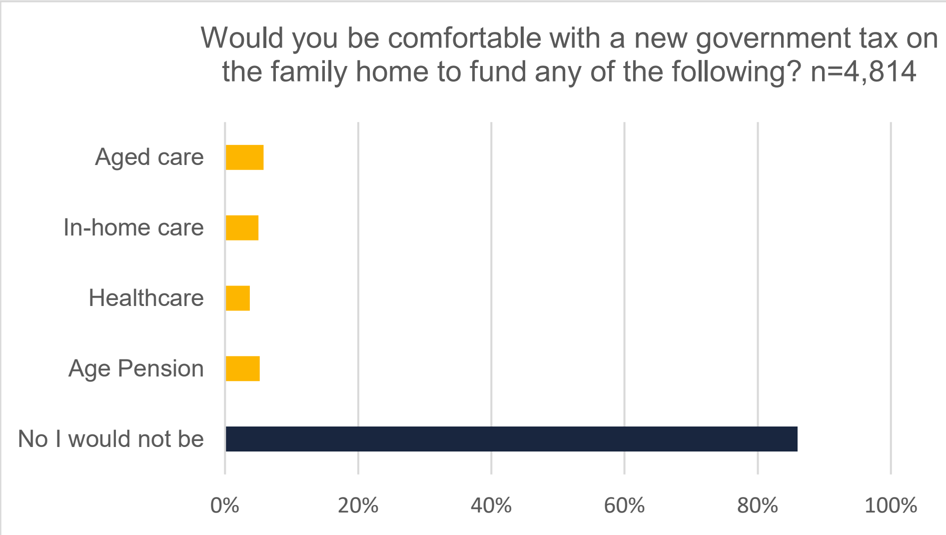


Source: Household Capital/Your Life Choices Retirement Survey, December 2019

Retirees won't accept a tax on the family home

Including the family home in the assets test is not likely to be a popular move, one which the government would be reluctant to take. However, if the family home remains excluded, it is essential that the government does not create a 'death by one thousand cuts' scenario by taxing the family home to fund retirement costs such as the Age Pension, in-home care or the transition to a residential aged care facility. Any such retirement tax would reduce choice and flexibility for retirees to draw on their own property to self-fund retirement.

Figure two: Retirees don't want a tax on the home to fund retirement expenses



Source: Household Capital/Your Life Choices Retirement Survey, December 2019

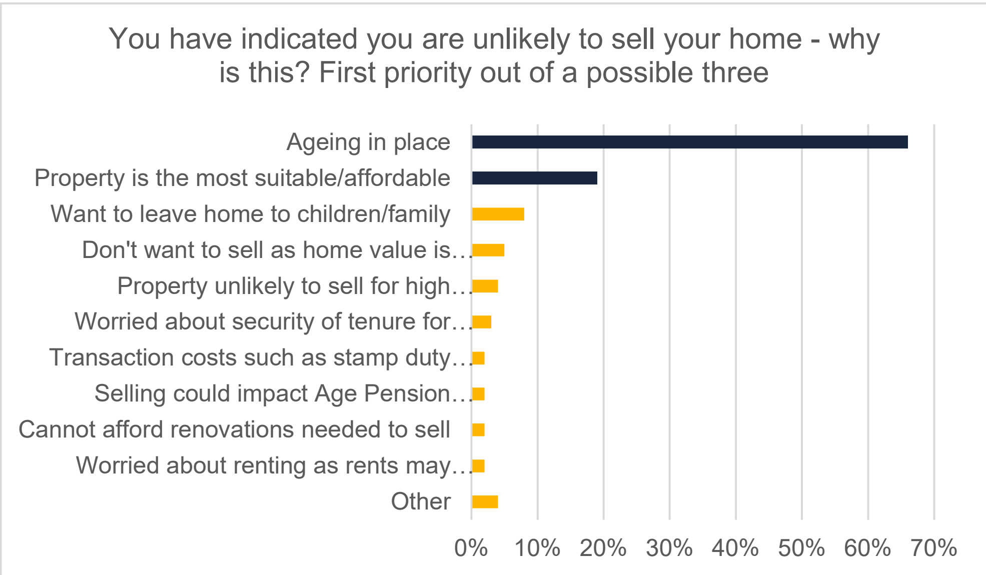
Note: some respondents selected more than type of expense response

Australians want to age at home, not downsize

Selling the family home, moving to a lower-priced property and using the differential to fund retirement is often suggested as a major opportunity to improve access to home equity.

Several limitations to this approach have been observed, most notably that Australian retirees want to age in place, in their family home (figure three). Not only is ageing in place preferred by the vast majority of retired Australians, ageing in place costs the government significantly less than institutional aged care. While many government policies support ageing in place, the retirement funding system requires new settings to enable adequate funding of ageing in place.

Figure three: Downsizing intentions of older Australians



Source: Productivity Commission, 2015

When older Australians move, financial downsizing is somewhat more common than physical downsizing, nevertheless, it is still not a usual housing path. Among all older age groups, fewer than 20 per cent of individuals who sold their existing home to buy another reduced their net level of housing equity in the process[1].

Fair treatment for all proceeds of home equity

The downsizer measure permits the concessional treatment of $300,000/$600,000 (single/couple) from the proceeds of downsizing. In the year ended 1 July 2019, just 4246 older Australians had taken advantage of this measure, equating to less than one percent of retired Australians.

Older Australians should be incentivised to use their home equity to improve their retirement funding by having this measure applied to all forms of equity release. Household Capital proposes concessional treatment of $300,000/$600,000 (single/couple) of the proceeds of any home equity access, from downsizing, reverse mortgage or otherwise, to encourage more widespread self-funded retirement.

Responsible use of home equity is crucial

Traditional bank reverse mortgages ran into trouble by lending to retirees for short term consumption, leaving those clients cash poor and asset depleted. A focus on long-term consumption – using home equity to improve retirement funding, renovating or modifying the home to make it safe and comfortable for retirement or funding care requirements – is necessary.

The 2012 Consumer Credit legislation which regulates reverse mortgages is world class and provides significant consumer protections. The ASIC 2018 review of the performance of the reverse mortgage market and regulation found no major shortcomings of the regulatory environment for responsible reverse mortgage lending. In addition, the Pension Loans Scheme has been expanded, however it provides limited choice in home equity retirement funding.

Home equity is private property saved by each homeowner. The market for home equity should be supported to provide flexibility and choice to retired homeowners to draw on their wealth to complement the pension and superannuation systems.

Responsible lending practices are also important, including the role played by mortgage brokers in establishing reverse mortgages. Without having to abide by a best interests duty, some brokers may establish larger loans than necessary and focus on those paying the highest rate of commission, not those necessarily best for the client. As a result, those retirees may find their home equity being depleted more quickly. A mortgage broker ‘best interests’ test specific to reverse mortgages would further improve customer protection in the use of home equity retirement funding.

[1] Examining the housing choices of older Australians, Australian Housing and Urban Research Institute, Nov 2019

RETIREMENT INCOME REVIEW – RESPONSE

Overview

Australia's population is ageing, which presents both challenges and opportunities. There's an overwhelming perception that the challenges outweigh the opportunities, with focus on the increasing demand for financial support and services from older Australians. Instead of being seen as a 'grey tsunami', an economic burden or sustainability issue, our unprecedented longevity should be celebrated and supported.

The focus must shift to helping retirees to flourish and the economic and social benefits that will flow from this. As Australians age, their expenditure to meet their wellbeing and lifestyle needs can stimulate our domestic economy and positively impact the country's bottom line. Getting the right retirement funding mix is integral to this shift.

Longer, healthy lives will enable Australians to spend a greater part of their retirement living independently. Australians can expect to live – and need to plan for – around 25-30 years in retirement. A review of retirement incomes alone is too narrow.

Since the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, it is increasingly difficult for retirees to gain access to credit, making a large cohort of our population vulnerable to being unable to meet capital expenses throughout retirement. To ensure wellbeing in retirement, Australians need adequate funding – including income, credit and capital – as well as housing, healthcare and social connectedness.

Income and service measures for retirees are a significant cost to budget and are increasing in cost at a far faster rate than other expenditures. While longevity is on the rise, the birth rate has dropped below the replacement rate. Consequently, the dependency rate is projected to increase, from its current rate of 12 percent of Australians aged over 65, to 22 percent in 2050. This will place significant pressure on the federal budget.

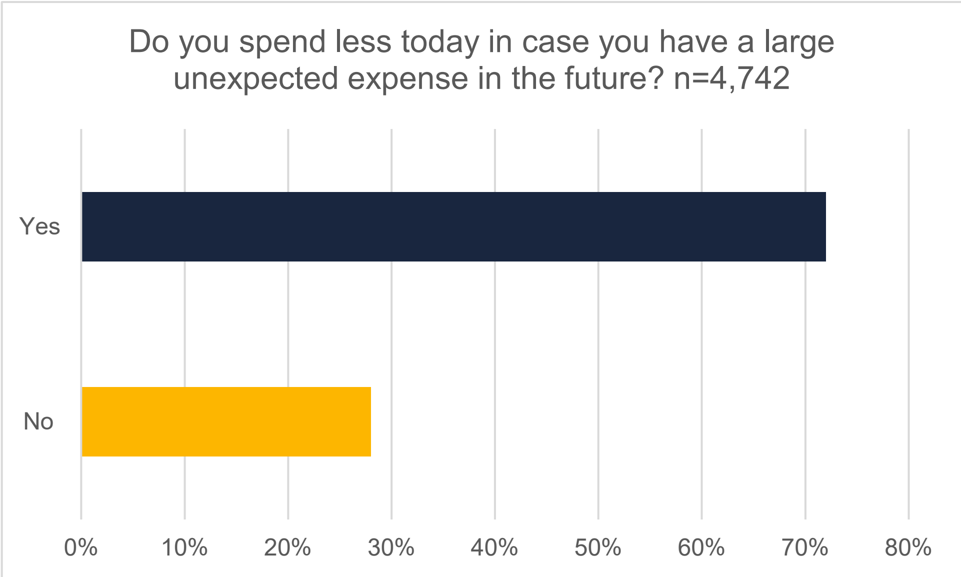
The government has a limited capacity to cover this growing expenditure; the most practical way is to require baby boomers to utilise some of the asset value of their home. This approach has the multiple benefits of encouraging adequate retirement funding, adequate retirement housing and more cost effective ageing in place.

Drawing on home equity can reduce the impact of ageing on the public purse and, at the same time, increases the total retirement funding available. This does not mean a direct tax on the home; rather, it provides for measures via means testing and cost effective incentives for baby boomers to utilise their most significant asset.

Australia's retirees

That retirees don't feel financially secure is evident in different ways, particularly when you examine spending patterns. Even those retired Australians with adequate retirement funding tend to self-insure against both longevity and financial contingencies by underspending in early retirement to ensure they can meet any large and unexpected expenses in their later years. As illustrated in figure four, a recent survey found 70 percent of retirees hold back their spending today in case of future need.

Figure four: Spending in retirement



Source: Household Capital/Your Life Choices Retirement Survey, December 2019

Such precautionary saving is driven by uncertainty around longevity, health and residential aged care needs, and is a potentially expensive form of 'self-insurance' that can lower living standards in old age.[2] Underspending by a significant and growing demographic sector also has implications for the broader economy.

Each of the government, the private sector and the individual plays an important role in enabling older Australians to achieve adequate retirement funding.

The government provides the Age Pension as a safety net and supports both in-home and residential aged care. It's important these services are continued to be offered with a reasonable breadth of eligibility. The government should also continue to provide its oversight of the superannuation industry; however, the constant change to superannuation rules and taxes has undermined confidence in the system by both retired and working Australians.

The private sector should continue to manage accumulation and decumulation retirement products and provide other forms of retirement funding, such as access to home equity. Individuals need to be encouraged and incentivised to save for retirement through their voluntary contributions to super, other investments and the family home.

Despite high levels of median wealth in Australia, retirees experience high levels of relative poverty. When compulsory superannuation was introduced in 1987, many baby boomers were more than halfway through their working life.

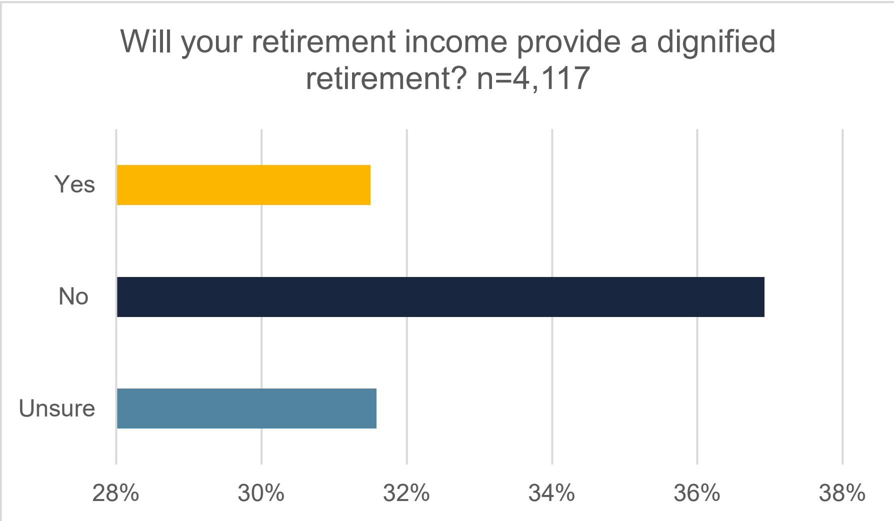
Baby boomers not only had insufficient time in the system, but also a phasing in of contributions, starting at three percent. Whatever the outcome of the discussion on the legislated increase to 12 percent, it will have minimal impact for baby boomers. This group has substantially missed out on a mature system resulting from higher levels of contribution and the power of compound returns over time.

As a result the median household superannuation savings at retirement is only around $200,000, estimated to support a 'comfortable' retirement income for just 10-15 years.

[2] *Housing decisions of older Australians*, Productivity Commission, 2015

Many Australian retirees face the remainder of their lives dependent on the inadequate age pension. A shortfall in superannuation savings means Australian retirees may not only endure inadequate income, but also have no access to funds to meet capital spending or contingencies throughout retirement. As illustrated by figure five, less than one third of retired Australians believe their current retirement income will provide a dignified retirement.

Figure five: Will your retirement income provide you with a dignified retirement?

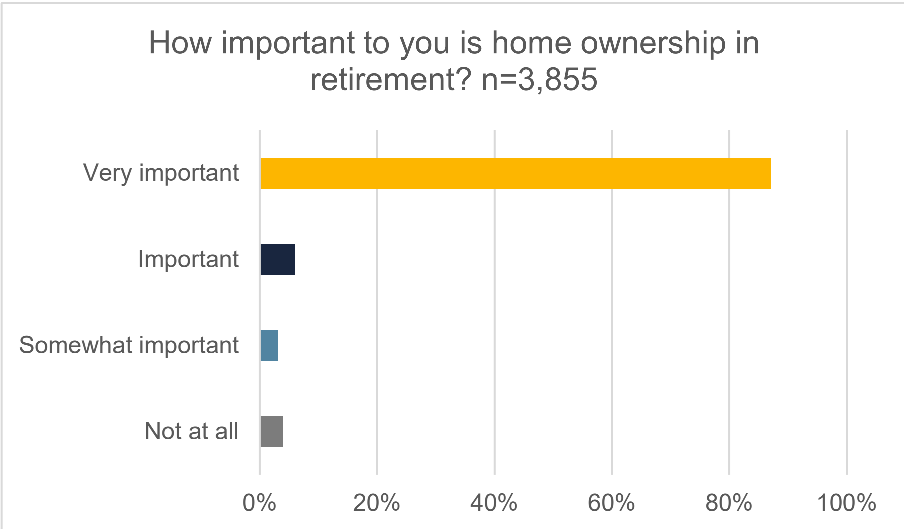


Source: Household Capital/Your Life Choices Retirement Survey, December 2019

Retirement needs

Housing is integral to people's wellbeing, particularly for older Australians. For many older people home ownership provides security and independence in retirement[3]. Home ownership in retirement is very important to 87 percent of Australians (figure six) and 60 percent wish to remain in their home until the end of their lives (figure seven). This reinforces the 2015 findings of the Productivity Commission (figure three).

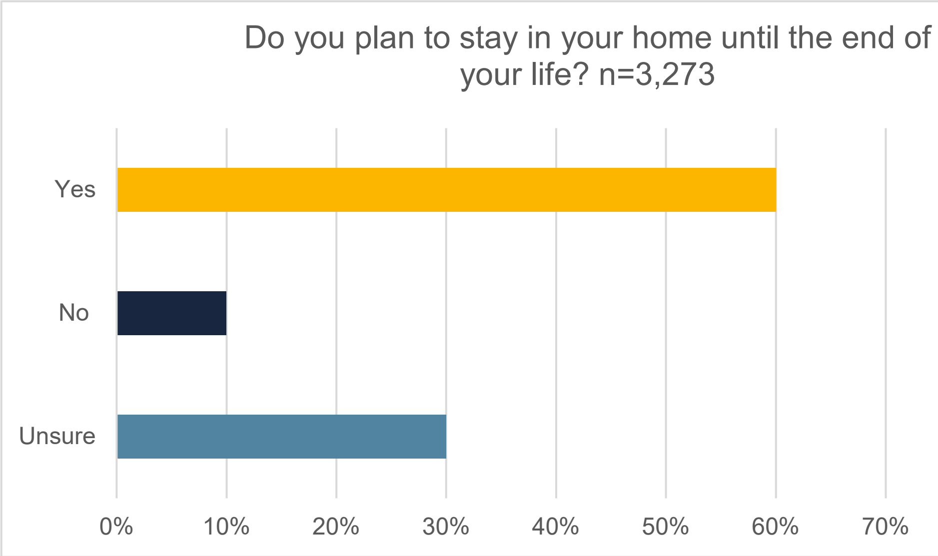
Figure six: Importance of home ownership



Source: Household Capital/Your Life Choices Retirement Survey, December 2019

[3] *Housing decisions of older Australians*, Productivity Commission, 2015

Figure seven: Intentions to live at home

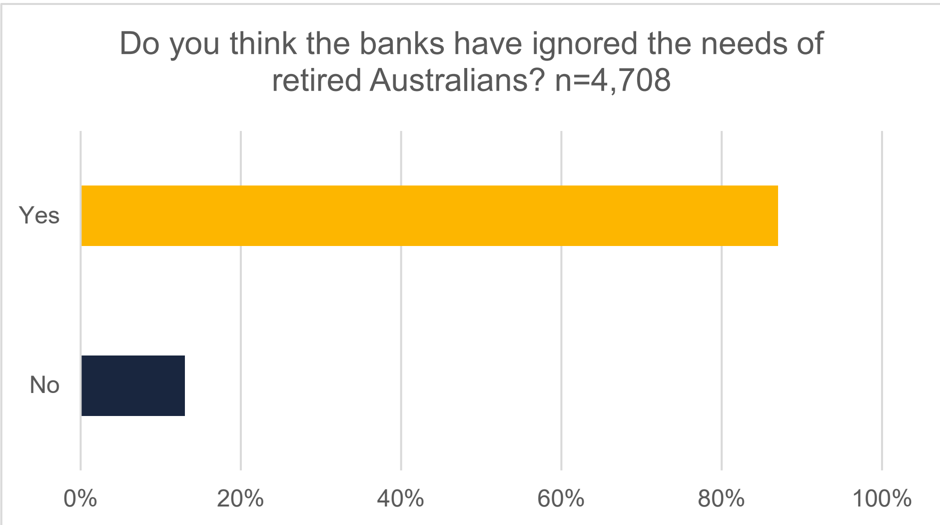


Source: Household Capital/Your Life Choices Retirement Survey, December 2019

Housing, retirement funding, healthcare and social connectedness are essential ingredients for wellbeing. In the context of retirement income, there's a strong need for financial advice and service delivery around transitioning into retirement, as well as in-home services and for some, the eventual move into residential aged care. The government does not have capacity to fund all of this; accordingly, this retirement income review should take a broader approach to consider a 'whole of retirement' funding model.

Retirement funding needs to include access to income and capital. Many older Australians, including some of the poorest retirees, continue to save (spending less than their Age Pension) even very late in life. The main reasons for such behaviour are precautionary saving to insure against both longevity and financial (often capital) contingencies. Australia's banks are compounding this problem by turning their backs on retirees (figure eight). Without both a steady job and a residential property, the banks won't provide finance, regardless of the value of the property.

Figure eight: The banks ignore retiree needs



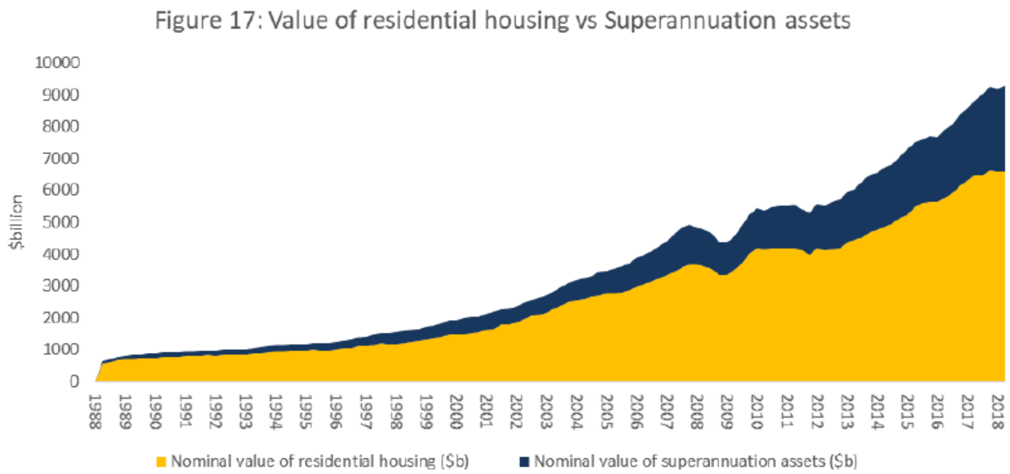
Source: Household Capital/Your Life Choices Retirement Survey, December 2019

The third pillar

As well as income, retirees need flexible access to capital. Because home equity can provide both income and capital, it should be an integral part of the third pillar of retirement funding. It's widely distributed and accessible to retired Australians, and therefore meets the government's needs for adequate, sustainable and accessible sources of retirement funding.

Residential housing remains the most significant store of wealth for Australian households, despite the introduction of superannuation in the late 1980s. Although baby boomers have not had time in the system to achieve superannuation adequacy, they do have a valuable housing asset (figure nine).

Figure nine: Value of residential housing vs superannuation assets



Source: ABS 2018, APRA 2018

Approximately 80% of retirees own their own home; however, this wealth is locked away and largely inaccessible to fund retirement needs. In total, there is more than one trillion dollars in untapped home equity owned by Australian retirees.

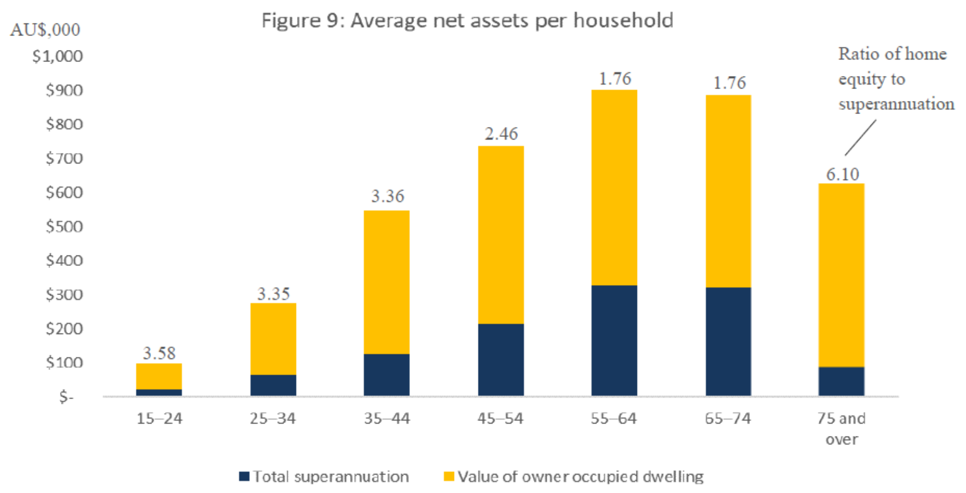
Given that most retirees wish to stay in their own home as they age, this untapped savings is a valuable resource that could be utilised to provide improved retirement funding. Importantly, home equity provides for those needs that enhance older Australians' wellbeing; housing, funding, and using in-home care services, support for long healthy lives during which retirees remain connected with their community.

Figure ten shows the total average superannuation versus home equity for Australian households during the course of work and retirement. Within 10 years of retirement, superannuation savings are largely depleted. For Australian homeowners at retirement, the average household home equity is typically almost twice the value of superannuation. By the time retired cohorts have reached 75+ years of age, home equity savings have grown to over six times the value of superannuation. On average, Australians' superannuation lasts about 10-15 years after which many Australians in

> "There is little rationale for active government intervention in the equity release market in the current policy environment. Options for intervention could be carefully considered in the event of substantial reforms to tax and transfer policies affecting the principal residence…"
>
> "However, an approach in which the government attempts to 'pick winners' in a new industry may be ill-advised. Focusing on specific products could reduce the incentive to innovate, and cause providers to focus on securing and retaining assistance rather than improving their products."
>
> *Housing decisions of older Australians, Productivity Commission, 2015*

retirement can expect a further 10-15 years of *underfunded or inadequate* retirement supported by the Age Pension.

Figure ten: Average net assets per household



Source: ABS 2018. Average includes renters.

While superannuation alone is inadequate, most Australians have sufficient total resources to support high quality, in-home living throughout their increasing and uncertain longevity. By including home equity in the three pillars of retirement, Australian retirees can achieve funding adequacy throughout the full course of 25+ years of retirement. However, to do this retirees must be able to responsibly and cost-effectively access home equity savings to generate retirement income.

Why aren't people drawing on home equity?

At a higher level, home equity has not been a policy area. It's not been explained in a positive way as something that's legitimate and acceptable. The longer-term benefits of responsible use of home equity need to be supported as a valid long-term funding mechanism for retirement, not a lever to pull in desperation or as a last resort.

The government's support of home equity is evidenced by the revamped Pensions Loan Scheme and downsizer measure. The ability to contribute up to $300,000 as an individual, or $600,000 as a couple, from the proceeds of a downsizing sale into superannuation should be extended to all forms of home equity.

Greater support for, and concessional treatment of home equity – particularly when used to top up superannuation and pensions – will create a positive perception that the government is acting in the interests of retirees.

Retirees can find it challenging to access capital locked up in the family home for the purpose of retirement funding. Four main approaches have been available to retirees: downsizing, lines of credit or offset accounts provided by the banks, home reversion schemes and traditional reverse mortgages. Each of these approaches has significant downside in terms of cost of access, security of tenure in the home or the ability to fund long term retirement income.

Australians have been reluctant to access their home equity through a reverse mortgage because the system wasn't trusted or focused on the longer-term. As clearly identified by the ASIC 2018 review of the reverse mortgage industry, the traditional bank reverse mortgages focused on short term consumption, not long-term retirement funding.

Australia, since 2012, has had a strongly regulated environment with respect to the reverse mortgage product and provider market. Appropriately, the pre-2012 abuses have been largely removed from the market. Retirees in Australia are protected by robust Loan to Value Ratio (LVR) controls, the 'no negative equity guarantee' and no default provisions (guaranteed occupancy); this regulatory environment is world-leading and should provide comfort to retirees that they will maintain retirement housing and significant home equity in their family home. Both ASIC and APRA have been proactive and diligent in their oversight of the sector and have developed appropriate regulation and supervision.

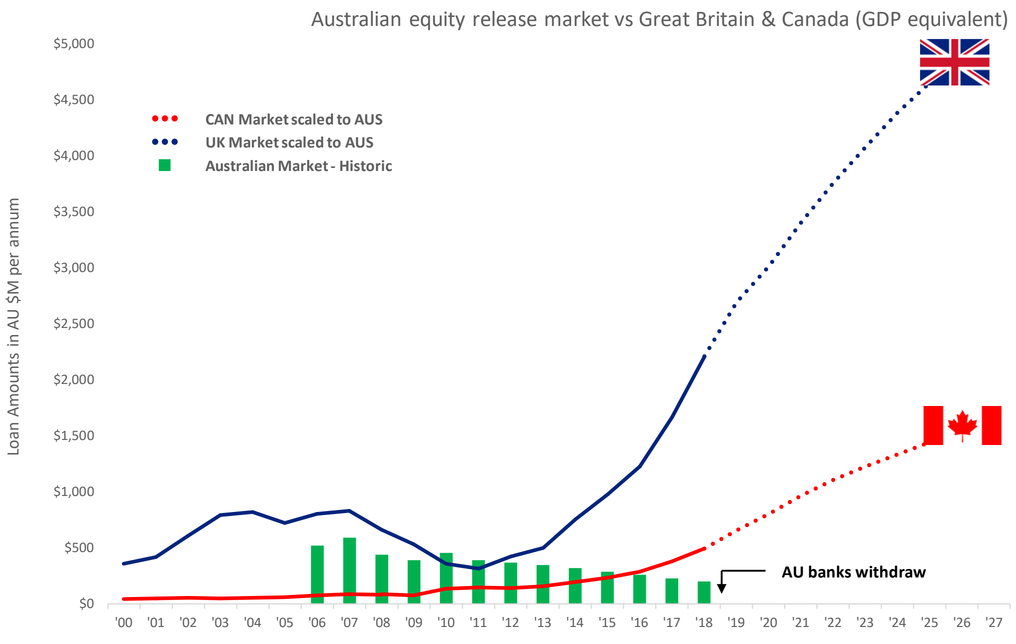
Regrettably, in the intermediary distribution sector there remains potential for miss-selling. Reverse mortgages are a Consumer Credit product and are therefore exempt from a best interest test and prohibition of commission based sales. Whatever the justification for the exemption applying to mortgage brokers, reverse mortgages should not be exempt from tougher regulations that apply in respect of financial advice.

It's important for the government to note, retirees won't accept a tax on the family home to provide retirement income or other services (figure two). Homeowners need to remain in control of their property; a piecemeal 'tax' on the home to cover expenses, such as in-home care, is confusing and inequitable.

Any decision to draw down on home equity to help fund retirement income and/or aged care should be voluntary and made after consultation with families and trusted advisers, not mandatorily via creeping taxation arising from complex policy settings and it certainly should not be administered by Centrelink as a one-size fits-all government program.

The value of home equity is its ability to provide a form of longevity insurance, to provide funding once other forms of retirement savings consumed. It has been a demonstrable success in the United Kingdom and Canada (figure eleven), countries with a similar economic backdrop and demographic profile. As well as better funding retirees, both countries have had a noticeable uptick in consumer spending in line with this growth.

Figure eleven: Australian equity release market vs UK and Canada



Source: Household Capital, SEQUAL, UK Equity Release Council, CHIP

This growth in the UK and Canadian markets comes without the strong regulatory parameters of equity drawdown that protects Australian retirees.

RECOMMENDATIONS

1. Responsible use of home equity

Home equity needs to be embraced as a legitimate and acceptable long-term funding mechanism for retirement. By helping retirees to better access and responsibly use home equity for retirement funding, several important areas of social and economic policy can be addressed:

- Providing appropriate housing (including aged care) and funding for retirement
- Retirees with greater incomes and increased confidence in their ability to fund retirement will be more active, healthier and happier
- Support policies to promote in-home retirement, such as the Commonwealth Home Support Program (CHSP)
- Developing countries with ageing demographics face the challenge of secular stagnation – inadequate consumption to sustain economic growth

Retirees are a large group with significant inaccessible wealth in home equity and major unmet needs in consumption for wellbeing. By unlocking home equity to improve retirement funding, both quality of life in retirement and economic activity can be enhanced.

2. Concessional treatment of home equity drawdowns

All forms of home equity, whether accessed via a reverse mortgage or through downsizing, should have some proceeds ring-fenced as exempt from the assets test and concessionally treated when contributing proceeds to a superannuation or pension account.

Older Australians should be incentivised to use their home equity to improve their retirement funding by having this measure applied to all forms of equity release. Household Capital proposes concessional treatment of $300,000/$600,000 (single/couple) of the proceeds of any home equity access, from downsizing, reverse mortgage or otherwise, to encourage more widespread self-funded retirement.

3. A broader focus for superannuation funds

To a large extent, super funds have not adequately focused on the retirement income sector. The government needs to take a leading role in the establishment of appropriate parameters to expand from being primarily accumulation focused to better include retired Australians. How can these people optimise their available assets to provide income and capital for retirement?

Super funds should offer appropriate products to ensure retirees have adequate 'whole of retirement' funding, which should include access to home equity retirement funding. This should be a legislated minimum service provision for all super funds.

4. Responsible lending practices

Responsible lending practices are essential, in particular the role played by mortgage brokers in establishing reverse mortgages. A mortgage broker 'best interests' test specific to reverse mortgages would improve customer protection when using home equity to fund retirement.

Concluding remarks

The broad policy and legislative framework for responsible access to home equity is in place, is comprehensive and sound. There are no major barriers to the transformation of home equity to play a foundation role in funding retirement. Some suggestions which may accelerate the development of the market for home equity access include:

- Publish full costs of in-home care packages (including waiting lists)
- Publish full costs to government of aged care (per place)
- Review APRA regulatory capital requirements for reverse mortgages issued within ASIC LVR limits
- Clarify liquidity requirements for super funds holding reverse-mortgage based property assets
- Ensure the PLS is complementary with first-mortgage reverse mortgage.

Home equity meets each of the government's requirements for adequacy, equity, sustainability and cohesion and can meet the widespread funding needs of Australian retirees.

Australians know that the family home provides retirement lifestyle, wellbeing, housing and funding. The federal government must support the retirement funding sector to deliver better outcomes in retirement.

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