SUBMISSION TO THE RETIREMENT INCOME REVIEW

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Thank you for the opportunity to make a submission to the Australian Government's Retirement Income Review.

I am currently a Professor of Economics at the School of Economics, Finance and Property, Curtin University, specialising in housing economics and population ageing. My research has investigated the changing nature of home ownership, mortgage stress among older home owners, the treatment of housing assets in retirement intergenerational housing concerns, housing affordability dynamics, and the links between housing and non-shelter outcomes.

Housing assets are the dominant asset for the majority of older Australians, and therefore crucial in supporting the financial wellbeing of Australians in retirement. It has been identified in the Review consultation paper as an important source of voluntary savings which form the third pillar of the retirement income system. Indeed, such is the importance of home ownership in retirement that it has sometime been referred to as a separate fourth pillar of the retirement income system (Yates et al. 2016). Conversely, those who do not own housing assets in old age lack the financial security that home ownership provides in retirement.

This submission describes three key issues that affect the effectiveness of home ownership as a form of voluntary savings supporting retirement incomes:

1. Growing precariousness in the home ownership sector driven by developments in the housing market and labour market, and demographic trends (**consultation question 7**);
2. The favourable treatment of owner-occupied housing assets within the retirement income system that may lead to sub-optimal savings behaviour (**consultation questions 22, 23, 24**);
3. The expansion of housing asset based welfare in Australia (**consultation question 6).**

This submission will also discuss the potential implications of each of the above issues in relation to their impacts on the retirement income security of both current and future retirees. The potential implications are assessed drawing on one or more of the following principles adequacy, sustainability, equity and efficiency (**consultation questions 10, 13, 18**).

The rest of this submission is set out as follows. Section 1 describes the key trends driving growing precariousness in the home ownership sector and potential implications for adequacy and sustainability the retirement income system. Section 2 explains how reliance on housing as an asset base for welfare has grown over time and emphasises potential implications for the retirement income system on the equity and efficiency front. Section 3 compares the treatment of housing assets versus superannuation assets within the retirement income system (and the aged care system), highlighting potential implications for equity and efficiency.

1. GROWING PRECARIOUSNESS IN THE HOME OWNERSHIP SECTOR

1.1 Key trends

Traditionally, it has been assumed that for the majority of Australians, their housing careers would progress smoothly in a linear fashion. Hence, a typical housing career would involve leaving the parental home upon reaching adulthood, renting while saving up for a home deposit, purchasing one's first home backed by a mortgage loan, and paying off the loan till one achieves outright ownership in retirement (Wood and Ong 2012). However, linear housing careers are losing their relevance in three ways.

While the housing market boom of the late 1990s and early 2000s have generally benefited home owners, soaring house prices have pushed the 'great Australian dream' of ownership out of the reach of growing numbers of young people (Ong 2017). For current masses of young people who will be Australia's **future retirees, lifelong renting into old age has become a very real possibility**. Given the highly rationed public housing stock, there will be greater pressure on the private rental sector to meet rising demand for rental housing. However, at present the sector appears unable to supply adequate quantities of secure and affordable housing (Wood and Ong 2017). Security and affordability represent two critical housing requirements for those who find themselves renting in old age on low incomes.

While the home ownership sector has traditionally provided more tenure security than the private rental sector, the former is also transforming into a more precarious sector increasingly marked by **loss of home ownership among older people** (Ong et al. 2015). Population weighted estimates from the Household, Income and Labour Dynamics in Australia (HILDA) Survey indicate that 1.9 million people exited home ownership into the rental sector during the first decade of the millennium (2001-2010), out of which 500,000 were aged 50 years or over. Even though not all departures from home ownership are involuntary, marital breakdown and mortgage stress have been identified as important factors that precipitate a loss of home ownership among older people (Wood et al. 2010).

Even among those who do manage to sustain home ownership into later life, another source of precariousness has emerged in the form of **growing mortgage indebtedness**. As **real house prices have outstripped real income growth** over the long-run, households have had to borrow more to purchase a home (Ong et al. 2019). Estimates from the Australian Bureau of Statistics' Surveys of Income and Housing show that the share of mortgagors among home owners aged 55 years and over has nearly tripled from 10% in 1990 to 28% in 2015. Among mortgagors aged 55 years and over, mean mortgage debt increased more than 500% from $33,000 in 1990 to $186,000 (at constant 2015 prices), while real average house prices rose at a slower rate of 300% and real income growth lagged even further behind, doubling over the same period (Ong et al. 2019).

The growing precariousness in the home ownership sector has also been driven by a range of forces from outside the housing market. Firstly, the last three decades of the 20 century saw widespread growth in non-standard forms of employment, driven primarily by growth in part-time and casual employment. **Workforce casualisation** has remained a marked feature of Australian labour markets since, with the share of casual employment remaining at 20% since 2001 (albeit with mild fluctuations in between) (Laß and Wooden 2019). Casual employment is often insecure or short-term in nature. These labour market features are unhelpful and inherently incompatible with the need to make fixed long-term mortgage commitments (Beer and Faulkner 2009). Secondly, divorce rates are also at historically high levels compared to the era prior to the 1970s (Australian Institute of Family Studies 2020). **Marital breakdowns** typically let to division of assets, including housing assets, and the overall growth in lone-person households in the population is a negative as far as home ownership is concerned as single people do not enjoy the benefits of economies of scale and pooling of resources with a spouse to sustain mortgage payments.

1.2 Potential implications for the retirement income system

There exists a need to review the retirement income system in light of the above trends. If a 'business as usual' approach is taken, the following are some potential implications for the **adequacy and sustainability** of the retirement income system in the coming years.

Adequacy and sustainability of the home ownership pillar: As growing numbers of Australians enter retirement without the backing of housing wealth, there will a two-fold implication to consider. Firstly, outright ownership plays a crucial role in supporting retirement income by reducing on-going housing expenses, while acting as a store of wealth that could be unlocked income be insufficient in retirement. As the number of retirees holding little to no housing wealth grows, it calls into question whether the contributions that home ownership has made to the financial security of the present generation of older Australians will continue to be adequate and whether it can be sustained for future generations of retirees. Secondly, there will be fiscal ramifications for government budgets on housing assistance. If current trends in population ageing and in the home ownership sector continue into the future, they will likely lead to a significant increase in the number of older Australians needing Commonwealth Rent Assistance (CRA) or public housing. If home ownership rates remain constant, demographic change alone is projected to nearly double real government spending on CRA for the 55 years and over cohort from $585 million in 2011 to $961 million by 2031. At a modest 5 percentage point decline in the rate of home ownership, there will likely be a threefold increase in the number of CRA recipients aged 55 years and over between 2011-2031, such that real government spending on CRA is projected to more than triple by 2031 (Wood et al. 2020). While not formally part of the retirement income system, housing assistance has implications for the overall adequacy and sustainability of other pillars of the retirement income system (see below).

Adequacy and sustainability of the age pension pillar: The current age pension system relies on an assumption that elderly low-income people will have relatively low housing costs because they would on their homes outright by the time they retire, so can get by on smaller pensions (Castles 1998). It is further assumed that the minority who are unable to enter outright ownership in old age can be accommodated in private rental housing subsidised by CRA or in public housing at affordable rents (Wood and Ong 2012). If growing numbers of older Australians enter retirement with high mortgage debt burdens or as renters, current age pension levels may be inadequate for sustaining housing costs in old age. Moreover, the current age pension system may not be sustainable, that is, for the current generation of young renters who will make up the future retiree population, current age pension rates may not continue to deliver adequate retirement incomes given the higher housing costs associated with renter as opposed to home owning.

Adequacy and sustainability of the superannuation guarantee pillar: As the superannuation guarantee system matures and growing numbers of Australians find themselves renting in old age, significant numbers may be motivated to use lump sum superannuation pay outs to finance home purchase in later life. Evidence of current home owners using superannuation drawdowns to finance home purchase is currently inconclusive, but this may be because current retirees have not benefited fully from the superannuation guarantee system which was only introduced in 1992. Future cohorts will retire having benefited from the ability to accumulate superannuation throughout their entire working lives, resulting in higher superannuation balances for future retirees (Wood et al. 2020). If superannuation balances are increasingly drawn down by future retirees to reduce mortgage debt or finance transitions into home ownership in retirement, this calls into question the adequacy and sustainability of the superannuation system. While substituting housing wealth for superannuation wealth may be a rational move on the part of retirees, such moves would dilute the capacity of the superannuation guarantee system to allow Australians to achieve adequate retirement incomes. It will be important to monitor the asset substitution behaviour of upcoming cohorts of retirees as more Australians retire with mortgage debt and higher levels of superannuation than previous generations.

2. THE FAVOURABLE TREATMENT OF HOUSING IN ASSETS TESTS

2.1 Incentive structures

Under the **age pension assets test**, the family home is exempt when determining the level of age pension entitlements. On the other hand, superannuation wealth is assessable. Hence, shifting wealth from superannuation investments into the family home can potentially increase the level of one's age pension entitlement. However, this undermines a key objective of the superannuation guarantee, which is to reduce reliance on the age pension (Wood et al. 2020).

Under the **residential aged care assets test**, the housing equity stored in an aged care client's place of primary residence is also favourably treated in comparison to superannuation. The family home is exempt from assets test if a spouse or dependant is still residing in the home; otherwise, the amount of assessable housing equity is subject to a cap of $169,079.20 (as at 20 September 2019). On the other hand, superannuation balances are assessable without any exemptions even if the superannuation savings are needed to support a spouse or dependant and not subject to any caps (My Aged Care 2019). This creates incentives for aged care clients to shift wealth from superannuation investments into the family home to benefit from the exemptions and caps that apply to the latter asset type (Wood et al. 2020).

2.2 Potential implications for the retirement income system

The preferential treatment of owner-occupied housing assets contributes to a reduction in equity and efficiency within the retirement income system.

Vertical and horizontal equity: From a vertical equity perspective, the preferential treatment of the family home in age pension and aged care assets tests results in higher levels of income support to those who have substantial wealth accumulated in their family home, at the expense of those who are not home owners. Hence, public funding is not targeted strongly on those in greatest need. From a horizontal equity perspective, the favourable treatment of housing assets in assets tests advantages those with a significant share of their wealth accumulated in the family home as compared to others with the same overall wealth level within a more diversified portfolio. Hence, persons with the same total wealth level are treated differently (Ong and Wood 2016).

Sub-optimal savings behaviour: The preferential treatment of the family home in age pension and aged care assets tests provide incentives for wealth accumulation in housing assets at the expense of superannuation assets. This has a potential to lead to unbalanced wealth portfolios that are over-exposed to house price risks. This concern is exacerbated by the fact that unlike many other income-generating assets, there are typically no insurance products designed to hedge the risk of house price declines (Shiller 2003; Smith and Searle 2010). These asymmetries between the treatment of owner-occupied housing assets and superannuation assets are inconsequential if the majority of Australian retirees are outright owners. Unfortunately, as detailed in section 1, as house prices have increased over time, more and more home owners are carrying higher LVRs, making them more susceptible to house price risk.

3. THE EXPANSION OF HOUSING ASSET BASED WELFARE

3.1 Key trends

Ironically, precariousness in home ownership is escalating at a time when reliance on housing as an asset base for welfare is also intensifying. Successive governments have implicitly encouraged housing as an asset base for welfare through the use of concessionary assets tests outlined in the previous section, tax subsidies as well as assistance for first home purchase. In the post-World War II decades, it was relatively easy to implicitly substitute housing wealth for age pensions as governments could heavily subside home ownership without driving up real house prices. This **substitution was implicit**; low-income retirees had low housing costs if they were outright owners and could therefore get by on smaller pensions. However, in recent years, fiscal pressures have prompted more intensive policy and industry interest in **explicit substitution** of housing wealth for age pensions in supporting the welfare of older Australians (Wood and Ong 2012).

Recent examples include:

- The Productivity Commission's (2011) recommendation for a government-backed Aged Care Equity Release scheme to enable elderly home owners withdraw part of their housing equity to help finance their accommodation and care costs.
- Expansion of the Australian Government's Pension Loan Scheme, a reverse mortgage style scheme that enables retirees qualifying for the age pension to receive a fortnightly loan to supplement their income by withdrawing equity from their home.
- *In situ* equity borrowing through flexible mortgage products available to home owners of all ages, that have developed in recent decades of financial deregulation and innovation (Ong et al. 2013).

3.2 Potential implications for the retirement income system

The expansion in housing asset base welfare can affect the operation of the retirement income system on multiple fronts. These impacts will likely manifest in the form of declining **equity and efficiency** as follows.

Intergenerational equity: There are actually some strong intergenerational equity arguments for encouraging housing asset based welfare. If current retirees who own substantial housing assets could draw down on some of their housing wealth to support their spending needs, this may relieve fiscal pressures and associated intergenerational equity concerns at a macro level. The use of housing equity by older parents towards their own needs may also go some way towards addressing the intergenerational transmission of advantage from parents to children of affluent background, if some parental housing wealth were diverted towards their own needs rather than passed on as intergenerational transfers (Ong 2016). Housing asset based welfare measures could generate fiscal savings, but would of course only be beneficial from a social policy perspective if these savings were diverted towards supporting core areas such as income, housing or care for those in greatest need.

Intra-generational equity: Housing asset based welfare policies may introduce new intra-generational inequities into Australian societies. The fact is that housing asset based welfare will only benefit those who own sufficient amounts of housing equity to support spending needs in retirement. While the majority of older Australians are home owners, there remain multiple groups who would be excluded from the benefits of housing asset based welfare in later life. These include older renters, home owners residing in areas with weak house price appreciation rates, and home owners with high LVR's. There is a gender equity concern too. Single older women have relatively low levels of superannuation wealth compared with older men. The former's assets are more likely to be concentrated in her family home and therefore more exposed to the house price risks associated with housing asset based welfare (see below) (Ong and Wood 2016).

Financial risks: A shift towards housing asset based welfare can increase retirees' exposure to financial risks on multiple fronts, including (but not limited to):

- **House price risk** Housing asset based welfare is inherently predicated on the assumption that house prices will continue to rise over time. However, in reality, downturns in housing market conditions do occur. Housing market fluctuations would weaken the reliability of housing as asset base for welfare (Ong et al. 2013).
- **Repayment risk** - Housing asset based welfare has largely grown in recent decades on the back of the introduction of debt-based instruments and therefore contributed to growing mortgage indebtedness among older home owners. Home owners who carry a mortgage debt into retirement are in turn exposed to greater repayment (and house price) risks in later life. Indeed, among mortgagors aged 55 years and over, their average mortgage debt to income ratio tripled from 71% in 1987 to 211% in 2015 (Ong et al. 2019).
- **Longevity risk** Those who underestimate their life expectancies risk being left with insufficient assets to support needs in old age, especially if unexpected health and care needs arise. Couples face additional challenges in having to account for different lifespans and patterns of health and care needs of both spouses (Jefferson et al. 2017).

CONCLUSION

The evidence raised in this submission presents a strong case for government to take into account the possible erosion of home ownership is a reliable contributor to retirement income security in the coming years. The need to plan forward in anticipation of changes in the home ownership sector cannot be understated, given the centrality that the family home plays within the wealth portfolios of most older Australians.

It is obvious that the levers that affect the home ownership sector are not confined to the retirement income system. In fact, these levers can be drawn from a range of policy domains, including but not limited to the tax, monetary, housing supply and planning systems. Nonetheless, there are various measures that lie within the scope of the retirement income system, or the wider income support system, that can mitigate some of the potential implications raised in this submission. These include, but are not limited to, re-investigating the adequacy of the age pension as the numbers of older private renters grow, increasing rent assistance to help older private renter retirees cope with rental cost burdens, re-considering the viability of continuing to exempt the entire value of the family home from means testing given the family home is both a consumption and investment good for most Australian home owners, and provision of objective government-backed financial literacy programs and product education services to promote optimal savings and borrowing behaviours in old age.

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