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Housing as the fourth pillar of Australia's retirement income system

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1. Background

Australia's retirement income system is generally seen as being based on three pillars: a publicly provided means-tested age pension, mandatory tax-advantaged private superannuation savings and voluntary savings which, depending on the form they take, also are often tax-advantaged. The age pension provides a safety net to retirement income, consistent with the traditional role of the welfare state. The second two pillars form the basis of what has been described as an asset-based approach to welfare, where public support is used to encourage accumulation of sufficient private wealth to ensure an adequate income in old age.

Owner-occupied housing is often regarded as a fourth pillar of Australia's retirement income system. It is both similar to, but also different from, the conventional three pillars. It is similar in that: i) the consumption stream it generates (in the form of untaxed housing services) protects older households from housing costs that could otherwise push them into after-housing poverty; and ii) it is the largest single source of household wealth for most older households and, as such, is a potential source of retirement income (Grattan, 2015: 12). It differs in that it simultaneously serves these roles, providing for consumption needs in the form of shelter while contributing to household wealth. In other words, owner-occupied housing is not simply a savings vehicle, but also provides current consumption (Treasury, 2016: 123).

Home ownership is seen as providing people with a sense of physical and emotional security and safety and a personal space in which they can be themselves. It provides independence, security, a sense of safety and a sense of belonging. It is seen as a response to a growing need for the sense of control and authority that people feel they are losing in many other aspects of their lives (Senate Select Committee, 2008: 16, citing work by Ipsos-Mackay). The safety net it provides if households exhaust their retirement savings is seen as benefiting both retirees and the community (Kelly et al, 2013: 7).

These perceived benefits are often used to justify the advantageous treatment accorded to owner-occupied housing in Australia's tax-transfer system. For 2015-16, for example, Treasury estimated that the income tax advantages for owner-occupied housing based solely on its exemption from the CGT exceeded $50b (Treasury 2016: 8).[1] This estimate does not include the benefits that arise because imputed rental income from owner-occupied housing is exempt from the income tax, because owner-occupied housing is exempt from both the income and assets tests for the Age Pension, or because it is exempt from land taxes. Kelly et al (2013: 8), in a Grattan Institute report, estimated these latter three exemptions amounted to a further $20b or so in 2013. There is considerable evidence to show that the tax expenditures associated with owner-occupied housing primarily benefit older and higher income households (Yates, 2010:56; Kelly et al, 2013: 17).

However, while the economic and social benefits that owner-occupied housing provides may offer some justification for ensuring that home ownership is accessible to those who value its characteristics, they do not provide any justification for providing higher subsidies to higher income households. As has been suggested in a number of places, the current structure of tax concessions provided to owner-occupied housing benefits home-owners, rather than those trying to access home ownership (eg, SERC, 2015: 143). On the basis of extremely conservative capital gains assumptions (of 3 per cent per year), Kelly et al (2013: 27) estimate income and land tax exemptions for owner-occupied housing provide benefits of $8,000 per household in the top income quintile compared with only $2,800 for those in the lowest income

[1] This estimate is based on a revenue foregone approach to estimating tax expenditures. It is considerably in excess of the $30b estimate of the superannuation concession.

quintile in 2011-12 with the result that just over one third of all income tax concessions go to households in the highest income quintile.[2] These tax concessions are not as unequally distributed as those from superannuation where over half of the concessions go to households in the top income quintile (Grattan, 2015: 26).[3]

The capacity of owner-occupied housing to provide the benefits outlined above and to provide protection for households in retirement obviously holds only for those who have been able to obtain access to home-ownership before retirement and who have been able to maintain this in their post-retirement years.

2. Housing and older households

2.1 Tenure and housing costs

Currently home ownership amongst older households is relatively high. In 2013-14, of the 2m households with a head aged 65 years or more, 84 per cent were owner-occupiers, with all but 8 per cent owning their dwelling without a mortgage. This compares with 67 per cent of Australia's 8.8m households who were owner-occupiers, of whom more than half had a mortgage on their dwelling. See Table 1. Of the 226,000 older households who rented, slightly more were private rather than social renters. This is in stark contrast with the population as a whole where the vast majority of the 28 per cent of households who rented did so in the private rental market and social renters accounted for only 4 per cent of all households.

Table 1: Households by tenure: Australia, 2013-14

	Households by tenure			
	All households		Households 65+	
	no. ('000s)	%	no. ('000s)	%
owner without a mortgage	2,755	31	1,527	76
owner with a mortgage	3,134	36	162	8
private renter	2,103	24	126	6
social/public renter	312	4	100	5
other*	462	5	86	4
All households	8,766	100	2,000	100

Source: Australian Bureau of Statistics Survey of Income and Housing, 2013-14. Results derived from ABS Basic CURF data.

* other includes 1.7% of households living rent free or renting from a relative and 1.8% living under a life-tenure scheme

[2] The favourable treatment of owner-occupied housing under the assets test does not follow this trend to the same extent as very few higher wealth households receive full or part pensions. On the other hand, in 2011-12, 40 per cent of expenditure on the age pension did go to households with more than $500,000 in net wealth (Kelly et al, 2013: 27)

[3] Note: home-ownership concessions are reported by disposable income quintile where income includes untaxed superannuation income; superannuation concessions are reported by taxable income quintile, where income excludes untaxed superannuation income.

High rates of home ownership, and particularly of home ownership without a mortgage, protect older households from high housing costs. Because the incidence of non-mortgaged home ownership among older households is considerably higher than for the population as a whole, the overall proportion of older households with high housing costs is lower than for the population as a whole. See Table 2.

However, the proportions of older households with a mortgage experiencing high housing cost burdens is similar to that for the population as a whole while the proportions of older households in private rental with high housing cost burdens is double that of the population as a whole.

Table 2: Housing cost burdens# by tenure: Australia, 2013-14

	Housing cost ratios					
	All households			Households 65+		
	<30%	≥ 30%	≥ 50%	<30%	≥ 30%	≥ 50%
	%	%	%	%	%	%
owner without a mortgage	97	3	2	98	2	1
owner with a mortgage	79	21	7	80	20	8
private renter	66	34	11	32	68	23
social/public renter	85	15	2	86	14	2
other*	81	19	7	75	25	9
All households	82	18	6	91	9	4

Housing cost burdens are described here by the ratio of total housing costs to gross household income.
* other includes 1.7% of households living rent free or renting from a relative and 1.8% living under a life-tenure scheme
Source: Australian Bureau of Statistics Survey of Income and Housing, 2013-14. Results derived from household weighted ABS Basic CURF data.

In general, high housing cost burdens occur primarily for lower income households but, with the exception of older households in private rental, even when data are disaggregated by income, the share of older owner households with high housing costs is below the population wide share. See Table 3.

Older owners without a mortgage are more likely have access to rate concessions from their local councils than are younger owners and may be more likely to defer maintenance and repairs. Older low income owners with a mortgage are far more likely to have paid off most of their mortgage debt.

On the other hand, high income older households with a mortgage do have higher housing costs in relation to their income than all high income households with a mortgage.

The most severe housing cost burdens, however, are born by households in the private rental market. Older households are disproportionately affected.[4] In private rental, the proportions of older households with high housing costs extends well beyond households in the first (equivalised disposable) income quintile into the second income quintile where the majority of

[4] In 2013-14 older households represented only 6 per cent of all households in the private rental market but were disproportionately represented in the lowest 2 income quintiles, with 76 per cent of all older households in private rental having such low incomes compared with only 38 per cent of all private renter households.

older households reliant solely on the age pension and rent assistance are located and even into the third income quintile where older households have additional income to supplement the age pension.[5]

Table 3: Share of households with housing costs >= 30% income by income quintile[#] and tenure: Australia, 2013-14

	All households					Households 65+				
	Q1	Q2	Q3	Q4	Q5	Q1	Q2	Q3	Q4	Q5
	%	%	%	%	%	%	%	%	%	%
owner without a mortgage	10	0	0	0	0	5	0	0	0	0
owner with a mortgage	68	33	22	15	6	33	22	20	9	18
private renter	88	52	25	10	2	86	75	41	12	0
social/public renter	19	11	0	3	0	18	5	0	0	0
other*	35	24	10	2	1	30	25	13	2	1
All households	39	23	15	10	3	15	8	5	0	9

Source: Australian Bureau of Statistics Survey of Income and Housing, 2013-14. Results derived from household weighted ABS Basic CURF data.
[#] Income quintiles based on household disposable income; including negative and zero incomes; same quintiles used for all households and those aged 65+.
* other includes 1.7% of households living rent free or renting from a relative and 1.8% living under a life-tenure scheme

2.2 Impact of housing on living standards

Tenure and housing costs in relation to income have a significant impact on living standards for older households. High housing costs can push households into after-housing poverty but low housing costs can protect them from this. A recent OECD report, for example, showed that the poverty rate for older Australians was one of the highest among OECD countries (OECD, 2015).[6] However, as Bradbury (2016) argues, income is not a good indicator of living standards for older households where retirees hold substantial housing wealth as is the case in Australia. The OECD cautions that a significant omission from their poverty measure is the imputed income from home ownership and the associated lower housing costs associated with home ownership. Two approaches have been used in the literature to address this – adding a measure of imputed rent to income, or subtracting housing costs from income (creating 'after-housing' income). Bradbury and Gubhaju (2010: 1) suggest that, if it is easy for people to liquidate their housing assets to finance non-housing consumption, then inclusion of imputed rent in income provides a better measure of living standards whereas, if housing is illiquid and older households are more likely to be over- rather than under-consuming housing, then an after-housing measure of income is a more appropriate indicator of living standards. Yates and

[5] In December 2014, the mid-point of the ABS 2013-14 survey, maximum pension payments (including rent assistance) for a single person was $483.90 and for a couple was $693.40. The cut off points for households in the first and second income quintiles were, respectively, $474 per week and $670 for a single person (and 50 per cent higher – that is, $711 and $1035 - for a couple). Results for older non-home owning households with incomes above Q2 are based on small sample sizes and likely to be unreliable.
[6] Using a relative poverty line based on half the median household income of the whole population. The OECD also assumes that couples need only 1.4 times the income of single people to reach the same living standard, compared to a 1.5 ratio in the current Australian Age Pension (following the large increase in single pension in 2009).

Bradbury (2010: 203) show that, on an after-housing measure, income poverty in Australia is reduced considerably for most households with the result that Australia's relative international performance improves markedly. Australia changes from having one of the highest before housing poverty rates to one of the lowest after-housing poverty rates (among countries for which comparable data are available).[7]

2.3 Household wealth in retirement

This improvement arises because of the housing wealth held by older households in Australia. Table 4 presents a snapshot of asset and debt portfolios of Australians aged 45+ in 2013-14.[8]

Table 4: Asset and debts of Australians aged 45+ years, by age band, 2013-14

	Mean household assets and liabilities			Household assets and liabilites as percentage of totals		
	45–54	55–64	65+	45–54	55–64	65+
	$'000s	$'000s	$'000s	%	%	%
Asset						
Principal residence	481	514	468	41	38	44
Other residential property	144	157	78	12	12	7
Superannuation	196	316	159	17	23	15
Other assets	358	372	363	30	27	34
Total	1,178	1,358	1,068	100	100	100
Debt						
Principal residence	113	55	6	53	43	28
Other residential property	62	43	9	29	34	38
Other debt	37	30	8	17	24	34
Total	212	129	23	100	100	100
Net worth						
Principal residence	368	459	462	38	37	44
Other residential property	81	113	69	8	9	7
Superannuation	196	316	159	20	26	15
Other assets	321	341	355	33	28	34
Total net worth	967	1,230	1,045	100	100	100

Source: Australian Bureau of Statistics Survey of Income and Housing, 2013-14. Results derived from household weighted ABS Basic CURF data.

Table 4 clearly shows that the family home is the most important store of wealth in the portfolios of older Australians, representing over 40 per cent of the total household net worth of those over 65 in 2013-14 and slightly lower shares for those aged 45-54 and 55-64. Superannuation, introduced as a compulsory form of saving only in 1992, ranks a somewhat distant second, with a lower share (at barely 15 per cent of total net worth) for those over 65 compared with over 20 per cent for those aged 45-64. This is because the most intensive working years of the over 65's

[7] With lower after-housing poverty than the US, UK, Italy and Sweden (but still higher than Canada and Finland).

[8] The composition of asset and debt portfolios remained virtually unchanged between 2002 and 2010 (Ong et al, 2013a: 59).

would have preceded the introduction of the compulsory superannuation guarantee in 1992. A small fraction may have taken superannuation pay-outs and placed them in other investments (see below). However, even if this were taken into account, it is clear that superannuation has yet to become the primary source of wealth in retirement.

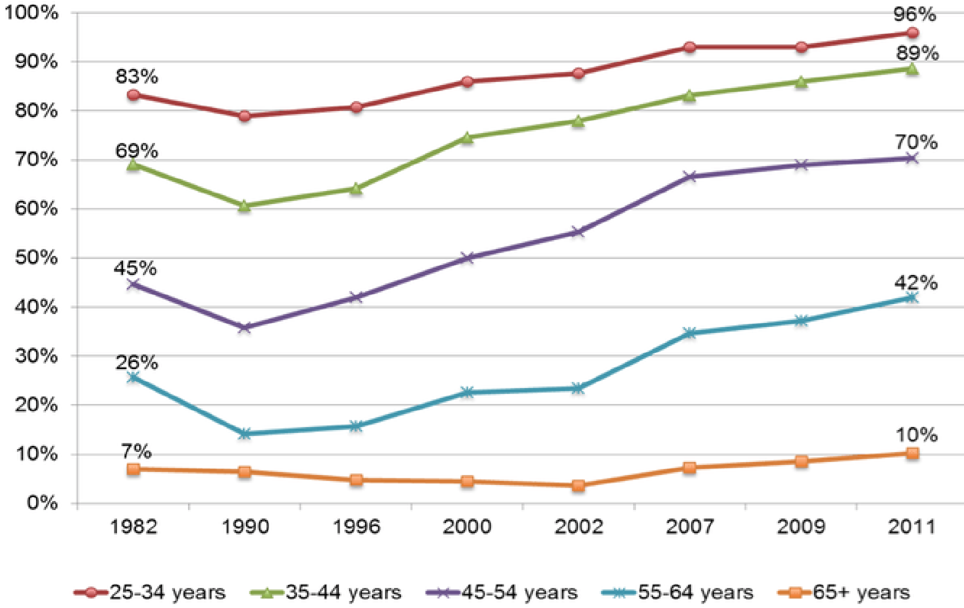
There are a number of reasons why it is more likely to be so in the future. Superannuation, generated by both compulsory and voluntary contributions, currently provides households with an alternative tax-advantaged form of wealth accumulation that, in the long-run at least, can compete with wealth accumulation via home ownership in terms of the tax concessions provided. Any tightening of the concessions currently given to the family home in the assets test for the age pension may reinforce a redistribution of household wealth away from owner-occupied housing and towards superannuation.

In addition, as increasing land prices have made access to home-ownership increasingly difficult in locations other than at the urban fringe or in non-metropolitan households, an increasing number of households are making life-style choices to rent in inner city locations rather than become home owners, at least in their younger years.

While those currently aged 45-64 years have higher accumulated superannuation wealth than those aged 65+, they also have significantly higher levels of mortgage debt secured against their family home. This finding is to be expected as those currently aged 65+ have had more years over their lifetime to repay debt and were more likely to enter home ownership at a time when lower levels of mortgage debt were required because dwelling prices were significantly lower.

This pattern, however, might be changing. Ong et al (2013b) and Wood et al (2015) have shown that, over the past 25 years or so, a rising share of over 55s have housing debt associated with increased gearing (and equity withdrawal). See Figure 1. For those who have a mortgage, the average mortgage debt to income ratio has increased dramatically in the two decades from 1990. For older persons, for example, it has risen from 80 to 200 per cent (Wood et al, 2015).

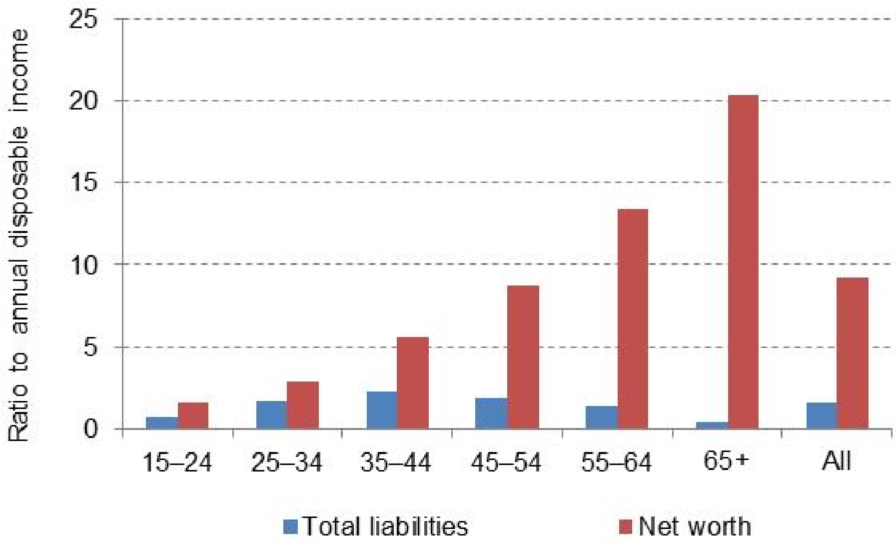
Figure 1: Percentage of home owners with a mortgage debt



Source: Wood et al (2015). Data relate to persons, not households.

The aggregate data for 2013-14, however, suggests that total household debt, both in relation to total net worth (as shown in Table 4) but also in relation to disposable income (as shown in Figure 2), is still relatively low. Productivity Commission (2015b: 46) indicates debt has grown less than assets and that those with debt in later life have means to sustain this (Bray, 2013). Ong et al (2013b: 54; 2015) find that those who take out in situ mortgage equity withdrawal typically have reasonably sound economic positions and do not face greater exposure to repayment or negative equity risk than those who have not increased their debt holdings. The greatest risks are faced by those who experience adverse life events, such as marital breakdown, ill health, or unemployment.

Figure 2: Ratio liabilities and net worth to household disposable income, 2013-14



Source: Australian Bureau of Statistics Household Income and Wealth, 2013-14, Cat. No. 6523.0, Data cube 6523do00012_201314.xls Tables 12.1 and 12.2.

The rise in mortgage debt among older households raises two important questions. Firstly, will a faster rate of superannuation accumulation by the 'young' old impact negatively on the rate of paying down mortgage debt (or increase the appetite for debt) during working lives? Secondly, are Australians in fact using superannuation lump sum withdrawals to pay down mortgage debt in retirement?

The answers to the above questions have profound implications for post-retirement incomes. In relation to the first question, Kelly et al (2013) offer evidence that gives some credence to concerns that households are willing to use their accumulated superannuation wealth to offset rising debt levels once retired. Nationally, the growth in superannuation balances over the last two decades has been matched by an increase in household debt. Hence, it may be that households are becoming more comfortable with taking on mortgage debt in an era of sustained house price appreciation in the knowledge that they can access their superannuation 'nest egg' after preservation age to pay down this debt (Cassells et al. 2015).

In relation to the second question, it is unclear whether lump sum superannuation withdrawals are being used to pay down debt in retirement as relatively few retirees make lump sum superannuation withdrawals upon retirement. The recent Productivity Commission study on superannuation policy for post-retirement (2015a) found that less than 30 per cent of superannuation benefits are accessed as lump sums and that the small number of retirees who do make lump sum superannuation withdrawals use the funds to pay down debt.[9] However, Bray (2013) finds little systematic evidence of the use of superannuation lump sums to pay off debt.

[9] Ong et al. (2013a) found similar results from the HILDA Survey although their results are based on a small sample size. They found that mortgagors aged 45+ who withdrew superannuation as a lump sum in adjacent years between 2001 and 2010 were much more likely to have reduced mortgage debt over the same period than those similarly aged mortgagors who did not make lump sum withdrawals.

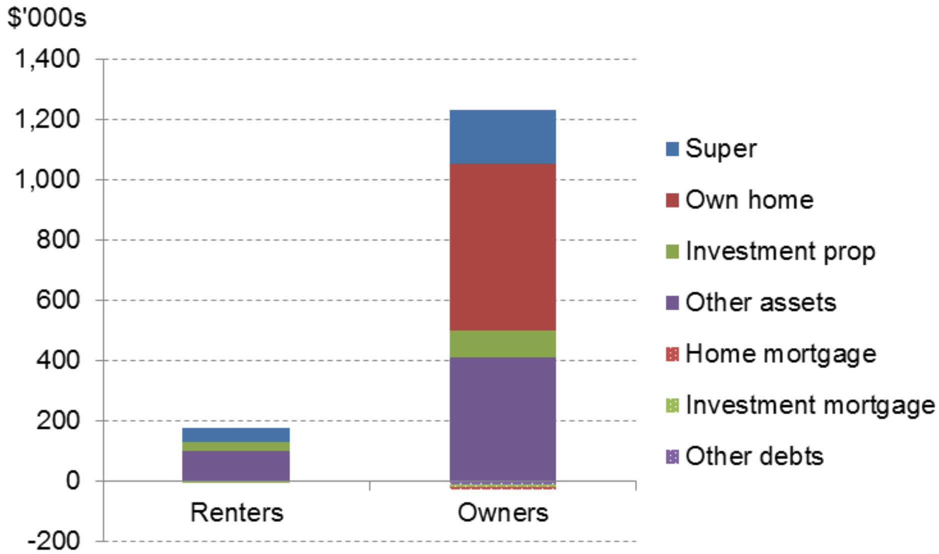
This leads to the third point, the potential impact of home equity withdrawal (HEW) on the robustness of housing wealth as an asset base in old age. Government policies (such as tax expenditures and concessionary asset tests) that encourage accumulation of wealth in the primary home are a cornerstone of Australian social policy. These policies are prefaced on the assumption that homeowners will own their homes outright in old age, hence lower incomes in retirement will be matched by low housing costs, and retirees can therefore get by on smaller pensions (Castles 1998; Baxter and McDonald 2005). However, homeowners that use HEW to meet spending needs earlier in their life cycle will eat into housing wealth. As shown in Figure 1, an increasing proportion of older Australians is approaching retirement with outstanding mortgage debt, a trend that (on early indications) has not been reversed by the GFC. While some may pay off their mortgage debt using lump sum superannuation payouts, those who do not presumably will continue making regular mortgage repayments after they retire.

The implications for retirement incomes policy of the relationship between rising superannuation levels and growing indebtedness in an era of deregulated mortgage markets need to be considered. Those who choose to use their housing wealth (via increased mortgage debt) to bring forward superannuation balances for consumption pre-retirement will have fewer assets in retirement to support consumption. Those who do not pay off their debts have increased demands on their income and are exposed to interest rate risk. In either case, the growing indebtedness of older households is likely to dilute the capacity of the superannuation system to contribute to self-sufficiency in retirement. This is perhaps not surprising. It could be seen as an unavoidable 'leakage' of compulsory superannuation as some people rearrange their affairs to negate its impact. Nonetheless, this needs to be accounted for when considering the likely impact of superannuation on retirement wealth.

2.4 Tenure outcomes and trends

Despite these concerns, the potential implications for living standards for households who retire with relatively high levels of mortgage debt are likely to be relatively minor compared with the problems faced by households who, while they may retire with no housing debt, also retire with no housing assets. The averages reported in Table 4 hide the unequal distribution of net wealth amongst those of retirement age. Figure 3 highlights the disparities in wealth holdings for older households who retire as renters or as owners and shows the significant wealth holdings of the latter.

Figure 3: Assets and debts of owners and renters aged 65+, 2013-14



Australian Bureau of Statistics Survey of Income and Housing, 2013-14. Results derived from household weighted ABS Basic CURF data.

A significant proportion of households, in fact, retire with little or no household wealth. In the main, these are the households who have been unable to access (or sustain) home ownership during their pre-retirement years. They are often also the households who retire with little or no income other than that provided through the welfare system. They are what the ABS refers to as low economic resource households.

These households form the basis of what Yates and Bradbury (2010: 194) describe as 'systematic and disturbing exceptions' to the generalization that, in international comparisons, Australia ranks among the best rather than the worst when income poverty rates are measured after housing costs rather than before housing costs. In the early 2000s, older renters in Australia had a before-housing poverty rate that was approximately twice that of older homeowners and an after-housing poverty rate that was at least four times that of older homeowners (ibid: 203). These results reflect both the lower incidence of home ownership amongst lower income older households (see Figure 3) and the higher incidence of housing stress for lower income renter households, particularly for those in private rental (see Table 3). For these reasons, a critical question is whether older households in the future will experience the same protection from high housing costs enjoyed by the current cohort because of their high rate of (generally debt free) homeownership and their relatively low reliance on the private rental market.

Current tenure trends reinforce concerns about the future protection that housing will provide for older households. From at least the mid-1980s there has been a discernible decline in home ownership rates among younger households. By the mid-1990s, this was substantial only for those younger than 35 years but by the mid-2000s had filtered through to those younger than 45 and by the mid-2010s to those younger than 55. In the 25 years since 1988-89, home ownership rates for households aged 25-34 years had fallen by 21 percentage points to below 39 percent; those for households aged 35-44 by 12 percentage points to 63 per cent; those for households aged 45-54 by 10 percentage points to 74 per cent and those for households in the pre-retirement age group 55-64 years by 4 percentage points to 80 per cent. See Table 5.

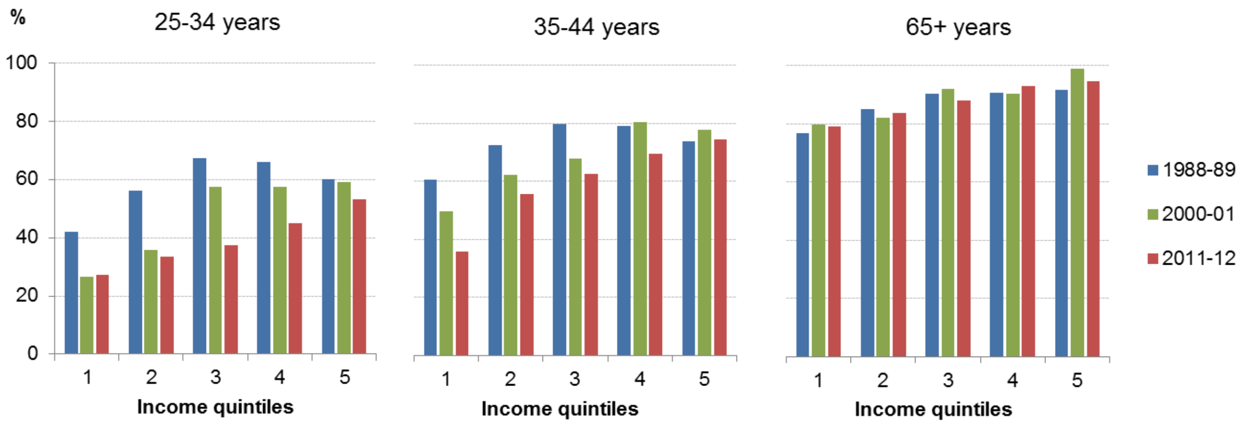
Table 5: Home ownership rates by age: 1988-2013

	Age of head of household					
	25-34	35-44	45-54	55-64	65+	All
	%	%	%	%	%	%
1988-89	59.7	74.4	83.1	84.4	83.4	72.7
1993-94	50.7	70.3	80.3	81.5	82.5	68.5
1995-96	50.4	71.6	81.3	85.1	83.5	70.9
1998-99	48.4	70.9	78.9	81.3	85.0	69.4
2000-01	50.8	69.1	79.2	83.6	84.2	70.4
2002-03	49.4	67.9	79.2	81.7	83.1	69.5
2003-04	50.0	67.8	78.8	82.5	83.1	70.0
2005-06	47.8	66.1	77.9	81.4	84.6	69.3
2007-08	43.4	65.1	76.0	82.6	83.2	68.2
2009-10	44.8	63.6	76.3	81.6	84.6	68.8
2011-12	42.0	62.2	74.5	80.1	83.9	67.4
2013-14	38.7	62.6	73.5	80.4	84.5	67.2
% point change over 25 years	-21.0	-11.8	-9.6	-4.0	1.1	-5.5

Source: Australian Bureau of Statistics Surveys of Income and Housing. Results derived from ABS Basic CURF data. Data are household weighted.

Across all households, and particularly for younger households, these declines have been most pronounced for households in the middle income quintiles – in turn, households most likely to be potential first time buyers unable to purchase a suitable dwelling in an acceptable location because of affordability constraints. See Figure 4.

Figure 4: Home ownership rates by income quintile and selected age groups: 1988-2011



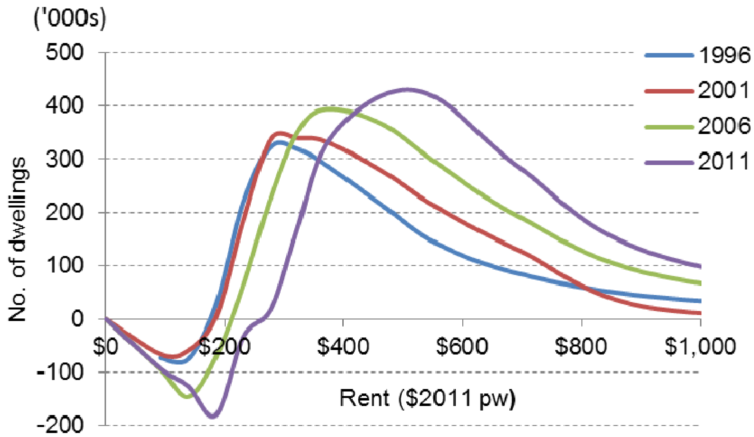
Source: Australian Bureau of Statistics Surveys of Income and Housing. Results derived from ABS Basic CURF data. Income quintiles based on equivalised disposable income for the population as a whole. Data are household weighted. (Yates, 2015)

Without some significant change in current trends, over the next 25 years these declines mean that an increasing proportion of households will retire without the protection against high housing costs provided by non-mortgaged home ownership. Any tendency for older homeowners to move out of homeownership into renting, such as reported by Ong et al. (2015) for home owners aged 45 and over, will reinforce this.

Currently most low-income and asset poor older renters are able to cope with rental costs because they are in the public or social rental system. However, since the mid-1990s, the social rental stock has declined as a proportion of total rental stock (Productivity Commission, 2015c: chapter 17) and that which is available increasingly is allocated to households with health and/or social needs. Yates (2015: 75) estimates that the share of low-income, low-asset older households in the private rental market could increase from a current share of less than 2 out of every 5 renter households to 7 out of every 10.

The supply of affordable housing in the private rental market, however, has declined steadily over the past 25 years both in absolute terms and in relation to the underlying need for this in terms of the numbers of low income households in private rental and the rental stock they potentially can afford. See Figure 5.

Figure 5: Trends in shortages (-)/surpluses (+) of affordable private rental dwellings



Source: Hulse et. al (2015: Figure 7) derived from customised ABS data from Australian Census of Population and Housing

The private rental market is also relatively ill-equipped to allocate that affordable housing which does exist to those most in need of it because of their limited capacity to pay. Housing shortages for low income households are exacerbated by the allocation of affordable dwellings to higher income households. This has led to a shortage of affordable dwellings that are available to lower income households in the private rental market that has steadily increased since the mid-1990s (Hulse et al, 2015: 45).

These broad trends suggest that an increasing proportion of older households are likely to rely on the private rental market in their retirement years. The data reported in Table 3 suggest that these are the households who, in the future, are likely to face excessively high housing costs in relation to their income.

3: Potential policy solutions/issues for older households

The analysis presented above suggests a clear priority for policy options to recognise the importance of housing when ensuring adequate living standards in retirement.

If the primary objective of retirement income policy is '*to provide adequate income for all Australians through all the years of retirement,'*[10] then the top policy priority must be to address the living standards of renters who retire with low income and low wealth. The living standards of households who retire with low to modest income and modest wealth should be addressed next. As subsidiary objectives such as *'alleviating fiscal pressures on Government'* are taken into account, attention can then be turned to focusing on ways to '*encourage to greater self-provision in retirement*' for households with adequate income and wealth.

[10] These objectives are taken from CRSI discussion paper *Objectives of the Superannuation System* (25 January 2016)

3.1: Low income, low wealth older renters

The key housing attributes valued by older households include privacy and autonomy, affordability, security of tenure, adaptability for future care, location, suitability, size, amenity and space.[11] Policies intended to protect their living standards need to ensure these attributes are protected.

Broad policy directions for low economic resource households can work either through increasing the supply of affordable rental housing in the public or private sectors and/or reducing the housing cost burden of housing that is available.

Increased supply of affordable social rental housing

Housing costs for low income, low wealth renters can be reduced by policies that increase the supply of social (public or community owned) housing that is appropriate to their needs, provides them with access to the services they require and which ensures independence, security, a sense of safety and a sense of belonging. As acknowledged in the terms of reference for the Affordable Housing Working Group ('the Working Group') established by the Australian Government under the Council on Federal Financial Relations (CFFR)[12], there is 'currently a structural problem in Australia where the demand for affordable housing outstrips its supply, leading to lengthy social housing waitlists and some low-income households facing rental stress or being unable to retain housing at all. The problem is too big for governments to solve (and finance) alone, requiring a long-term market-oriented response, at scale.'

Over the past few years, considerable work has been undertaken on ways in which private sector finance can be utilized to expand the under-supply of social and affordable housing. Milligan et al (2015) provide an overview of this work, identify the barriers that need to overcome to attract institutional finance to the affordable housing sector and set out a 10 point strategy for achieving this objective.[13] One key recommendation is the establishment of a specialist financial intermediary to raise funds (for example through bond issues with some form of credit enhancement such as a guarantee).

The Affordable Housing Working Group is due to provide its final report on these issues to Heads of Treasuries by 30 June 2016.

Increased supply of affordable private rental housing

A less direct way of achieving this outcome might be to provide incentives to increase supply of appropriate affordable private rental housing, such as by making tax concessions to private investors conditional upon the concession being used to provide appropriate, secure and affordable rental housing for over 65s.

As with policies to expand the use of institutional investment into affordable rental housing, mechanisms need to be in place to ensure that the dwellings so provided are, indeed, both appropriate and are allocated to the intended group. Use of well-regulated community housing providers to manage such housing is an obvious way of achieving this.

Questions such as how the need for long term security and the potential for conflicts between landlord and tenant rights are to be dealt with are issues that need to be addressed. In broad terms, however, any policy that encourages diversity in housing form and an increase in the

[11] These attributes are taken from Jones et al. (2007).

[12] Details available at http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/CFFR-Affordable-Housing-Working-Group.

[13] This report provides an update of Milligan et al (2013) and builds on ealier work by Lawson et al (2014) and Lawson et al (2012)

supply of affordable housing, particularly of housing that meets the needs of older households in terms of providing access to the services they need, is desirable.

Increased rent assistance

Each of the above solutions is likely to require an increase in rent assistance, particularly for high needs households. Design issues as to whether such assistance could be or should be provided through an increase in Commonwealth Rent Assistance (CRA), whether it should be available only to pensioners, whether it should vary by region and/or be tied to market rents, whether it should be targeted to providers rather than individuals and tied to an increase in supply are all issues that need to be addressed, as is the question of what the likely impact is on rents in the private market if increases in CRA are not tied to an increase in the supply of affordable rental supply.

The question of whether support should vary spatially to ensure that it is adequate to protect older renters who have developed a strong sense of belonging to a specific location from the risk of being priced out of their current dwelling and away from the community support that they have come to rely upon should also be considered.

Use of superannuation funds to fund home purchase

A final option, unlikely to be of relevance for low economic resource households, is to encourage use of superannuation assets to fund home purchase should these be sufficient to do so. The current cohorts of older households have little accumulated superannuation wealth either in retirement or as they near retirement. This may change if inability to access home ownership during pre-retirement years causes a substitution of wealth accumulation away from housing and towards superannuation but is unlikely to do so in the short or medium term.

Obvious issues with this proposal arise from the adequacy of accumulated superannuation to serve this role and the adequacy of the retirement income of a low economic resource household to fund any debt funding that might be available to supplement superannuation assets. Such a solution may simply replace rental stress with mortgage stress and leave households with the same sense of insecurity that they experience in the private rental market. By diluting the capacity of the superannuation system to contribute to self-sufficiency in retirement, this proposal is likely to result in the same increased pressure on the age pension system as proposals to increase CRA.

More generally, it needs to be recognized that any asset-based welfare policy will inevitably have gaps – through which life-time disadvantaged people are the most likely to fall through. There will always be a substantial number of people who arrive in old age with minimal assets, and assisting these people should remain a priority.

3.2: Low-modest income, modest wealth older households

Broad policy options for households who do not fall into the low economic resource category are likely to depend on their tenure status (which, in turn, is likely to affect their relative income and wealth status).

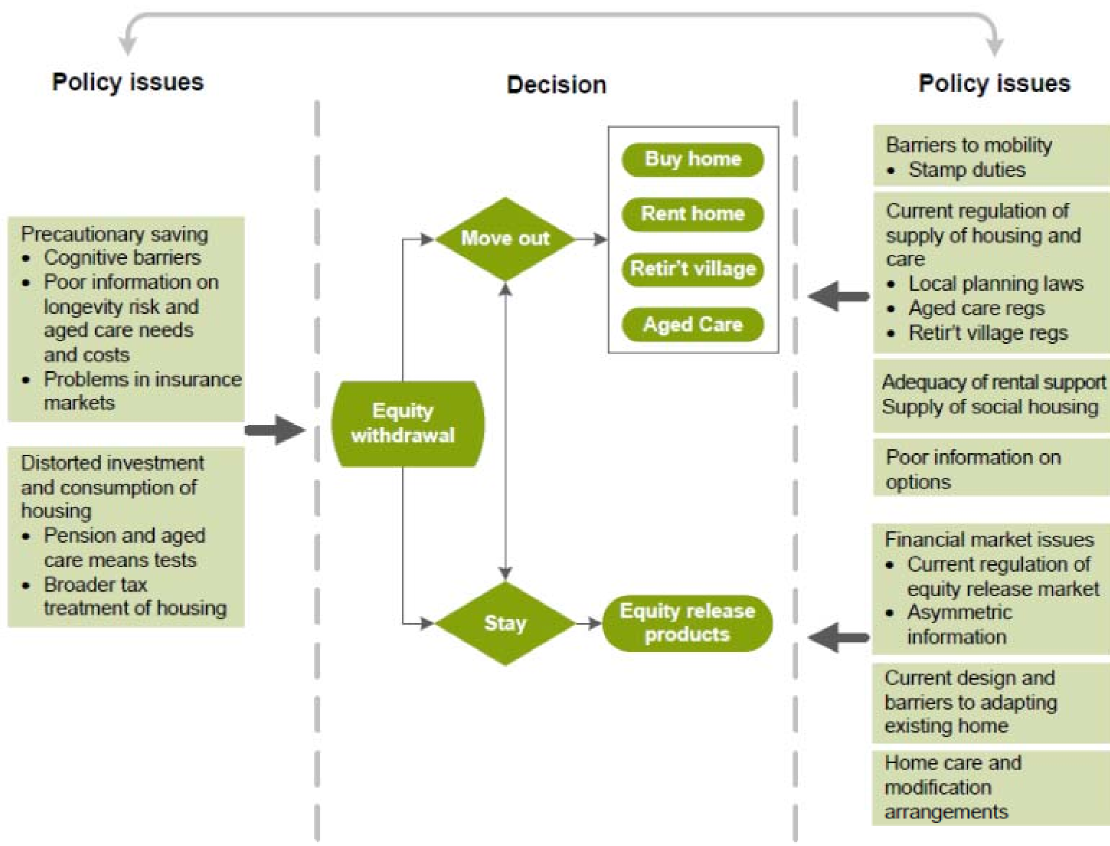
Policy options, and associated issues, for modest income, modest wealth older households who are renters are similar to those outlined above for low income, low wealth renters.

For modest net wealth owner-occupier households with a mortgage, options are likely to differ depending on whether their mortgage is associated with investment or owner-occupied, property. Households facing negative income flows or facing mortgage stress as a result of their decision to debt finance an investment property can choose to redeem their assets and pay-off any outstanding debts. Should a capital loss on their investment assets leave them in a position of negative equity, then policy options to assist mortgaged owner-occupiers will be relevant given that any debt arising from liquidation of their assets will have the same impact on their net wealth as would a mortgage.

Options both for mortgaged and non-mortgaged owner-occupiers wishing to increase their retirement income include downsizing or in-situ equity release through a variety of equity release mechanisms such as loan based reverse mortgages based on taking out a loan against the family home or equity based home reversion or shared equity schemes based on selling a proportion of equity in the family home.

Policy issues related to these housing decisions are illustrated in Figure 6. Only those options that relate to remaining in the private housing market are considered below.

Figure 6: Policy issues affecting housing decisions of older Australians



Source: Productivity Commission (2015b: 46)

Downsizing

The most straightforward policy option for low or modest income households facing mortgage stress as a result of having to pay off a mortgage on their owner-occupied property is to assist households to extract equity from their property and to reduce their housing debt by downsizing. There are, however, a number of constraints which dilute incentives to downsize.

A key issue with downsizing policy is the availability of suitable dwelling stock for older households. Judd et al. (2014) find that the most common difficulty cited by those who have downsized since turning 50 years is the availability of an appropriately housing type (64 per cent). Concerns over the affordability of housing (45 per cent) and suitability of locations (33 per cent) are also important factors were further significant factors. The stock of appropriate housing is seen as being constrained partly by laws that restrict investment in retirement villages, planning regulations that inhibit smaller and innovative housing development and partly by an incomplete understanding of what seniors want and can afford (Hugo et al, 2011, cited in Treasury, 2011b: 22).

Judd et al. (2014) also highlight the emotional costs of moving on not just older home owners but their adult children who have left the family home but resist downsizing intentions by their ageing parents because of their ties to what they regard as “their family home” (ibid: 114). Ong et al. (2013b) find that downsizing is associated with potential social isolation. Home owners express concerns that downsizing will result in moves into unfamiliar communities or the loss of accommodation space for visiting family members.

Policies such as those outlined above to address the shortage of affordable housing supply can be used to increase supply of dwellings for rent or for purchase and can be used to at least ameliorate some aspects of these availability constraints. Given the attachment that many older households have to place, and their increasing need to have access to health-related services, any new affordable housing supply needs to be in locations that meet these older persons’ needs.

Other constraints to downsizing also exist. Currently, the structure of the tax-transfer system provides no incentives for shifting wealth out of the family home. Transaction costs, the operation of means tests and moving costs all eat into the housing equity realised on downsizing (and/or selling up). Tax-benefit simulations by Ong et al. (2013b) show that home owners aged 45+ who downsized between 2001 and 2010 incurred stamp duty liabilities equivalent to around 8-10 per cent of the housing equity released. When legal costs and moving costs are added, over 10 per cent of the equity released would be lost through downsizing.

Proceeds from the sale of the family home also become an assessable asset under the means test for the age pension, and any equity re-invested in a financial asset becomes subject to deeming rules under the income test. Ong et al (2013b) find that 60 per cent of downsizing episodes by home owners aged 45+ result in a reduction in income support payments.[14] Home owners who are affected are likely to experience a 20 per cent reduction in their income support payments on average. Interviews with home owners aged 45+ confirm there is a perception that transaction and other moving-related costs can eat into the equity released through downsizing. However, Judd et al. (2014) find that among those who have downsized since turning 50 years, a very small percentage (5.4 per cent) cite “fees or stamp duty costs” as a difficulty encountered in moving.

An alternative to downsizing is to provide older households with opportunities for ‘in situ’ equity release. In situ equity release can be achieved either through debt (for example, reverse mortgages) or equity (for example, home reversion schemes) products. An overview of these products, a comparison of the products available and a discussion of in situ equity release in relation to the funding of residential aged care services is covered in Productivity Commission (2015b). Such options are more likely only to be available to households who do not have a mortgage.

Although this in situ option clearly eliminates the emotional costs of leaving the family home, it is seen as raising more complex problems than those that arise with downsizing (Ong et al, 2013b).

[14] Increases to the asset test taper rate in January 2017 will accentuate this effect.

'In situ' equity release via reverse mortgages

The amount that can be borrowed under a reverse mortgage scheme increases with age, starting from roughly 15-20 per cent of the value of the home at age 60 and increasing by 1 per cent per for each year above 60. The market for equity release products, however, is very small, covering an estimated 1-2 per cent of older home owners. The value of outstanding reverse mortgages accounts for less than 0.5 per cent of home equity currently owned by older Australians and the average debt of a reverse mortgagor in 2015 was less than $100,000 (Productivity Commission, 2015b: 25).

A major problem is that in situ equity release is fraught with risks because it is facilitated through loans that have to be repaid in the future. During the loan tenure, the borrower is exposed to a range of risks related to fluctuations in housing and mortgage market conditions. Housing and financial risks include longevity, repayment and negative or limited equity risk. There are also challenges associated with family and intergenerational relationships.

As equity release is a form of borrowing in later life, borrowers will be exposed to longevity risk. Assets might run out and/or debt balloon to unexpected levels very late in life, affecting the adequacy of savings and income in old age. Use of a reverse mortgage reduces the option of using housing assets later in life to protect against future needs (such as aged care). One approach to this would be to build some form of insurance against these risks into the reverse mortgage product.

Repayment risk can be a problem if interest rates rise or incomes fall. Attempts to reduce interest rate risk by fixing interest rates can result in high costs if the agreement needs to be broken. In terms of income risk, Ong et al. (2013b) find that *in situ* equity borrowers aged 45+ do not necessarily face greater exposure to repayment risk than other similarly aged mortgagors who do not release equity. However, the study finds that repayment risk is highly correlated with adverse life events such as marital breakdown, ill health and unemployment. Such events will impact on in situ borrowers more severely because their levels of mortgage indebtedness are roughly 1.5 times the level owed by other mortgagors who do not engage in in situ equity withdrawal. For those over retirement age, income risk might be relatively low but they will still face expenditure risks that could have a similar impact. For example, they might still wish to hold precautionary saving against unexpected expensive medical expenditures or the income risks facing their children.

Negative equity risk is negligible but Ong et al. (2013b) find that one in five home owners aged 45+ who engage in equity withdrawal have housing equity that is less than 40 per cent of the value of their homes (defined by the study as being in limited equity risk), compared to one in ten other mortgagors who do not engage in equity withdrawal. Upper bound estimates from a scenario modelling exercise in their study show that the Productivity Commission's (2011) recommended Aged Care Equity Release scheme may sharply increase the incidence of limited equity risk among elderly home owners aged 75+ assuming a full user pays setting. In 2012, however, the Government introduced statutory 'negative equity protection' on all new reverse mortgage contracts.[15]

The impact on family and intergenerational relationships also provides a further potential source of risk with in situ equity release products. Interviews with key service providers indicated cases of adult children who oppose parents' decisions to engage in equity release due to their personal motivations to inherit their parents' house. In other cases, elderly parents release equity to provide financial assistance to adult children with the children making repayments.

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[15] ASIC, at https://www.moneysmart.gov.au/superannuation-and-retirement/income-sources-in-retirement/home-equity-release/reverse-mortgages. Accessed 8 March 2016

However, the elderly parents become exposed to default risk if their children experience adverse life events e.g. job loss or business failure. Family tensions also arise if one sibling learns that the parent has used funds from equity release to help another sibling (Ong et al., 2013b).

'In situ' equity release via home reversion schemes

These schemes are based on selling a fixed proportion of the family home in return for a (generally discounted) lump sum payment. Currently these options are only available for households living in Sydney or Melbourne and there is only one home reversion provider which means there is no competition in the market.[16]

Many of the same risks apply with reverse mortgages. In addition, because the returns to the provider are based on future capital value of the home, the costs of such schemes are unknown. Questions of pension eligibility also arise.

The risks associated with such schemes and their limited availability in the market suggest there might be a role for introduction of a government provided or at least regulated shared equity scheme.

In broad terms, however, demand for equity release products is low because there is a general reluctance for older people to tap into their housing wealth because: they have a strong aversion to debt; they have a desire to preserve home equity for precautionary savings or bequest motives; there is risk and uncertainty associated with the products available; and because of concerns about the effect of equity withdrawal on eligibility for the pension and for aged care support (Productivity Commission, 2015b: 26). For these reasons, the Commission does not consider there are strong efficiency or equity arguments for active government intervention. It also argues that there would be a number of equity concerns if policy changes such as a tightening of the means testing for the age pension compelled a large number of older people to draw down their home equity (ibid: 165).

It does suggest, however, that there may be a role for government provision of equity release products as a part of wider tax and transfer reform but that this would depend on the broader policy context and any reforms affecting the principal residence. A redesigned pensioner loans scheme (PLS) might address equity concerns if the means test for the pension was reformed. A deferment scheme or might be appropriate to complement aged care co-contributions or introduction of a land tax on the principal place of residence (ibid: 171).

Provision of a safety net for mortgaged home owners in mortgage stress

An alternative shorter term solution might be to provide mortgage payment protection insurance under certain circumstances. Mortgage insurance for households temporarily facing mortgage stress as a result of adverse life events has underpinned mortgage payment protection insurance schemes in a number of countries. UK based research, however, suggests private sector have been expensive and unpopular with those most at risk least likely to take up private insurance or to have had access to it. State based schemes have generally been inadequate (see, for example, Ford and Quilgars, 2001).

Public sector schemes raise the question of whether limited public subsidies should be directed to households with at least modest wealth at the expense of those with limited or no wealth. For older households, they also raise the question of whether any support provided is likely to be temporary. This notwithstanding, such schemes are still available for pensioner households in

[16] ASIC, at https://www.moneysmart.gov.au/superannuation-and-retirement/income-sources-in-retirement/home-equity-release/home-reversion-schemes. Accessed 8 March 2016

the UK,[17] and the Scottish government operates mortgage to rent and mortgage to shared equity schemes to assist home owners experiencing difficulty.[18]

One option to address some of the issues surrounding such schemes would be to make such insurance compulsory for all borrowers and to fund it by a hypothecated charge on all housing loan contracts.

3.3 Adequate income, adequate wealth older households

Households who enter retirement with adequate incomes and adequate wealth are likely to provide the basis for policy options that can be used to make the current retirement income system more efficient and, in doing so, also can provide the funds to make it more equitable. As highlighted in the introduction, to the extent that their wealth is based on housing and superannuation assets, these households are currently beneficiaries of the significant tax expenditures associated with these assets and of their favourable treatment in the income and assets tests for the age pension. There are a number of ways in which these inequitable and distortionary concessions might be reduced.

Inclusion of the family home in the assets test[19]

Both the AFTS review (the Henry review) (AFTS, 2010: 97) and the National Commission of Audit (the Shepherd report) (2014: 160-161) recommended use of a single, comprehensive income based means test (extended to include deemed income from assets, including the family home above a relatively high, indexed threshold). Excluding, or continuing to exclude, the family home from the means test for the pension runs the risk of reinforcing beliefs that the best way to protect household assets is to invest in owner-occupied housing. It runs the risk of encouraging households to upsize, rather than downsize.

The Grattan Institute estimate that over $20b in Age Pension payments is made to households with substantial property assets, with over half being made to households with more than $0.5m in net assets. They estimate that exemption of the family home from the assets test amounts imposes an annual cost on the budget of around $7b per year (Daley et al. 2013: 6). Their solution is to include owner-occupied housing in the assets test and to allow those who fail the asset test as a result to receive the Age Pension. The amount received, however, would be claimed back when the dwelling is transferred or sold. This is equivalent to the government providing a no-interest reverse mortgage.[20]

Such a policy is seen as being more equitable and efficient in that it treats renters and owners neutrally and would encourage investment in balanced wealth portfolios and is fairer to those to invest in assets other than housing. It will not discourage households from down-sizing.

While the treatment of the family home in the assets test is best considered as part of reform of the whole tax/transfer system, there are a number of policy issues that need to be considered including tax base and tax mix issues.

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[17] See, for example, https://www.gov.uk/support-for-mortgage-interest/overview.

[18] See, for example, http://www.gov.scot/Topics/Built-Environment/Housing/privateowners/Repossession/hosf-1.

[19] To the extent that inclusion of the family home in the assets test introduces hardship for low income households, such a policy would need to be supported by one or more the options outlined in the previous sub-section and would need to address the issues raised with these options.

[20] They estimate the effect of the value of the debt accumulated by the government would reduce the budget bottom line from $7b to $5b as a result of this measure.

Wealth taxes

Ingles (2016) argues that the assets test in the welfare system the acts as a wealth tax in the welfare system but raises the question as to why wealth taxation should be confined to the not-so-well-off. He proposes, instead, introduction of a broad based wealth tax which could be implemented either as a separate structure or by deeming income from assets and integrating it with the wealth tax. This could either replace existing capital income taxes or by giving a rebate for these from the wealth tax due.

Removing capital gains tax concession

The most significant tax advantages to adequately resourced home owners, however, arise not because of its exemption from the assets test but because of its exemption from the capital gains tax, estimated to be around $15b for owner-occupation and a further $5b for investment housing (Daley et al, 2013: 6).[21]

Both the estimates of the size of the benefit, and proposals to remove the capital gains tax exemption, are generally hotly contested. Estimates vary according to whether interest deductions are included or not and according to assumptions made about the impact of changes on the rate of dwelling price inflation. Proposals to remove the exemption are generally seen as politically controversial and are not covered further here.[22] The need for such taxes could be eliminated by introduction of a broad based wealth tax.

Land taxes

Land used for owner occupied housing is currently exempt from land tax, while land used for private rental housing is subject to land tax. These arrangements introduce inefficiencies into housing markets by distorting the allocation of land between competing uses. They also make housing less affordable in private rental markets. The Henry Review has proposed that a broad based land tax be uniformly applied to land for both owner occupied and rental housing. Such a move would remove the distortionary effects arising from current non-tenure neutral land tax provisions. Because the supply of land is fixed, the broad based land tax would be capitalized into lower land prices and would lower the housing cost burdens of older – and indeed all – private rental tenants. The Henry Review proposed a simultaneous abolition of stamp duty, a move that would remove one of the financial barriers to downsizing cited by older home owners and reduce access constraints for first home buyers (Wood et al 2012).

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[21] This excludes a further $2b because of negative gearing.

[22] As witnessed, for example, by the instruction to the Henry review committee to exclude consideration of this possibility of a capital gains tax on the family home from their otherwise comprehensive review of the tax system and by the response to Labor proposals to change the negative gearing and CGT regime for investors in established dwellings.

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