Homesafe
SOLUTIONS

25 February 2009

The Review Secretariat
AFTS Secretariat
The Treasury
Langton Crescent
Parkes ACT 2600

By Email: AFTS@treasury.gov.au

Dear Panel Members,

Re: Australia's Future Tax System – Submission on the Retirement Income System

The Consultation Paper on retirement incomes discusses the role of home ownership as part of "A Robust Incomes Policy".

The sole product of this company enables home owners over the age of 60 years to access the equity in their homes without going into debt. As a result this company is particularly interested in the development of policies which will enable retirees to access the equity in their homes with safety, security and certainty.

The attached Submission sets out how home ownership should be the fourth pillar of the Retirement Income System.

I trust that this Submission will assist you in developing a Robust Retirement Income System.

Please do not hesitate to contact me if you require any further information.

Yours sincerely,

Peter Szabo
Managing Director

Encl.

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AUSTRALIA'S FUTURE TAX SYSTEM

SUBMISSION

ON THE

RETIREMENT INCOME SYSTEM

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Summary of Submission

- Home ownership amongst Australian retirees is exceptionally high when compared with overseas experience.

- Independent groups such as the Institute of Actuaries of Australia and experts such as Dr Bruce Bradbury have highlighted the potential role of home ownership in a retirement income system.

- The unique place of home ownership in Australia means that it is really the fourth pillar of the retirement income system.

- It is the absence of universally available safe, secure and certain products that have prevented retirees from properly accessing the considerable surplus wealth in their homes.

- Government has a role to facilitate the market for home equity release products so that retirees can access the equity in their homes thereby relieving the stress on the first pillar being the age pension.

1. Introduction

The issue which we have addressed in this submission is the role of home ownership as an integral part of retirement incomes policy.

The Australia's future tax system Retirement Consultation paper (the "Consultation Paper") briefly discusses the role of home ownership on pages 27 and 28 as part of Section 4 which is titled "A Robust Retirement Income System".

This section has the following Consultation questions:

Q 4.1 At what age should an individual be able to access their superannuation and at what age should they become eligible for the Age Pension?

Q.4.2 What is the role of individuals in dealing with investment and longevity risk in accumulating and drawing down their retirement income? Do financial markets provide the means to deal with these risks? If not, is there a role for government to address these shortcomings?

Even though Q 4.2 may indirectly cover the role of home ownership (and home equity release) in a retirement income system we believe that the issue of home ownership should be a separate question. This submission has been based on the question **"*What is the role of home ownership in A Robust Retirement Income System?".***

2. <u>Home Ownership – Is it the fourth pillar of a retirement income system?</u>

The Consultation Paper refers to three pillars of the retirement income system being:

- A Government funded Age Pension.
- Compulsory saving through the superannuation guarantee.
- Voluntary Saving.

On page 27 of the Consultation Paper housing is considered to be part of voluntary saving on account of the homeowner having the benefit of not having to pay rent during their retirement. It is our submission that this classification of home ownership significantly understates its potential role in a retirement incomes policy and inadvertently groups a form of necessary saving (the need for one's own home) with truly voluntary saving. Furthermore, given the level of home ownership in Australia and in particular amongst Australians over the age of 65 years ***home ownership could and should be considered as the fourth pillar of the Australian retirement income system***.

Australians spend a significant part of their working lives paying off their home loans.

Once someone takes on a home loan its repayment hardly becomes voluntary. Clearly, even though these loan repayments may be not voluntary they are nevertheless a very important form of savings. We would submit that voluntary savings are generally invested in readily realisable assets. This is of course not the case with the family home in that it firstly needs to provides shelter and only secondly is available to provide a source of income.

This proposition has been recognised by the Institute of Actuaries of Australia in their submission to the Harmer Committee in Section 6 where they state:

> *"Given the relatively modest level of projected retirement savings and the resulting reliance on the Age Pension, we would not expect that retirement savings will be sufficient to meet anything other than basic living costs for most Australians.*
>
> *However, older Australians have a high level of home ownership with 89% of couples and 77% of singles over age 65 owning a home. Consequently, older Australians are asset rich and income poor compared to the wider population.*
>
> *Given that older Australians are likely to face significant costs for health and/or aged care in addition to their basic living costs, their ability to access home equity for this purpose will be essential".*

The issue of the level of housing wealth amongst older Australians has also been noted by Dr Bruce Bradbury, Senior Research Fellow at the Social Policy Research Centre at the University of New South Wales in his paper dated 25 August 2008 and titled: Does the Australian Model lead to over-consumption of housing?" (the paper can be found at http://www.iariw.org).

Dr Bradbury inter alia makes the following comments:

> *"Owner-occupied housing has long been seen as a key pillar of retirement saving in Australia. The Australian elderly receive a relatively small amount of their income from occupational pensions, have high home ownership and private saving, and Australia is particularly unusual in that the majority of the aged population receive an income and assets-tested aged pension (which excludes the owner-occupied home)."* ***Page ii – Housing and Retirement, Abstract – paragraph 1***
>
> *"Where Australia differs, however, is in the differences of housing wealth patterns across age groups. High rates of home ownership continue into the post-retirement years in Australia, while they decline steeply in most other countries. The US is the exception, where home ownership rates among the*

elderly are also high. The level of home-ownership wealth, falls steeply with age in all countries other than Australia, including the US." ***page 31 – Housing and Retirement, Section 6. Summary and Conclusion – paragraph 2***

"Nonetheless, the fact that the housing wealth patterns of the Australian elderly are so divergent from those of people in other comparable countries suggests that particular attention needs to be paid to this issue in this country. Policy options to increase the ability of the elderly to take better advantage of their housing wealth might include stamp duty concessions to enable down-valuing, housing supply interventions to ensure an adequate supply of suitable smaller dwellings for the elderly, and a greater role for the state (or for new private sector institutions) in managing the longevity and other risks associated with reverse mortgage and similar schemes. Moreover, in future years as superannuation schemes mature and the Australian aged enter retirement with a broader range of wealth holdings, it may be necessary to revisit the question of the special exclusion of the own-home from the Age Pension assets test." ***pages 31 & 32 – Housing and Retirement, Section 6. Summary and Conclusion – paragraph 7***

The culture of homeownership in Australia provides Australians with a home where they can live with autonomy and independence and once it is fully paid a potential source of retirement income.

However, in utilising the family home as a source of retirement income it needs to be recognised that the family home is not just another asset which can be readily sold. Not only does the family home provide shelter but also a network of support services. A sale of the family home may realise some funds but may well result in an increase in demand for services which were previously being provided by the community. The cost of providing these services will clearly reduce the financial benefit which would have been anticipated from the sale of the family home. This issue of course does not arise with home equity release arrangements.

As mentioned above the Consultation Paper has noted the role of home ownership as a source of retirement income when it states "…Instead of receiving investment income, a home owner receives the benefit of not paying rent during their retirement…" Actuaries would refer to this benefit as a life interest in the home. However, in most cases the value of this life interest will be significantly less than the value of the home when someone goes into retirement (i.e. the other reason why Australians seek to buy a home being the potential for retirement incomes). For a couple going into retirement this extra value is likely to be at least 50% of the value of their home. The question is how can the retiree unlock the extra value in order to augment their retirement income having regard (as with all investments) to the risks associated with investment and longevity.

We submit that the family home is indeed the fourth pillar of the retirement income system and should in fact be treated as the fourth pillar because of:

- The unique place of home ownership in Australia.

- The level of home ownership amongst retirees.

- The housing security provided for retirees.

- The significant residual value remaining in the home after providing for the rights of life tenure.

3. Accessing the surplus value in the home

The major impediment to retirees being able to access the extra value in their homes (i.e., the value in excess of what is required to provide life tenure) is the absence of universally available products which are simple, secure and safe.

As stated in the previous section all products should have a guarantee of life tenure for the retiree homeowner. It therefore follows that a significant issue with all products will be the availability of funding which covers the life span of the individual retiree homeowner. In fact, product providers and retiree homeowners will need to carefully consider the risks associated with:

- Longevity
- Property values; and
- Interest rates.

As with Question 4.2 of the Consultation Paper the issues here are:

- Who carries the longevity risk - the individual or the product provider?
- Who carries the risk associated with future property values and interest rates (investment risk) – the individual or the product provider?

A useful axiom in assessing who should carry/retain a risk is to consider whether the person carrying the risk can cope with the consequences of the actual occurrence of the risk. For example, homeowners generally choose not to carry the risk of losing their home. Whereas most mobile telephone users may choose to carry the risk of losing their mobile telephone.

At present there are two product categories which enable retirees to access some of the surplus value in their homes. Unfortunately neither product category is universally available.

The two product categories are:

- Capitalising interest loans called reverse mortgages; and

- Debt free transactions currently only offered by this Company.[1]
  (This type of transaction is also sometimes referred to as a reversion)

The risk profile of the two product categories are distinctly different. Under a reverse mortgage the retiree homeowner borrows say 15% of the value of their home say $75,000 on a home valued at $500,000. The amount eventually to be repaid will depend upon how long the retiree will live and interest rates during the period of the loan. The share of home which will be required to repay the loan will depend upon the sale proceeds from selling the home and the amount of the loan at that time. A standard feature of reverse mortgages is that the lender limits the borrower's liability to repay to the sale proceeds of the home known as the no negative equity guarantee. It can be seen that under a reverse mortgage the borrower (the retiree homeowner) carries the risks associated with:

- Longevity;

- Property values; and

- Interest rates.

The interest rate risk can be alleviated by choosing a fixed rate product and the longevity and property risks are mitigated by the existence of the no negative equity guarantee whereby the amount of the loan cannot exceed the sale

[1] See the appendix for a description of the Company.

proceeds of the home. Given that the retiree homeowner is carrying these risks lenders significantly limit the amount they will lend in order to ensure that the value of the home (the lender's security) will always cover the amount of the loan plus compound interest.

In contrast to the risk profile of a reverse mortgage the aim of the debt free transaction is to shift the risks of longevity and property from the individual to the purchaser/product provider.

The main characteristic of the debt free transaction offered by this Company are:

- The homeowner sells a share of the future sale proceeds of the home.
- The homeowner remains the legal owner of the whole property whilst they are alive.
- The homeowner has an absolute right to live in the property whilst they are alive.
- The homeowner retains the right to the share of the sale proceeds they have not sold.
- The homeowner controls when the home is to be sold.
- The cash payment to the homeowner is less than the face value of the share because of the entitlements retained by the homeowner including the life interest in the home.
- The homeowner is entitled to rebates in the event that the home is sold earlier than expected (the Early Sale Rebate) or the sale proceeds exceed a specified benchmark (Excess Proceeds Rebate).

As a result of the characteristics of the debt free transaction, the homeowner has protected the unsold share of the home from the risks of longevity and property. Furthermore, the homeowner is able to participate in favourable experience through the two rebates.

These two product categories give retirees the important choice regarding both longevity and property risk. Given a retiree's risk profile they are able to choose the product category which suits them best provided that they meet the eligibility criteria.

The funding for the debt free transaction needs to be provided by long term **investors** seeking an exposure to residential property on a pooled basis. This contrasts with the funding of reverse mortgages which is provided by long-term **lenders** such as major banks.

In order for both product categories to thrive there is a need for long-term investors in residential property. Even though it is of lesser importance for reverse mortgages there is a need for an investor to carry the risk of the no negative equity guarantee. However, for the debt free transaction it is of vital importance that there are long term investors prepared to accept both the:

- longevity risk; and

- investment/property risk.

The primary reason why there are insufficient products available which enable retirees to access the surplus equity in their homes is the absence of long-term investors and lenders. We believe that it is largely this market failure that has prevented home ownership becoming the fourth pillar of the retirement income system. If this market failure can be overcome then there may well be in excess of $500 billion of the value in the homes of current retirees which could be used to augment their retirement incomes.

4. The role of Government

Why should Government be involved with enabling home ownership to be the fourth pillar of a Robust Retirement Income System. The answer is that if Government wants to, or has to, contain its exposure to the age pension (the first pillar) then there needs to be another source of funds to augment retirement incomes. In the long term the second and third pillars (namely the SGC and voluntary savings) may well fill this need. However, in the short term (which is probably at least ten to twenty years) these second and third pillars are unlikely to provide significant relief to the Government's need to fund the age pension. Therefore, Government needs to be involved with making home ownership the fourth pillar because there is probably no alternative.

Unlike the role of Government with the first two pillars namely the age pension and the superannuation guarantee contribution the role of Government with the fourth pillar (home ownership) should be as a facilitator in order to ensure that there are safe, secure and certain products. In this way, individual retirees will have the ability to choose whether to access the extra equity in their homes in order to augment their retirement incomes. In time, an ageing population, with an increasing need for services will no doubt realise that the home can be used to buy those additional services provided that life tenure has been guaranteed. As a result the demands on the Government funded age pension will be alleviated.

5. How should the Government be involved?

Government has a history of initiating and supporting economic activity which has socially desirable outcomes. This has particularly been the case when private sector markets have been reluctant to participate. The failure of investment markets to support products which enable senior Australians to access the equity in their homes is another example of the need for Government to take a pro-active role in ensuring that investment markets participate in an investment which has a socially desirable outcome.

The principle issue concerning investment markets has been the absence of scale and hence the absence of liquidity.

The role of Government would therefore be to assist product providers to achieve a scale which would attract market participants such as industry superannuation funds and public investment funds such as the Future Fund. The actual mechanics of an involvement of Government are not the subject of this submission. However, there are numerous past examples in areas such as infrastructure, health care and agriculture.

Appendix

In 2004 Peter Szabo an Actuary with more than 30 years experience together with Bendigo Bank Ltd (now Bendigo and Adelaide Bank Ltd) decided that the Australian market needed a product which enabled senior homeowners the opportunity to access the equity in their homes without going into debt. As a result of this decision the jointly owned company Homesafe Solutions Pty Ltd entered the market in 2005 offering the product Homesafe Debt Free Equity Release.

At the present time Homesafe Solutions Pty Ltd has assets in excess of $100M but has had to limit its distribution on account of an unwillingness of institutional investors to invest in this new asset class of long term interests in residential property.