Supplementary submission to the Re:think Tax Discussion Paper

Unlocking home equity for senior Australians to free up extra retirement income

22 July 2015

Introduction

To complement the Property Council's primary submission to the 'Re:think' tax reform discussion paper, this submission focuses on one structural reform option to create a new source of income for many senior Australians, and thereby reduce reliance on the age pension as their exclusive income.

For a number of years the Property Council has actively promoted age pension reform that allows full-rate age pensioners to 'downsize' and free up some of the significant home equity that many have built up in their principal place of residence. A pensioner's home is part of their wealth but is underutilised in retirement income support policy.

The age pension reform the Property Council supports does not incentivise pensioners to move, or in any way distort pensioner's housing preferences, which is an individual choice that public policy settings should respect. What the reform does is remove the penalty on those who want to move to a home that is smaller, easier to manage, cheaper to maintain and potentially safer – thereby extending independence and potentially reducing the need for taxpayer funded age services.

This submission explains the rationale, policy proposal, indicative costs and offsetting savings that can be conservatively forecast from allowing eligible pensioners to access a portion of their home equity by increasing the asset free area for home owners.

Age pension means test and how it stops people from downsizing

The problem

All Australians over 65 who satisfy either the income or assets test for the age pension are eligible to receive it. The full rate of pension is payable under the asset test for homeowners who have total assets (excluding principal place of residence) of less than $202,000 ($286,500 for a couple). Under changes passed by the Federal Parliament in June 2015, to take effect from 1 January 2017, the full pension will be available to single home owners with total assets (excluding principal place of residence) of $250,000 (or $375,000 for a couple combined).

Under current settings, single pensioners who have more than $202,000 of assets have their pension reduced by $1.50 per fortnight for every $1000 of assets over the asset free threshold (this will become $3 per fortnight for every $1000 of assets from 1 January 2017). If a pensioner with assets close to the threshold downsizes, and makes a cash surplus of $150,000 from selling her family home and buying a smaller home, her pension would be cut by $5850 per year.

This clearly acts in practical terms as a penalty, and means that some pensioners who wish to downsize choose not to. Their decision not to downsize does not save the Australian Government any money – they continue to receive the pension at a high rate, because they have not got the cash benefit of any of their home equity.

While it is impossible to be certain what numbers of pensioners wish to downsize, a survey of more than 2000 Australians over 50 by National Seniors Australia in 2014 showed that 30 per cent of pensioners who are considering downsizing see the pension asset test as a significant barrier.

Table 1: Comparison of pension received after sale of house under current (2015) and future (2017) pension arrangements

Examples	Judith	Edith	George and Beatrice	Allan and Valerie
Total non-home assets	$300,000	$300,000	$300,000	$300,000
Value of old home	$400,000	$400,000	$550,000	$550,000
Value of new home	$250,000	$500,000	$350,000	$600,000
Annual pension received before sale of house (1 Jul 2015)	$18,681	$18,681	$33,404	$33,404
Annual pension before sale of house under 2017 changes	$19,266	$19,266	$33,718	$33,718
Annual pension received after sale of house (current rules)	$12,931 (-$5750)	$22,047 (+$3366)	$25,604 (-$7800)	$33,718 (+$314)
Annual pension after sale of house from 2017	$7566 (-$11700)	$21,908 (+$2642)	$25,194 (-$8524)	$33,718 (Unchanged)

The table above shows that the perverse effect of the pension means test is to penalise people who move into a smaller home, even when this home is designed to extend physical independence and alleviate social isolation (as, for example, retirement villages are). This perverse penalty will increase in 2017, as the claw-back of pension for those who have assets above the asset free area doubles.

The Solution

In order to get around this public policy problem, the Property Council suggests the following reform.

1. Make a highly targeted adjustment to the age pension means test, by increasing the asset free threshold for age pensioners who:
   - Are homeowners;
   - Aged 75 or over;
   - Receive the full age pension; and
   - Purchase a cheaper home within 12 months (this aligns with the time Centrelink currently allows for sale proceeds from a family home not to be assessed). NB: a lower price is the best proxy for downsizing.
2. The asset free area for eligible pensioners should be increased by a modest amount – we suggest somewhere between $100,000 and $200,000 - to avoid inequity and achieve the public policy objectives set out below. Fairness and welfare system integrity suggests that age pensioners who make hundreds of thousands of dollars out of a home sale should not retain the full pension.

Unlocking home equity: maximising the private and public benefits of downsizing

The policy criteria outlined above will:

- Protect against exploitation (or 'welfare creep') by Australians who qualify for a part pension (those at the upper end of allowable assets for the pension), but for whom the age pension means test is not a real barrier to downsizing;
- Reduce government distortion of personal preferences, and enables older people on low incomes to downsize if they wish to, and to live in smaller homes that are more manageable to clean and maintain, with lower rates and utility bills;
- Potentially extend the independence of frail older people, and significantly delay entry into residential aged care, by freeing over 75s to move into smaller homes and apartments that are specially designed for older people (e.g. ramps rather than stairs, grab rails in bathrooms, close to public transport and community facilities);
- Allow full rate pensioners to enjoy a higher quality of life by accessing services they currently struggle to pay or simply can't afford, e.g. private health care, home care services, meals-on-wheels, taxis;

- Enable pensioners to support themselves better, and reduce certain taxpayer subsidies for health and aged care through higher co-contributions (e.g. to home care packages, PBS payments, residential aged care);

- Improve efficiency in the housing market – thousands of large family homes may be sold, and private money (age pensioner's home equity plus capital investment by senior's housing developers) leveraged into greater housing supply; and

- Does not rely on the value or valuation of principal place of residence either for policy design or implementation.

Cost of unlocking home equity

The 'cost' of increasing the age pension asset free area for full rate home owning pensioners over 75 years old is notional. That is, it represents the cost of continuing to make age pension payments that the Government already pays, because most age pensioners make the economically rational decision not to downsize under current rules.

Above 1.39 million, or 59 per cent, of all pensioners receive the full pension, with this number forecast to increase over time. 75.1 per cent of pensioners own their home, and 1.11 million pensioners are over 75 (a combination of full and part rate pensions).

Indicative costings done for the Property Council show that the costs are very sensitive to assumptions about the existing level of assets of eligible pensioners. There is no publicly available information on how many pensioners are close to the existing $202,000 threshold under the assets test, so assessment has been done on two scenarios, described below.

The assumptions used in estimating the cost of the scenarios are:

- Ten per cent of all pensioners who are eligible (using eligibility criteria outlined under solutions section above) will decide to downsize because of the new policy, or 49,000 people;

- An additional 29,500 pensioners who may have downsized regardless of the policy will also benefit. This is the economic 'deadweight' of the policy. (Six per cent of all homeowners sell their property annually at the moment);

- Thirty three per cent of those who downsize will have a cash surplus of $100,000 after they have purchased a smaller home; 33 per cent will have a cash surplus of $150,000, and 33 per cent will end up with $200,000 more than they started with.

Scenario 1 is the most conservative model, and assumes that the average existing assets of eligible pensioners is already at the top of the asset free area. Therefore the ongoing pension cost to Government per annum is $38.4 million (if the assets test threshold is lifted by $100,000); $96 million (if the threshold is lifted by $150,000) and $173 million (if the threshold is lifted by $200,000).

Scenario 2 is a less conservative average, and assumes that the average existing assets of eligible pensioners is currently around half of the threshold for eligibility for the full pension, or $101,000. Therefore the ongoing pension cost to Government of the new policy per annum is zero (if the threshold is lifted by $100,000); $18.8 million (if the threshold is lifted by $150,000) and $57 million (if the threshold is lifted by $200,000).

These calculations are all for single pensioners under the asset test. There would be minor downward variations for couples, and for pensioners assessed under the income test (Centrelink applies the income or asset test, whichever results in less pension payable).

Savings from unlocking home equity

There are many public policy benefits of allowing the least 'well off' pensioners in Australia (i.e. those eligible for the full pension) to unlock a modest amount of their home equity without it affecting their pension, as summarised above.

Many of these benefits can be modelled, but one of the most significant and direct cost savings is in reduced residential aged care expenditure by the Australian Government.

In 2014, the specialist aged care consultant firm (Grant Thornton) was commissioned by the Property Council to quantify the savings to the health and aged care portfolios of people over 65 who choose to downsize to a retirement village, which evidence shows keep people healthier, happier and living independently for longer.

The savings represented by the current number of over 65s who live in retirement villages includes $1.98 billion p.a. in federal aged care savings (Grant Thornton – the full report can be viewed at http://www.retirementliving.org.au/industry/services/research/). This is because people who live in retirement villages, and subsequently move to residential aged care, enter on average 5 years later than the general population (Australian Institute of Health and Welfare). As the annual cost to the federal government of an aged care bed is $51,078 (Productivity Commission – Report on Government Services, January 2015), a 5 year delay saves the government around $260,000 per person. This is based on the figure of 7609 people moving from a retirement village to residential aged care in 2013 (AIHW).

The AIHW findings about delayed entry to residential aged care can be applied to the number of pensioners assumed to take up the 'unlocking home equity' proposal outlined above and move to a retirement village. Currently, 5.7 per cent of older people live in retirement villages. Therefore the estimated savings to the Australian Government from implementing the policy, counting only the residential aged care savings from 5.7 per cent of downsizers electing to move to a retirement village, is $86 million (assuming the average full rate pensioners has assets in the middle of the asset free area- Scenario 2 - and the Government increases the threshold by $200,000).

Other government savings, and additional revenue, will come from:

- Spending by pensioners of the home equity they unlock;

- Tax and jobs from building more retirement communities and seniors housing;
- Reduction in hospitalisation rates (from less falls and faster discharge) of older people freed up to move to homes and communities built to support independence.

Conclusion

A structural change to the age pension as described in this submission would remove a significant disincentive to downsizing for senior Australians, and create many social and economic benefits because the health and aged care savings would significantly outstrip the notional cost of continued age pension spend.

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