

Level 2, 5 Martin Place
Sydney NSW 2000 Australia
GPO Box 3698
Sydney NSW 2001

challenger.com.au
Telephone 02 9994 7000

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Committee Secretary
Senate Standing Committee on Economics
Parliament House
Canberra ACT 2600

Re: Improving consumer experiences, choice, and outcomes in Australia's retirement system

Challenger welcomes the opportunity to provide a supplementary submission to this Inquiry.

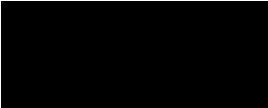
The public hearing on 12 March 2024 and the Interim Report comprehensively covered the differing perspectives on the immediate effects of allowing first home buyers to withdraw their superannuation contributions for use toward a home deposit (the **proposal**).

However, there was less detail in the hearing and Interim Report on the long-run effects of the proposal. This submission focuses on the potential implications of the proposal once it has been up and running for some time, making four key observations:

1. Some individuals would have higher super balances while some would have lower balances, so the aggregate effect depends on a range of factors.
2. The scheme would likely lead to a small increase in home ownership.
3. Households saving for a deposit, and some near and in retirement, would pay less tax.
4. The greatest increase in welfare from the proposal would likely be for the small number of low-income households who become homeowners, although it would likely be used more by high-income households.

Challenger has been a strong advocate of retirement income reform for many years, an issue which is deeply aligned to our purpose of providing customers with financial security for a better retirement. Home ownership is a key pillar of financial security for many retirees and we welcome the opportunity to be involved in this important policy discussion.

Yours sincerely



Stu Kingham
Chief Commercial Officer
Challenger Limited

To conceptualise the long-run effects of the proposal it is useful to consider how households would use such a scheme over their lifetime and its impact on the composition of their assets.

1. In the long-run, **aggregate superannuation balances may be higher or lower** under the proposal. The aggregate effect would depend on households' decisions and the net returns on superannuation relative to those on housing.
 - Young workers starting to work with the proposal already in place who intend to purchase a home would have an incentive to save for a deposit within superannuation due to its tax-preferred status. Additional personal contributions would increase superannuation balances of young workers until they withdraw for a housing deposit. If they withdraw employer contributions their superannuation balance will obviously then be lower than otherwise, but if they only withdrew personal contributions intended to be used for a deposit, their balance would be no different to otherwise.
 - Under the proposal, when these households subsequently sell their home, they would have the option to put the initial superannuation withdrawal (and capital gain) back into superannuation or roll it over into another home purchase. When households sell their first home, many will likely be upgrading and so will need the superannuation-financed equity from their first home for the subsequent purchase, and so they will not re-contribute the funds back into superannuation when selling their first home.

However, households generally sell and buy a new home several times over their life (the typical holding period is around 10 years).¹ With subsequent housing transactions, as they get closer to retirement, some households would likely choose to boost their tax-preferred savings by paying some of the proceeds from their housing sale into their superannuation, particularly if they are downsizing. Specifically, under the proposal they could inject an amount equal to their initial superannuation withdrawal, grossed up by the appreciation of the dwelling(s).

If a household were in effect re-contributing the voluntary contributions they initially made when they were saving for a deposit, these funds would not have been in superannuation in the absence of the proposal and so this could contribute to the household having a higher superannuation balance at retirement. The extent to which households re-contribution funds back into superannuation will depend on their other assets and the tax they would pay on other assets relative to superannuation.

Many young workers, and those near and in retirement who re-contribute, would have higher superannuation balances, but those in the early years of home ownership (and some in later years) would have lower average balances.

The overall effect of the policy on aggregate superannuation balances would depend on the ages and behaviour of the population as well as the capital gains on housing, which is tax free, relative to the return on superannuation assets, which is subject to tax prior to retirement.

2. The scheme would likely lead to a small **increase in home ownership**.
 - If households can withdraw their employer contributions as well as their own personal contributions, households who would have purchased a home even in the absence of the proposal will purchase earlier as they will have sufficient funds for a deposit sooner. The preferred-tax status of superannuation will also contribute a higher deposit as savings will attract lower tax, enabling households to purchase earlier. In aggregate this could lead to a small increase in home ownership.

¹ The median holding period for owner occupiers is estimated to be 10.5 years, although the mean will be higher because some households own their home for much longer. See G Bandeira, M Malakellis and M Warlters (2022) "Holding periods of residential property buyers in NSW" NSW Treasury paper 22-13
<https://www.treasury.nsw.gov.au/sites/default/files/2022-04/trp22-13-holding-periods-of-residential-property-buyers-in-nsw.pdf>

A simple calculation suggests households purchasing 3 years earlier could increase the aggregate home ownership rate by up to 3 percentage points.

- Perhaps more importantly, there could be a small share of households who would otherwise not have become homeowners who might be able to purchase with the assistance of the proposed scheme.
 - Most people who retire not owning a home have few assets and so even this proposal would not have enabled them to purchase a home. Demographic data from the Department of Social Services indicate that in December 2023 there were 699,000 people out of 2,580,000 Age Pension recipients who were not homeowners (27%). Of these, only 24,000 (less than 0.4% of the total population over age 66.5) had more than \$500,000 in household assets.²
 - For a small share of low-income households, being able to access employer contributions could provide them with sufficient funds for a deposit early enough in their career to be eligible for a mortgage that enables the purchase of a home. These households could end up having more assets by retirement for a couple of reasons:
 1. If the return on housing (price appreciation plus effective rent) exceeds the mortgage interest rate, as it has historically, homeowners can significantly benefit from the leverage of a home loan; and
 2. The discipline of a mortgage might increase households net saving behaviour and increase their lifetime savings.

While these households' total assets, including their home, superannuation, and other assets, could be higher, they would almost certainly have lower superannuation balances as they would unlikely be able to recontribute to superannuation later in life.

- Given low-income retirees are financially much better off if they own a home, because of the interaction with the assets test for the Age Pension, this scheme could contribute the greatest increase in welfare for these low-income households who become homeowners under the proposal.
 - The share of the population who retire not owning a home but would have the lifetime income and assets that could enable home ownership is likely to be small.
3. Because the earnings of superannuation assets face a lower tax rate than other assets such as bank deposits, enabling households saving for a deposit to do so in the superannuation system would **reduce the tax paid** by saving households. In addition, by re-contributing their housing equity to superannuation when they sell, some households may also end up with a larger share of their assets in the superannuation system as they near, and are in, retirement. This would reduce the total tax they pay.
 4. In aggregate, **higher income households** would use superannuation for a housing deposit more than lower income households, reflecting their higher rates of home purchasing.

Overall, there are long-run consequences of the proposal for aggregate home ownership and superannuation balances. More important could be the implications for the small share of households who do not own a home by retirement but have had lifetime income and assets that mean home ownership could be feasible with some assistance. This relates to the three pillars identified in the Retirement Income Review of the Age Pension, compulsory superannuation and voluntary saving (including housing).

² Source: Department of Social Service (<https://data.gov.au/data/dataset/dss-payment-demographic-data>). Note, this does not include the small number of retirees not eligible for the Age Pension who are renting (having never owned a home). Given their larger asset position we do not include them in these calculations as we assume they are renters by choice and so the proposal would not have induced them to purchase a home.

The attached Appendix considers simulations for three different types of households to illustrate these differences. These simulations highlight the benefits that a superannuation for housing policy could provide to these different households, comparing their superannuation balance and total net assets at different ages. The clearest benefit will accrue to those households that would use the policy to purchase a house but would not be able to save for a deposit without the policy. The Appendix provides a breakdown of this benefit, driven by the leverage to rising house prices over time.

Challenger strongly supports the development of policy settings for the benefit of Australian retirees. Developing measures to improve retirees' financial security is central to this objective, which for many includes home ownership.

Appendix

This Appendix presents simple projections to illustrate potential long-term implications of the proposal for three representative households:

1. A typical household with a total income of \$120,000;
2. A higher-income household with an income of \$200,000; and
3. A lower-income household with an income of \$90,000.

The benefits are proportionately greatest for the lower-income household who, in the model simulation, cannot afford to purchase a home in the absence of the proposal but can with the benefit of the proposal. However, it is quite a specific lifetime income profile that enables a household to afford to purchase a home under the proposal, but cannot without it, and so it is likely to be only a small share of households that would be in this category.

The results are sensitive to some of the assumptions used in the calibration, as highlighted for the third example.³

³ The assumptions include: access of up to 100% of superannuation balance as a deposit for housing; 2.5% price inflation; 3.5% wage inflation; 3.5% house price increases; 6% (post fees, pre-tax) super fund returns, 4.5% (post fees, pre-tax) non-super returns; 5.5% mortgage interest rates; 4% gross rental yields; a 3% transaction cost on home purchase, including stamp duty; a 20% deposit for housing purchase; 30 year mortgage terms; super drawdowns at 2% higher than the minimum rate; social security settings as at 1 June 2024; tax rates and super contributions as at 1 July 2024. The wealthy household purchases a dwelling valued at \$1.6m in 2024, while the other two scenarios involve a \$800,000 dwelling. For simplicity only one house purchase in a lifetime has been modelled (no upgrading). These scenarios are indicative illustrations only.

Example 1: Typical household

In the base case of our model scenario, a household with a combined (equal) income of \$120,000 a year will have saved enough for a 20% deposit by age 39.

If they were able to use an unlimited amount of their superannuation for a housing deposit, it might be possible for this household to buy their home by age 32 – seven years earlier than otherwise. The model assumes that they buy an equivalent dwelling to what they can buy in the base case. Because they purchase it earlier, assuming 3.5% per annum average house price growth, their purchase price is lower than in the base case. The additional seven years of home ownership provides a benefit to the household through the earlier leverage that they have to the housing market (assuming housing prices increase over time).

The long-term impact on the household's financial situation depends on what the household does with their additional savings over time. Given the lower purchase price, they would have lower mortgage payments, and would repay the mortgage earlier, before they retire. This would enable the household to make additional contributions into superannuation. With this reinvestment, their superannuation balance is likely to be higher than the base case by the time that they retire. The modelling assumes that their consumption is the same as the base case.

Figure 1: Model simulations for typical household



Note: amounts shown are in real terms, adjusting for inflation

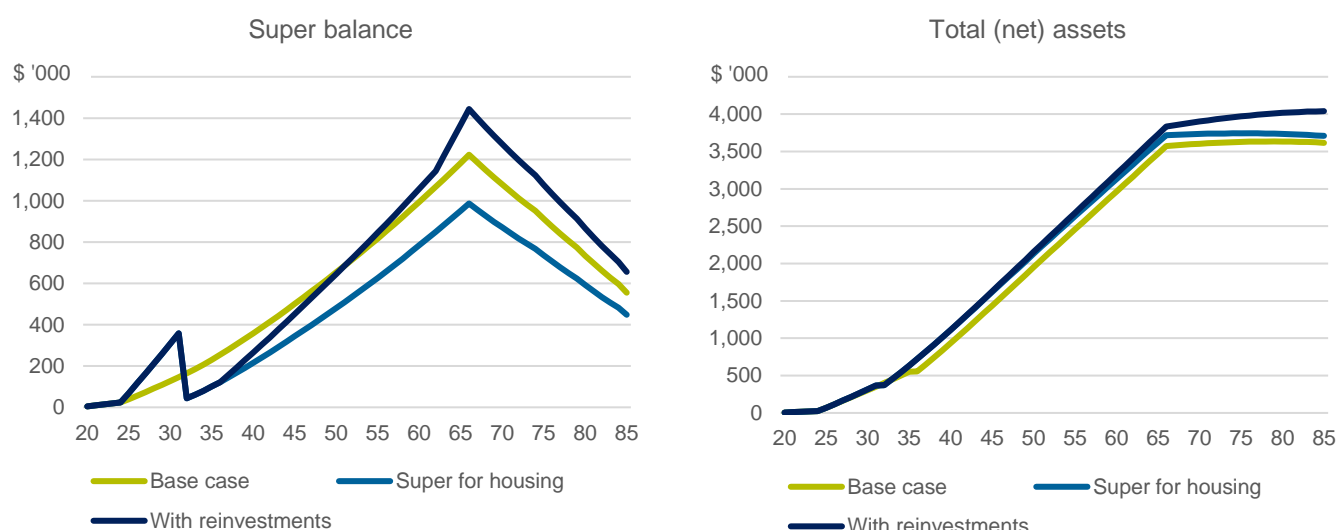
Example 2: Higher-income household

A higher-income couple can save at a faster rate and so the proposal reduces the time to save a deposit by less than it did for the typical couple.

They have a combined income of \$200,000 and, after tax and rent, would be able to save enough to purchase a home by age 36. If the policy allowed for the total superannuation balance to be used in the dwelling purchase, it would be beneficial for a higher-income household to place all their savings in superannuation initially. This would enable them to purchase their home five years earlier at age 31. They would also have a lower mortgage enabling them to invest more into superannuation.

Over the long run a higher-income household is likely to benefit from a higher (leveraged) exposure to the housing market. The ability to reinvest savings into superannuation will mean that a higher-income household will easily be able to generate a larger superannuation balance at retirement than the base case of not withdrawing for housing.

Figure 2: Model simulations for higher-income household



Note: amounts shown are in real terms, adjusting for inflation

Example 3: Lower-income household

Our third simulation is for a lower-income household with income (before tax) around \$90,000 a year who are unlikely to be able to afford to purchase a house without the proposal. Their saving, outside of superannuation, at age 37 is only just over \$40,000.

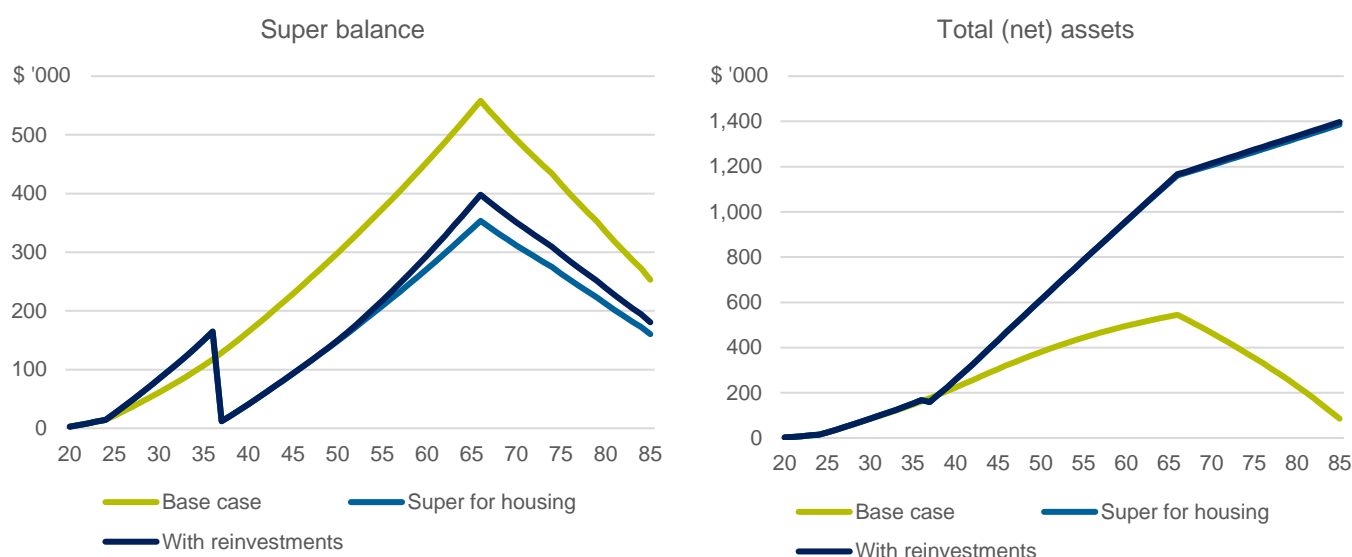
At age 37, they have a combined \$120,000 in super. If they could use all their super to purchase a home, they could make a 20% deposit for a \$800,000 dwelling. Mortgage payments over \$44,000 a year would be difficult initially but if they both keep their jobs and earn wage increases, the payments will be more affordable over time.

Under the proposal, the lower-income household could own their own home at retirement. They would still have a small mortgage to pay off by drawing a lump sum from their superannuation. Their remaining superannuation balance will be modest, and they are likely to begin retirement on a full Age Pension.

In this simulation, in the absence of the proposal, the household is unable to save enough for a deposit early enough in their life that they can get a mortgage to largely pay off while working. As a result, they would always rent. They would have a higher superannuation balance, but still not enough to purchase a home outright at retirement. Their income from superannuation would be higher but they would have rent to pay and might not get the full Age Pension at the start of retirement, based on current non-homeowner limits.

In aggregate, this lower-income household would be better off under the proposal if they are able to withdraw all their super for a housing deposit. They would have their home and once the mortgage is paid off would have some additional cash flow. Their super balance would be lower across their lifetime, with approximately \$200,000 less super, in today's terms, at retirement. Even if the additional cashflow is reinvested into superannuation, their balance would be below the base case at retirement. There is further improvement in their financial position in retirement, relative to the base case, due to the cost of renting which far exceeds to rental supplement.

Figure 3: Model simulations for lower-income household



Note: amounts shown are in real terms, adjusting for inflation

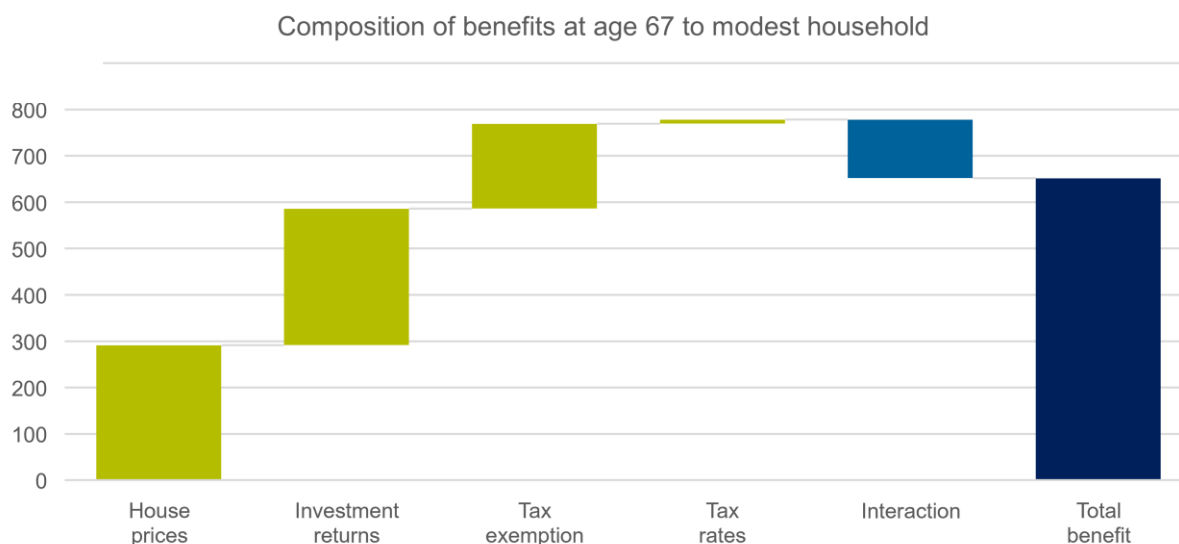
There are several drivers of the higher net assets at retirement of the lower-income household. In this simulation, the benefits for the hypothetical lower-income household at retirement (at age 67), worth around \$650,000 in today's terms, can be attributed to several factors which interact with each other.

- Leverage created by the mortgage as the total return to housing (house price appreciate plus imputed rent) typically exceeds the mortgage interest rate. The greater the value of the home purchased, the higher the leverage and the larger the benefit. In isolation this accounts for 45% of the benefit in the modest household example.
- Differences in expected returns from superannuation, the family home, other savings, and mortgage interest rates. These add an additional 45% of the benefits.
- The tax exemption on the family home, creates value and is worth 28% of the benefits in isolation.
- The different tax rates for earnings, superannuation, and other savings add a small (1%) net benefit.

The various components interact with each other, and in aggregate, the total benefit is reduced by this interaction. For example, the difference in returns exaggerates the tax differences.

The increasing benefit after retirement for homeowners relate to the fact that rental supplement payments are not sufficient to cover the cost of renting for the base case household who rent their whole life.

Figure 4



Note: the tax exemption refers to owner-occupied housing not being subject to tax