Real Estate Institute of Australia

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21 JUL 2005
House of Representatives
Standing Committee on
Economics, Finance &
Public Administration

SUBMISSION 9

House of representatives Standing Committee on Economics, Finance and Public Administration
Submission No: 9
Date Received: 21/7/05
Secretary: SB.

19 July 2005

Committee Secretary
Standing Committee on Economics, Finance
and Public Administration
House of Representatives
Parliament House
CANBERRA ACT 2600

Dear Sir/Madam

Please find enclosed the submission from the Real Estate Institute of Australia to the Inquiry into Improving the Superannuation Savings of People Under Age 40 being conducted by the House of Representatives Standing Committee on Economics, Finance and Public Administration.

On behalf of the Institute, I would welcome the opportunity to discuss the submission with the Committee.

Yours sincerely

B Stevens

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REAL ESTATE INSTITUTE OF AUSTRALIA SUBMISSION TO THE HOUSE OF REPRESENTATIVES ECONOMICS, FINANCE AND ADMINISTRATION COMMITTEE INQUIRY INTO IMPROVING THE SUPERANNUATION SAVINGS OF PEOPLE UNDER AGE 40

PROPOSAL

1. The Real Estate Institute of Australia (REIA) proposes that home ownership be formally recognised as the fourth pillar of self funded retirement and that the superannuation savings of people under age 40 be improved through the implementation of a scheme allowing early access to voluntary superannuation contributions for the purposes of generating wealth through purchasing a home.

BACKGROUND

2. The REIA welcomes the opportunity to make a submission to the House of Representatives Economics, Finance and Public Administration Committee *Inquiry into Improving the Superannuation Savings of People under Age 40.*

3. The REIA is the peak national professional association for the real estate industry in Australia. REIA has eight members, comprised of the State and Territory Real Estate Institutes, through which about 80% of real estate agencies are collectively represented. The industry has about 77,000 directly employed individuals.

ISSUES

The Importance of Self-Funded Retirement

4. The population boom which occurred post World War II has had a profound effect on the population profile of many western countries, including Australia. The OECD projects that the proportion of the Australian population aged over 65 will increase from 12.8% in 2003 to around 27% in 2050 (OECD 2005). By 2050, there will be just two individuals of working age for every person of retirement age, as compared to the current ratio of five to one.

5. This demographic shift will lead to upwards pressure on public spending on pensions, health care and longer term care. The Productivity Commission (2005) predicts that Commonwealth spending on Age Pensions between 2003-04 and 2044-45 will increase by 1.7% of GDP to around 4.6% of GDP, without some form of intervention. Assuming a constant rate of increase, the REIA estimates that this will amount to cumulative fiscal pressure of $562bn over the period.

6. The OECD projects that spending on health care and aged care in Australia will increase from 4.7% of GDP in 2002 to 9.9% of GDP in 2042. At the same time, the decline in the ratio of working age persons will result in a shrinking relative tax base.

7. In light of this situation, the ability of retirees to adequately fund their retirement has come under scrutiny from both the Australian Government and the population at large. Increased rates of self-funded retirement will reduce the impost on a social security system supported by a shrinking relative tax base.

8. Several OECD reports (Carey 1999, OECD 2005) state that retirement income is comprised of three main components, or 'pillars', in Australia. The first is the means tested Government supported Age Pension safety net which is available to individuals who have been resident in Australia for at least 10 years and have reached the qualifying age (currently 65 for men and 62 for women). Full Aged Pension payments are low in Australia as compared with other OECD countries, amounting to around 20-24% of average weekly earnings as at May 2004. In recognition of the important traditional role of housing for retiring Australians, owner-occupied housing is excluded from the Aged Pension means test.

9. Approximately 54% of Australians of pension age receive a full pension payment with a further 28% receiving a part payment (Treasury 2002). Only 18% of this age group are *not* eligible for the Age Pension and are either self-funded retirees or receive an alternative welfare support payment.

10. The second pillar encompasses compulsory employment based pension funds, or superannuation, as supported by the Commonwealth's Superannuation Guarantee. Under this scheme, employers must contribute 9% of most employee's base wages which is fully vested in the employee and fully preserved until retirement, disability or death.

11. The third pillar comprises voluntary savings, including sums voluntarily placed in superannuation funds, interest bearing investments, the purchase of owner-occupied housing and other private savings (including investment in residential and commercial property). These components are similar in most OECD countries.

12. The Commonwealth Government has publicly recognised these three pillars of Australia's retirement income system (Treasury 2002), with home ownership explicit within the third pillar.

13. The REIA asserts that, the Commonwealth Government should recognise home ownership as a stand alone *fourth pillar* of self-funded retirement in Australia, due to the socio-economic significance of home ownership for Australians.

Superannuation

14. Superannuation in Australia is generated through both compulsory and voluntary means and is just one element in a spectrum of possible retirement income streams. Superannuation is perhaps the simplest of these options in that almost all working Australians are subject to the Superannuation Guarantee and collected monies are managed on behalf of the client through subsequent investment, primarily in the stock market.

15. Average superannuation accumulated funds at retirement are currently around $83,000 and estimated to rise to $100,000 by June 2010, and $136,000 by June 2020 in today's dollar terms (Treasury 2002). These figures are subject to wide variations, but are nonetheless significantly increasing as the Superannuation Guarantee takes effect.

Wealth Creation

16. According to the OECD, wealth is an important resource in retirement which helps to diversify income risk while also buffering against unexpected financial developments (OECD 2001).

17. While superannuation is an increasingly important element in wealth creation in Australia, the OECD suggests that housing wealth has the potential to play a much more important role in self-funded retirement than is currently the case, assuming a ready means of converting housing wealth to retirement income.

18. Most Australians do not have the funds to simply save for their retirement (particularly while paying rent) and will need to invest borrowed money with the assistance of supporting tax incentives such as negative gearing. The home can be used as equity in order to provide the cornerstone of wealth creation. Full home ownership delivers ongoing rent savings.

19. Thus, the question arises: "*Should this inquiry be centred on improving the superannuation savings of people under age 40, or should the inquiry be exploring all possible mechanisms able to generate wealth and enhance the ability of this age group to better plan for self-funded retirement?*"

20. The REIA asserts that the superannuation debate explicitly includes home ownership and that all mechanisms able to enhance the ability of the under 40 age group to be better prepared for self-funded retirement should be considered.

Home Ownership in Self-Funded Retirement

21. Home ownership is highly valued by Australians with around 67% of all people owning their own home (Census 2001). Home ownership is widely recognised as being central to social and family stability and can provide considerable social benefits for individuals and families including an invaluable sense of security and general well-being.

22. Full home owners derive substantial benefit through relief from ongoing housing costs - a benefit of special importance to retirees. A retiree that does not own their own home would today require an additional investment of around $200,000 at 5% (to yield a return of $200 per week) to self-fund the rent for a modest retirement dwelling without drawing down on savings or relying on the age pension as compared to a retiring home owner. Even in this simple case, such an investment is unlikely to be adequate as inflationary pressures will also act to erode this capital investment over time as rents increase throughout the remainder of the retiree's lifespan. As shown at Paragraph 15 above, this amount is currently unattainable.

23. Those who own their home early in life will eventually accumulate long-term tax-free capital gains (equity) which may be invested in other forms of wealth creation activity throughout life. Retirees owning their own homes have control of an asset which may be used to further support retirement through a downsize sale, conversion to a rental property or as leverage for other financial services such as a reverse mortgage. In this manner, the equity held in a retiree's home may be used to help provide both accommodation and care during retirement years, significantly alleviating the pressure on State and Federal Governments to provide these services.

24. A report by Allen Consulting Group in 2002 estimated that the daily cost of residential care (e.g. 'live in' nursing / retirement home) during 2001-02 was around $163 in a 'high care' facility and around $100 in a 'low care' facility. If the person cared for was to remain in their own home, providing their own meals and housing however, Allen estimated that this cost could be lowered to around $90 per day (high care) and $35 per day (low care). On current projections, a 5-10% increase in the proportion of 'low care' retirees remaining in their own homes could generate savings of between $210m and $420m per annum by 2021.

25. Additionally, many retirees traditionally view the family home as a significant inheritance legacy for their surviving family members if it can be maintained.

26. The Commonwealth has previously acknowledged that home ownership has a direct bearing on the adequacy of retirement income through accumulated savings and lower accommodation costs upon retirement (Treasury 2002).

27. The importance of home ownership is not lost on the current retiring generation with the Australian Housing Survey 1999 determining that over 80% of households, in which the reference person was aged over 65, owned their home outright and a further 4% were purchasing.

28. Preliminary estimates undertaken by Treasury in 2002 suggest that households headed by persons over age 65 have 45% of their private wealth in housing and land, 40% in financial assets such as deposits, shares, securities, and insurance reserves and 15% of assets in funded and unfunded private pension funds.

29. The Reserve Bank's Statement on Monetary Policy, May 2005, supports the notion that the general population in Australia tends to lean towards home ownership as the primary household asset. In contrast to retirees (above), 59.8 % of total household wealth is held as housing once the entire Australian population is considered (i.e. including younger people with minimal superannuation savings).

30. There are also broader national benefits for higher rates of home ownership. The Commonwealth Treasury has publicly acknowledged that the desire to achieve home ownership provides a strong incentive for individual saving. This saving helps to reduce excessive consumption of imported goods while also increasing domestic employment – taking pressure off interest rates and general fiscal policy. Perhaps even more important in the context of national / state budgets, retirees remaining in their own homes help to alleviate the burden on Federal and State Governments for the construction and operation of nursing / retirement homes, as demonstrated at Paragraph 24.

31. Overall, home ownership has both financial and social benefits for participating individuals and the economy while reducing the need for public expenditure on housing for retirees. For these reasons, the REIA is highly supportive of Government initiatives encouraging home ownership and wealth creation such as the First Home Owners Grant Scheme, negative gearing and the capital gains tax regime.

32. The REIA will address the specific terms of reference for the Inquiry in this context within the sections to follow.

SPECIFIC TERMS OF REFERENCE

Barriers and/or Disincentives to Contribute to Superannuation

33. In seeking to identify the barriers and disincentives for people under age 40 to contribute to superannuation, it is important to recognise the economic and social changes which are widely recognised as taking place in Australian society (AHURI 2005), including:

a. the changing employment profile in Australia (casualisation of the workforce);
b. increased rates of divorce;
c. delayed and second family formation;
d. greater longevity;
e. longer education;
f. later commencement of first job;
g. changing consumption trends; and
h. unprecedented levels of household debt.

34. These economic and social changes appear to be extending the traditional preferences for resource allocation of those in the young adult age cohort over a much longer period, predominately into the mid 30s, and in many cases past 40 years of age. This under 40 cohort is now more than ever facing delayed life expenses which, in the past, were non-existent, much less common or addressed in a previous life stage, including:

a. repayment of education expenses (HECS);
b. divorce settlements;
c. later child rearing;
d. travel;
e. other lifestyle choices; and
f. home purchase.

35. The REIA believes that these competing demands for the consumer dollar result in powerful disincentives for people under age 40 when considering the net benefit of increasing contributions to superannuation. While superannuation is 'locked up' and unavailable for use until retirement, expenditure on the 'life course' items above provides tangible benefits in the more immediate future and in the case of housing, well into retirement.

Current Incentives in Place to Encourage Voluntary Superannuation Contributions

36. When considering whether or not the current incentives in place to encourage voluntary superannuation contributions are adequate, it is important to consider the *relative* incentive as compared to alternative investment strategies.

37. While superannuation co-contribution arrangements and a favourable taxation status for both contributions and earnings act as powerful incentives for some individuals to make voluntary contributions towards superannuation savings, these incentives do not in themselves overcome the strong resource allocation preferences of the under 40 cohort as outlined in the previous section. For example, superannuation is of little immediate use in a low-income child-rearing household and additional voluntary superannuation contributions are likely to carry a high opportunity cost in terms of living standards during working life.

38. The poor performance of superannuation funds in recent years is in stark contrast with the strong performance of other investment options, particularly direct property investment. A quick visit to www.selectingsuper.com.au will demonstrate that the five year average return for Australian superannuation funds to April 2005 ranged between 3.3% and 8.1% when default investment options are chosen. This does not offer incentive for people to provide funds to superannuation for investment in an asset that is performing badly.

39. A recent report commissioned by the Australian Direct Property Investment Association (ADPIA 2005) reveals that while shares have delivered the greatest annual rate of return over the past 20 years (13.4%), property has generated similar returns with much lower volatility (Chart 1 – Annex A). Property has performed well and Australians understand property investment.

40. Further, the ADPIA report concluded that higher investment in direct property could drastically reduce the chances of a negative return in an investment portfolio (Chart 2 – Annex B). Superannuation funds invest significantly in the stock market.

41. Taking a more general view, for any individual, a more diversified investment portfolio for self-funded retirement will:

a. lower overall risk;
b. increase investment choice;
c. allow greater control; and
d. provide powerful incentives through the realisation of more immediate practical benefits, perhaps more closely reflecting the individuals resource allocation preferences.

42. In addition to superannuation funds in the stock market, home ownership represents a balanced investment approach for self-funded retirement by simultaneously providing an appreciating investment asset in itself, as well as the equity for the cornerstone of further investment in direct property.

43. Home ownership, provides enduring benefits throughout all life stages and is already an integral part of planning for self-funded retirement for most Australians. In contrast to increased voluntary superannuation contributions, home purchase can make a significant contribution to personal wealth creation *while also* providing social benefits including family values.

44. Clearly, the incentive for individuals to make increased voluntary contributions to their superannuation must be improved while enhancing the achievement of other life goals, such as home ownership.

Improving their awareness of the importance of saving for their retirement

45. For a person in their early twenties, with many of life's goals as yet undefined, retirement may seem like a long way off. Add to this the rapidly changing resource allocation preferences in the under 40 cohort and this situation results in delayed recognition of the importance of saving for self-funded retirement for most younger people.

46. Despite the fact that the individual's best income generating years may still lay ahead, the compounding nature of superannuation over time will almost always result in the earliest contributions generating the highest per unit value upon retirement. For this reason, there is a clear need to encourage individuals to begin contributing to superannuation at the earliest possible point in the individual's investment life.

47. Targeted education is therefore important for promoting the benefits of saving for retirement in the under 40 cohort. An education campaign will be more successful however if the Commonwealth adopts a holistic approach to saving for retirement and promotes an appropriate investment mix for those in each particular life stage.

48. If the Commonwealth Government was to formally declare home ownership as the forth pillar of self-funded retirement, opportunities arise to promote the benefits of saving for retirement while also providing tangible incentives, socio-economic improvement and a mechanism for generating further wealth creation.

49. The REIA considers that a valuable mechanism for achieving higher rates of both voluntary superannuation contributions and home ownership would be a scheme allowing early access to voluntary super contributions. Incentives for voluntary savings would include favourable tax treatment.

EARLY ACCESS TO SUPERANNUATION

50. House prices in Australia have moved constantly upwards since mid-1996 (Chart 3 – Annex C) and market conditions are making it increasingly difficult for both first homebuyers and low income earners to enter the property market. In March 2005, first homebuyers constituted just 15.6% of the market place (Chart 4 – Annex D), which is well down on the 13 year average of 20.7%.

51. In response to concerns that a significant sector of the Australian community may be unable to become home owners due to decreasing housing affordability, the REIA commissioned a report on Early Access to Superannuation for Home Purchase by Professor Julian Disney, Director of the Social Justice Project, University of New South Wales during March 2003.

52. The report explores the potential for people not otherwise able to purchase a home to achieve full ownership before or upon retirement through access to their voluntary superannuation contributions and concludes that such a scheme represents an important opportunity that could enable a larger proportion of lower and middle income earners to realise home ownership, underpinning self-funded retirement.

53. A scheme for early access to superannuation would not only enable earlier home ownership in the under 40 age group, it will have the added benefit of encouraging participants to make additional voluntary superannuation contributions as a means of saving for a home. In doing so, this process will expose the cohort to the importance of saving for retirement while also enabling personal wealth creation through the generation of increased asset equity.

54. This housing wealth can be unlocked through the development and promotion of supporting strategies able to convert the asset wealth of a retiree into either imputed or actual income. Currently, this wealth may be unlocked through a downsize sale, leasing the property or through other means such as a reverse mortgage.

55. In order to ensure that the raison d'être of superannuation is preserved, a scheme for access to superannuation could involve several important principles, e.g.:

a. access is only available to first home buyers;
b. access is for the purpose of providing or augmenting a deposit for a home;
c. only voluntary savings in the superannuation scheme are available;
d. there must be a certain level of funds in the scheme; and
e. the home must be owner-occupied for a period of time before sale or lease.

56. If the Commonwealth Government was to formally recognise home ownership as the fourth pillar of self-funded retirement, the launch and wide promotion of a national scheme allowing access to voluntary superannuation contributions would avail the Government with a positive conduit to promote the benefits of saving for self-funded retirement to those in the target under 40 age group.

SUMMARY

57. The REIA recognises the importance of planning for an increased proportion of self-funded retirees in Australia to help reduce the impost on the social security system in the face of an aging population and a declining relative tax base. The REIA considers that this inquiry represents an opportunity to consider the merits of an early access to superannuation scheme for encouraging increased voluntary superannuation contributions in younger age cohorts and assisting a larger proportion of Australians generate personal wealth and become self-funded retirees.

58. Superannuation represents just one option in a spectrum of potential investments able to deliver retirement income and is 'locked up' until the statutory preservation age, delivering negligible tangible benefits to the contributing individual until this time.

59. Home ownership or the ability to pay rent is a key part of self-funded retirement. It delivers ongoing social and financial benefits over the investor's working life and into retirement. Moreover, self-funded retirement will significantly reduce the impost on Federal and State Government budgets in the future.

60. The REIA proposes that home ownership be formally recognised as the fourth pillar of self funded retirement and that the superannuation savings of people under age 40 be improved through the implementation of a scheme allowing early access to voluntary superannuation contributions for the purposes of generating wealth through purchasing a home.

Prepared by:

Secretariat
Real Estate Institute of Australia

19 July 2005

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ANNEX A
REIA SUBMISSION TO SUPERANNUATION SAVINGS INQUIRY
DATED 19 JULY 2005

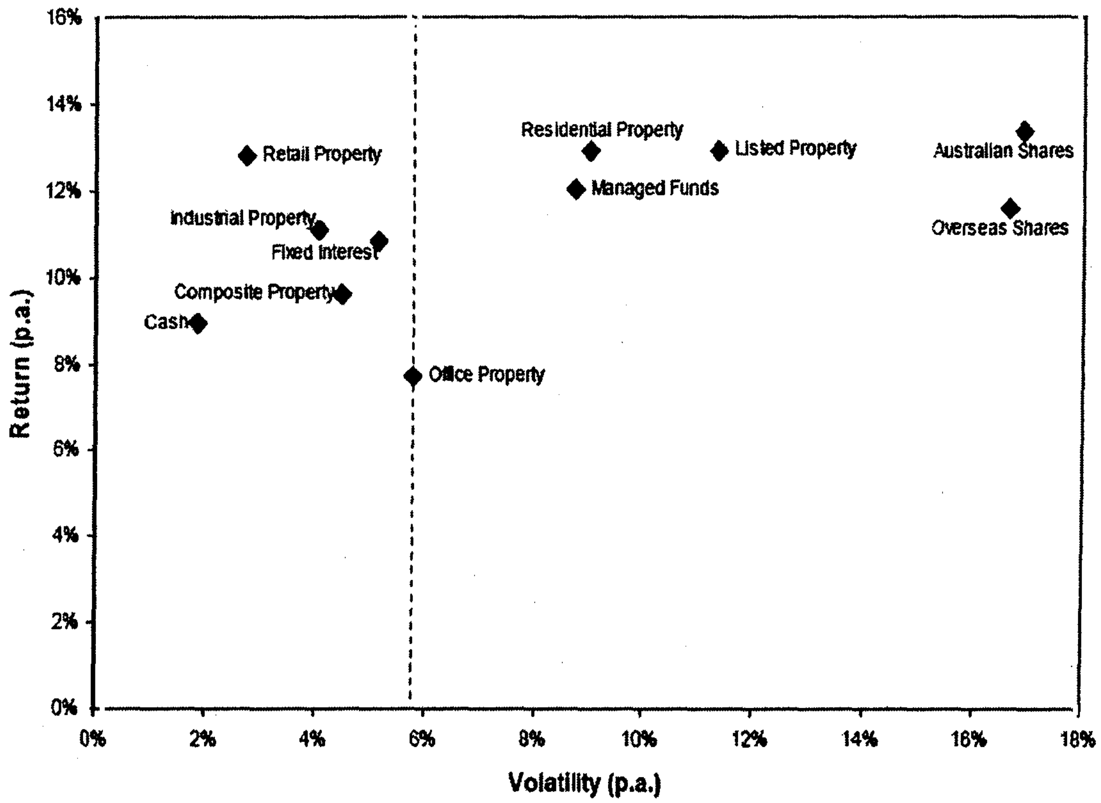

Chart 1: *Asset Class Performance Dec 1984 – Dec 2005. Source: ADPIA Investment Report 2005.*

ANNEX B
REIA SUBMISSION TO SUPERANNUATION SAVINGS INQUIRY
DATED 19 JULY 2005

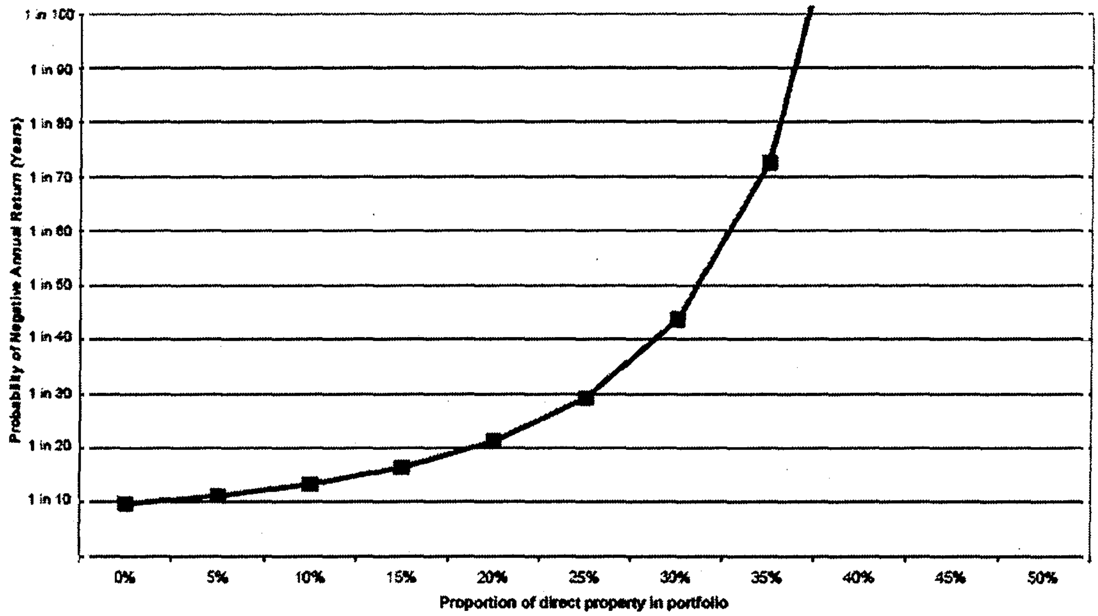

Chart 2: *Property within a Diversified Portfolio and the Possibility of a Negative Return Dec 1984 – Dec 2004. Source: ADPIA Investment Report 2005.*

ANNEX C
REIA SUBMISSION TO SUPERANNUATION SAVINGS INQUIRY
DATED 19 JULY 2005

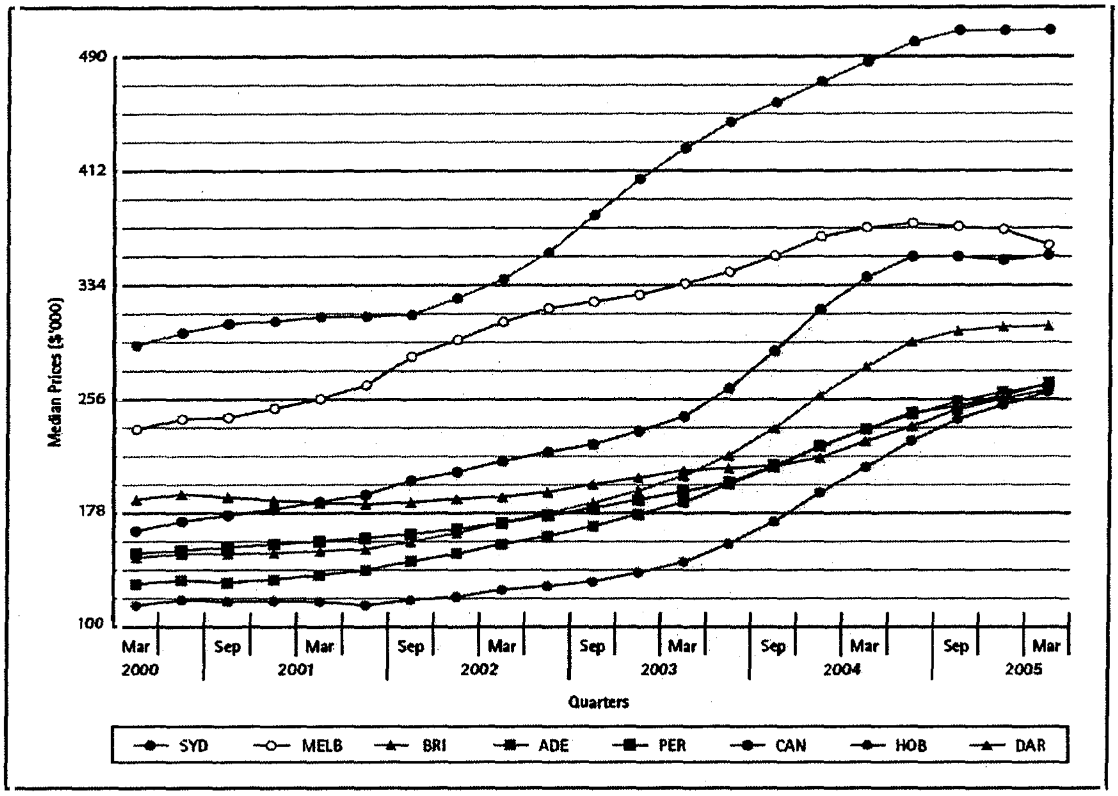

Chart 3: *Moving Annual Median House Prices, Capital Cities.*

ANNEX D
REIA SUBMISSION TO SUPERANNUATION SAVINGS INQUIRY
DATED 19 JULY 2005

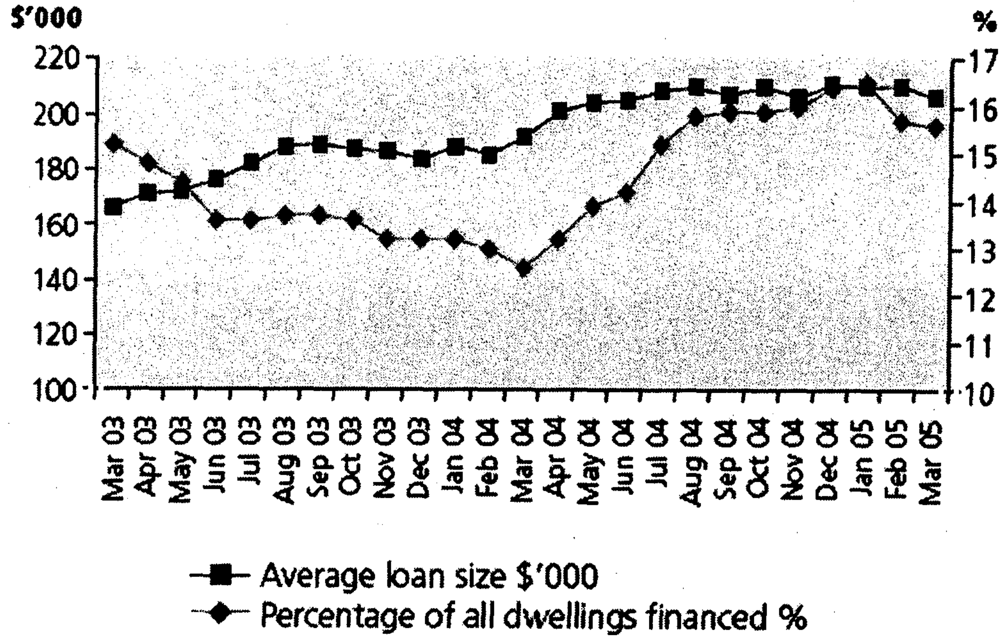

Chart 4: *First Home Buyers' Share of all Dwellings Financed. Source: ABS, Cat, No. 5609.0.*