Housing in retirement: the emerging challenge to retirement incomes policy

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Grattan Institute

Housing in retirement

Most Australians can look forward to a comfortable retirement

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- **But renters struggle** – in retirement and beforehand

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- **Home ownership is declining**, especially among **young and the poor**
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- **Falling home ownership** means retirement incomes will become **more unequal**

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How should policymakers respond?

- Raise **Rent Assistance** by 40%; benchmark to rents paid by low-income earners
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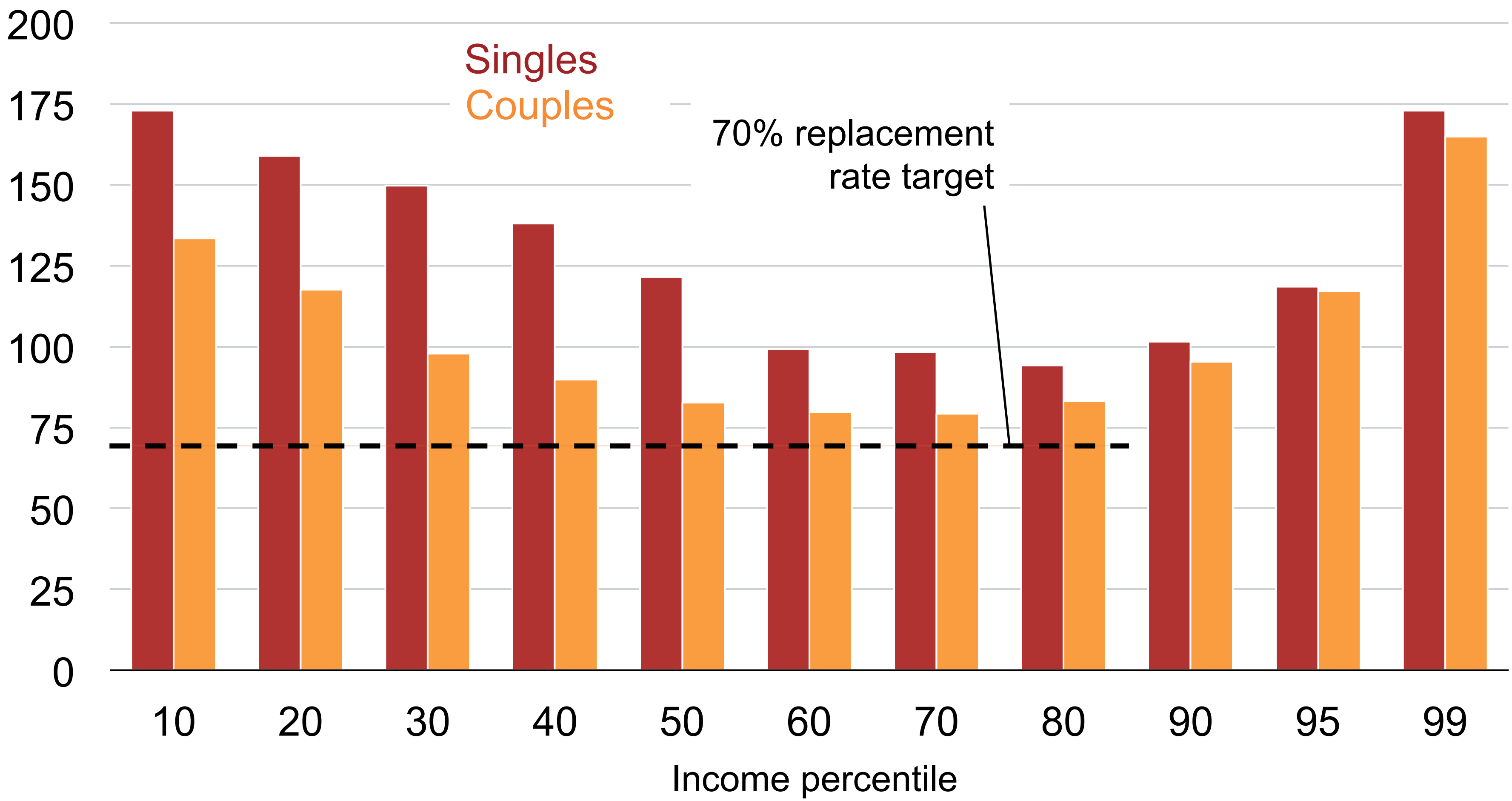
What should our retirement incomes system aim to achieve?

- Ensure some **minimum** standard of living in retirement
- Facilitate **lifetime consumption smoothing**
- Not about boosting **inheritances**
- Be fiscally **sustainable**
- Maintain **incentives** to work, save and invest
- Manage **risks**: investment; longevity etc.

Retirees today appear to have the same or higher incomes than when they were working

Disposable income for households aged 65-84 in 2015, relative to income for households aged 45-64 in 1995, $2015-16



Notes: Disposable income includes income of head of household and their partner, but not children. Incomes adjusted due to changes in how the ABS defines incomes between surveys.
Source: ABS Survey of Income and Housing; Grattan analysis.

Those entering the workforce today will be able to maintain their standard of living in retirement

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Replacement rates, by employment earnings percentile, CPI deflated, per cent

Notes: Models retirement income of a person born in 1985, who works uninterrupted from 30 to 67, and dies at age 92. Assumes wages growth falls by the amount of any Super Guarantee increase. Includes savings outside super. Employment earnings adjusted to account for movements up and down the earnings distribution. Retirement savings drawn down over 26 years to leave a small bequest in addition to the home. Retirement income deflated by CPI

Source: Grattan Retirement Income Projector

Why are our numbers different? We don’t assume spending needs rise through retirement

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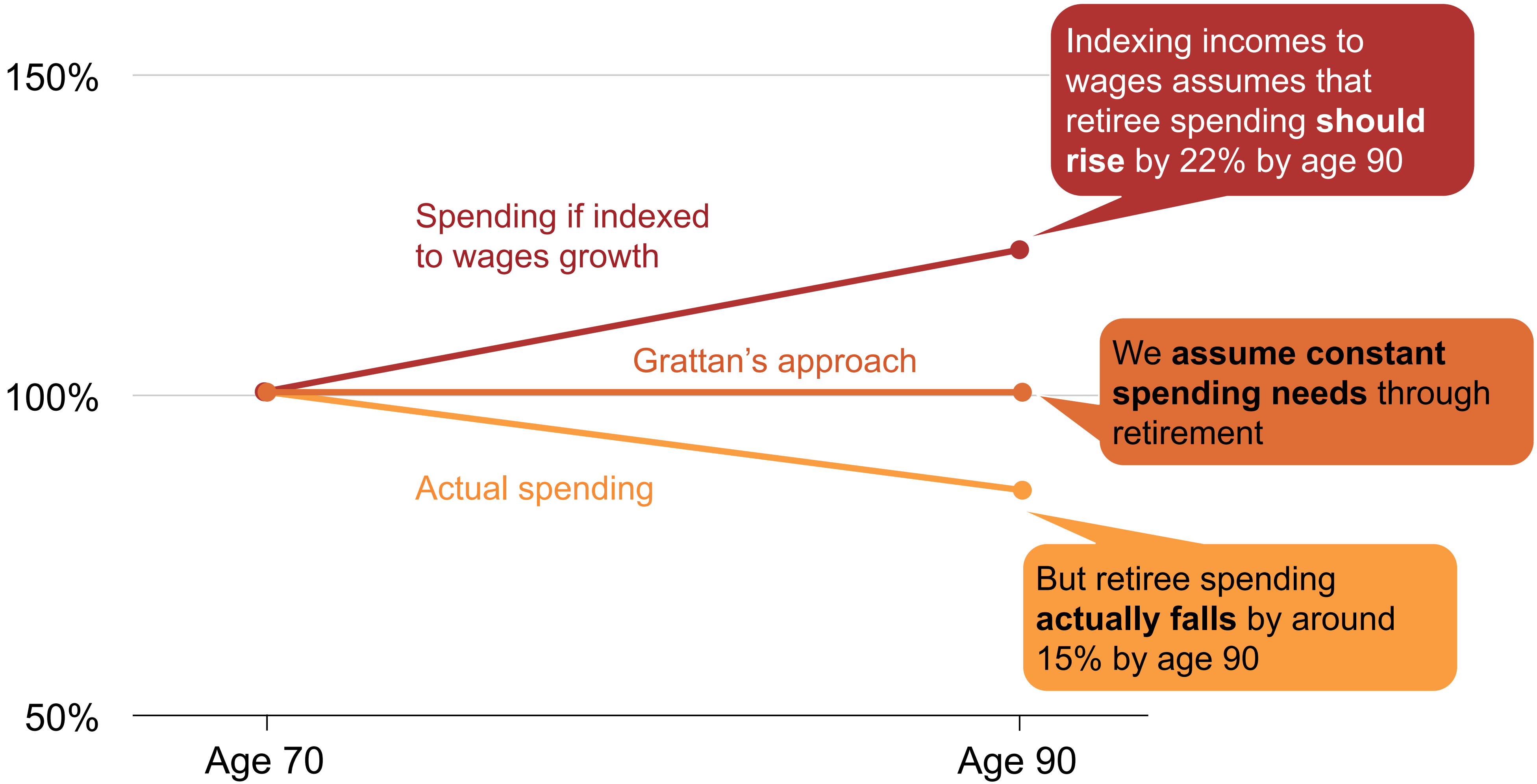
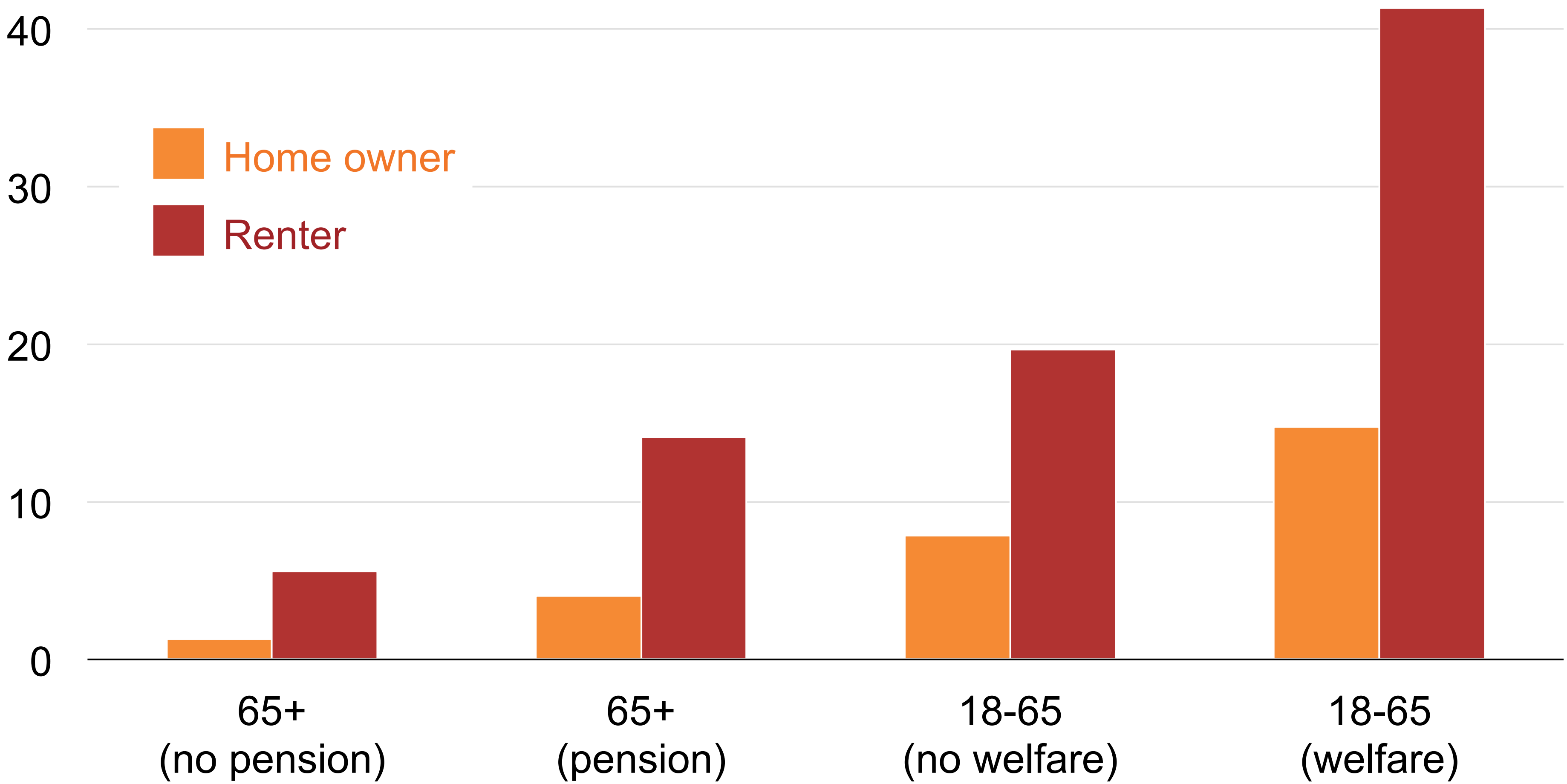
Real (inflation adjusted) retiree spending as a proportion of their spending at age 70



Notes: Assumes annual real wages growth of 1 per cent.
Source: Grattan analysis.

Retirees that rent are more likely to experience financial stress…

Percentage of households facing at least one financial stress, 2015-16



Notes: Financial stress defined as money shortage leading to 1) skipped meals; 2) not heating home; 3) failing to pay gas, electricity or telephone bills on time; or 4) failing to pay registration insurance on time. 'Pension' and 'welfare' includes all those receiving cash benefits of more than $100 per week

Sources: *Money in Retirement*, Figure 3.3.

… and retired renters report much higher rates of poverty than retired homeowners

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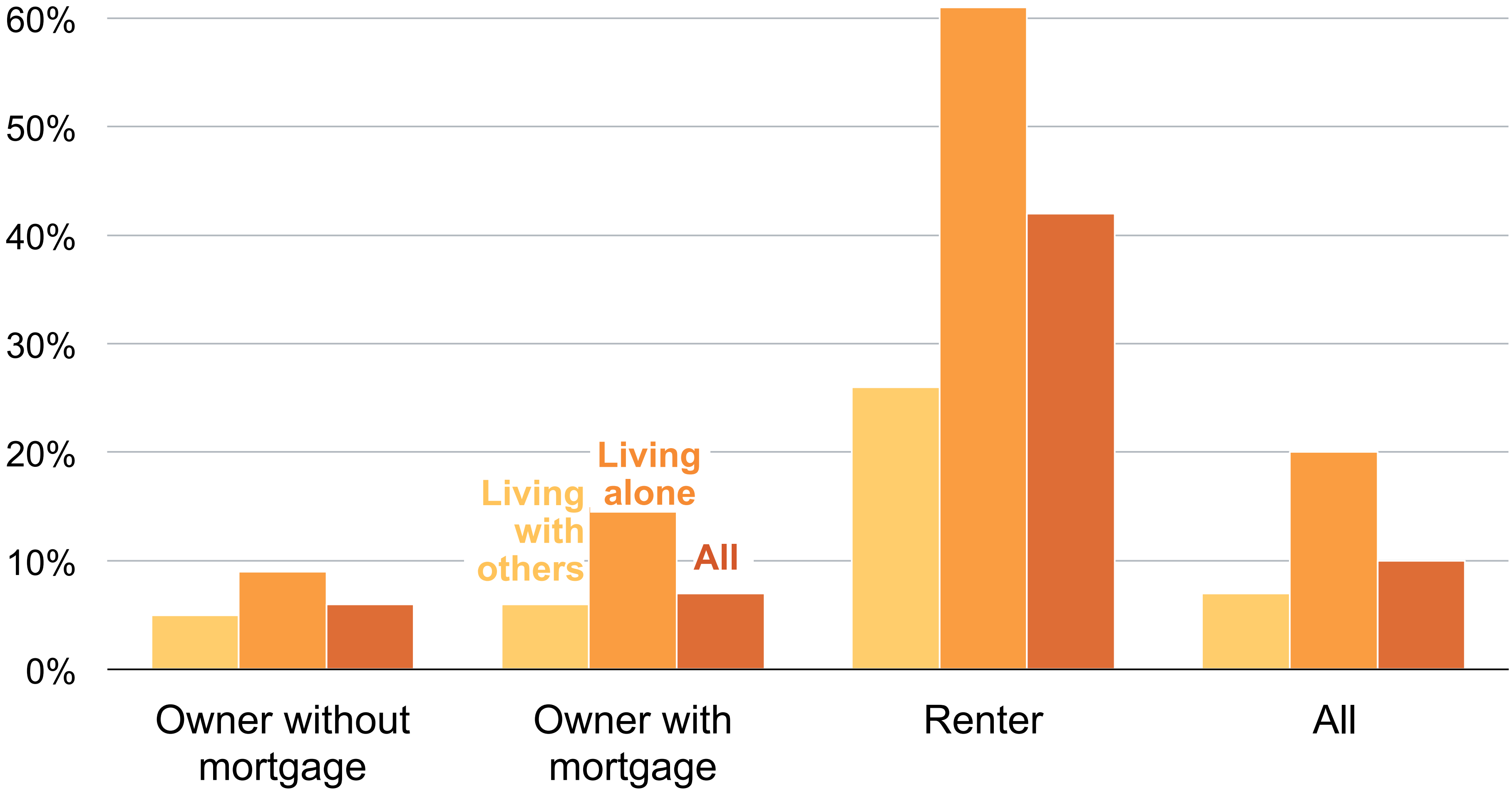
Old-age poverty rate after including imputed rent, ages 65+



Note: Poverty rate is the proportion of people aged 65+ who have equivalised disposable household income (plus imputed rent) below 50% of population-wide median.
Source: CEPAR (2019) calculations based ABS SIH data.

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Home ownership is falling fast among younger, poorer Australians

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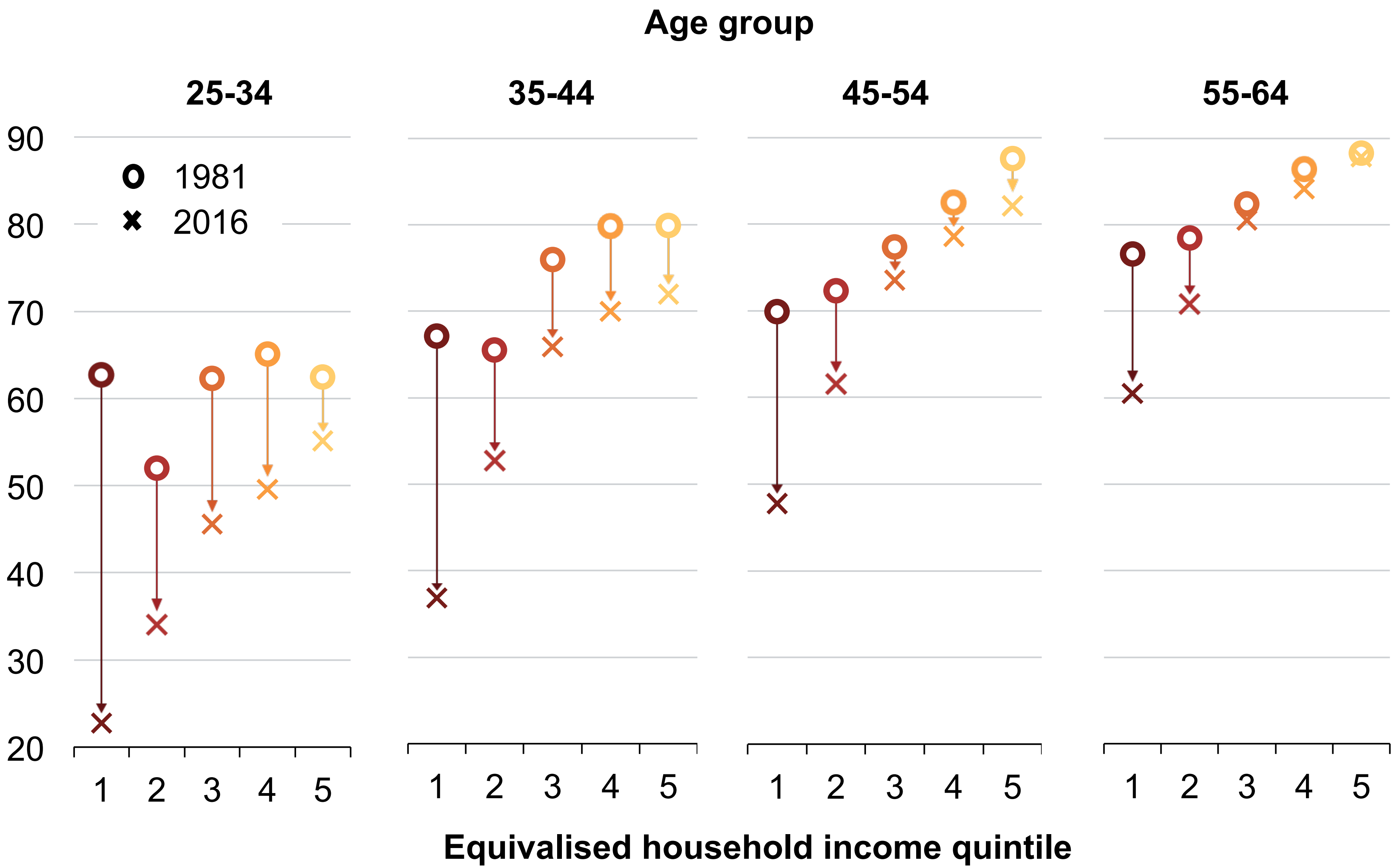
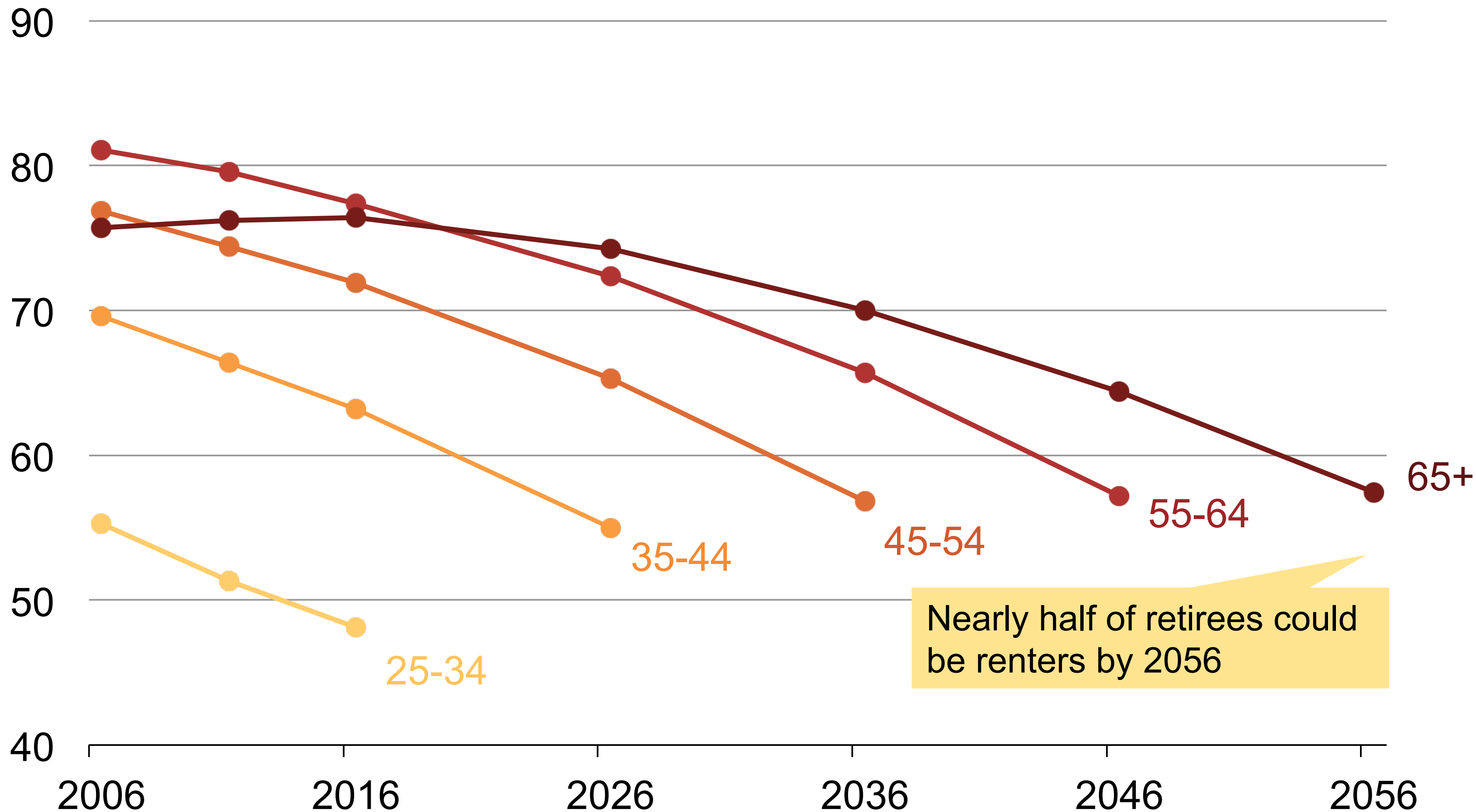
Home ownership rates by age and income, 1981 and 2016



Source: Census; Burke et al 2014; ABS.

If current tends continue, far fewer retirees could own their own homes in future

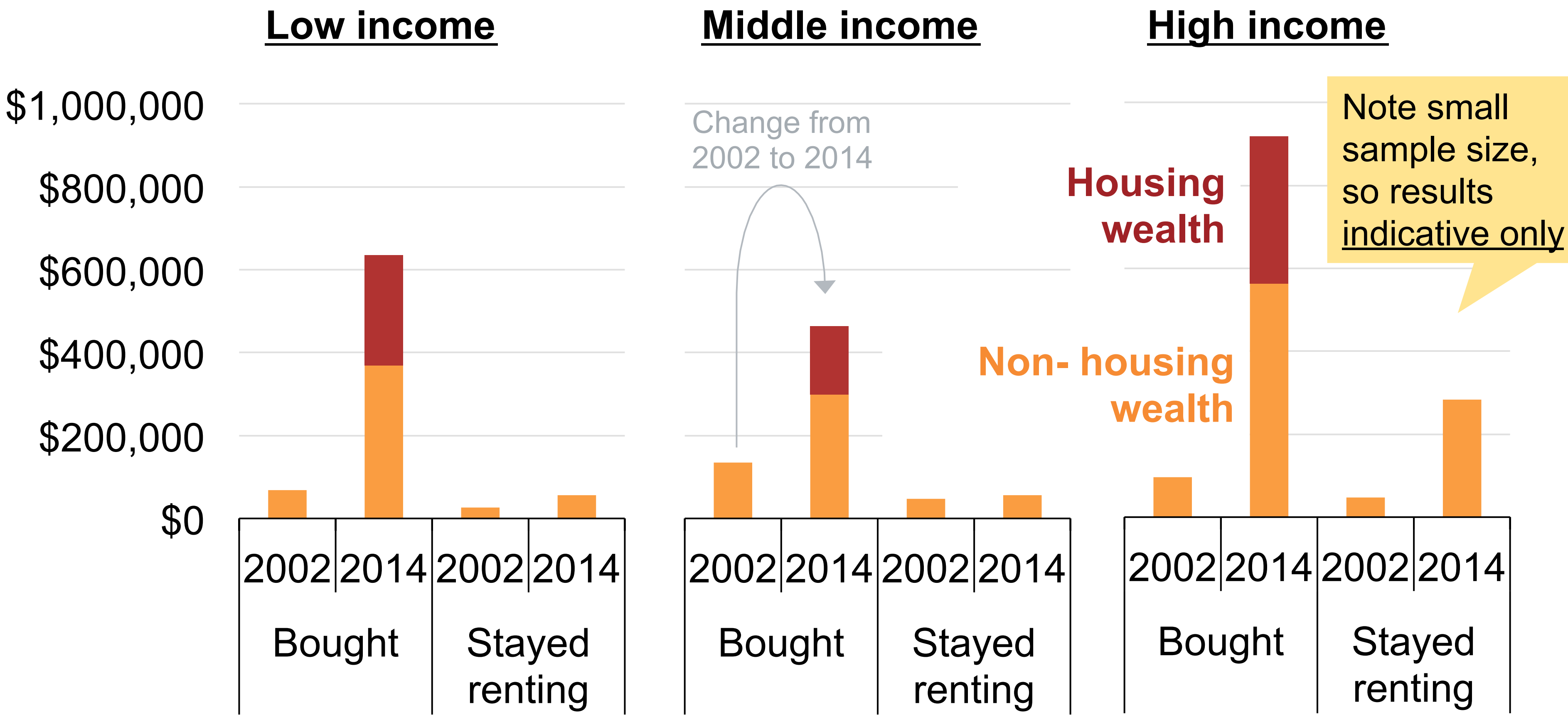
Home ownership rates by age, 2006 to 2056



Notes: Home ownership rates lower than traditionally reported since calculated on a per-person basis, rather than a household basis.
Source: ABS (2018); Grattan analysis.

Renters appear to *save less* than homeowners on equivalent incomes

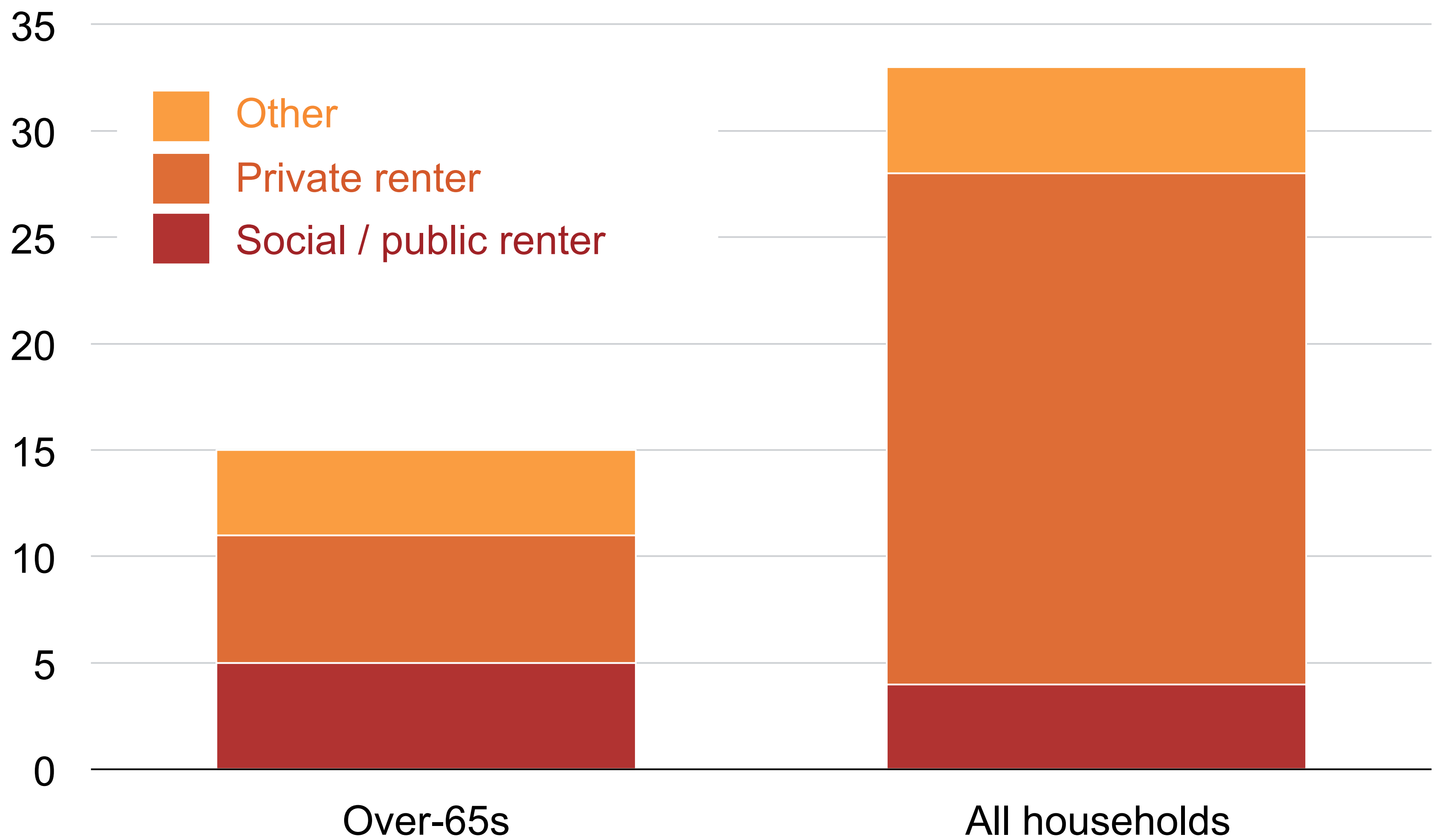
Net wealth of couple only renters aged below 40 years in 2002, grouped by whether they had bought a house by 2014



Notes: Unweighted small sample from HILDA should be treated with caution. But the findings are confirmed in the USA by Turner (2009). Even Turner's results do not prove causation, because those who stay renting are likely to be experiencing other challenges that might limit their wealth. Income grouped into three groups based on the average percentile of household disposable income in 2002 and 2014. Wealth is average net wealth for total household.
Source: HILDA; Grattan analysis.

Future retirees will be more likely to live in private rental housing

Renters as proportion of population



Source: Daley, Coates and Wiltshire (2018), *Housing affordability: re-imagining the Australian Dream,* Figure 4.4

Homeowners' housing costs decline sharply as households approach retirement, renters don't

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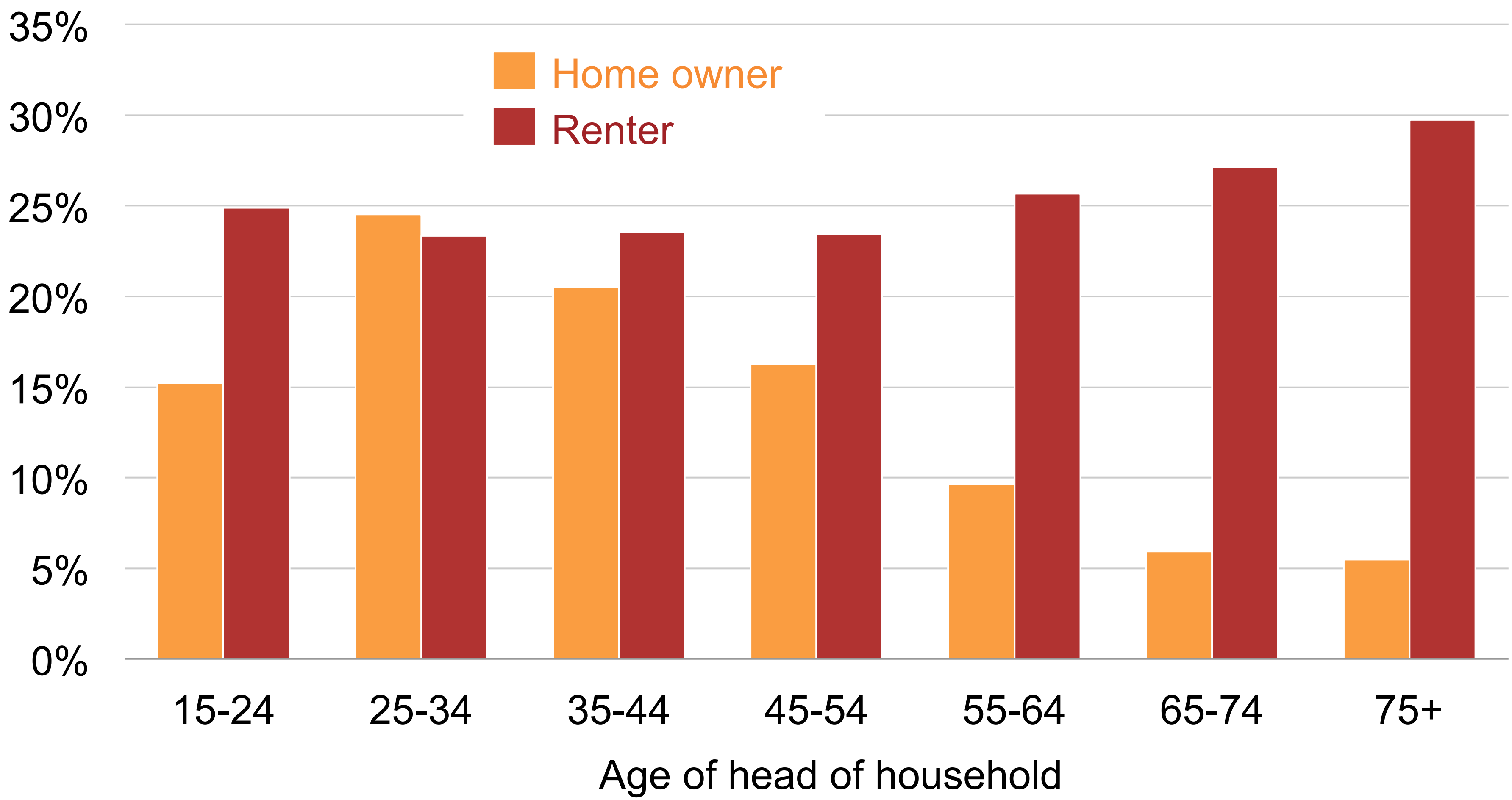
Housing costs as a share of household disposable income, 2015-16



Notes: Housing costs include mortgage interest and principal repayments and general rates for homeowners, and rental payments for renters. Does not include imputed rent.
Source: *Money in Retirement*.

Retirement will become more unequal: renters will need to save more to replace pre-retirement earnings

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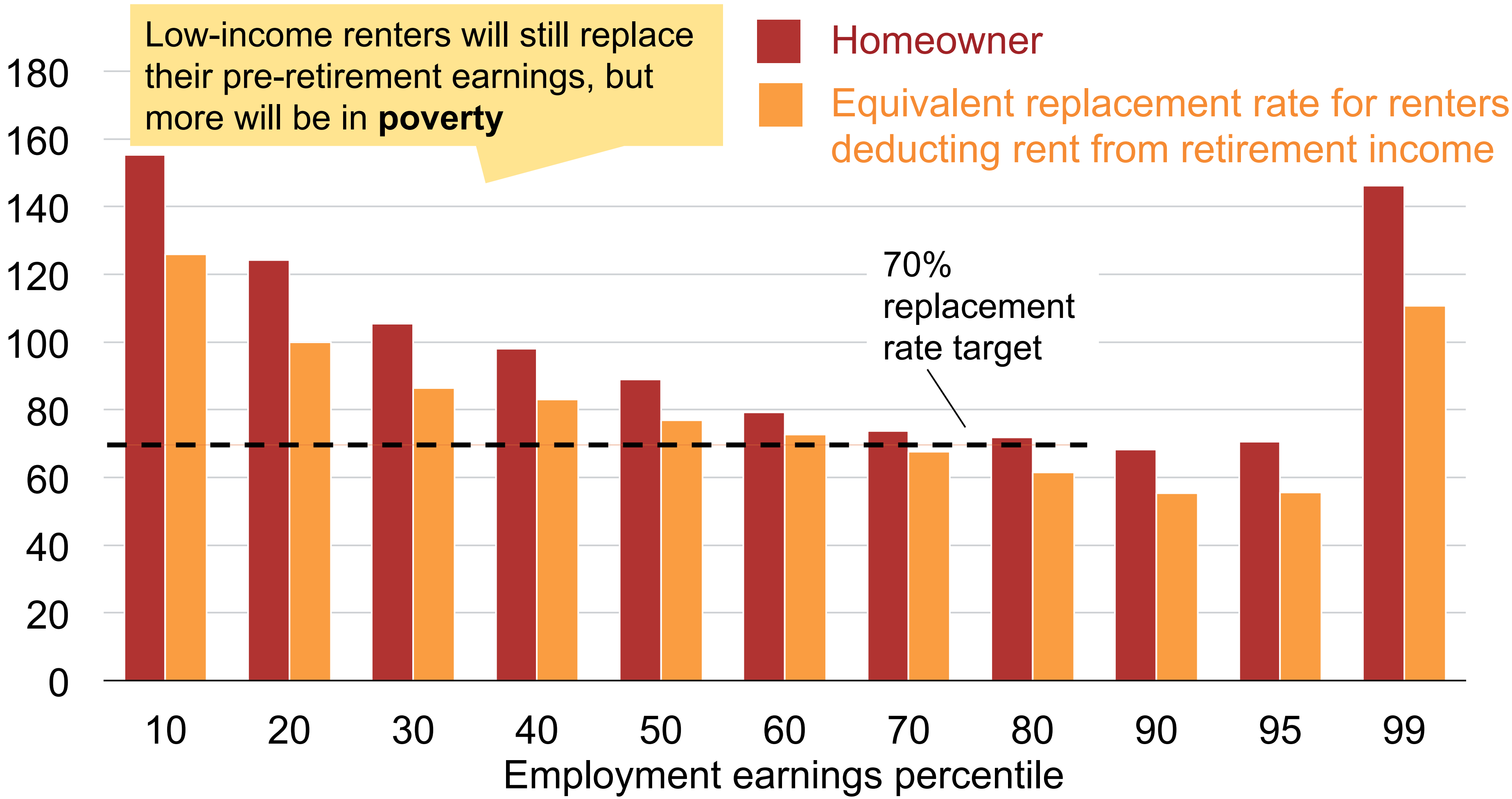
Replacement rates, by employment earnings percentile, CPI deflated, per cent



Notes: The equivalent replacement rate for renters is calculated as retirement income plus Rent Assistance less the additional housing costs that renters pay relative to home owners in retirement, divided by the pre-retirement income without any allowance for housing costs. Assuming rent is 30 per cent of retirement income including any Rent Assistance received.
Source: Grattan Retirement Income Projector.

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Rising house prices mean Australians are spending more of their *lifetime* income paying off the home

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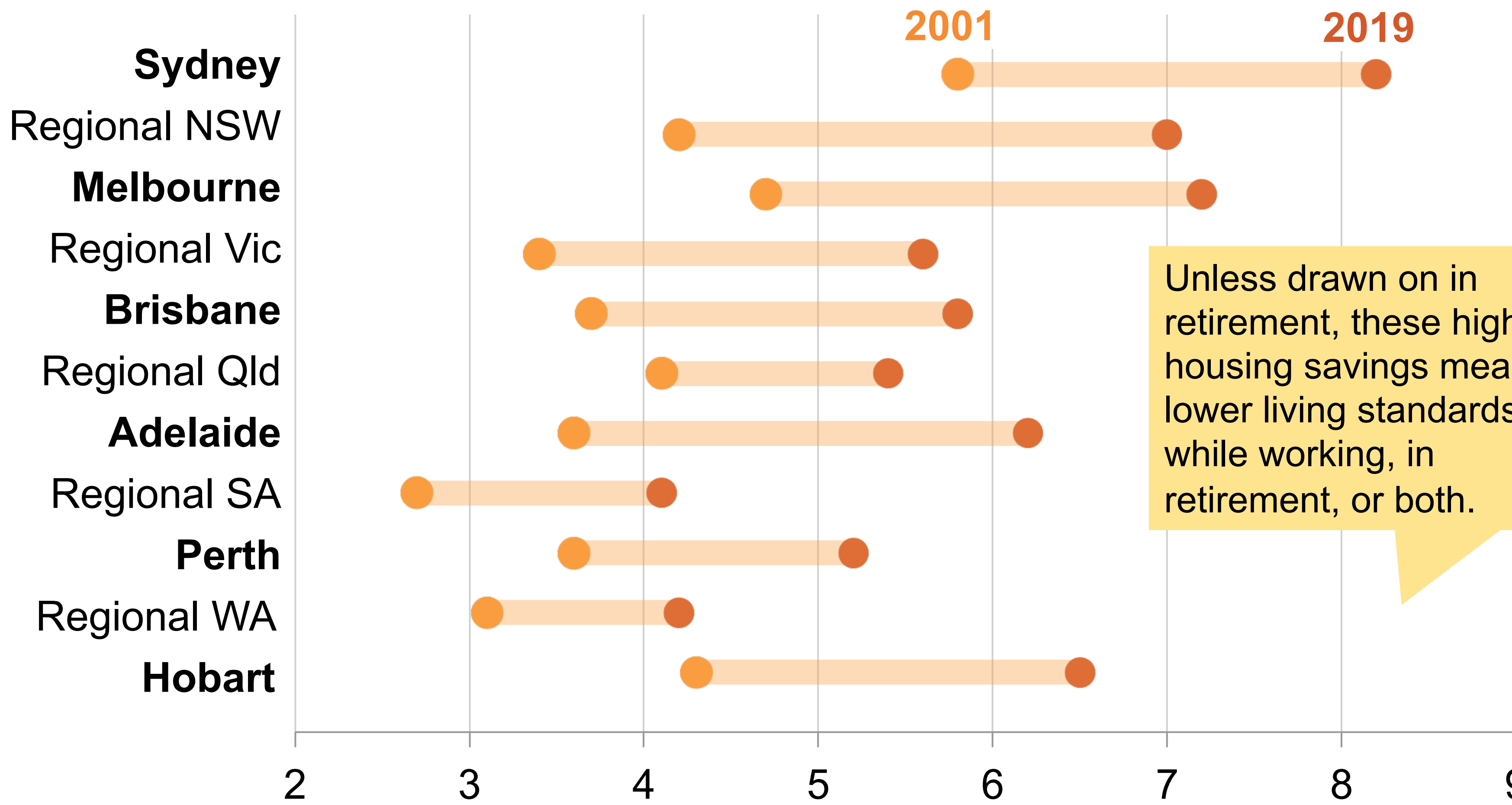
Ratio of median dwelling price to median annual gross household income



Unless drawn on in retirement, these higher housing savings mean lower living standards while working, in retirement, or both.

Notes: Median household income from ANU analysis
Source: Core Logic Housing Affordability Report – December 2016; ANZ Housing Affordability Report – November 2019.

Younger Australians are saving much more than they used to

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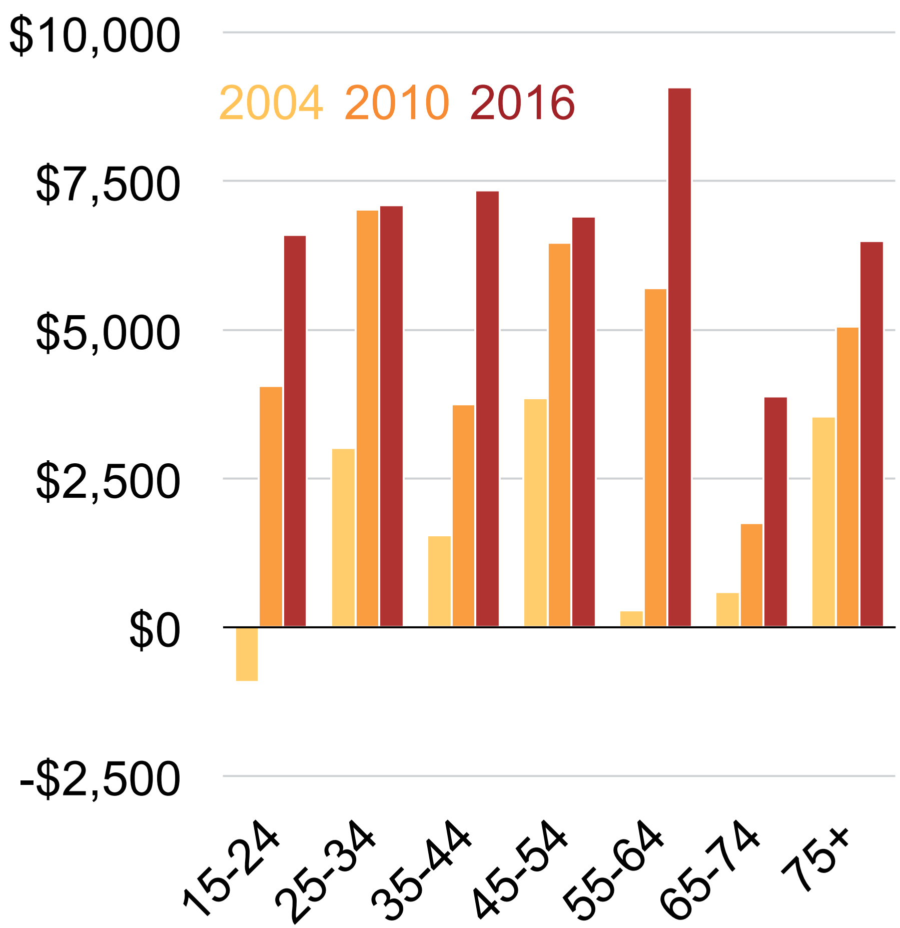
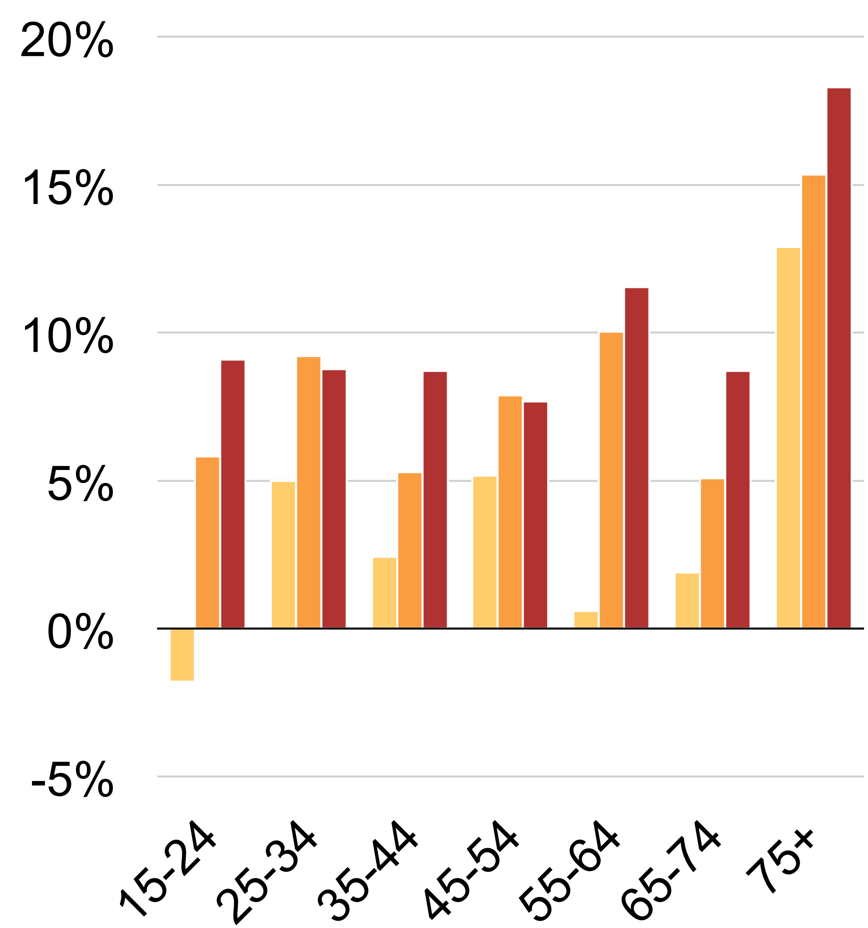
Median annual savings, in 2016 dollars



Median savings rate



Notes: Savings = disposable income minus total expenditure on goods and services, divided by household equivalisation factor. Savings rate = savings as a proportion of equivalised disposable income. Where the disposable income or expenditure of a household was negative we have adjusted it to zero, as per the ABS's preferred method. Age group is the age of the household reference person. Excludes compulsory superannuation contributions as not drawn from disposable income.

Source: *Generation Gap, Figure 4.5*.

More older Australians are stuck with a mortgage as they approach retirement

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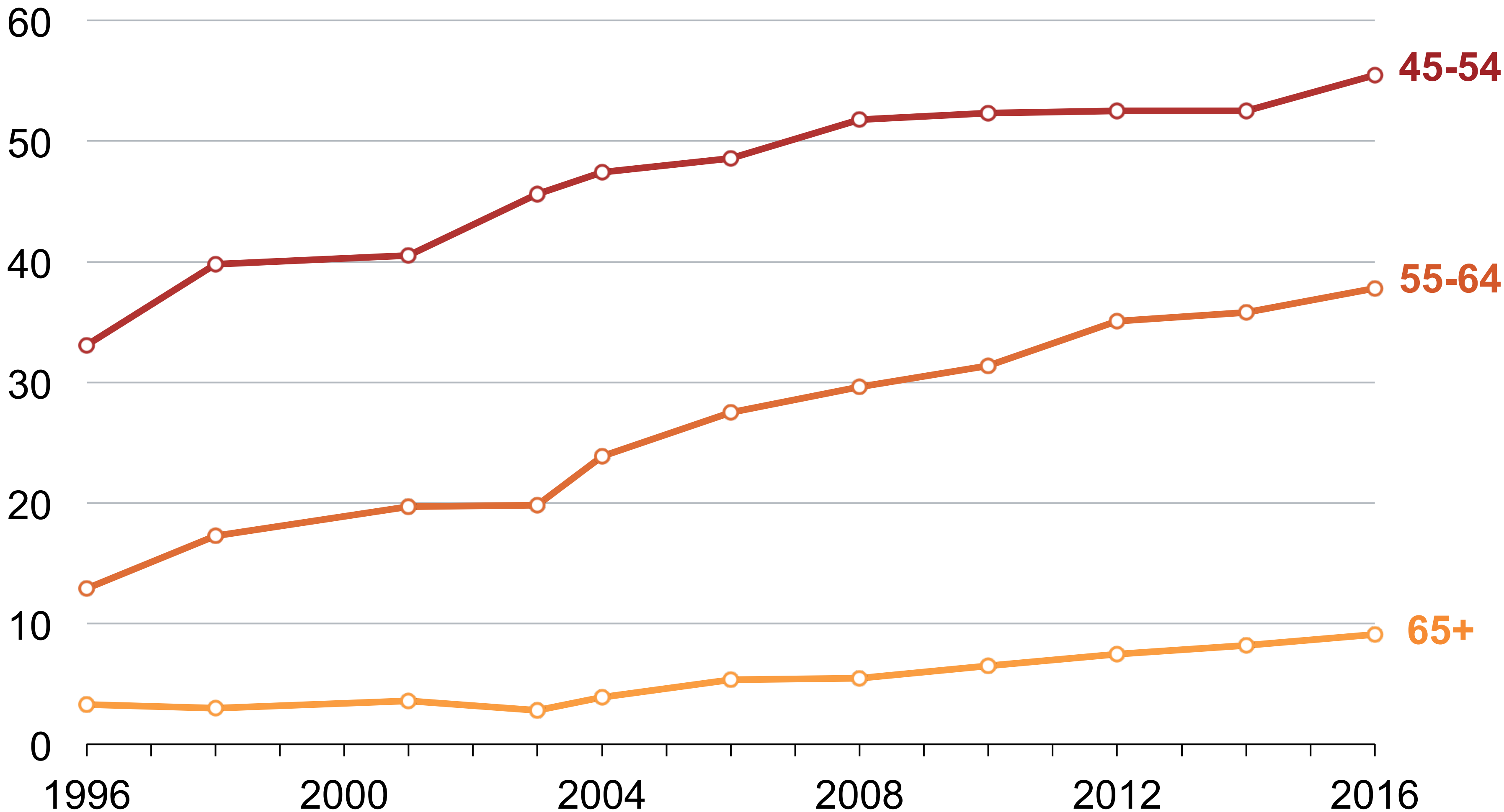
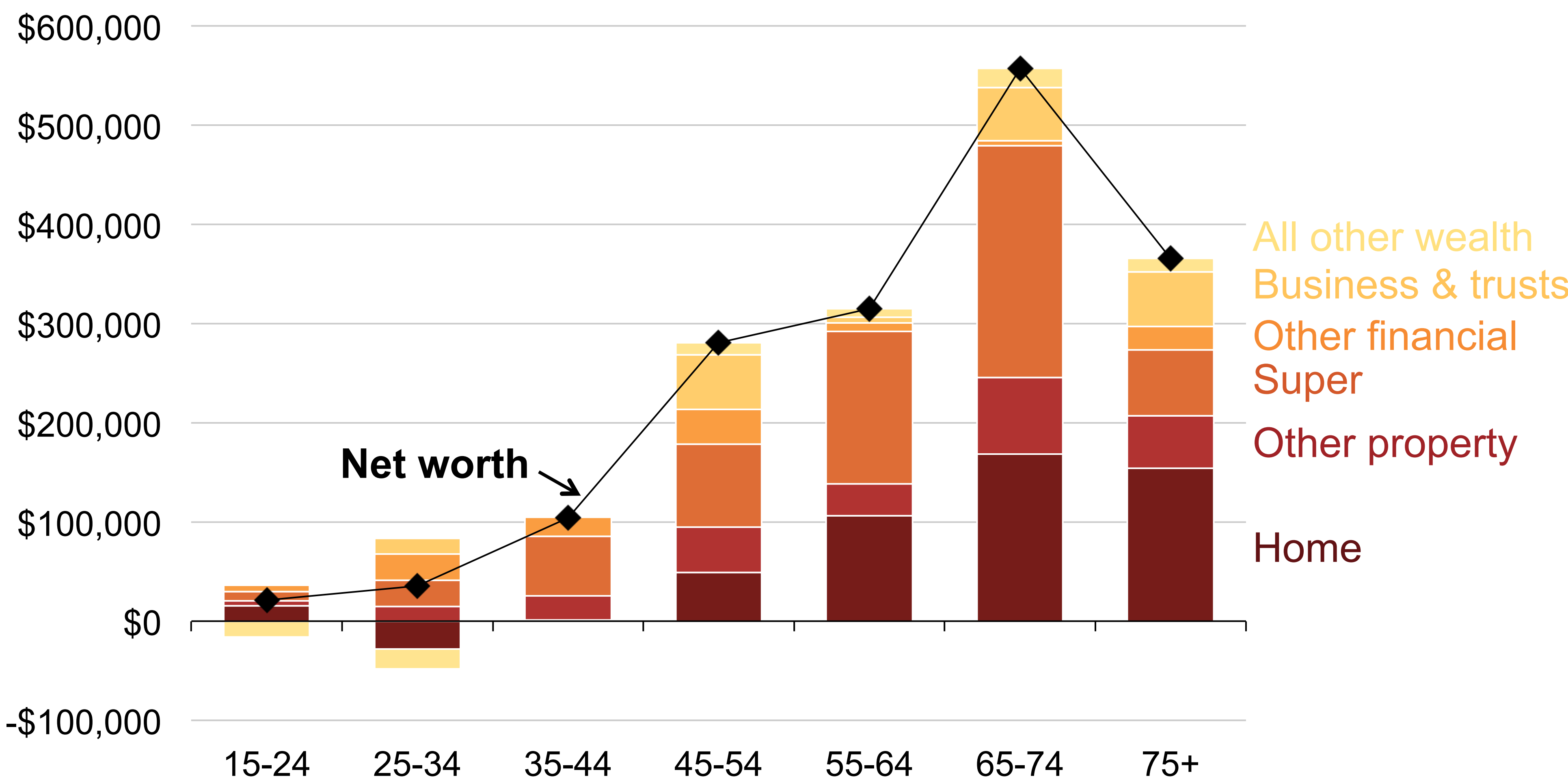
Per cent of households that own their home with a mortgage, by age group



Notes: Age of household reference person. Chart shows data from all available surveys. Data for 65+ for 2005-06, 2007-08, 2009-10, 2011-12 is estimated using population shares of five-year age groups due to lack of data.
Source: ABS Catalogue 4130.0 - Housing Occupancy and Costs.

But those mortgage debts are typically offset by much large housing *assets*

Change **in mean wealth per household in 2015-16, compared to households of the same age in 2003-04, in 2015-16 dollars**



Notes: Each asset type is net of liabilities. Age group is the age of the household reference person.
Source: ABS Survey of Income and Housing (various years).

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Boosting Rent Assistance is more targeted than increasing the Age Pension

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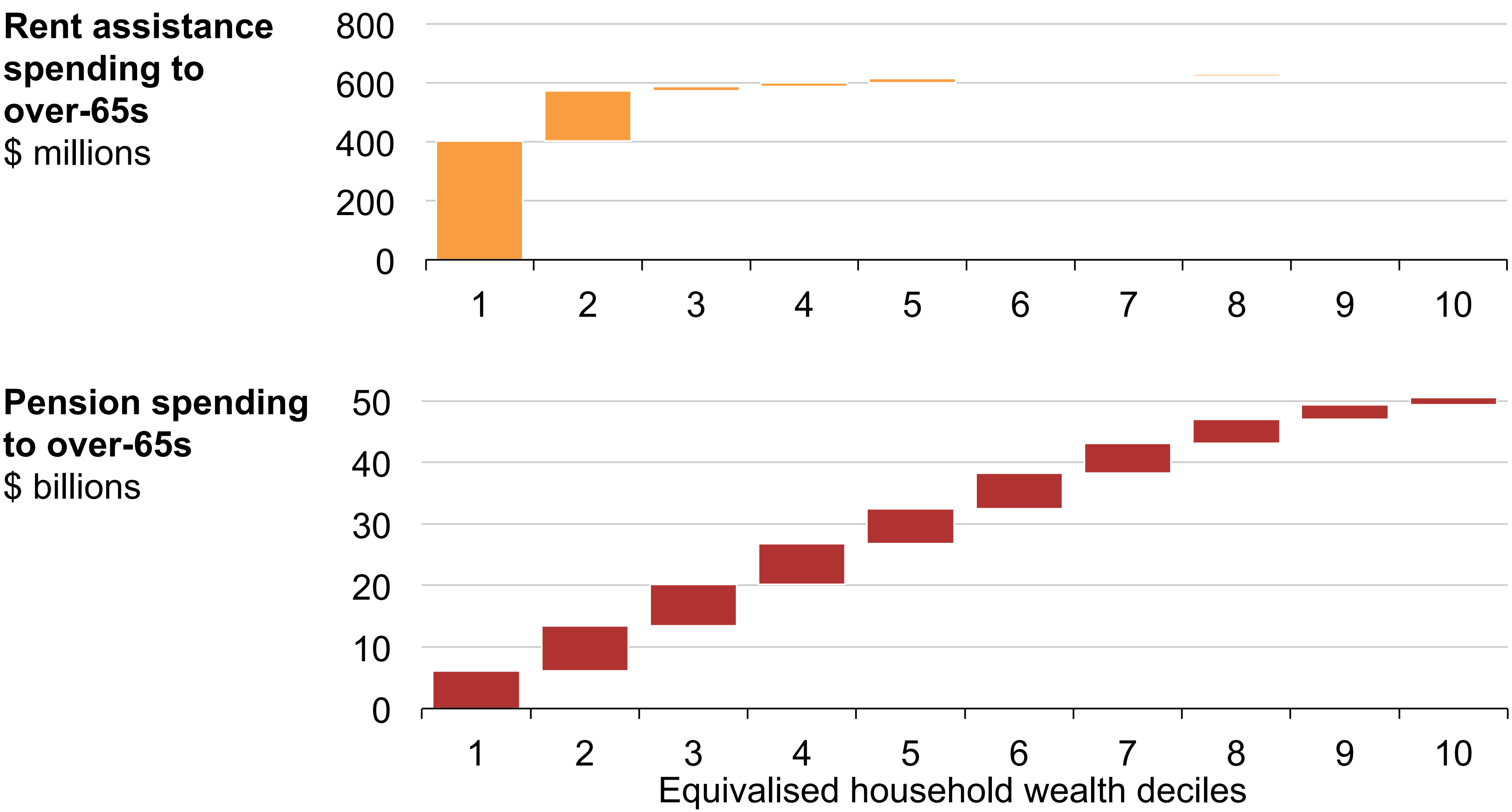
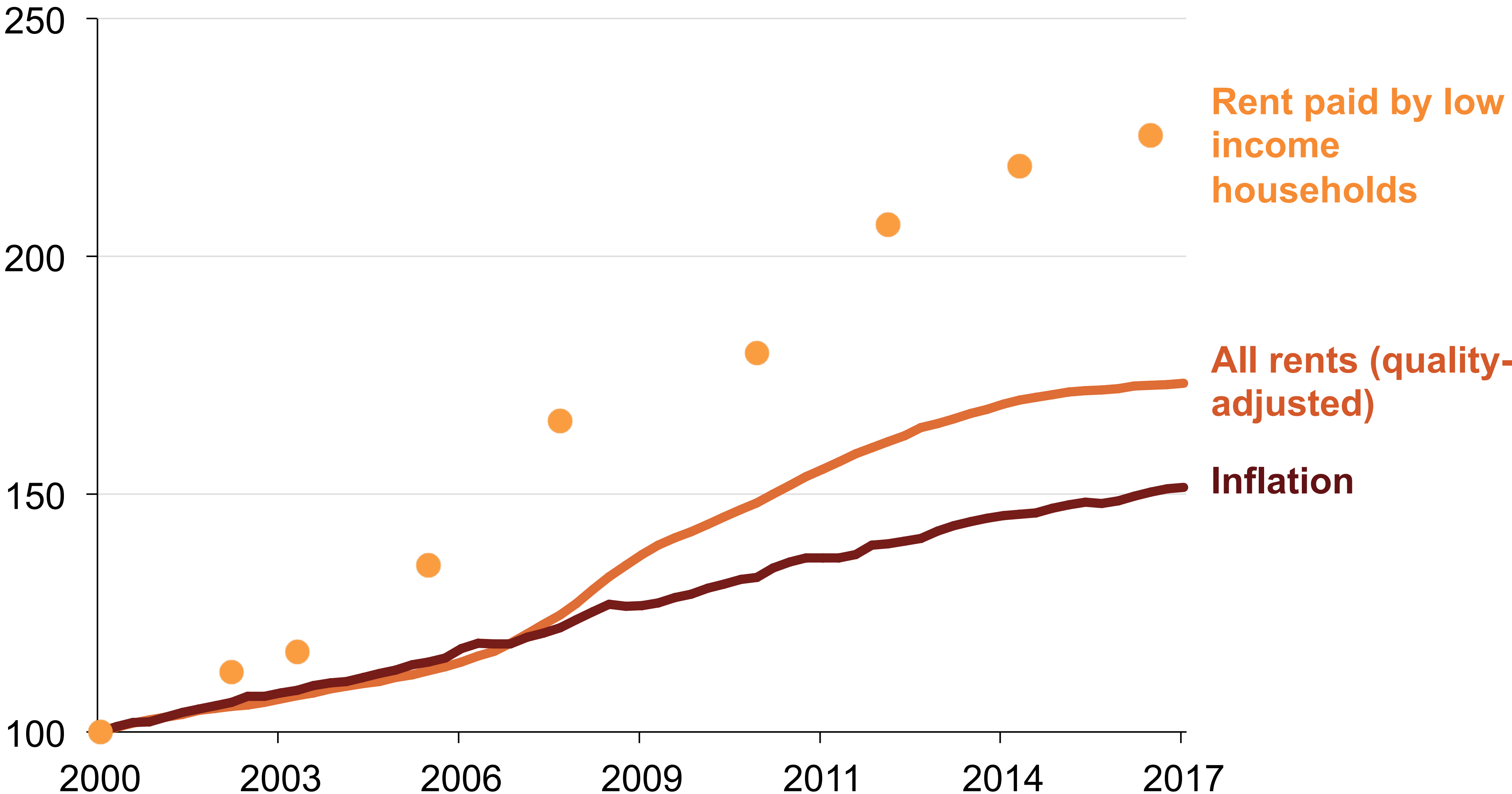
Benefits from Rent Assistance and the Age Pension for over-65s, 2015-16



Notes: “Pension” includes both the Age Pension and other government pensions and allowances, such as disability, carer or family support payments received by younger people in a household with a household head aged 65 and over.
Source: *Money in Retirement*, Figure 7.2.

Actual rents paid by low-income households are rising much faster than inflation

Rent prices and CPI, indexed to December 2000



Source: Productivity Commission (2018), *Reforms to Human Services: Social Housing in Australia*, Figure 6.1.

Promoting home equity release should be the priority, but lots of community resistance

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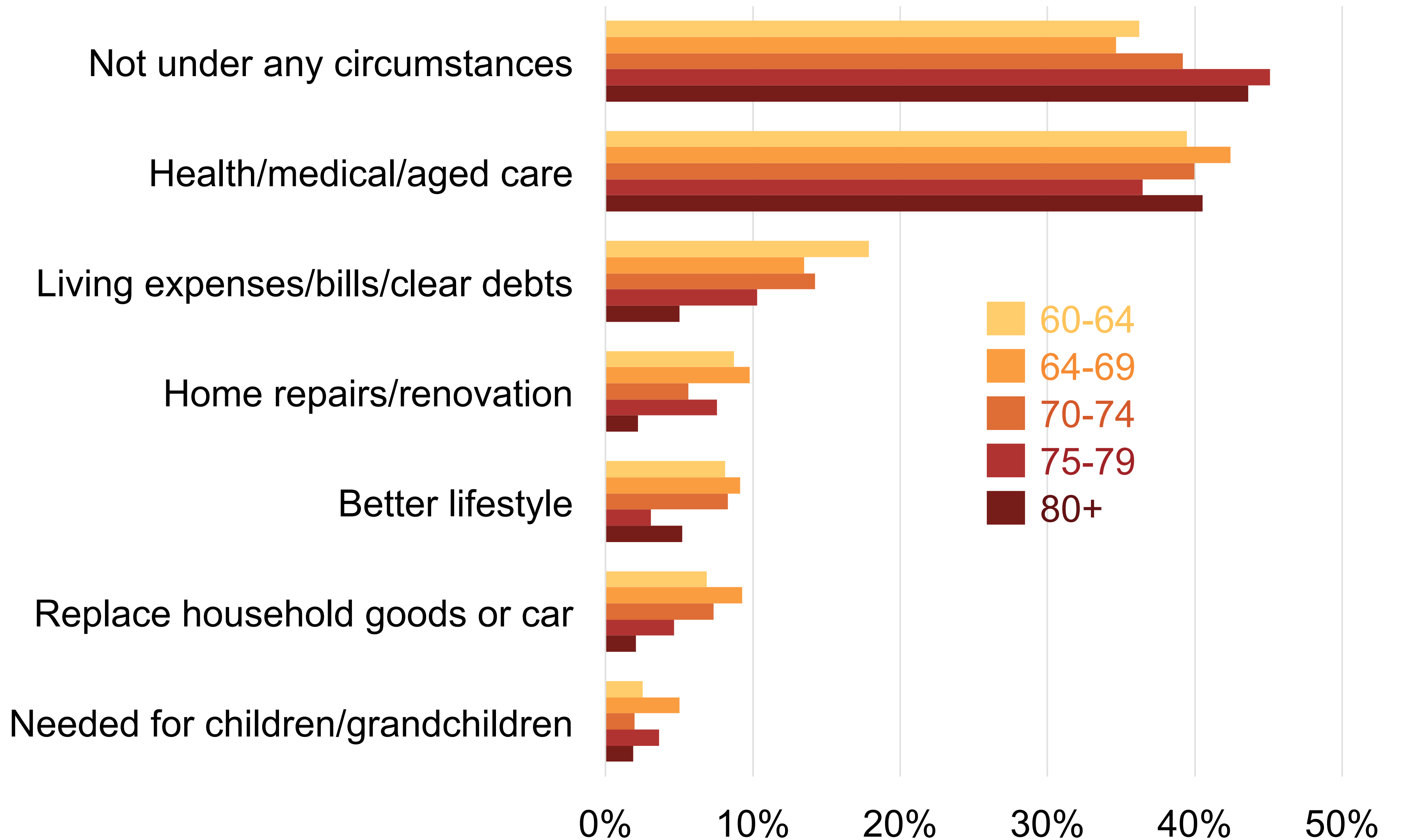
Reasons for drawing on home equity



Source: Productivity Commission, Housing Decisions of Older Australians (2015).

Exempting the home from the pension assets test will become untenable as home ownership falls

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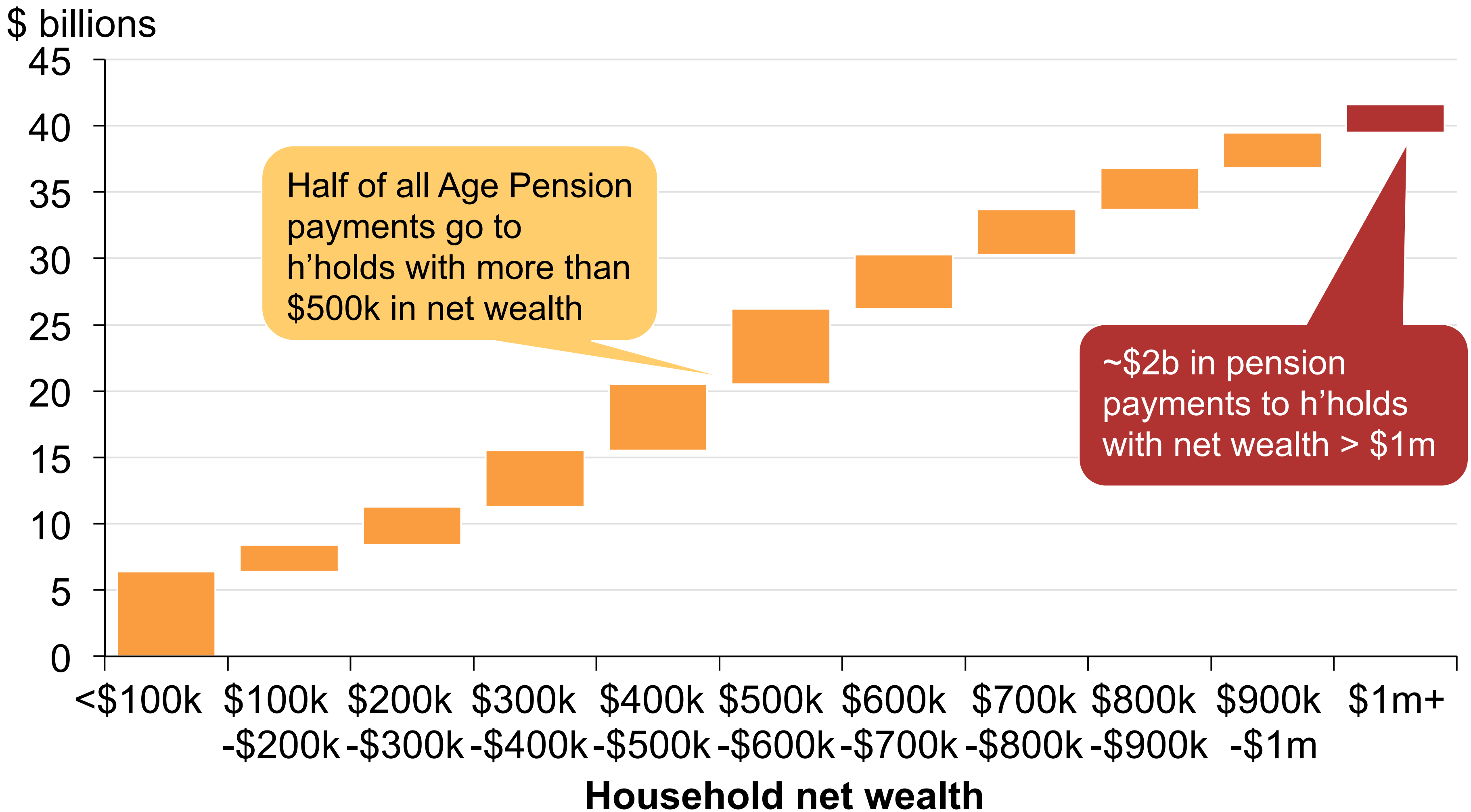
Total Age Pension payments by net wealth of household, 2013-14



Notes: Annual Age Pension payments reported in survey are grossed up to by 10 per cent to reflect aggregate Age Pension payments for the 2013-14 financial year. Excludes impact of Age Pension asset test changes that took effect from 1 January 2017.
Source: Grattan analysis of ABS Survey of Income and Housing 2013-14; 2013-14 Commonwealth DSS Portfolio Budget Statement.

Government pays for most aged care, and demand is expected to rise substantially

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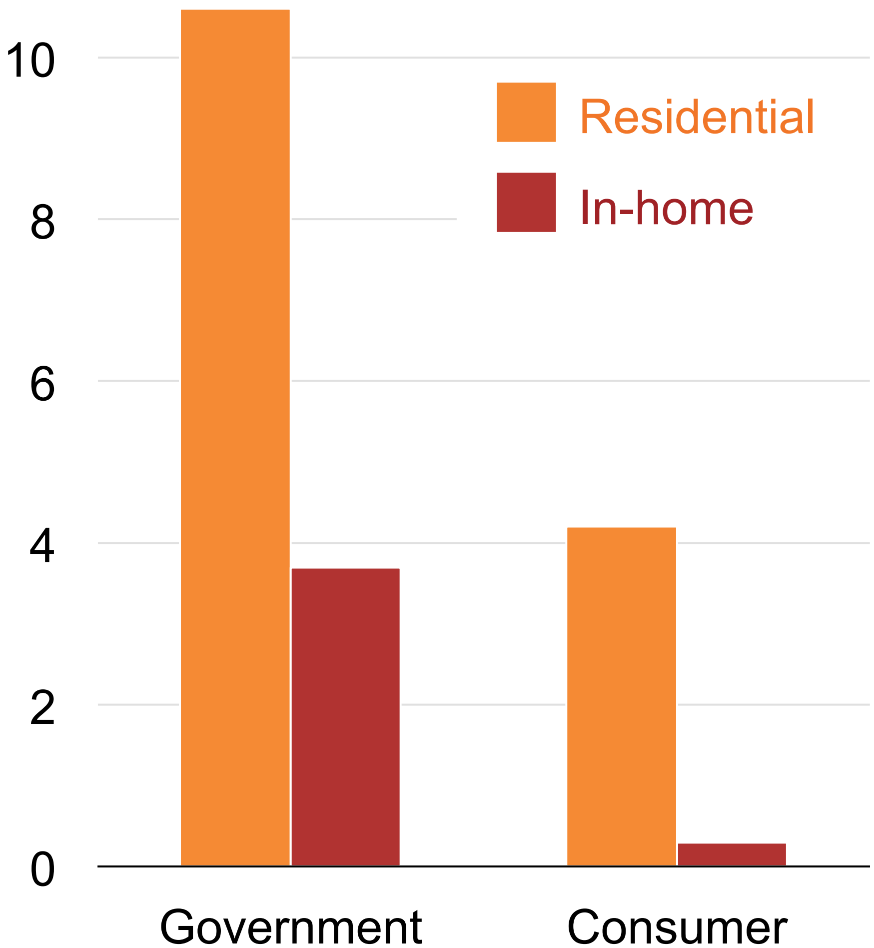
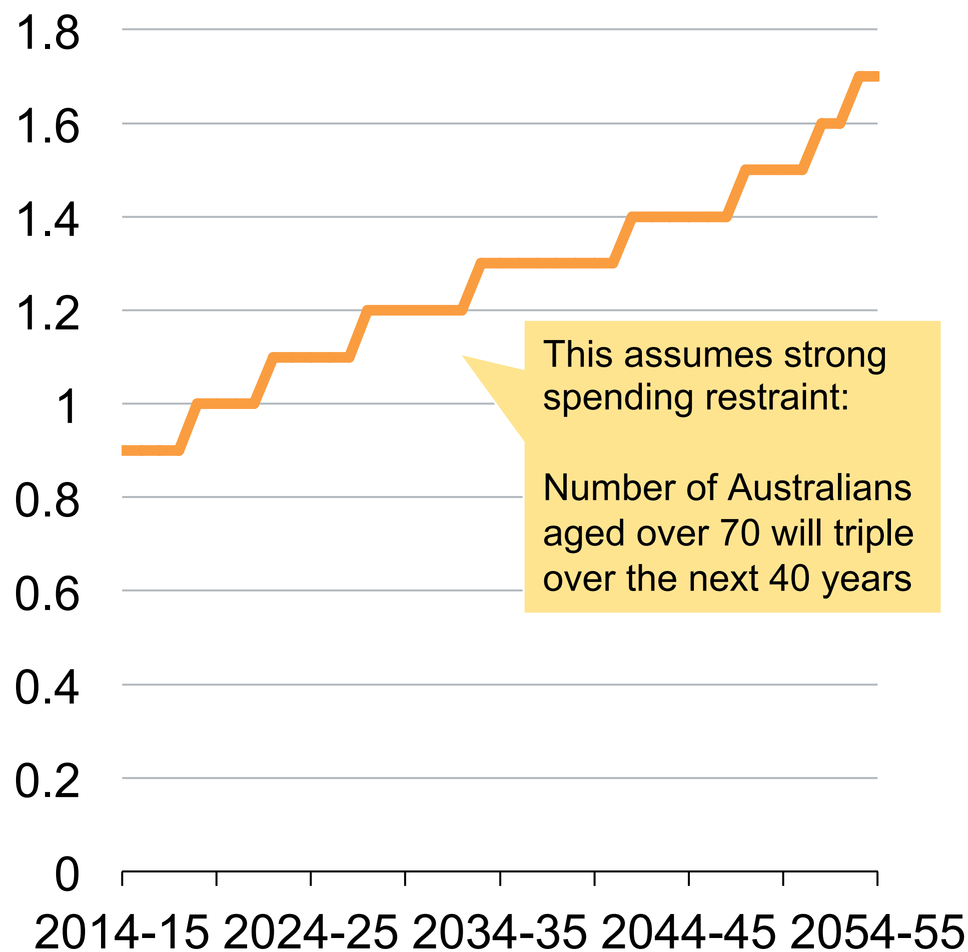
Funding for aged care by source, 2017, $ billions



Source: Legislated Review of Aged Care 2017, Figure 2.3.

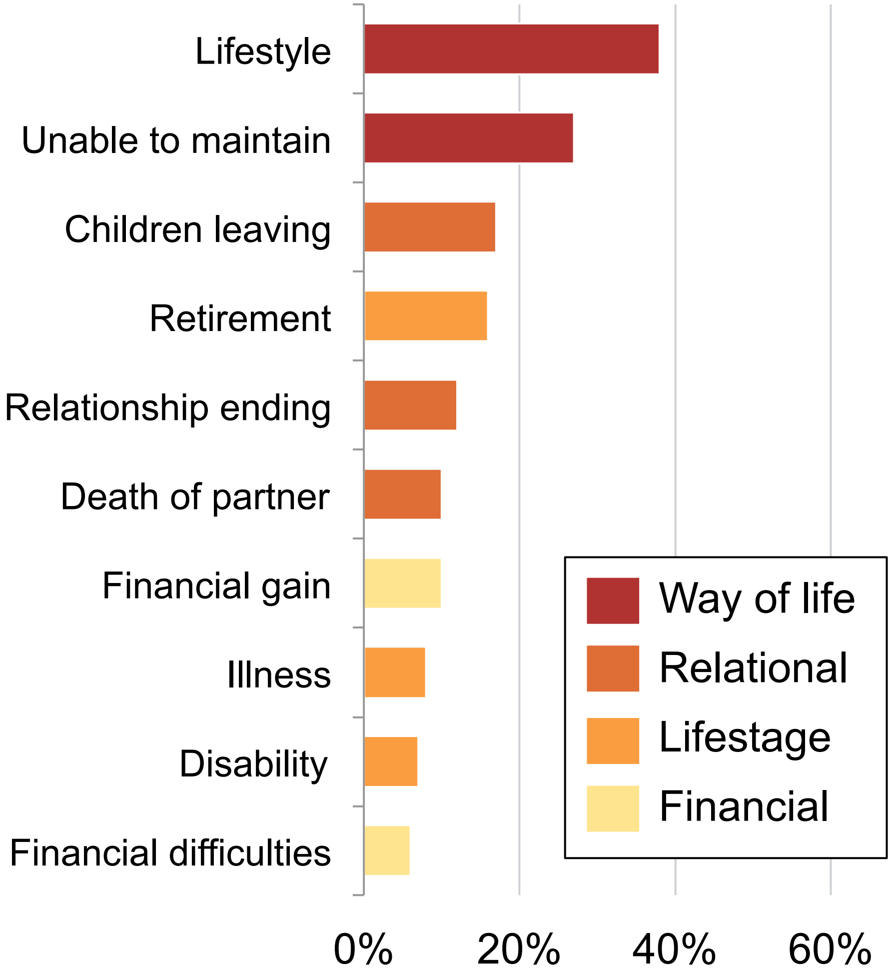
Projected age Care expenditure as share of GDP, per cent



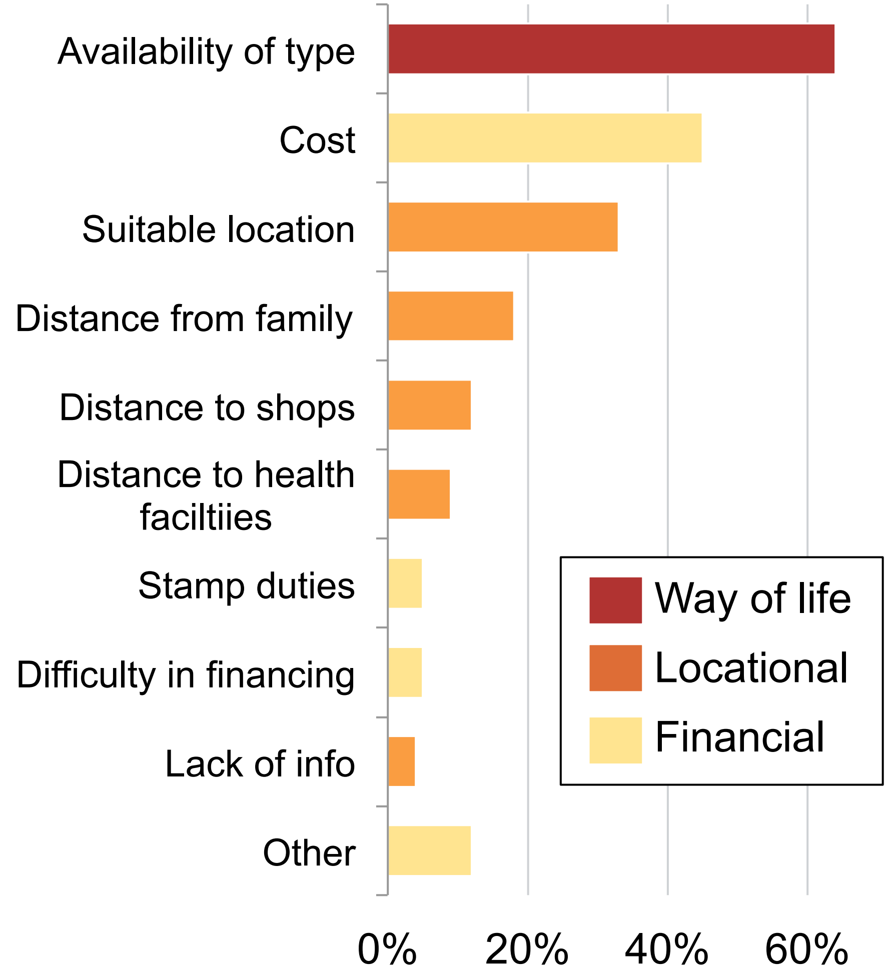
Source: Australian Government (2015), *Intergenerational Report*

The choice to downsize results mainly from lifestyle and relational, not financial, issues

Reasons for downsizing, percentage of downsizers

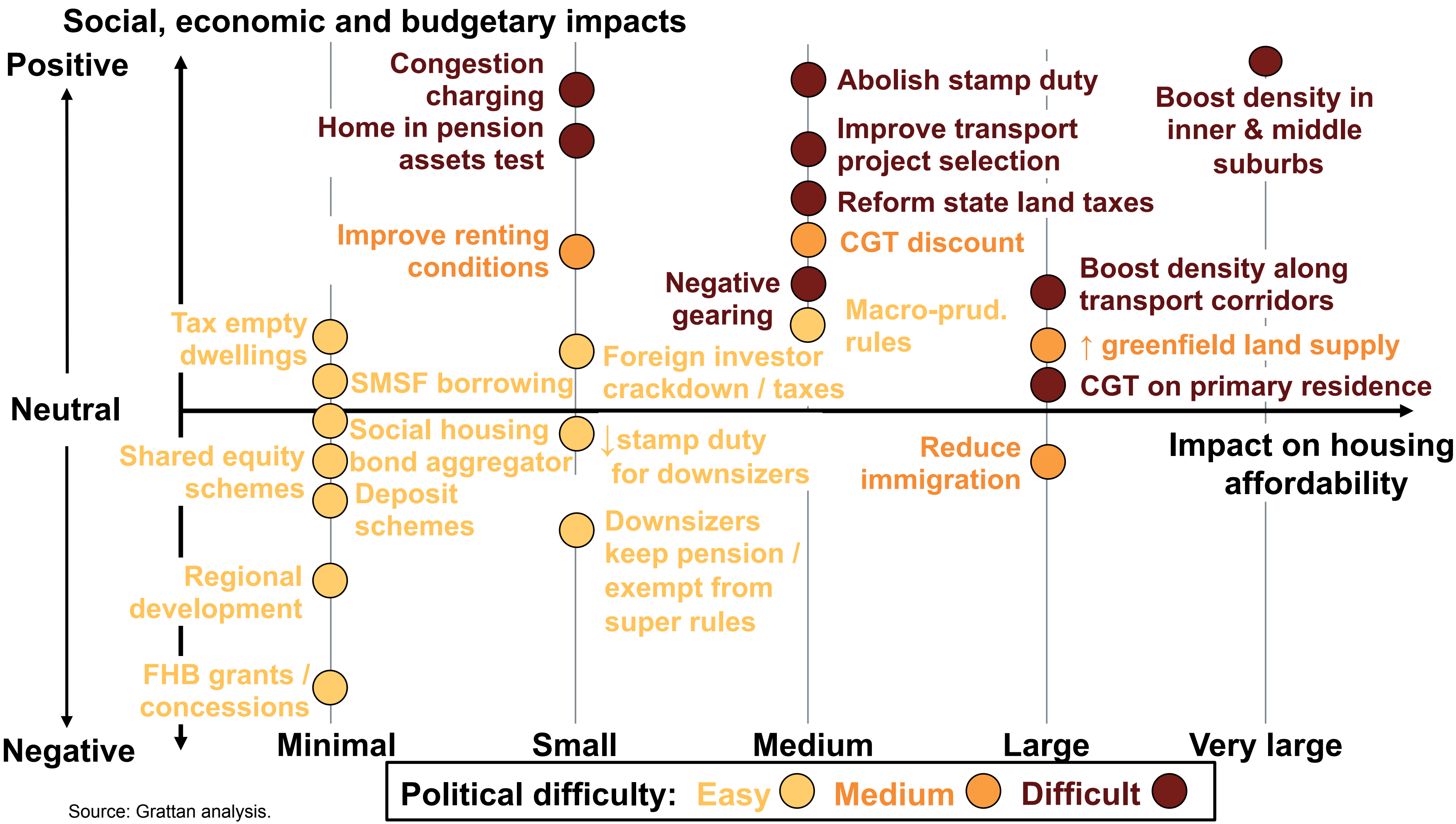


Problem when downsizing, percentage of downsizers



Source: Judd et al 2014

Make housing cheaper – to rent or buy – involves making some tough calls



Source: Grattan analysis.
Notes: Prospective policies are evaluated on whether they would improve access to more affordable housing for the community overall, assuming no other policy changes. Assessment of measures that boost households' purchasing power includes impact on overall house prices. Our estimates of the economic, budgetary or social impacts should not be treated with spurious precision. For many of these effects there is no common metric, and their relative importance depends on the weighting of different political values. Consequently our assessments are generally directional and aim to produce an informed discussion.

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Retirement incomes will be adequate even using less favourable calculations and assumptions

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Replacement rate for median income earner

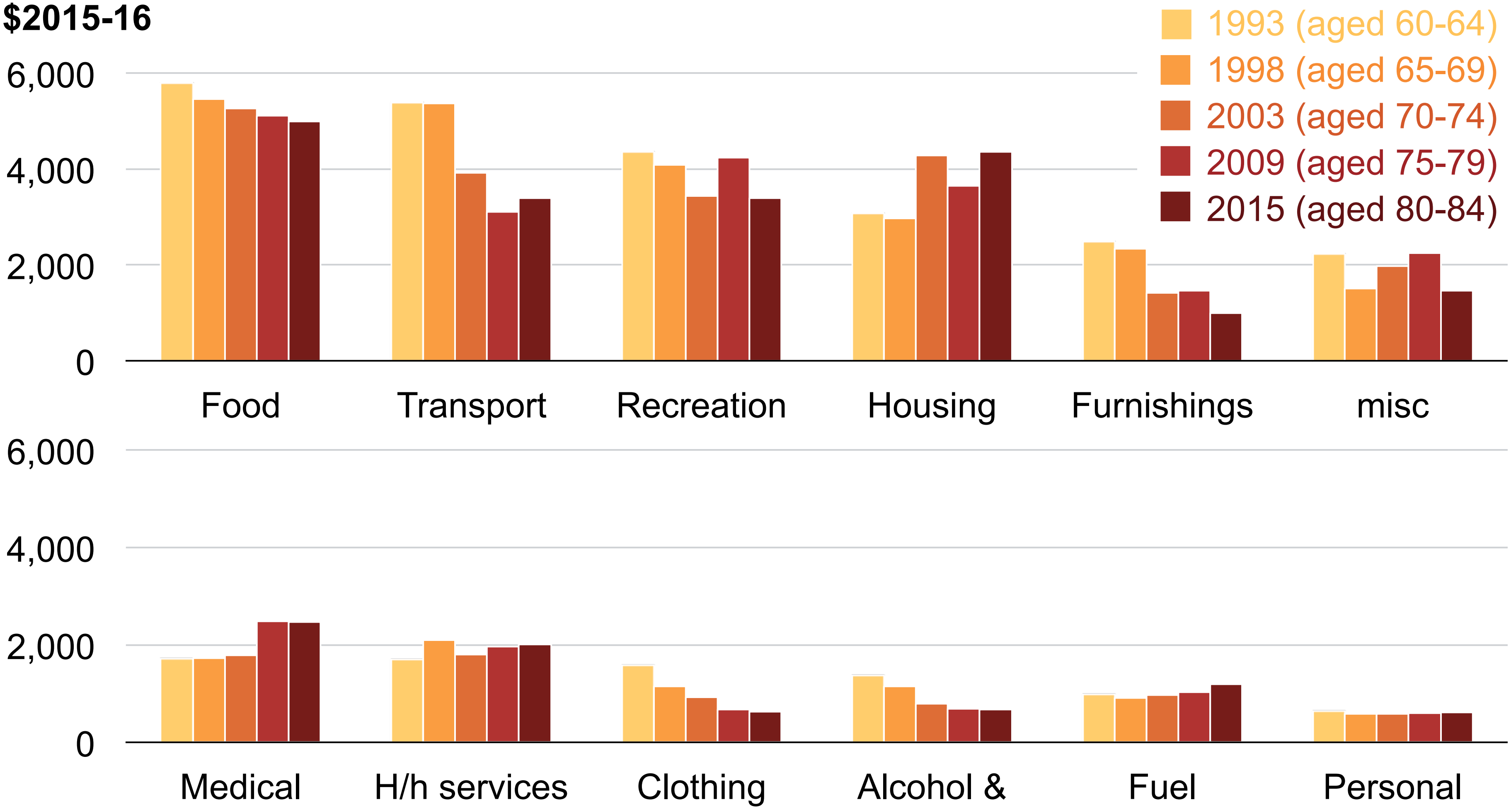
Retirement age income comparator	Whole of retirement			
Working age income comparator	last 5 years	whole working	last 5 years	whole working
Deflation	CPI	CPI	wage	wage
Current policy	**0.89**	**0.94**	**0.76**	**0.69**
Assumptions				
Lower investment returns	0.86	0.91	0.73	0.67
Minimum draw down	0.81	0.86	0.69	0.63
No non-super savings	0.89	0.94	0.75	0.69
Policy changes				
SG remains at 9.5%	0.87	0.93	0.74	0.68
Assets test taper rate to $2.25	0.92	0.97	0.78	0.72
SG remains at 9.5%; assets test taper rate $2.25	0.89	0.95	0.76	0.70
As above + super tax breaks + SAPTO + M/care levy	0.88	0.93	0.75	0.68
Retirement age to 70 (on its own)	1.00	1.01	0.86	0.74
All of the above	0.99	1.00	0.86	0.73

Notes: "Current Policy": policy as currently legislated, including: 12% Superannuation Guarantee from 2025; retirement age at 67; existing superannuation tax breaks with indexation of relevant caps and thresholds. "Full Grattan package": SG remains at 9.5%; Age Pension asset taper rate lowered so Pension reduced by $2.25 a fortnight per $1,000 in assessable assets; SAPTO and Medicare levy changes as recommended in Grattan Institute's *Age of Entitlement* report; superannuation tax breaks tightened to $11,000 annual cap on pre-tax super contributions, $50,000 annual cap on post-tax super contributions and 15% tax on earnings in the pension phase.

Source: Grattan Retirement Income Model.

Lower spending in retirement is driven by food, transport, furnishings, clothing and recreation

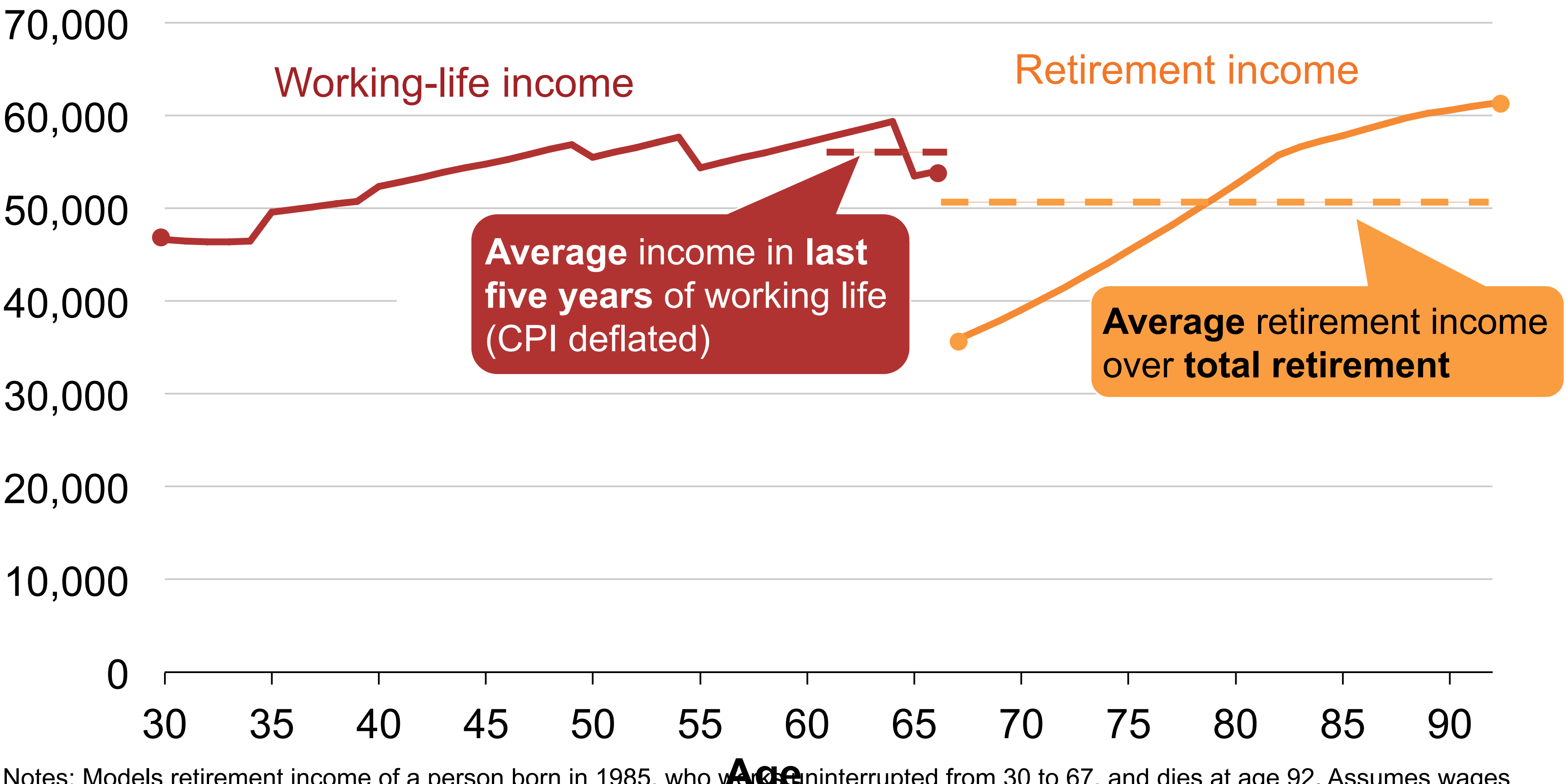
Equivalised household annual expenditures for cohort of retiree households as they age, $2015-16



Notes: Spending from 1993-94, 1998-99, 2003-04, 2009-10 and 2015-16 Household Expenditure Survey. Each line represents a single cohort across time as they age. While the age cohorts are 5 years apart, there was a gap of 6 years between the last three HES surveys. Spending deflated by CPI.
Source: ABS Household Expenditure Survey (multiple years); Grattan analysis.

How we measure replacement rates: all of retirement compared to last five years working

Real annual income, median earner, $2015-6 (CPI-deflated)



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Source: Grattan Retirement Income Projector:

Projecting future retirement incomes: the Grattan Retirement Income Projector (or GRIP)

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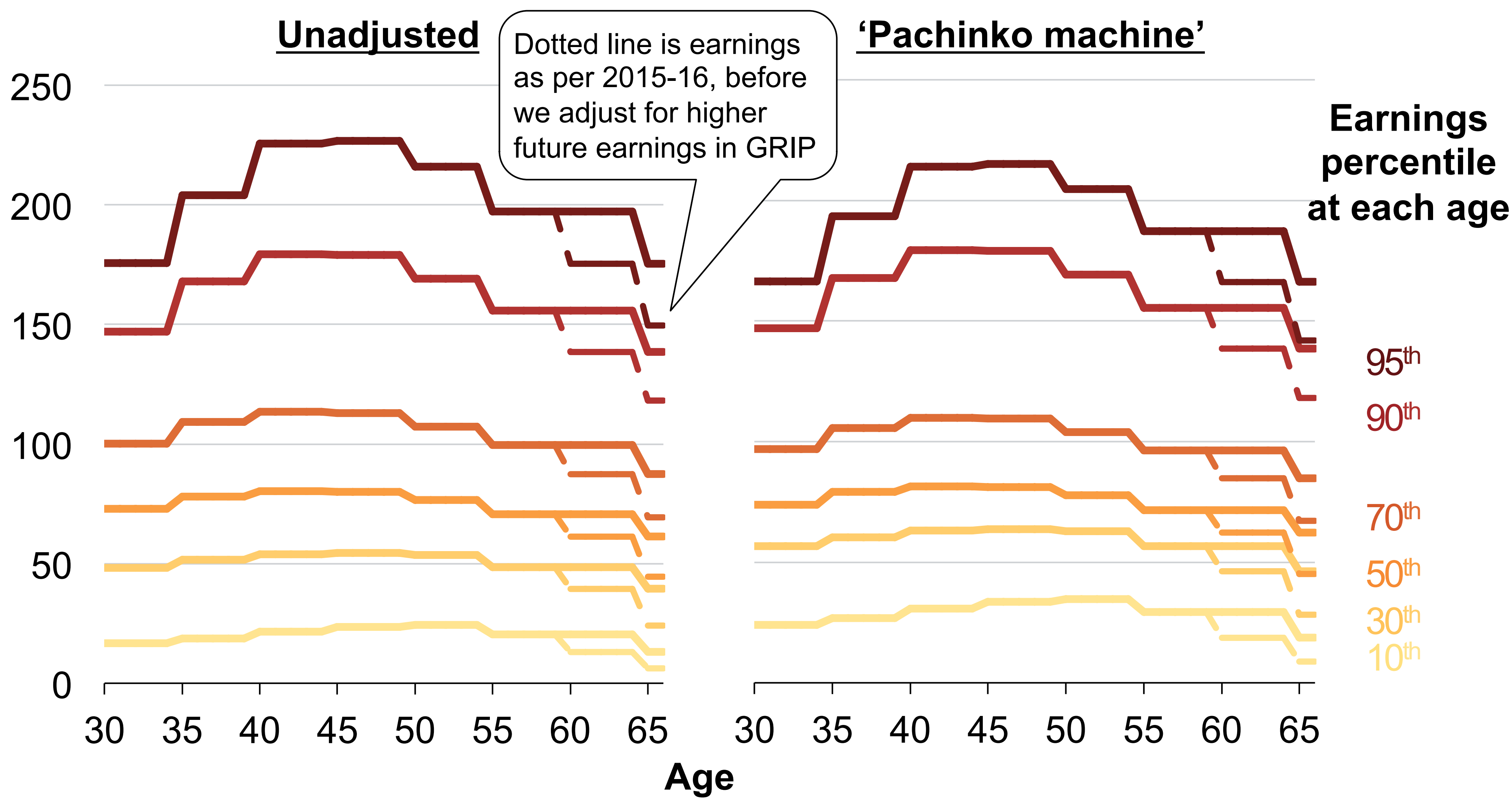
Salary income as per cent of AWOTE by age at different starting earnings points



Notes: Lifetime income adjusted using a transition matrix which reflects the likelihood of moving up and down the income distribution of the course of a person's working life.
Source: Grattan analysis of ATO Tax Statistics 2013-14; HILDA; Grattan analysis.

Incomes have risen across the board; but less so after housing costs

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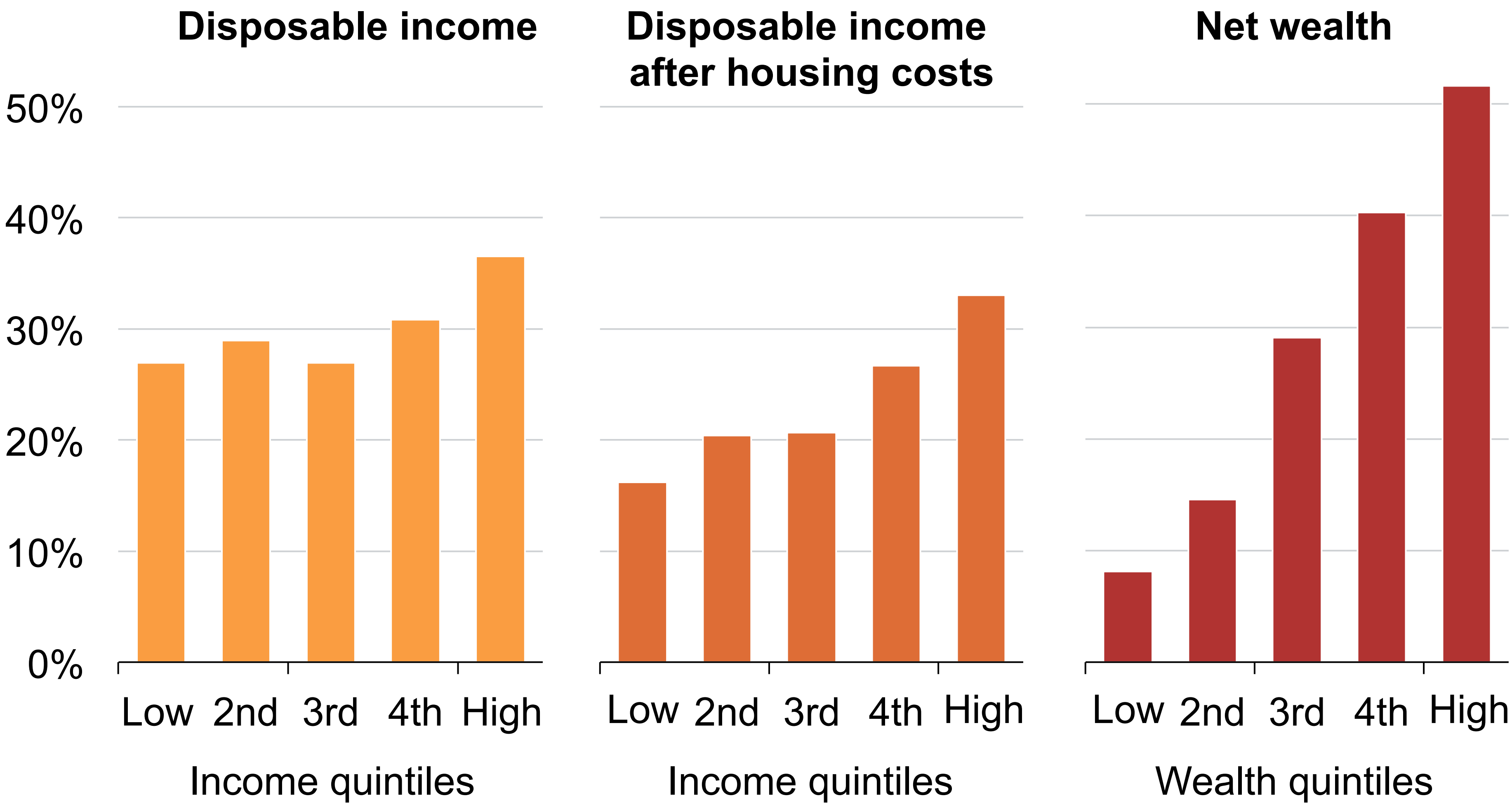
Real growth from 2003-04 to 2015-16 per equivalised household



Notes: Income estimates for 2003–04 onwards are not perfectly comparable with estimates for 2015-16 due to improvements in measuring income introduced in the 2007–08 cycle.
Source: Source: for income, ABS SIH 2003-04 and SIH 2015-16; for wealth, ABS 6523.0 Household Income and Wealth

The housing stock is shifting in our capital cities, but there is still a way to go

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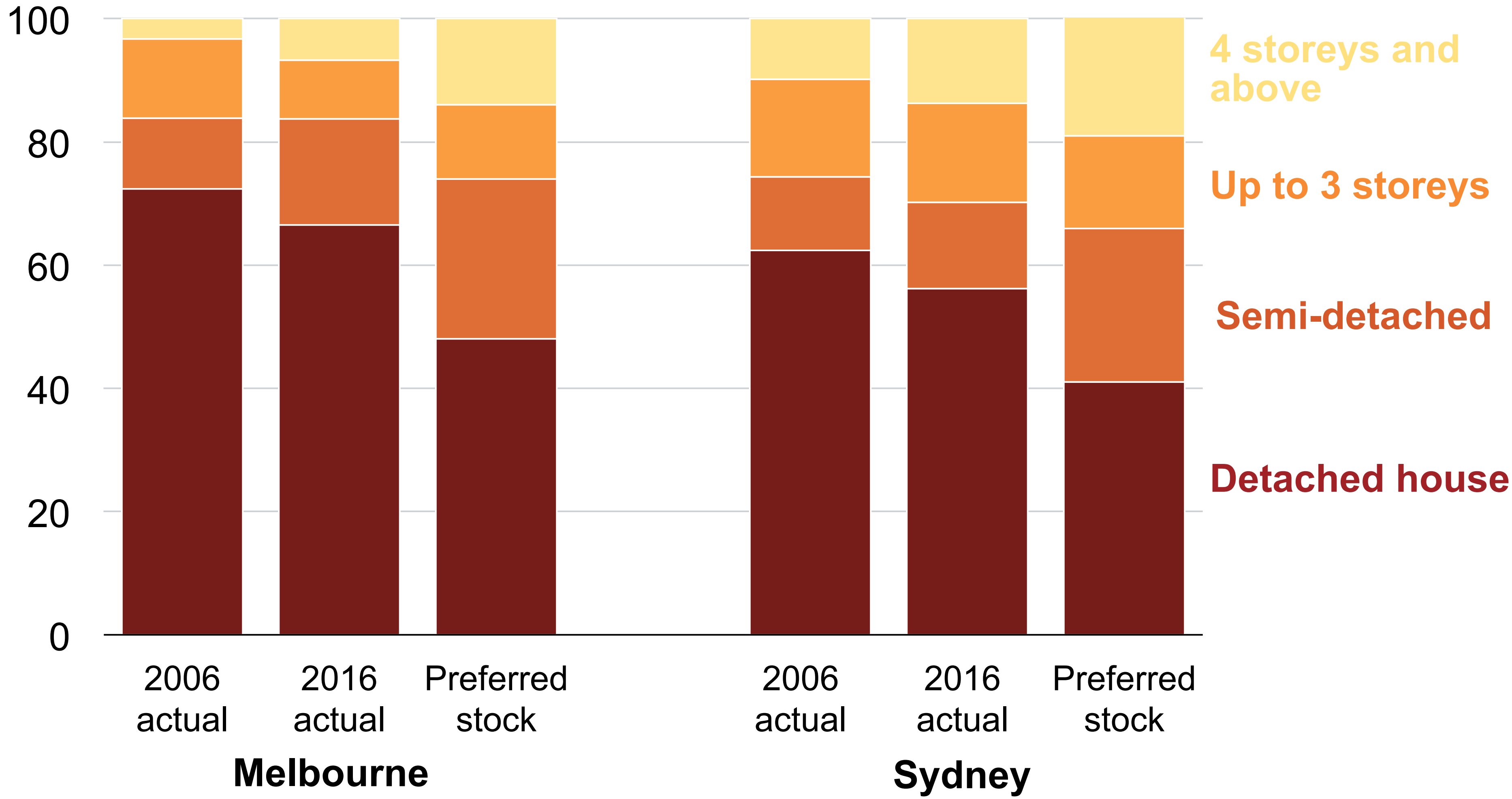
Per cent of housing stock, actual and preferred



Notes: 'Preferred stock' is from the survey of 700 residents about housing preferences from Grattan's 2011 report, The housing we'd choose. Data may not sum to 100 due to rounding. Excludes dwellings listed as 'Not stated' and 'Other dwellings', such as caravans.

The Age Pension appears adequate, at least for homeowners

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	Housing tenure	Annual value (single)	Welfare payments relative to standard	Annual value (couple)	Welfare payments relative to standard
Low Cost Budget Standards	Homeowner	$22,651	105%	$31,144	115%
	Public renter	$20,335	117%	$31,346	115%
	Private renter	$26,533	102%	$38,862	101%
Henderson Poverty Line	Including housing costs	$21,868	109%	$30,975	116%
OECD poverty (ABS equiv)	All tenure types	$23,372	102%	$35,060	102%
OECD poverty (new OECD equiv)	All tenure types	$26,300	91%	$37,191	97%
Max Age Pension + supplement	Homeowner	$23,824		$35,916	
Max Age Pension + supplement + Rent Assistance	Private renter	$27,105		$39,244	

Notes and sources: See *Daley et al* 2018 Money in Retirement: More than Enough, Table 3.2.

It is harder to save a 20% deposit, but higher LVR loans are available

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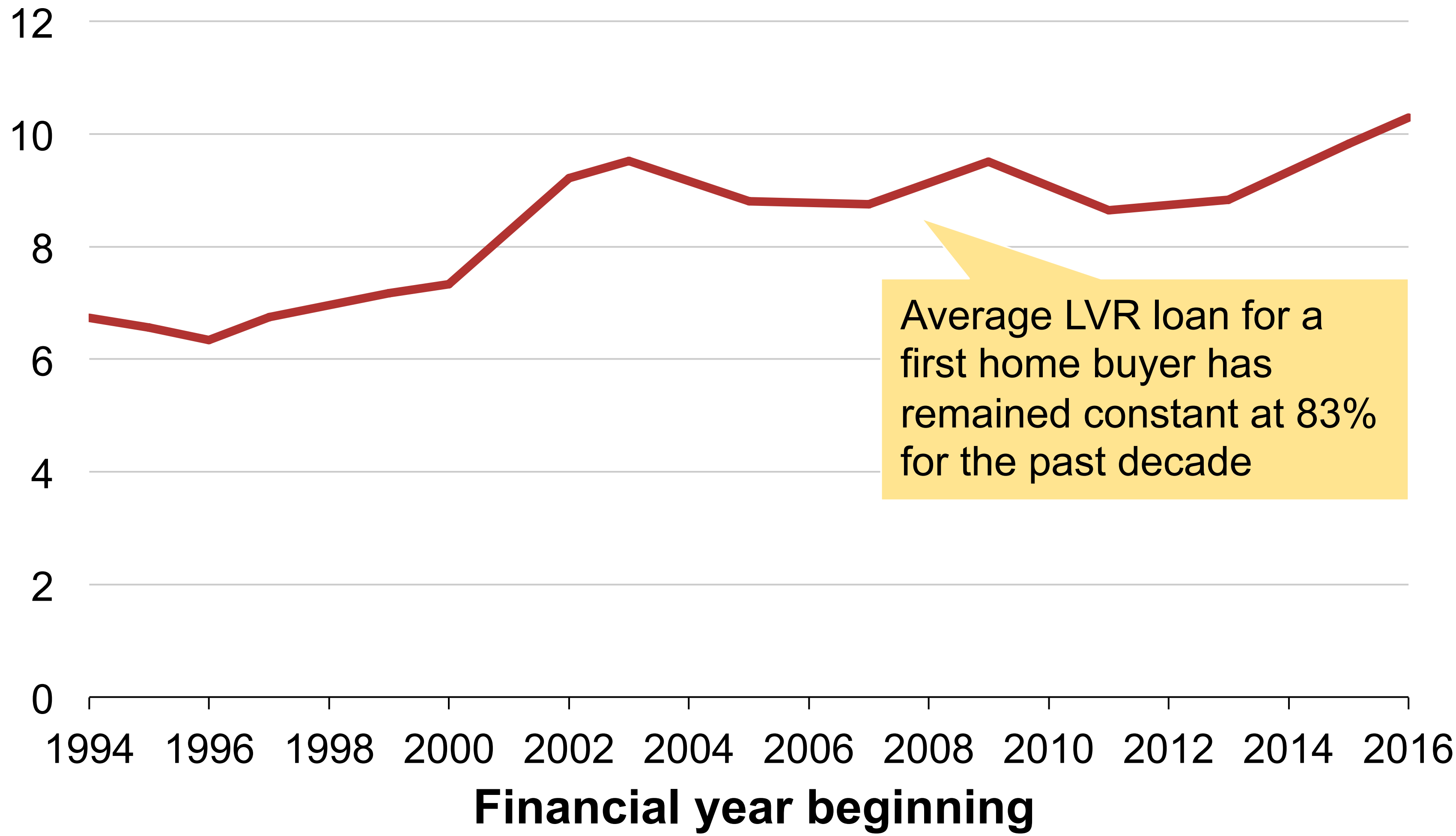
Years to save a deposit for average residential dwelling



Notes: House price is average residential dwelling price from ABS 6416.0. Assumes deposit is formed by saving 15 per cent of gross household income, projected forwards by average growth in the wage price index.
Sources: ABS; RBA; Grattan analysis

A home is harder to pay off given larger loans and low wages growth

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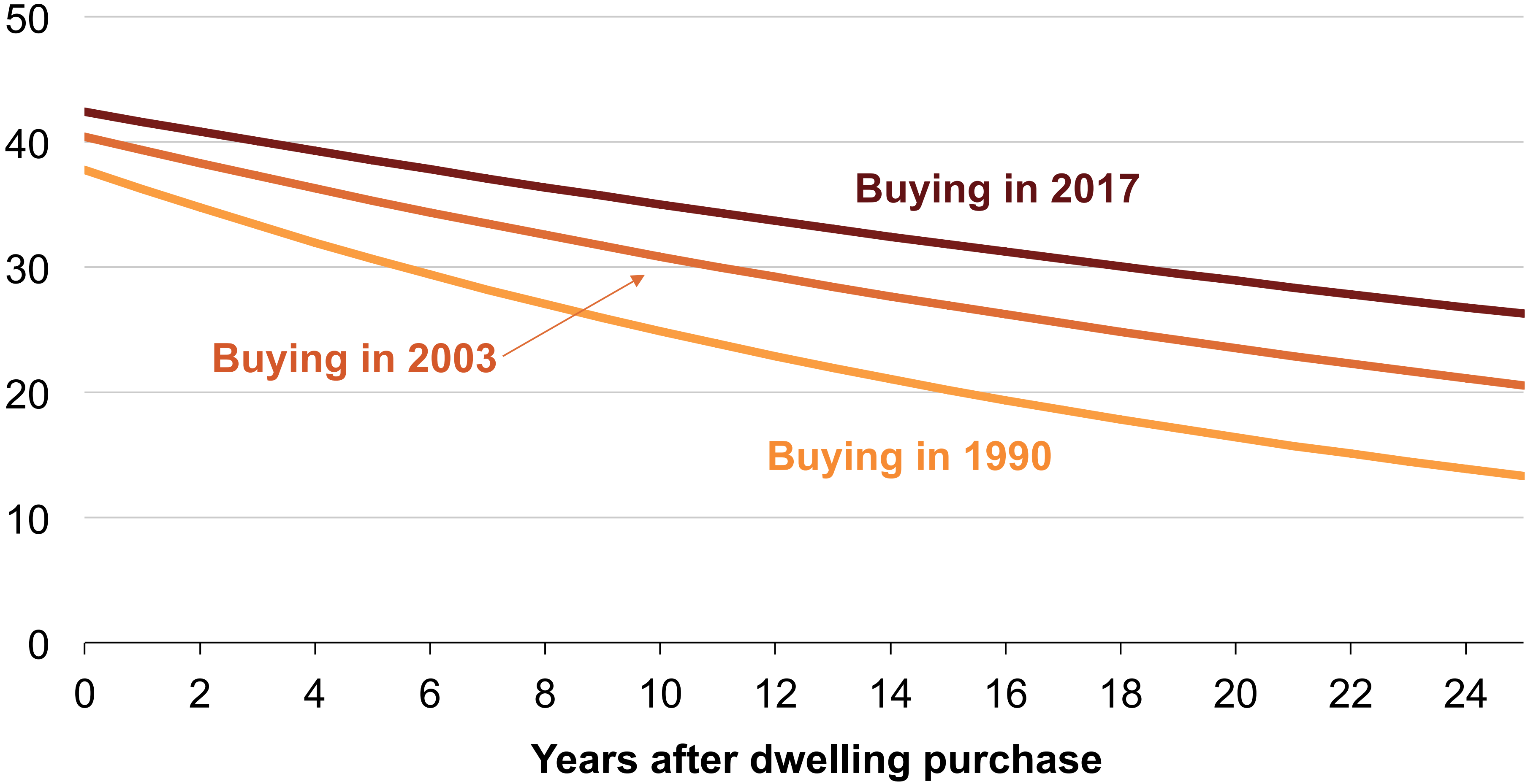
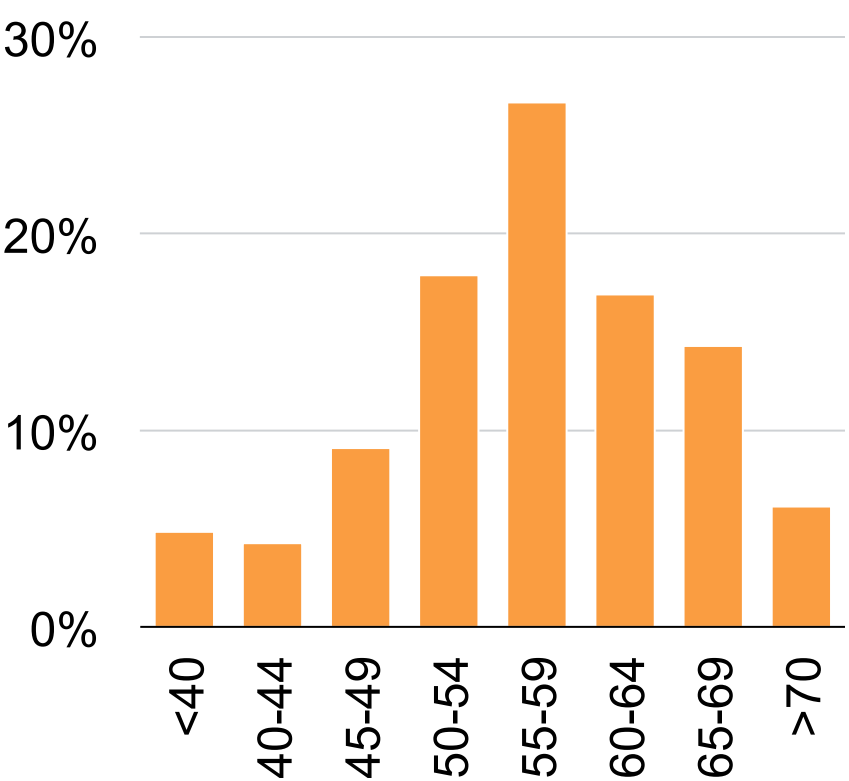
Mortgage repayments on an average house (20 per cent deposit), per cent of median household income, 25 year principal and interest loan



Notes: 2017 average dwelling price is $669,700; 2003 house price is $319,802 1990 house price is $141,517. Mortgage repayments on an average house (20 per cent deposit), 25 year principal and interest loan. Average wages and interest rates over life of loan. Current wage growth and interest rates projected forwards.
Source: ABS; RBA; Grattan analysis; CoreLogic Australia (2016).

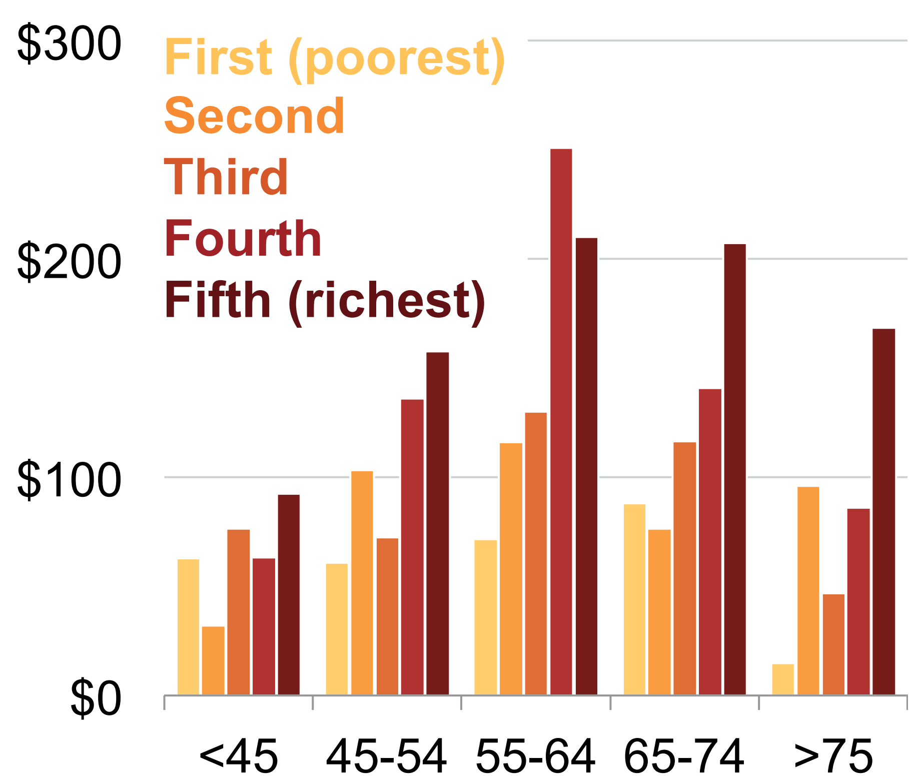
Inheritances won't solve it: large inheritances go to those that are already wealthy

Share of inheritance money received by children of the deceased, by age



Notes: In probate data, the age of the recipient is only identifiable for children of the deceased, which represents three quarters of final estate money. Includes only estates where no bequest was made to a spouse. This will almost always correspond to 'final estates'; that is, estates of people without a surviving spouse.
Source: Grattan analysis of probate files, Victoria, 2016.

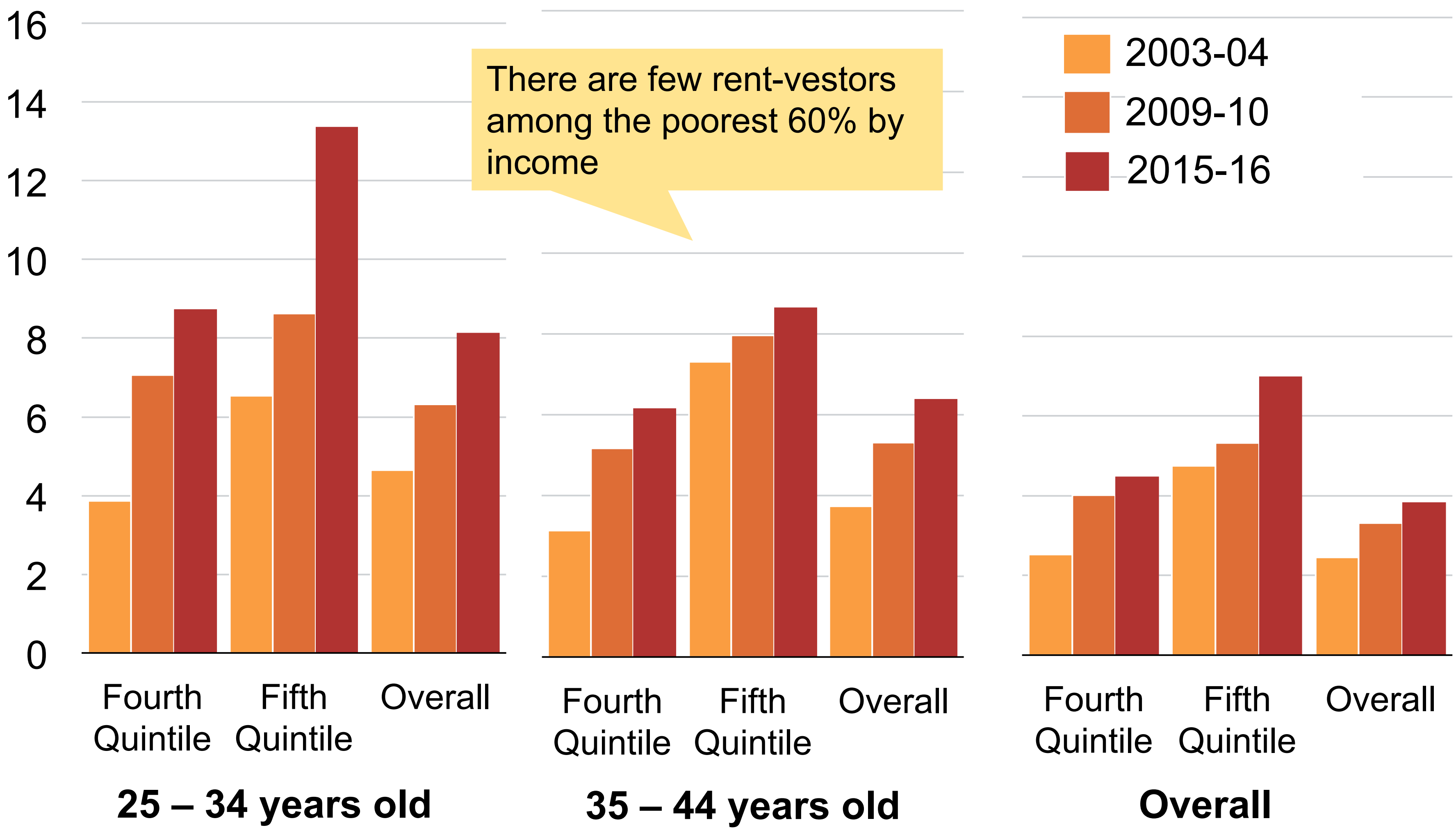
Average size of inheritance, by wealth quintile and age band, $2017-18 thousands



Notes: Data on inheritances by wealth of recipient is not available from the probate records, so we use data from HILDA on self-reported inheritances. Wealth quintile based on most recently-captured wealth information for an individual prior to the inheritance. Individuals are allotted to a wealth quintile within their 5-year age band.
Source: HILDA surveys, 2002 to 2017.

Rent-vesting won't solve it: really only popular among wealthier younger Australians

Percentage of households than both rent and own a property, 2003-04 to 2015-16



Notes: Income quintiles are calculated using household disposable income, equivalised by family size.
Source: 2003-04, 2009-10 and 2015-16 Survey of Income and Housing.

Australian literature suggests increasing Rent Assistance has little impact on rents

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Most of any increase in Rent Assistance wouldn't be spent on rents	**Foard (1995)** – Renters are likely to spend almost all additional net income on non-housing goods and services **Pender (1996)** – Even with a segmented private rental market, a $100 million increase in CRA would only increase rents by 0.59% **Bray (1997)** – When people on low incomes gain higher incomes, they spend most of it on food, clothing, or bills
Rents would be unlikely to increase	**Vipond (1987) –** The price elasticity of supply for the private rental stock is almost perfectly elastic, meaning landlords don't increase rents when demand increases **Bray (1997)** – Each $1 of Rent Assistance raises rents by 1 and 5 cents **Hulse (2002) –** concludes Australian housing market is already relatively well-informed, regulated, and competitive – suggesting CRA increases would be unlikely to cause rental price inflation
When rents have risen in other countries, markets have been different	**Fack (2006)** – Reforming housing assistance in France in the 1990s lead to rents increasing nearly 80 cents in the dollar. But French supply for lower-cost rental housing is almost perfectly inelastic. **Kangasharju (2010)** – Increasing housing allowances in Finland in 2002 also increased rents by 60 to 70 cents in the dollar. But in Finland housing allowances are paid directly to the landlords.

Including owner occupied housing in the assets test is wildly popular – amongst policy thinkers

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ACOSS	Effectively include first $340,500 value of home
The Australia Institute	Include family home above a threshold (unspecified) Expand Pension Loans Scheme to become equivalent rent assistance
Grattan Institute	Fully include the family home, and expand Pension Loans Scheme
Centre for Independent Studies	Fully include the family home, and develop reverse mortgage market with government-guarantee
Business Council of Australia	Include value of family home (noncommittal about threshold)
Henry Review	Include family home above a relatively high (unspecified) threshold
Productivity Commission	Include family home above a threshold similar to NCoA suggestion
National Commission of Audit	Include family home above a threshold of $500,000 for singles and $750,000 for couples
Rice Warner	Include value of family home over $1.5m, and immediately withdraw all pension above this threshold
Ingles and Stewart	Include some of the value of the family home, but be cautious given gender equity issues