Contributing the Family Home to Super

An innovative proposal designed to assist with the accommodation and income needs of older Australians wishing to remain in their own homes.

Abstract

There has been much discussion in the media about including the family home in the pension assets test. Regardless of the merits or otherwise of this proposal, it raises a fundamental question- what do the newly pension-deprived retirees live on? Mostly, the answer seems to involve either the sale of the family home- "downsizing"; or some form of reverse mortgage. Both of these options have problems. Many older people simply do not want to move, and reverse mortgages necessarily involve a compounding interest problem.

An alternative approach would be to allow retirees to "contribute" their family home to super. In effect, this would mean "swapping" the home for an equivalent dollar value balance in an APRA regulated superannuation fund, coupled with a right of life tenancy, if they require it. The earnings on their new diversified superannuation balance would fund a fixed rental payment and provide additional income, which could be supplemented by a drawing on the capital component, if required, down to an actuarially determined minimum balance. On death, the residual balance would be paid to dependents as per any super balance.

In other words, instead of gaining a pool of money on which interest is payable, they gain a pool of money on which interest is earned.

Under this scheme, retirees can access their home equity without the trap of compounding interest; they benefit from diversification of their asset base; they retain the right of abode; and their house is maintained by its new institutional owner. People will quickly come to understand that being a secure tenant is not really different to being an owner, as people in Germany and other Northern European countries demonstrate. All of this would be underpinned by the existing, robust regulatory supervision of APRA.

This proposal also provides a means of addressing longevity risk issues for self-funded retirees- they would be more willing to spend their superannuation balance knowing they have a straightforward means to unitise the value of their home, through superannuation, late in life.

The option would be simply enabled by relaxing contribution limits and age restrictions for this one-off transfer. It would provide a fair and efficient alternative to downsizing or reverse mortgages for retirees seeking to access the equity tied up in their homes. This is essential if the Government tightens the asset test for pensions; and it is worthy of further consideration even if they do not.

The Proposal

Many studies have highlighted the challenge of meeting the lifestyle, care and accommodation needs of older Australians. One dimension of this challenge is the fact that it has proven difficult for people to access the wealth tied up in their homes. The options available to people, from selling the home and "downsizing", to reverse mortgage type options, have a range of problems associated with them.

Some commentators have suggested that the Government intervene to establish a "reverse mortgage" provider. This comes with a series of challenges and would represent a significant incursion by Government into the banking and financial services market.

Our proposal provides an alternative means to achieve the same objective, leveraging the existing superannuation sector's regulatory safeguards, the vast pool of capital, and hunger for investment assets. It offers a solution which is practical, ethical, fair to older people, and commercial.

The core proposition is a pooled super trust structure which acquires people's homes on fair terms, via an "in specie" contribution type mechanism but with a right of tenancy attached. The acquiring fund would provide the vendor with the sale proceeds in the form of a balance in an APRA regulated Super Fund, which would in turn provide a pension income stream to pay the agreed rental and provide additional income to the member.

Regulatory change would be required to permit older Australians to contribute their home "in-specie" in very specific circumstances. Other regulatory changes may be required to ensure no disadvantage accrues to vendors in terms of Age Pension eligibility.

Problem definition

As Professor Sam Wylie of Melbourne Business School succinctly put it in a recent article in The Conversation:

> There is another retirement savings problem that is of first order importance but unrelated to financial advice. Elderly households need a way of releasing the equity in their homes without the uncertainty that they will lose control of their residence.
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> The largest form of saving that most Australian households undertake over their lifetimes is that they buy homes that appreciate in value. The equity that Australian households have in residential real estate (value minus debt) is about A$2.8 trillion. That is nearly twice the A$1.6 trillion that Australian households have in retirement savings. Yet, there is no direct connection between these great pools of value.
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> There is a missing institution in the Australian financial system. What is needed is a financial organisation that will allow Australian households to borrow against their homes without any fear of losing control of the home and at an interest rate close to government treasury rates.

> There are reverse mortgage products in the market. But those products are too expensive and poorly structured for most households. Releasing the equity in the homes of retirees is essential for solving the fiscal problems of the ageing of the Australian population.

Older people's homes are their largest asset, however it is difficult to unlock the value in the home-selling the home and then using the proceeds to buy or rent a smaller abode represents an emotional wrench, and has high transaction costs, and reverse mortgages are expensive and risky for the property owner. Even a highly subsidised reverse mortgage model is problematic due the compounding effect of drawdowns and interest.

In addition, retaining almost all your wealth in a single asset provides no investment diversification to the owner, and as people get older the house may deteriorate due to lack of maintenance.

Solution Summary

One innovative solution to this challenge is to establish an entity, based on a pooled super trust structure with seed funding from major APRA regulated super players ("the Fund"). This "special purpose" entity would enable older Australians to contribute their property "in specie" to the Fund, based on an agreed fair market value and with a right of tenancy attached, for an agreed rent (fixed or variable).

The sale proceeds would be provided as a superannuation account balance in an existing APRA regulated super fund.

Pension payments from this superannuation balance would fund both the rental payment to the Fund (as the new owner of the property) and provide a pension income stream to the member.

Those contributing their home could be given the option of securing guaranteed lifetime tenancy through an actuarially determined combination of annual drawdown limits, supplemented if necessary by "group" or fund level longevity insurance.

The Fund would own and manage a large portfolio of residential rental properties, some of which would be rented to their former owners and some which would be rented on the open market. Any regulated super fund would be able to invest in the Fund, providing unprecedented ease of access to the residential real estate asset class.

Benefits

The key benefit is that older Australians gain the opportunity to unlock the value in their homes with security of tenure provided for, without the risks and costs associated with reverse mortgage type structures.

They would convert the value of their home into a more diversified savings pool, significantly mitigating the risks of holding a single asset, protected by the existing APRA Superannuation supervisory regime.

Their properties will be properly maintained and insured, retaining their value and providing a significant lifestyle benefit to the residents who may not otherwise have the physical or financial means to maintain their homes.

From the perspective of the superannuation funds, a significant new investment asset class becomes available. Given high levels of owner-occupancy in Australia there is limited scope for funds to access the established residential property market on a systematic, scaled basis. The historically strong financial performance of this asset class, combined with the undoubted “social benefit” dimension, would make this an attractive investment option for the major superannuation funds. The fact that the fund would be a Pooled Super Trust enables any superannuation fund to invest and enjoy the benefits of the asset class underpinned by a high level of certainty in their rental return.

Key regulatory issues

The first key issue for resolution is that the superannuation contribution rules and caps would need to be relaxed to permit the in-specie contribution of a person or couple’s principal residence, including relaxing both the age and work test constraints and the annual limits. The required changes could be heavily proscribed to limit the contribution to the principal residence (including such things as minimum ownership periods to prevent misuse of the provisions). The changes would also be limited to contribution to a fund which conformed to this model and there would also need to be constraints on lump sum or pension withdrawals and rollovers into SMSFs to ensure rental commitments can be met.

The second key issue is the Age Pension eligibility rules, which have generous “principal residence” concessions currently embedded in them.

There are two approaches to this. One possibility is that this type of arrangement would provide a means of establishing a replacement income stream if the principal residence assets test exemption was wound back.

Alternatively, regulations exempting the value of the contributed home from the assets and income test could be introduced, ensuring equivalence to the existing pension entitlements is maintained.

A hybrid or incremental approach would see this exemption capped at a reasonable level, which would have the benefit of reducing the Government’s pension expenditure over time compared with a “no change” scenario.

Preliminary analysis suggests that the economic and social benefits of enabling people to stay in their own homes (and unlock some of the capital therein), coupled with the reduction in pension payments, would be significant.

Broad economic implications

The proposal provides an effective means of unlocking value in residential real estate, which is currently tied up due to a combination of structural impediments and fear on the part of the older people about loss of abode.

This is likely to have a stimulatory impact as older Australians participating in the scheme would have increased disposable income, and spending on economically efficient home maintenance, and in home care and support, would also increase. Flow on economic and social benefits of enabling older people to remain in their own homes for longer may also be measurable.

There are potentially some negative revenue or expenditure impacts as the scheme would provide an alternative to people choosing to rent out their property as a means of funding their retirement (where the rental income would be subject to tax), or to downsizing (where capital released from the sale of a property would count for assets test purposes).

There are however some potential savings to Government from a reduction in pension payments, depending on the asset test and income test treatment of the contributed home.

These economic impacts would need to be modelled as part of the process of developing a submission to Government seeking regulatory support for the scheme.

How the Fund would operate

Seed funding would be provided by a consortium of large superannuation funds seeking to gain access to the established residential property asset class, to create a specialised Pooled Super Trust holding the assets.

The Fund would then acquire properties via an “in-specie contribution” mechanism, with the resultant superannuation member balance available to be rolled over to a participating APRA regulated fund. The Fund would not have individual members.

The terms of the acquisition would include a right (but no obligation) of life tenancy at an agreed market rent.

Given residential rents are in general lower than the average long term rate of return for super funds the resultant earnings on the member’s super balance would fund the rent while providing additional income. Members could also withdraw some of their capital component (subject to any drawdown limits agreed to).

The fund could manage its exposure to the longevity risk implied by the life tenancy commitment through actuarially determined age based drawdown limits and “group” longevity insurance.

The Fund could deal as it sees fit with the acquired properties after the vendor no longer rents it (due to death or otherwise), based upon optimising returns to the super funds investing in the Fund.

The Fund would look to the Defence Housing Authority (DHA) model for maintaining properties in optimum condition including regular painting and other maintenance tasks, benefitting from significant economies of scale. This could be done in-house or outsourced to an entity like DHA.