
Older Australians and the Bucket List: Speaking notes¹

Today I'm here to share with you some of the Commission's recent work looking into superannuation policy for post-retirement, and the housing decisions of older Australians.

This work is part of a suite of policy relevant research on Australia's ageing population which we have self-initiated at the Commission.

Overview

Just to give you a roadmap of how I'll be presenting. First up I'll talk about the implications of population ageing and demographic trends for policy in the retirement income system.

In the following two sections, I'll focus on what I like to think of as two of three 'buckets' for funding the retirement years of older Australians. These are superannuation and the family home.

My fellow panel speakers will have more to say on the age pension – the 3rd bucket.

Older Australians: The policy imperative

At the Commission, we see ageing as perhaps the most formidable policy imperative. So let me take you through a brief snapshot of our recent contributions in this space.

Productivity at the PC (Caring for Older Australians)

In 2011, our inquiry report on *Caring for Older Australians* looked at the entire spectrum of issues affecting Australia's aged care system and identified a bunch of policies that distorted accommodation outcomes of older Australians.

The report led to a number of important reforms to the aged care system, the two most enduring being a shift in policy focus to in home care and the separation of accommodation and care costs in residential aged care.

Now some of these policy changes are still being implemented (and as always a few remain in the yet to do list).

¹ Speaking notes to an address to the Economic and Social Outlook Conference 2015 - *Rebuilding Foundations for Reform* - on 6 November 2015 in Melbourne.

Productivity at the PC (An Ageing Australia: Preparing for the Future)

Then in 2013, the Commission released our first flagship research paper on ageing and its impacts on economic growth and government budgets. Here we called out loud and clear that many older Australians are asset rich but income poor, and that they could tap into their home equity to pay for government services in old age.

Productivity at the PC (Superannuation Policy for Post-Retirement)

Then earlier this year, we published a report examining when and how older Australians access their superannuation. And I'll canter through some of our findings and policy observations shortly.

Productivity at the PC (Housing Decisions of Older Australians)

And at the end of this month, we'll be releasing another flagship research paper, this time on the housing decisions of older Australians. It will focus on older people's relationship with their homes, as a place to live and as a potential source of income and wealth.

We will get in and unpack older people's attitudes and behaviours around a bunch of key decisions that affect their retirement planning and wellbeing outcomes.

Whether to stay put or sell up, move into residential aged care, tap into home equity or hold onto it for a rainy day (or for the grandkids) — all these decisions materially impact whether older Australians enjoy wellbeing in retirement — today and in the future.

Australia's population is ageing

So turning first to what's driving the policy imperative? First, the age profile of Australia is structurally changing — it is really a demographic seismic shift.

Our projections suggest the share of the population over 65 will increase from 1 in 7 today to 1 in 4 by 2055.

And this is really fundamental when we come to understanding who's underwriting the buckets.

Longevity trends

And this population ageing is primarily being driven by increasing longevity. As this chart shows, the life expectancy of males and females continues to grow.

And furthermore, male life expectancy is slowly catching up with that of females. A baby boy born in 1971 could expect to live to about 68, a baby girl to nearly 75 — almost 7 years more.

By 2012, this gap had narrowed to just 4.4 years, and both males and females born now can expect to live to 80 or more.

A key implication of male longevity catching up is a greater likelihood of people remaining couples into old age – and so being a ‘hopeless romantic’ (being a couple for longer in retirement) is a key determinant of wellbeing in old age.

Income poor, asset rich

Older Australians also tend to be income poor and asset rich. The green and red lines show that household wealth accumulates over the lifetime and is greater in older age groups; this is primarily a result of high rates of home ownership – just over 80% for older Australians.

And strong house price growth in recent times (5.5% on average each year over the past 10 years) has boosted the wealth of the current older households, in comparison to earlier cohorts of the same age.

Now in contrast, the blue and yellow lines show that older households (not surprisingly) tend to have lower incomes relative to other age groups.

Many substantially reliant on age pension

But most older households rely substantially on government payments once they enter retirement and stop receiving employment income.

Around 70% of Age Pension eligible people receive the full or part pension, and government payments such as this make up the main source of income for older households.

Cost of government services increases with age

In addition to the large outlay on the age pension, some other government expenditures increase with age, most notably health and aged care.

So the fall out of this demographic shift – this ageing population - is well known — they have been examined extensively by the Commission and others — with key foci being around wellbeing and fiscal sustainability.

But there has been limited work done on how well placed the retirement income system is to deal with this demographic shift especially in terms of policies that impact the post retirement or decumulation phase of super.

And here we are dealing with a veritable herd of sacred policy cows. So we have been slowly rounding them up one by one through our self-initiated research. So first let me share how I view the retirement income system.

The retirement income system (Three buckets)

Many talk about the 3 pillars of the retirement income system – David Murray most recently. But I really see the retirement income system as comprising three ‘buckets’ – and buckets that can and should be drained (decumulated) over time to provide income and deliver wellbeing in old age.

First the Age Pension, second Super and private savings and third the family home. And in doing so it is important to watch what happens to the water levels of each bucket – how they are being drained.

The retirement income system (Three unequal-sized buckets)

Now the Government (ultimately today’s taxpayers) are the chief bucket underwriter - providing a continued income stream through the Age Pension to a large portion of the elderly population.

Look at it as the government (or should I say taxpayers) being the insurer of the base level of longevity risk.

And the insurance payment is for most the primary source of income in old age, or a top-up for part pensioners.

And this bucket is being well drained.

With the estimated Age Pension spend in 2014-15 about \$42 billion, or 2.9 per cent of GDP. Now that’s about 10 per cent of total Australian Government expenditure.

This is forecast to grow to 3.7 per cent of GDP by 2050, despite a maturing super system running in parallel. So a well-drained bucket – with a constant and material flow of retirement funding.

Retirees tend to draw on their Super and private savings to fund their consumption – and we have found they do this in a very prudent way – a common pattern of conservative and even precautionary decumulation. So some draining of the bucket.

And then releasing equity from the family home can provide income in retirement, but older households are often reluctant to tap into this – and we’ll explore whether this is another tale of precautionary behaviour.

So what's in the last two buckets of super and the family home in 2013-14, older Australians (65+) held \$339 billion in super balances and \$926 billion in home equity – so these are well stocked but perhaps not well drained buckets.

So let's look at when and how bucket number 2 is being drained.

Older Australians: When and how they access super

Many policy levers impact retirement incomes. This year, we looked at 2 significant component parts of the super system – to ask and answer – when and how do people access their super.

The policy context

Turning first to the historical policy context - while life expectancies have been increasing steadily, Age Pension policy has remained relatively static since it was introduced at the turn of the last century.

Super has been a relative newcomer, a teenager today, with the Super Guarantee introduced in 1992 .

But super arrangements have seen quite a few 'reforms' and a lot of tax tinkering since its inception.

But these have been largely directed at the accumulation phase. The decumulation phase has remained a relative policy orphan.

And this is not just about the Age Pension eligibility age it is also about when people can access their super – the preservation age. And the gap between the Preservation Age (PA) and Age Pension Age (APA) really matters.

The preservation age is currently 55 and being raised to 60 by 2025 – so reducing the gap between the PA and the APA from 10 to 7 years. But the further mooted but not legislated increase in the APA to 70 will simply restore the gap to 10 years. So as part of the Super report, we modelled (after we first built a behavioural simulation model) what would happen if you raised the PA - the age at which people could access their Super.

So let me cover off our key findings.

Raising the preservation age – effects

The key take-outs are that by 2055:

Older worker participation would increase by a modest 2 percentage points.

Those who delay retirement would stay in the labour force for 2 years longer, giving them a 10% boost to their super balances at retirement.

Raising the preservation age – fiscal effects

The Commission also modelled the fiscal impact on the Australian Government. We found that raising the preservation age would mean that, in 2055.

The government would receive around \$5 billion per year more in tax receipts as households delay their retirement and Age Pension outlays would fall by around \$2 billion per year.

The result?

A net annual fiscal gain of around \$7 billion by 2055. And this would mainly come from increased tax revenue from wealthier households. A progressive policy change.

So while a pretty good fiscal dividend. You may ask why such a modest impact on mature age workforce participation.

And here's the rub - it is because diversity really matters in understanding and designing policy for post-retirement. Let me show what I mean by that diversity.

Many people have low or no superannuation

Given we really have a teenage super system, today's retirees have not had many years under the compulsory super system.

So many people have very low levels of super or simply none at all. 15% of people aged 44-55 had no superannuation whatsoever, and only 10% had super of more than \$230,000.

The majority of this age group had less than \$100,000 of super. And this is where you start to see the emerging theme of our super report – that diversity matters and understanding that diversity is key to getting policy right.

The median matters

Now the situation for those aged over 65 today is worse. And here is a cautionary take out. When thinking about diverse circumstances, it is important to remember that averages do not tell the whole story (indeed they arguably mask the real story).

So it is better to look at the balance of the middle – or 'median' – household:

- While the average super balance of a 65-74 year old is over \$300,000 the median is zero. As such retirement income policies based on the 'average household' are unlikely to match most people's circumstances.
- So it is not surprising then that raising the preservation age may not have much of an impact on the middle that matters.

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- For those with modest superannuation balances, the Age Pension will continue to play an integral part of their retirement income – the Intergenerational Report forecasts tell us as much.

So for most 65-plus households, the family home is by far the lion's share of their household wealth (bucket number 3 that I'll come to shortly).

Not everyone chooses when they retire

Now while everyone is focussing on super returns the other two and perhaps biggest drivers of what ends up in the super bucket is the person's income during their working life and the age at which they retire.

And while there's a perception that retirement happens at 65, for some people it is quite a bit earlier, and it is not always by choice.

Almost one half of men and around one third of women who retire between the ages of 60 and 64 do so involuntarily.

Ill health and redundancy are some of the key reasons why people might end up retired earlier than they'd like to be. So turning now to what folk spend their super on and is that problematic or not.

Most super is not taken in lump sums

Now the use of superannuation lump sums attracts a fair bit of attention. But the Commission's report found that lump sums are not really problematic.

For one thing, most super assets are taken as income stream rollovers at retirement. And interestingly, when retirees take their Super as a lump sum, it is typically those with modest balances.

Patterns of super draw-down

And they usually do not squander it recklessly. Many use their lump sums to modify their homes, invest the money or clear outstanding debts.

Older Australians: Housing decisions

So turning to the third bucket. This year, the Commission also analysed the housing decisions of older Australians and the policies affecting these decisions.

We think it is crucial that policymakers understand the preferences of older Australians when it comes to how they view their house. Linked with this is the potential for older Australians to use the family home differently in retirement.

Our current project

In this research project, we wanted to really drill down into the patterns of housing and financial decisions older Australians make, why they make these choices and the impact on living standards and on the wider economy.

Now getting solid evidence to support our study was a priority. As well as consulting widely and drawing on data from publicly available sources, we commissioned a comprehensive national survey of older Australians' views.

We also used some pretty neat analytical methods to simulate the effects of changing particular levers on older Australians' housing and financial outcomes.

Now here's the teaser lines - We will ask and answer (by end November) two pretty key questions:

What happens to AP reliance if some value of the family home is incorporated into the AP assets test?

What happens to the wellbeing of older Australians if they do draw down on the equity in the family home – how much can that wellbeing in old age be improved?

So now for a sneak preview – I'll share a few insights including from our survey of older Australians and how they view the family home.

Housing has a dual role

First it is important to recognise that housing is a special class of asset it is both an investment and a consumption good.

In other words, the home has a dual role: it is both a place to live and a potential source of income and wealth.

But it is a stubbornly illiquid asset – or undrained bucket.

Housing as a source of wealth

Housing is an important source of wealth over the lifetime. We wanted to get a handle on how older Australians view their homes.

Do they see the home as a potential source of income in retirement, as well as a place to live?

How do they feel about unlocking the equity in their home if they needed extra income?

How important is it for them to preserve their home asset for their beneficiaries, versus using it to support their living and care needs?

Most older Australians are homeowners

Now the likelihood of home ownership rises with age. Around 80% of older people own their home, and for most of them, this means owning it outright.

The family home is also the largest household asset for most older people – representing 43% of the wealth of older Australians.

Does life cycle theory explain wealth patterns?

Now the life cycle theory of consumption suggests that people want to smooth their consumption over their lifetime. Given that income is not constant over the lifetime, people can build up and run down their assets to do that ‘smoothing’.

However, real-life patterns of accumulation and decumulation of assets may not conform to this theory. And so we need to ask and answer why is this?

Essentially, people’s preferences and circumstances differ, they may be motivated to leave bequests and uncertainty about the future drives precautionary saving.

So let me share a sneak preview from our survey of older Australians and their housing decisions.

Home is primarily a place to live

The attitudes of older Australians are really important here. Older folk are more likely to see the home as a place to live, than as a source of income.

In a survey conducted by the Commission for this study:

Three quarters of homeowners aged 60 and over wanted to see out their retirement in their current home and around 70% of people saw their home as a financial safety net.

Half of these older Australians called out a bequest motive as their key priority.

In contrast, only 40% saw their home as a potential retirement income bucket.

The home is rarely considered a retirement fund

Most older people do not want their current home to play any role in funding their retirement, or have never even thought of their home in this way.

Less than 10% of survey respondents stated that their current home will be the primary way in which they will fund their retirement.

Little love for mortgages in retirement

Older people are also more averse to debt in retirement.

Nearly 40% of those we surveyed said they felt ‘not at all comfortable’ with the idea of having a mortgage during retirement, even if it could get them a better standard of living.

Housing as a place to live

Taking a step back, we can then zoom in on the aspect of housing that is considered a consumption good.

The family home provides housing services that affect people’s wellbeing, such as the location of the home, the characteristics of the dwelling (such as whether it is a single storey) and the security of tenure.

So turning to where do older Australians live.

Where do older Australians live?

Most older Australians live in private dwellings, either as owners or renters. It is a small proportion who are in age-specific housing such as retirement villages or residential aged care, and these tend to be people in their 80s.

Strong preference to live at home

And living in their own home is where over 80% of older folk want to stay.

Most older Australians have a strong preference to remain in their home as long as possible (including those who do downsize during retirement – which we’ll reveal in our report).

They feel that their home is the most suitable option for them and they are tied to their home’s current location whether for lifestyle or family reasons - the postcode rubber band is incredibly strong.

Residential aged care increasingly a last stop

Sometimes, however, the need for higher levels of care and more suitable accommodation means that some people need to move into residential aged care.

Most people entering permanent aged care are 80 years and older, with about a quarter of them being 90 and above.

Current trends in residential aged care show that it is increasingly a last and short stop - anecdotally average tenure is now much shorter than the reported 2-3 years.

A case of aligned interest

So while residential aged care can be necessary for some older people, for almost all older people it is not their preferred living arrangement. Nor does it come cheap, costing the Australian Government about \$10 billion in 2013-14.

Yet home-based care, where older people receive care and support services in-home, can be one way to align the planetary interests of the Government and older Australians — allowing older people to live independently for longer while also saving taxpayer money.

This is because home-based care is less costly to fund than residential aged care and services significantly more people. Put simply – its better bang for everyone’s buck.

There is already movement in this direction, with planning ratios set to shift the mix more towards home-based care.

Looking at issues in isolation is limiting

So in summing up.

Today I have talked about only a few aspects of retirement incomes – for two of the three buckets ... and a sneak preview of what we have in store for later this month.

But Looking at these issues on their own only gets you so far. There is potential for unintended consequences and stranded policies.

Ideally these issues need to be considered as part of a holistic review of retirement incomes. For me this is not an immediate ‘must do’, but it is a near-term priority.

And why so?

Simply put - so we have a chance of better understanding how older Australians view and use all the three buckets and better aligning the water levels in retirement for the wellbeing of older Australians.

Thank you