POLICY EVIDENCE SUMMARY

May 2018

The asset portfolio decisions of older Australians approaching retirement

Based on AHURI Final Report No. 298:
Asset portfolio retirement decisions: *the role of the tax and transfer system*

Australian Housing and Urban Research Institute

What this research is about

This research examined how Australia's tax and transfer system, especially in relation to the age pension, impacts on household retirement choices.

The context of this research

Economic challenges associated with an ageing population present policy choices for the Australian Government. An understanding of how financial decisions associated with retirement are shaped by the tax and transfer system is critical from a policy perspective, including how this shapes housing outcomes.

The Australian age pension

Publicly funded pensions in Australia are means-tested and highly targeted. Unlike many other countries, receiving the age pension in Australia is not dependent on contributions made throughout an individual's working life. Eligibility for the age pension in Australia requires the individual meet residency requirements, comply with income and asset tests, and have reached the eligibility age.

Although a means test is applied on both income and assets of potential recipients, the provisions result in a large proportion of retired individuals receiving at least a part pension. The Productivity Commission reported (in 2014) approximately 70 per cent of individuals aged over 65 received at least a part pension, with the majority in receipt of a full pension. Despite the relatively low value of the age pension, current high rates of home ownership among those aged over 65 mean that the majority of older Australians maintain a satisfactory standard of living during retirement years.

Eligibility for the age pension

Prior to 1 July 2017, single owner-occupiers were allowed to hold non-exempt assets to the value of $250,000 before the assets test reduces the age pension. In comparison, non-home owners could hold in excess of $450,000 in assets. Hence, the valuation placed on owner occupied housing by the means test was approximately $200,000.

Exempt assets include: the principal home and surrounding land up to two hectares on the same title; some properties larger than two hectares on the same title for rural customers and primary producers; granny flat rights (where the pensioner has paid for the right to live in a specific home for life); any property or money left to in an estate, which is inaccessible for up to 12 months; accommodation bonds paid to a residential aged care facility; some income streams depending on when purchased; a cemetery plot and a prepaid funeral, or up to two funeral bonds; aids for people with disability; money from the National Disability Insurance Scheme for people with disability; and a Special Disability Trust, if it meets certain requirements.

Table 1: Maximum value of non-exempt assets to be eligible for full age pension (prior to 1 July 2017)

	Home owner	Non-home owner
Maximum value of non-exempt assets to be eligible for full age pension		
single	$250,000	$450,000
member of a couple, combined	$375,000	$575,000
illness separated couple, combined	$375,000	$575,000
Ineligible for age pension when total assessable assets are more than:		
single	$546,250	$746,250
member of a couple, combined	$821,500	$1,021,500
illness separated couple, combined	$967,500	$1,167,500

Source: *Indexation rates July* (2017) Department of Social Services, Australian Government.

What is a taper rate?

When an individual holds assets over and above the threshold value of assets or income, the age pension is reduced according to the taper rate. For example, every $1,000 of assets reduces the amount of age pension received by $3.00 per fortnight ($78 per annum). The taper rate is applied from the point when a householder's age pension benefit first starts to be withdrawn due to them have having a threshold value of assets or income, to the point where the householder no longer receives the age pension due to them having a too high a value of assets or income.

The key findings

Older Australian households don't structure financial assets to maintain eligibility for age pension

Statistical analysis of HILDA datasets collected between 2002 and 2014 shows individuals and households who are close to losing their age pension eligibility (in terms of income) are not structuring their asset portfolios to maintain eligibility for the age pension. This includes not transferring wealth into owner-occupied housing in a way designed to maximise eligibility for the age pension.

It is important to note two important limitations of the empirical analyses presented. First, the analysis examines the impact of eligibility rules on portfolio allocation, while holding the wealth levels constant. The empirical methodology does not address changes in saving levels (e.g. households actively reducing savings).

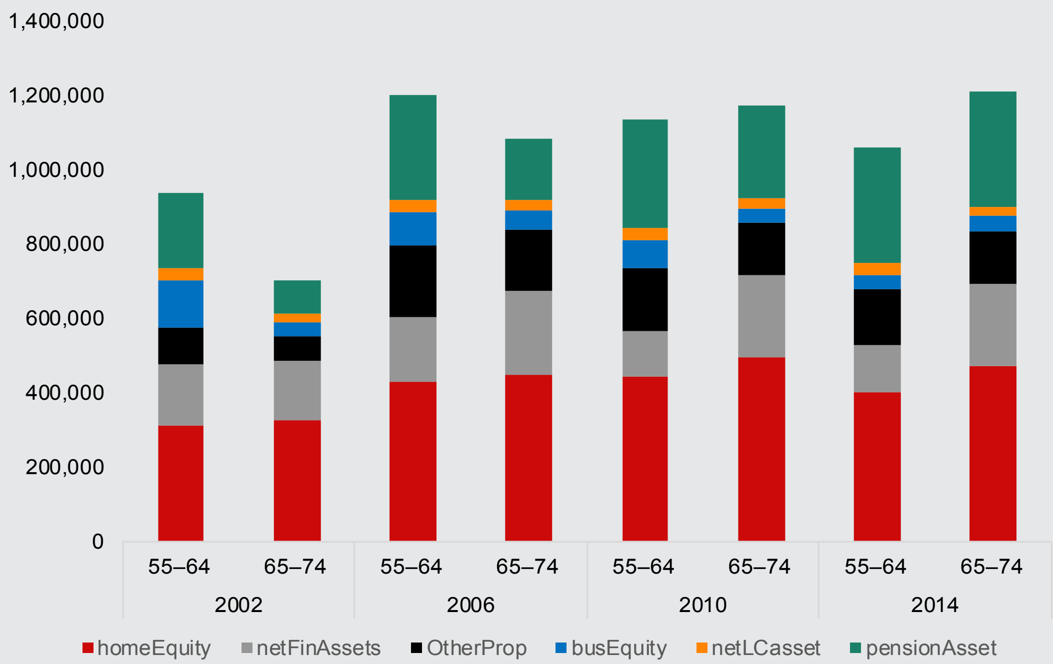
Further, the modelling does not capture long-term planning effects. The life-cycle model emphasises that decisions around saving, retirement and consumption during retirement are shaped over a long planning horizon. For example, households in the sample may have started planning portfolio allocations in their 30s or 40s. At the time of retirement, the means tests may not have a large impact on observed outcomes.

Changing wealth portfolio allocations of older Australians

The wealth portfolios of older Australians changed between 2002 and 2014:

1. **Growth in net worth**—Older Australians experienced rapid growth in their total net worth between 2002 and 2006, when for pre- and post-retirement cohorts aged 55–64 years and 65–74 years respectively, average net worth grew by 28 per cent and 53 per cent respectively. That growth slowed significantly between 2010 and 2014, and net wealth actually contracted in 2010 and 2014 for the pre-retirement cohort. For the post-retirement age cohort, growth in net wealth fell to 8 per cent between 2006 and 2010, and to 3 per cent in the final four years of data.
2. **Gradual decrease in financial assets**—Figure 1 indicates that older Australians gradually decreased the proportion of their asset portfolios dedicated to financial assets over the period 2002 to 2014, including a decline in the holdings of stocks or equities across 2006 to 2010 for both pre- and post-retirement cohorts. This suggests households responded strongly to an increase in the perceived riskiness associated with equities markets, and to a lesser extent bond markets, in the wake of the GFC.

Figure 1: Portfolio allocations of older households



Source: author's own calculations from HILDA waves 2, 6, 10 and 14.

3 **Increase in superannuation funds**—The destination for much of this wealth withdrawn from financial assets appears to be pension/superannuation funds—and in the case of the pre-retirement cohort, owner-occupied housing. Both pre- and post-retirement cohorts substantially increased the proportion of their portfolios dedicated to pension/superannuation funds over the period 2002–2006. This is consistent with government policies that encouraged private savings via compulsory and non-compulsory superannuation contributions during this period, and the increase in the value of those assets prior to the GFC.

4 **Strong growth in investment in property**—From 2002 to 2006 investments in property (excluding the principal residence) grew. The proportion of wealth dedicated to these assets grew from 10 per cent to 16 per cent for pre-retirement and from 9 per cent to 15 per cent for post-retirement cohorts during that period. While the proportion has remained relatively stable up to 2014, for those approaching retirement, property holdings other than the family home have gradually become more important in the context of the wealth portfolio. In 2002 around one quarter of responding households approaching retirement held property other than the family home and this has grown to 30 per cent in 2014. Similarly, in 2002 'other property' represented the fifth most valuable asset in the portfolios of those approaching retirement. By 2014 it had grown to become the third largest component of wealth for the pre-retirement cohort.

5 **Growth in value of owner-occupied housing**—The value of assets held in the owner-occupied home, as well as its contribution to net worth, grew steadily over time for the pre-retirement cohort.

Table 2: Percentage of before-tax salary contributed to superannuation: 2002–14

	Treatment group		Control group	
Year	Mean %	Standard dev.	Mean (%)	Standard dev.
2002	9.7	2.1	8.9	1.9
2006	11.7	6.3	9.3	2.0
2010	10.8	3.1	9.3	1.8
2014	12.2	3.8	10.3	3.7

Note: the first year after which the SS was abolished was 2006.

Source: author's own calculations from HILDA waves 2, 6, 10 and 14.

Owner-occupied housing increased from approximately one-third of net worth in 2002 to more than 40 per cent of net worth by 2010. Notwithstanding a slight decline in the following four years, it remains the case that owner-occupied housing represents a significant component of net wealth for Australian households entering retirement. For those in the post-retirement age cohort, however, the owner-occupied home has declined from 46 per cent of net worth in 2002 to 39 per cent in 2014.

The age pension taper rate

The age pension taper rate effectively acts as a wealth tax, reducing the level of consumption for those with relatively high assessable assets by limiting the amount of age pension they are eligible to receive.

In 2007 the taper rate applied to the age pension reduced from $3.00 per $1,000 of non-exempt assets (e.g. the family home not included in asset test) above the lower threshold, to $1.50 per $1,000 of assets. Individuals who previously received a reduced rate of the age pension as a result of the assets test, received a higher pension payment. In effect, the implicit wealth tax on holdings of non-exempt assets was reduced, increasing their age pension entitlements and lifetime wealth.

The research compared households whose heads are currently working and aged between 50 and 75 years old. The treatment group consists of all households which before the policy change held assets below the upper threshold level. The control group consists of the households which are ineligible for the age pension both before and after the change in the taper rate.

The findings were that households in the treatment group saved substantially more than those unaffected by the policy change.

In 2017 the age pension taper rate was reinstated to $3.00 per $1,000 of non-exempt assets.

Removal of the superannuation surcharge

In 2005 the superannuation surcharge, a tax introduced in 1996 on employer contributions to superannuation for high-income earners, was removed. The superannuation surcharge was imposed at a sliding rate up to a maximum of 15 per cent, meaning that the effective tax rate on superannuation contributions for high-income earners was as high as 30 per cent. In general, the lower and upper thresholds that defined the tax owing were adjusted annually.

The abolition of the surcharge meant that for those who were currently working and directing relatively large amounts of savings into superannuation, the effective tax rate on such savings was substantially reduced. The research indicates high-income individuals responded by increasing contributions to superannuation.

"Over time, the age pension could be structured in a way that makes it more tenure neutral"

The results suggest that by 2006, one year after the abolition of the superannuation surcharge, the treatment group increased before-tax salary contributions to superannuation by approximately 1.7 percentage points relative to the control group. These results indicate some effect from the abolition of the superannuation surcharge as higher income earners moved to take advantage of the lower tax rate on superannuation contributions.

By 2010–2014, though, this effect appears to have dissipated. It is important to stress that other significant changes to superannuation, the macro-economic environment and pension policy occurred over this time. Hence, accurate identification of the effect of the policy change is challenging.

What this research means for policy makers

The Australian retirement incomes system consists of four interconnected pillars. The three traditional pillars—namely the age pension, mandatory savings in the form of superannuation and private savings—are complemented by owner-occupied housing as the fourth pillar.

The policy lessons to be drawn from this report reflect a number of key considerations.

First, retirement income policy and the place of housing in that framework is complex and care must be taken when adopting piecemeal changes, as such changes can have unintended consequences. While this report has not considered changes to the taxation of housing assets directly, changes to one pillar are likely to impact on decisions related to the other pillars.

Second, the guiding principles of tax reform are that it develops a tax system that is fair, promotes efficiency and does not impose high administrative costs on those it taxes. Moreover, in terms of the tax and transfer system, any changes must be sustainable

Finally, in the context of retirement incomes policy change, it is critical that actual or proposed changes provide sufficient time and guidance for individuals to make appropriate decisions in the life-cycle context.

Over time, the age pension could be structured in a way that makes it more tenure neutral, by adjusting the respective thresholds for individuals or households that do and do not own property. In addition, taper rates applied to holdings of non-exempt assets should be balanced, taking into account the potential disincentives imposed by high effective marginal tax rates and the fiscal costs of lower taper rates.

Methodology

This research uses the wealth modules available in 2002, 2006, 2010 and 2014 of the HILDA Survey: a longitudinal dataset containing detailed information on the behaviours and outcomes experienced by Australian households.

The analysis also examined policy changes that provided natural taper rate and superannuation surcharge experiments.

Further information

TO CITE THE AHURI RESEARCH, PLEASE REFER TO:

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Contact details

Australian Housing and Urban Research Institute

Level 1
114 Flinders Street
Melbourne Victoria 3000

T +61 3 9660 2300
E information@ahuri.edu.au

ahuri.edu.au

twitter.com/AHURI_Research
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Australian Housing and Urban Research Institute