Australian Institute for Progress

Superannuation and Housing: growing the cake and eating it too

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Executive Summary

Research by the Australian Institute for Progress establishes that the biggest impediment to people entering the housing market is the deposit gap which has increased for the average Australian by 57.2%.

Other research shows that the greatest indicator of poverty in retirement is renting.

It is therefore in the interests of retirees to have both superannuation and their own residential dwelling.

Our earlier modelling demonstrated that the return on occupier-owned housing was far superior to the return obtained by even the best superannuation funds, so in 2016 we recommended that Australians should be able to borrow part of their deposit for a new house from their superannuation account.

We have revisited the situation and up-dated the figures over the last five years.

Even though the price of the average Australian dwelling has increased modestly by only 14% in the five years to September 2020, compared to GDP of 14%, the returns on equity to an average homeowner with a 5% deposit was modelled to be 15.57% pa, compared to 6.0% pa for superannuation reported by APRA.

We are therefore repeating our call for the government to allow Australian wage-earners to borrow from their superannuation accounts to contribute to the deposit on their first house, with these borrowings to be repaid over time.

The report also finds that such a scheme:

1. Meets the objectives of superannuation outlined in the *Wallis Inquiry*;
2. Will not significantly reduce the amount of superannuation available in retirement, but will increase standard of living for retirees;
3. Does not represent an unacceptable increase in investment risk for the borrower;
4. Is less risky than borrowing in an SMSF to fund an investment property, but provides a similar level of exposure to residential real estate as an investment class;
5. Will not inflate the cost of housing.

A number of members of the federal parliament have called for a scheme such as this. This report supports them, and we call on the Minister for Housing and the Minister for Superannuation, Financial Services and the Digital Economy to devise an appropriate scheme.

GRAHAM YOUNG
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Introduction

According to recent news reports[1], a number of senate crossbenchers, plus some government backbenchers, support the idea of allowing people to withdraw money from their superannuation fund to contribute towards a house deposit as a way of encouraging home ownership.

In June 2016 in "Housing affordability – the deposit gap"[2] we demonstrated that the problem with housing affordability was not repayments, but the time it takes to save a deposit. This had increased by 55% since the 90s, while repayments as a percentage of wages had stayed the same. (Our latest research to the September quarter 2020 shows that deposits now take 57.2% more time to save, and housing repayments are 26% less affordable than the 90s[3]).

We therefore suggested allowing access to super funds for first home buyers. Then in May the following year we modelled 5 years' worth of housing returns from 2011 to 2016 in "Housing investment – the last five years" [4], demonstrating, amongst other things, that the return on owner-occupied housing was far superior to most other forms of investment, including superannuation.

This paper is a brief update of aspects of the second paper where we have modelled owner-occupied housing for the five years between the fourth quarter 2015 and the third quarter 2020, inclusive. Price increases in housing were more subdued over that period than the previous one, so the overall performance differential *vis-à-vis* superannuation is less marked, but still significant.

For the 5 years to September 2020, our model shows an after-tax return to a first home buyer with a 10% deposit of 15.57%. This compares to the average return on superannuation over the same period of 7%, as reported to the APRA in their November 24 online edition of "Quarterly superannuation statistics"[5]. In our 2017 study superannuation returned on average 6.8% and owner-occupied housing returned 13.54% with a 20% deposit. This decreased to 9.61% in the most recent study.

As a result of both these studies we conclude that allowing Australians to borrow from their superannuation for a deposit on their first home will enhance their savings and security in retirement.

Methodology

The model was constructed using the following assumptions:

1. The gross rental yield on an average rental property in Australia in 2015 was 4%[6].
2. The value of the first home has been escalated in line with the increase in average house prices measured by the ABS[7].

[1] https://www.smh.com.au/politics/federal/dipping-into-super-for-first-home-deposit-gains-crossbench-support-20201124-p56hdb.html
[2] "Housing affordability – the deposit gap" https://aip.asn.au/wp-content/uploads/2016/07/Deposit_Gap_16_06_30.pdf
[3] "Housing affordability Index September Quarter 2020" https://aip.asn.au/wp-content/uploads/2021/02/Housing_Affordability_Index_September_2020.pdf
[4] "Housing investment – the last five years" https://aip.asn.au/wp-content/uploads/2017/05/Housing_the_last_five_years_17_05_03_V1.0.pdf
[5] https://www.apra.gov.au/quarterly-superannuation-statistics
[6] Derived from research by SQM Research https://sqmresearch.com.au/property-rental-yield.php?avg=1&t=1
[7] https://abs.gov.au/statistics/economy/price-indexes-and-inflation/residential-property-price-indexes-eight-capital-cities/latest-release

3. The initial rental yield on this home if it were bought by an investor is estimated using ABS household occupancy costs for 2017-18 and choosing the median cost for a tenant with private landlord.[8]
4. The theoretical rent of the property is imputed to the owner as income.
5. Interest rates are estimated by taking the RBA Cash Rate Target and adding 3% to it.
6. Purchase costs (stamp duty and legal fees) are estimated as 2% (the exact figure will vary depending on the state).
7. The model assumes the house continues to be held at the end of the period. This ensures it is comparable to superannuation, which cannot be drawn down until retirement, apart from exceptional circumstances, and then it is taxed.
8. No account has been taken of government assistance that might be available to first home buyers, but this is substantial, and can boost returns substantially.

Modelling superannuation support for owner-occupied living

Our model uses real averages across Australia to draw conclusions. Whilst any model is an approximation of reality, this ensures that ours keeps in touch with actuals. The modelling is of necessity retrospective because we can't know the future performance of either residential real estate or superannuation funds. By modelling the past we are essentially choosing the "null hypothesis" – that things will continue as they have without change.

It should be noted that the appreciation in real estate values over the last 5 years has been a very modest 14% (3.35% pa) on average, which compares with growth in GDP for the period of 14.7%.

Financial outcomes

Part of the secret of returns in residential real estate is the willingness and the ability of purchasers to gear their purchases. High gearing is possible in owner-occupied residential real estate because occupancy risk is limited to the owner-occupier and this is low because the owner-occupier will have an occupancy cost whether they rent or buy. As long as they are not over-committed and are employed, and the occupancy cost is appropriate to their income, they are at a low risk of default.

Another part of the secret is that as time goes by, the loan servicing cost will reduce compared to the occupancy value as the loan is repaid, and as inflation and growth in the economy raise average rents. The imputed value of the rent therefore becomes increasingly valuable to the owner-occupier.

Once the property is fully-owned without a mortgage, the value of the imputed rent will be the rental yield on a similar property, which at the moment would appear to be around 3%.[9] As rent is paid from after tax dollars, this equates to a gross 3% yield with a franking credit of up to 49%, rather than the company tax rate of 30%.

We have modelled four different scenarios. They are a 5%, 10%, 50% and 100% deposit. The annual returns over 5 years to the September Quarter, 2020 are shown in the table below.

Deposit	Return on equity over 5 years
5%	15.57%
10%	12.41%
50%	7.07%
100%	5.99%

[8] https://www.abs.gov.au/statistics/people/housing/housing-occupancy-and-costs/latest-release
[9] https://sqmresearch.com.au/property-rental-yield.php?avg=1&t=1

They can be contrasted with the median returns for superannuation funds with more than 4 members, taken from the APRA's "Quarterly Superannuation Statistics"[10].

Sep 19	Dec 19	Mar 20	Jun 20	Sep 20
7.4%	7.1%	3.7%	5.2%	6.0%

The owner-occupied housing is better, or equal, to the median return from superannuation over this same period, meaning home ownership provides a superior return to superannuation for most homeowners. Put another way, this means that forcing Australians to favour superannuation over home ownership as a savings vehicle will leave them with fewer assets at retirement, not more.

What should be the purpose of compulsory superannuation?

The purpose of compulsory superannuation is to provide a reasonable standard of living in retirement without relying on the old age pension. It is also to limit the call on the government for support in retirement.

The "Financial System Inquiry Final Report"[11] (the Wallis Inquiry) expressed this as:

> *To provide income in retirement to substitute or supplement the Age Pension*[12]

with one of six subsidiary objectives including:

> *Alleviate fiscal pressures on Government from the retirement income system*[13]

which it explained as:

> *Government's total contribution to the retirement income system, through both the Age Pension and superannuation tax concessions, needs to be sustainable and targeted. Higher private provisioning for retirement should reduce the burden on public finances.*[14]

A retiree who doesn't own their own home is highly likely to qualify for rent assistance. Further, one who does own their own home will likely enjoy a higher standard of living. So home ownership achieves two of the aims of the compulsory superannuation system – it raises the standard of living of the retiree, at the same time reducing the government's costs.

Arguments against allowing borrowings

A variety of arguments has been raised against this scheme. We will deal with some of the major ones.

[10] https://www.apra.gov.au/quarterly-superannuation-statistics
[11] Financial System Inquiry Final Report 2014, accessed at https://treasury.gov.au/sites/default/files/2019-03/p2014-FSI-01Final-Report.pdf
[12] Ibid p95
[13] Ibid p95
[14] Ibid p95

1. It will diminish the value of superannuation in retirement

As our financial modelling shows if it does diminish the value of superannuation in retirement it will most likely replace it with an equivalent increase in non-superannuation assets. It will also tend to increase the owner-occupier's net worth, diverting money that would have been paid in rent into savings in the form of equity in their own property. We also propose that the money used for a deposit be borrowed from the superannuation fund, so that it is paid back over time, and earns a rate of return for the fund in the meantime.

If an Australian retires without a house, but with a superannuation entitlement, then it would make best financial sense for them to take a lump sum and use it to buy a house. So the issue of the amount of super available in retirement is to a large degree a distraction. The issue is at what stage in their earnings cycle are Australians best to buy a house – towards the beginning, or at the end? If the former, then they will increase their total savings, if the latter, they will probably end-up with lower savings and resources.

2. Purchasing a property is a high-risk strategy compared to superannuation

This is true to some extent as loss of earning capacity, coupled to a decline in asset values may trigger a default.[15] However, defaults only tend to happen in severe circumstances, and loans in arrears more than 90 days tend to typically be less than a percent of total housing loans.[16]

Rent and mortgage costs tend to be closely related, so once you take account of the occupancy benefits of housing, the chance of not being able to meet mortgage repayments is minimal.

The risk also tends to be higher at the beginning of home ownership, when the purchaser is generally younger and more employable, rather than at the end, when the mortgage has been paid down, and the purchaser may be older and much less employable.

Millions of Australians would attest that home ownership has been how they have accumulated most of their wealth. According to the latest ABS study "Household Income and Wealth, Australia"[17] in 2017-18 the average Australian had an owner-occupied dwelling worth $500,600, against which they had a mortgage of $102,600, and superannuation of $213,700[18]. If there were a high risk in purchasing a house, you would not expect so much household wealth to be concentrated in it. If it were a risky asset, Australians would be expected to avoid home ownership. The ABS also reveals 66 per cent of Australians own, or are buying, their own home.[19] Again this is a high percentage for an allegedly risky asset.

Another factor to take into account is that residential real estate is a class of investment that it is difficult for a superannuation fund to get exposure to. This scheme would provide that access, albeit with a higher weighting than any other asset class.

While acknowledging that there is some increased risk we think that the pay-off to the individual, and the government, is sufficient to warrant accepting that risk, if the purchaser makes a decision

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[15] "The Determinants of Mortgage Defaults in Australia – Evidence for the Double-trigger Hypothesis" accessed from https://www.rba.gov.au/publications/rdp/2020/pdf/rdp2020-03.pdf

[16] https://www.macrobusiness.com.au/wp-content/uploads/2019/11/RMBS-Arrears-at-30Sept2019-1.pdf

[17] "Household Income and Wealth" ABS https://www.abs.gov.au/statistics/economy/finance/household-income-and-wealth-australia/latest-release

[18] 65230DO002_201718 Household Income and Wealth, Australia: Summary of Results, 2017–18

[19] ABS "Housing Occupancy and Costs" https://www.abs.gov.au/statistics/people/housing/housing-occupancy-and-costs/2017-18

that they see advantage in accepting it. It can also be mitigated by conditioning access to super for a deposit on servicing capacity and employment history.

3. Superannuation should not be used for residential housing

This is an argument that is rebutted by the government's own policies which allow a self-managed superfund to borrow to purchase a residential rental property. As such purchases generally attract a higher rate of interest, involve a higher rate of tax on sale, and involve a tenancy risk which is mitigated to a large extent in the case of owner-occupiers we would argue that our proposal is a less risky, and more beneficial proposition for the beneficiary of the superannuation fund.

4. It would inflate the cost of housing

This argument has two flaws. The first is the claim there will be increased demand for housing. The second, that even if there were increased demand, housing supply would not expand to meet demand.

When a purchaser buys their first house they do not necessarily add to the demand for dwellings because in many cases they are already renting a dwelling. So the net number of occupants changes little, just the equity structure of their habitation. As the aim of this policy is to increase housing ownership there will be some change in ownership structure with investors selling to homeowners, which could create some pressure if investors were unwilling to sell, but this will be counteracted by the normal increase in the housing stock via building of new homes.

We believe the Federal Government's HomeBuilder grant has helped to accelerate growth in housing stock, but this will not show up in statistics for another three to six months. As it is encouraging the building of new housing it is potentially leading to price moderation in the medium term, particularly as migration has gone to zero due to COVID-19.

In a properly working housing market higher prices should bring on new housing, increasing supply, and hence prices. Inasmuch as this doesn't happen in the Australian housing market, it is a sign of issues to do with restrictions on development, massive immigration, as well as the fall in interest rates.[20]

Factors to consider in designing a scheme

The purpose of this paper is not to define a complete scheme, but to examine and analyse some of the factors that should apply.

1. Who should be able to access the scheme?

While first home buyers are obviously one target of schemes like this, we believe that it is also appropriate to consider people who have owned a home in the past but for some reason don't now. This might be because of a relationship break-down, or financial hardship. These people are not able to access government benefits like deposit assistance schemes, which are limited to first home buyers. This is good policy as these schemes are a gift from the government to a homeowner, and so rightly should be limited in their availability.

As this scheme doesn't involve government assistance (although it may be used in situations where government assistance is available) then an equity consideration vis-à-vis other taxpayers should not be triggered. Superannuation is held on trust for the beneficiary, but it is ultimately for their benefit, and has come from their income. So using a small proportion of it to top-up a deposit so as to secure

[20] RBA Research Discussion Paper – RDP 2019-01 https://www.rba.gov.au/publications/rdp/2019/2019-01.html

greater financial security for the beneficiary at any stage in their life would appear to us to be in the interests of the beneficiary and the government.

This might need to be subject to an age cap to ensure that the potential borrower is not introducing unwarranted risk into their financial profile at a late stage in their life when they may be close to retirement.

On the other hand, banks will not lend to people who are close to retirement, so financial industry lending policies will probably police this issue without the need for legislative interference.

2. Should there be a maximum amount that can be withdrawn?

We think there should be, so as to limit the risk of over-commitment, although this will also be limited by financial institution lending policies.

One approach would be to calculate it by reference to a maximum house purchase price. This might be combined with a maximum percentage of the equity value of the superannuation benefit accrued to the purchaser, as well as an allowance for the time left to retirement – it might make sense for a younger person to be able to access a greater percentage of their super, than an older person, closer to retirement.

3. Relationship to the First Home Super Saver Scheme

The First Home Super Saver Scheme allows potential first home purchasers to deposit money into their superannuation scheme. This helps with saving because the return is likely to be higher than they will get on cash deposit with a bank. These payments are also tax-advantaged. Our scheme would be complementary to that scheme, and the mechanism already in place to administer that could be extended to cover our proposal.

Indeed, it might be worthwhile looking at broadening the use of such schemes. With interest on savings being negligible, many Australians are being forced to move up the risk curve just to get a return on their money while they aggregate it for a particular purpose, or when they are saving for contingencies. It is possible that the superannuation system, which is geared to be able to process deposits and withdrawals, could be used to provide a reasonable return for these purposes without unduly increasing the risk profile of the saver.

Conclusion

We have demonstrated that one of the largest barriers to home ownership is the time that it takes a potential owner to save the deposit. This has increased by 55% in terms of the time spent to save it as a function of average weekly earnings since the 1990s. This is largely a result of interest rate falls. As a result, loan repayments are as affordable now as they were in the 90s – the difficulty for many home buyers is saving a deposit to get into the market.

However, Australians are actually saving more than they were in the 90s, but a large proportion of those savings are going to superannuation. If they could access those savings, as well as the ones they are making voluntarily, then the deposit would cease to be the barrier that it is now.

The financial benefits from home ownership are significant, and equal, or superior to, superannuation, and for most Australians the family home is their largest asset going into retirement. Home ownership also confers a higher standard of living in retirement for the same income, as well as limiting government outlays for rental assistance.

A scheme to allow access to super contributions as a loan to be paid back into the superfund could be designed and administered as an adjunct to the First Home Super Saver Scheme, and could possibly be extended to people wanting to re-establish themselves in the housing market as well as first home buyers. Superannuation funds could also be used as a vehicle to increase returns and limit risks for the non-retirement savings of Australians.

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