ACIL ALLEN CONSULTING

REPORT TO
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USING SUPER FOR HOUSING IS A REALLY BAD IDEA

REASONS WHY

ACIL ALLEN CONSULTING PTY LTD
ABN 68 102 652 148

LEVEL FIFTEEN
127 CREEK STREET
BRISBANE QLD 4000
AUSTRALIA
T+61 7 3009 8700
F+61 7 3009 8799

LEVEL TWO
33 AINSLIE PLACE
CANBERRA ACT 2600
AUSTRALIA
T+61 2 6103 8200
F+61 2 6103 8233

LEVEL NINE
60 COLLINS STREET
MELBOURNE VIC 3000
AUSTRALIA
T+61 3 8650 6000
F+61 3 9654 6363

LEVEL ONE
50 PITT STREET
SYDNEY NSW 2000
AUSTRALIA
T+61 2 8272 5100
F+61 2 9247 2455

LEVEL TWELVE, BGC CENTRE
28 THE ESPLANADE
PERTH WA 6000
AUSTRALIA
T+61 8 9449 9600
F+61 8 9322 3955

161 WAKEFIELD STREET
ADELAIDE SA 5000
AUSTRALIA
T +61 8 8122 4965

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1. Introduction

Motivated by the need to make housing more affordable, recently a proposal has been floated from within the Commonwealth Government to allow first home buyers (FHBs) to access their superannuation[1] to help fund the purchase of their house.

This report argues that this proposal is a really bad idea, for the following reasons:

— It will be *futile*: any policy that just adds to housing demand, as this one does, will increase house prices, thus undoing whatever affordability advantages may be gained by giving FHBs access to this cash

— The superannuation savings of FHBs will *never recover*, thus worsening their standard of living in retirement and increasing their reliance on the age pension

— *Age pension costs* to government will *increase* for two reasons: first, because people will have lower superannuation balances and so will access the pension earlier and in greater amounts; second, because more of people's assets will be in their homes, which are exempt from the age pension asset test

— *Tax receipts* to government *will fall*, worsening its structural fiscal position, for two reasons: first, because lower superannuation balances will mean lower earnings on super which will in turn reduce the taxation receipts from those earnings; second, there will be no offsetting increasing in taxation from having more assets in the family home, because both capital gains and imputed rent from the family home are tax-free

— *Capital* will be *diverted* away from businesses who need the capital to grow

— More wealth will be concentrated in the family home, which will expose households to *greater financial risk*, and a possible catastrophic fall in wealth should there be a significant fall in house prices

— The *scheme* could easily be *cheated,* leading to no increase in home ownership, higher house prices and a reduction in superannuation savings. This will be *lose-lose-lose*.

2. The policy will be futile

Economist Saul Eslake has argued longer and better than anyone that giving cash to home buyers does not improve affordability. In fact giving cash to home buyers makes it worse. In his address in 2013 to the 122nd Annual Henry George Commemorative Dinner, titled 50 Years of Housing Failure, Eslake said[2]

"It's hard to think of any government policy that has been pursued for so long, in the face of such incontrovertible evidence that it doesn't work, than the policy of giving cash to first home buyers in the belief that doing so will promote home ownership."

Up until now, the policy instrument for giving first home buyers cash has been the First Home Owner Grant[3] (FHOG) which is simply a transfer from government (i.e. taxpayers) to FHBs. The proposal from the Assistant Treasurer is different in that FHBs would be using their own money rather than the taxpayers' but the effect would be the same – more money will be chasing (about the) same number of houses, and as a result, the price of houses will increase. FHBs will pay more for the same house, with essentially just as big a housing loan, as they would without the policy – but they will have spent

1 Specifically, by the Assistant Treasurer, Michael Sukkar: http://www.afr.com/news/michael-sukkar-says-superannuation-for-housing-could-work-20170313-guxcvi, http://www.smh.com.au/federal-politics/political-news/first-home-buyers-raiding-super-could-work-says-michael-sukkar-20170313-guxflp.html,

2 https://www.prosper.org.au/2013/09/03/saul-eslake-50-years-of-housing-failure/

3 http://www.firsthome.gov.au/

their superannuation. Another difference with the FHOG scheme is that it is likely that more cash will be available to FHBs, so house prices will go up by even more than they do with the FHOG scheme.

Suppose that FHBs have $50,000 in superannuation that they can access to put a deposit on a $500,000 house. Will house prices go up by the full $50,000? Probably not, because FHBs aren't the only buyers of houses, and there will probably be some supply response, which will dampen the demand effect of the extra $50,000 that FHBs have to spend. It is actually quite difficult to predict the precise effect on house prices of FHBs receiving a cash boost, because this requires parsing out all of the many other variables that affect house prices. But no one seriously doubts that the effect will be to put prices up.[4] Even the Assistant Treasurer acknowledges this, saying that he'd like to see measures which boost housing supply at the same time, to offset the effect on prices of the demand boost. But if the objective of policy is to make housing more affordable, why have any policies that will raise house prices? Why not instead just have policies that will lower prices?

3. The effect on lifetime superannuation savings

To show the effect of the proposed policy on lifetime superannuation savings, consider the following simple, but realistic, model of superannuation accumulation.

Suppose Joan Smith starts working at age 22 on a salary off $30,000 per year, puts 9.5 per cent of that salary into superannuation, receives annual salary increases (on top of CPI increases) of 2 per cent and works continuously until retiring at age 65. Suppose also that the real rate of earnings on her superannuation balances is 3.5 per cent per year. After accounting for the 15 percent tax on superannuation contributions and earnings Joan will retire with a superannuation balance of $368,563 (in real terms i.e. adjusting for inflation).

At age 34, Joan will have $50,521 accumulated in superannuation savings. Suppose that at that age she withdraws $50,000 from her superannuation to be used as deposit for a $500,000 house, leaving her with just about nothing in superannuation. On retirement at age 65, she will have just $244,496 in superannuation, about one third less than if she hadn't used her superannuation 31 years earlier as a house deposit. This scenario assumes that the policy doesn't inflate house prices. If it does (and it will), Joan will have to take even more out of her superannuation to pay for a deposit (or purchase a worse house), leaving her with even less superannuation when she retires.

It could be argued[5] that nevertheless this would be a smart financial decision, because houses grow in value over time and so what is lost in superannuation savings will be more than made up for in housing capital gains. However, this is a trivial argument. Obviously this will be true if house prices grow faster than superannuation earnings, but what if they don't? Just because house prices have grown fast recently doesn't mean that they will in the future. There have been periods in Australian history (the 1890s to the 1950s) where house prices didn't grow at all, and recently in some parts of the world house prices have crashed. No one knows what will happen to Australian house prices in the future, certainly not the long run future over many decades that is relevant to FHBs. It is extremely unsound to justify a policy that will certainly lower superannuation savings on the assumption that housing will prove to be a better alternative investment in the long run future.

4. Age pension costs will rise

The less people have saved in superannuation when they retire, the more likely it will be that they will receive the age pension either immediately they retire, or soon after they retire as they run down their retirement savings. To the extent that superannuation is meant to lessen the fiscal burden of the age pension, using superannuation for housing will be a retrograde step. While it may be true that people

4 According to Ken Morrison, CEO of the Property Council of Australia, allowing people to use their superannuation to buy housing is "well-meaning but self-defeating [policy] which will just send prices higher" (Australian Financial Review, p39, 27 March 2017).

5 http://www.smh.com.au/comment/paul-keating-is-wrong-firsthome-buyers-should-be-able-to-use-their-super-20170320-gv1w6d.html

will live in more valuable houses if earlier in their life they put their superannuation into buying a house, this won't help them meet the cost of living in their retirement because their houses won't generate any cash. They will be asset-rich and income-poor. The Government will pay them the age pension, for which they will be eligible, despite being asset-rich, because the family home doesn't count in the assets test for the pension. However, if on the contrary they do have sufficient superannuation, people won't need the age pension and they won't be eligible for it either because superannuation savings does count in the assets test.

A recently remarked-upon phenomenon is that an effect of high house prices is that people won't have paid off their mortgages by the time they retire.[6] They will then take their superannuation as a lump sum to pay off their mortgage, leaving them with insufficient superannuation to live off and hence they will need to receive the age pension. A policy of allowing people to use their superannuation to buy a house will worsen this trend in two ways: first, by reducing lifetime superannuation savings; second, by raising house prices.

5. The effect on taxation revenue

As is well-known, owner-occupied housing is taxed extremely preferentially. In particular, owner-occupied housing is not subject to capital gains tax. The cost of this exemption to the budget in 2016-17 is estimated by the Commonwealth Treasury to be $27.5 billion.[7] In addition, unlike the rent received by housing investors from their tenants, imputed rents received by home owners are also tax-free.[8] In contrast, superannuation, while relatively lightly taxed, does provide the Government with more revenue compared to a situation where the money goes into owner-occupied housing. A policy of allowing FHBs to use their superannuation for housing will worsen the Government's long run fiscal position, which is in bad enough shape already.

6. Diversion of capital

The effect of the taxation regime on housing investment is not straightforward to estimate but it is reasonable to assume that Australians put more money into their houses (bigger houses, more lavishly appointed, more frequently renovated) than would be the case under less generous tax arrangements. *Ipso facto*, it follows that Australians invest less in other things, such as businesses or other productive investments. But, at least this is where a large part of their superannuation savings go. Superannuation plays a very important role in the Australian economy by providing capital for businesses.[9] Diverting even more household savings towards housing would be a retrograde step. This is what would happen if FHBs could use their superannuation for housing.

7. Greater financial risk

The diversion of FHB savings away from superannuation towards their house will expose people to greater financial risk because more of their wealth will be concentrated in their house. It is never a good idea to have too much wealth in one asset. Other than the rich, people predominantly have their wealth in their house and their superannuation. Their superannuation, if wisely invested, will be diversified, but their house is just one asset.[10] Tilting the allocation of household savings away from superannuation, where it will be invested in a variety of assets, towards housing is poor financial

6 http://www.afr.com/news/politics/older-mortgagees-and-the-super-squeeze-20170321-gv3hym

7 Tax Expenditures Statement 2016, January 2017, Table E5, page 88. This is the amount of additional tax revenue that would be received if owner-occupied housing received the same capital gains tax discount that all other assets receive, instead of not being taxed at all.

8 Some countries, such as the Netherlands and Switzerland do tax imputed rent but with the *quid pro quo* that mortgage interest is tax deductible.

9 Allen Consulting Group, *Better living standards and a stronger economy: the role of superannuation in Australia,* report to ASFA, October 2009.

10 Many people, not only the wealthy, own investment properties, but investment housing is the same asset class as their home. When people buy investment properties they are not diversifying their assets. On the contrary, they are increasing their risk.

management. This will be true even if people have made significant (unrealised) capital gains on their house. In fact the bigger the capital gains, the bigger the risk.

8. Cheating the scheme

The scheme could be easily cheated. At present, people are prevented from withdrawing their superannuation for consumption purposes until they retire or are nearly retired. If people were allowed to use their superannuation for housing, they could sell their house as soon as they buy it, pay back their newly acquired mortgage and spend what had been their superannuation savings (or what is left of them after paying stamp duty on their house purchase, real estate agents' fees and marketing expenses on the sale and legal costs on the purchase and the sale) on consumption. This would completely defeat the intent of the superannuation system.

9. Conclusion

Allowing FHBs to use their superannuation to purchase a house is a really bad idea. It would devastate their retirement savings, increase house prices, expose the Government to lower tax revenue and higher age pension costs, divert capital away from businesses who could use it for productive purposes and expose people to greater financial risk. To top it all off, such a scheme could be easily cheated, leading to the trifecta of no more FHBs in their own home, far less superannuation savings and higher house prices. It would be lose-lose-lose.

If the Government wants to make housing more affordable for first home buyers then it should introduce policies that will do this. Skewering the superannuation system is not the way to do it.

ACIL ALLEN CONSULTING PTY LTD
ABN 68 102 652 148

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