“MyPlan”

My *self funding retirement* Plan

A rest of life annuity

EXECUTIVE SUMMARY

The Government is seeking ways to reform the superannuation/pension system. It is unlikely there is one “silver bullet” solution; rather it will be a mix of several elements to meet the needs of those who are of different ages, different needs and different income levels. “MyPlan” is offered as one segment of the solution..

MyPlan is aimed at retirees who do not want to leave their family home but are struggling to make ends meet on the pension or who have been adversely affected by the GFC and whose remaining super funds are meagre. One way or the other they need to find a source of extra funds.

MyPlan is a system whereby a retiree receives an annuity from the Government until death in exchange for the title to his/her house. It is entirely voluntary. Title to the house cannot pass until the death of the retiree.

The annuity is paid monthly and is indexed to inflation. It is based on a ratio to the value of the house and is geared so that when the house passes to the Government the sale of the house repays the sum of the annuities paid out. The residue is shared between the Government and the retirees estate. Retirees incomes will be significantly improved, in some cases doubled.

The Government does not charge interest on the funds created to service the annuity as instead it saves on the old age pension it would have otherwise had to pay out. Nor are there any lump sum loans. These are fundamental differences to reverse mortgage schemes.

Creating funds may be seen as “Quantitative Easing” but in this scheme the funds will be fully paid back on the sale of the house.

The Government can pay the annuity in one of two ways. It can raise the entire value of the house at year 1 and invest that in industrial projects or infra-structure that will pay an annual dividend which is the annuity paid to the retiree OR it can raise the amount of the yearly annuity and pay that directly to the retiree on a monthly basis.

The overall savings to the national economy are considerable.

Both parties benefit; the Government saves money, the retiree is better off. “Quid pro quo”

Creator and author

Peter C. Hall
February 2015

MyPlan

"My *self-funding retirement* Plan"

A rest of life annuity

"Me and the Government building the nation, together."

Australia has an ageing population, a source of great concern to the Government of the day and of tomorrow. The money paid out on the old age pension now approaches $45B and will increase as more people enter the retirement phase of their life, as the cost of living increases, and the financial markets erode the funds people had put aside over their working lifetime (the recent GFC had a profound affect on retiree's super funds and have consequently forced many thousands to turn to the Government pension for support. The documentary "Inside Job" suggests it could readily happen again.)

Today over 87% (approx. 3.18M) of retirees depend to varying degrees on the Government pension; personal superannuation does not provide enough. In the years ahead the situation gets worse.

- Those turning 65 will increase at a rate of over 45K per year. In 2012 they numbered 249,800 out of a total population of over 65 y.o's of 3.654M.
- In 2007 people aged 65 years and over made up 13% of Australia's population (I.e.2.73M.) This is By 2051 87% of people over 65 will have the lowest income of all 5 income groups.
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- All of this will put enormous pressure on the pension scheme and will become a horrific cost to the Government.
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- projected to increase to between 23% and 25% in 2056. (I.e.10.6M)

Is there a solution?

Philosophically the Government would prefer people to be able to fund their own welfare needs. However the reality is society expects Governments to provide but this is having an adverse effect on the stability of the economy as Governments resort to increasing levels of debt funding. The more they do this the more difficult it is to return to sound budgets and fiscal balance.

Many retirees are asset rich but cash poor for they are sitting on a significant pool of funds; their home, an asset that could be made to work harder. There are many retirees with a mortgage free home (estimated 300,000 singles and 1.3M couples) . Many have very little super and have to rely on the Government old age pension. They may well be interested in leveraging their house in order to double (or more) their income – if only they knew how.

"Downsizing" in whatever form is not the answer. It may free up some capital but such new new capital is then assessable by Centrelink as a source of deemed income thus reducing the pension the retiree was receiving. Similarly with reverse mortgages added to which the compounding interest cost is punitive. Besides, research shows that many people prefer to "age at home" among familiar surroundings.

Both downsizing and reverse mortgages are only stop gap measures and neither provide a nationwide solution whereas the following proposal is a "rest of life" assured income, CPI indexed, and helps reduce the cost burden of the national pension programme.

"MyPlan" suggests that per 10,000 retirees the savings to the national old age pension could be c.a.

$200M p.a.(or $6B to $9B over 20 years) and make available c.a. $10B in no-cost capital for investment in national projects.

So...................

- Say the retiree is living in an unencumbered home, has a SMSF of $225,000 and is receiving a partial Government pension of $33,046. The SMSF generates a further $13,520 (before being hit by another market "correction".). All up he might be receiving $46,566. However he is required to run down his SMSF capital and as he does that he has to rely more and more on the Government pension. His income is declining. Not a desirable outcome.
- (For the year 2011-2012 the average super at retirement was $197,000 for men and $105,000 for women. Worse still a survey in 2014 by REST Super Fund found that 37% of over 50's say they have less than $100,000 in super.)

However.........

Providing this is purely a matter of **CHOICE** for the retiree and subject to a water-tight contract suppose the Government took a covenant over title to his/her house and then;

- Say the house is worth $1,000,000. **The Government then releases new money to the value of 6% of the house or $60,00 which is provided to the retiree as the year 1 annuity.** Add the $13,520 from the SMSF – total is now $73,520. 60% more. (***see further examples below***)
- It is not taxed and is indexed each year at 2-3% CPI. The Government releases new money each year to this value. At the same time the house will be increasing in market value.
- Allowed the retiree to stay on in the house rent free until death.
- When the retiree dies the house is sold.
- The sale of the house (at the increased value at the time of death) will enable the Government to pay back the new money it "borrowed" from the national taxpayers and thus balance the nation's books.
- Should the retiree need to leave the house to move into a retirement village or Aged Care then the house is sold and the funds invested in a retirement unit and the same procedure recommences.

  OR

  nothing changes except the funds are paid directly to the aged care facility to provide for the person on a daily care cost basis.

Examples:

People can readily calculate whether to take up the scheme. e.g:

Mr. and Mrs. Smith live in a $1M home and have other assets of $823,000 the new threshold for a partial pension. They no longer qualify and now must live on the earnings of their $823,000 asset. Taking into account the fickle and volatile nature of investment markets they may earn 5 to 6 percent p.a. or say $40 to $50,000. Barely sufficient. However they could also take up the MyPlan scheme and generate another $60,000 as an annuity. Total now $110,000 p.a. Quite attractive.

But if their other assets were only $200,000 they could receive a partial pension of approx. $33,000 plus their returns of assets of say $10,000. Total now $43,000. Barely sufficient. If they were to forego the partial pension and leveraged the house they could add $60,000 to their assets return of $10,000. Total now $70,000. Much better.

However a Mr. and Mrs. Brown live in a house worth $500,000 and rely solely on the Government full pension of say $35,000. Hard going. The Government could consider a "threshold" arrangement whereby those with no other assets could leverage their house to a point where the combined income from the house, $30,000, plus a partial pension of $20,000 gave a minimum total of $50,000 which is considered to be the basic income by which people can live a reasonable lifestyle. The Government is still better off by $15,000 p.a. However the rate of annual increase of the partial pension must still be geared to the forecast annual increase in the value of the house.

**** Comment:** This new money should be provided direct by the Government and not from banks et al to avoid having to pay any interest and fees.

Quantitative Easing, or printing money, is OK providing:

A) it generates real savings in Government expenditure.
B) the money is paid back in real terms as would happen with MyPlan - when the retiree dies the Government takes possession of the house and sells it, so then the loan from the taxpayers is repaid.

In effect, the retiree is acting as guarantor to what amounts as a loan the Government has taken out from the Australian taxpayers.

Residual surplus is shared 50:50 between the Government and the beneficiaries of the estate should there be any. It does not add to the Government deficit and actually helps reduce it through reduced Government funded age pensions.

Another source of interest free funds might be uber rich people looking for somewhere safe to park their money as is currently happening in European banks. Parking their money with an Australian government managed investment might be much more appealing especially if they don't have to pay "parking fees". Although they would not earn interest on their funds they would be rewarded later when a house is sold and they would receive a percentage of the Government's share of the residual equity.

Why not the banks et al?

The primary motive for banks and commercial finance companies is to make a profit and to reward their shareholders and key personnel via attractive salaries and bonus packages. Super funds charge high fees so as to attract and keep investment managers and to spread gains made on one investment to cover losses made on others.. "MyPlan" requires only the admin charge of Centrelink to run it. Interest costs are not incurred. All "profits" are in the form of equity residual on the sale of the house and are shared between the Government and the owners estate with the beneficiaries being those agreed at the outset between the parties. It needs to be borne in mind the public are wary of commercial enterprises failing or changing hands so to ask a retiree to sign over ownership of his house to such organisations is likely to be met with a high degree of resistance. A contract with the Government can be and must be absolute.

How does this affect the retiree?

- The retiree is assured of a regular monthly income greater than the existing pension.
- He has an income that increases per year to keep pace with inflation.
- He has the right to draw extra funds from any existing superannuation he may have in place.
- All income is tax free. - because the Government is already making a significant saving through not having to pay out a pension. The Government should not "double dip".
- He is assured of a roof over his head – he can age at home, with dignity.
- He is assured of Aged Care.
- He has the satisfaction of knowing he is helping to provide the children of tomorrow with a better future.
- He leaves behind an ongoing income to his beneficiaries or to a charity.
- He has "done his bit for the nation".

And for those still working

- Suppose they are allowed to choose if they prefer to put their 9% super contribution (which is really a deduction from their wages they would otherwise have been receiving) towards paying off their mortgage providing they agree the house will be used to fund their retirement in the manner described. This also makes the mortgage repayments more affordable. It then takes the mystery out of superannuation planning.

- It is less risky than superannuation funds, stocks and shares, and “financial products”.
- Provides a feeling of being in control (“I understand my house and know how to look after it.”)

What benefit is this to the Government of the day?

- It gives it a solid collateral base on which to fund the scheme. i.e. residential real estate
- The Government will recoup/pay back all its borrowings and will be left with a surplus.
- It has the potential to cut the current pension cost (c.a.$45+B p.a.) dramatically.
- It helps build the nation with solid new money at no extra cost to the Government/taxpayer.
- *(per 10,000 retirees the savings to the old age pension cost could be c.a. $200m p.a.and no-cost capital available for investment in national projects c.a. $10B.)*
- More and more the Government wants people to stay on in their own homes. An improved income cash flow would enable retirees to hire care services as needed such as gardening, cleaning, delivered meals etc. without relying on Local Government services.
- At the same time this would create a whole new sector of service related jobs.
- It is not a cost to the taxpayer.
- It encourages young people to buy their own home knowing that it is also an investment that can be used for their future retirement.
- It may be a politically acceptable alternative to the Negative Gearing scheme – an “either/or” scenario.

Can this help the unemployment problem?

If a homeowner decides the current value of his house is sufficient to generate the retirement income he needs then he could activate this system at any age. Could this then encourage people to retire at an earlier age thus freeing up their job for some younger person? Could it mean people don’t have to keep on working? (Minister Scott Morrison 14 Feb 2015..........”as they found in New Zealand if you don't get kids coming out of school into work by the time they are 25, or even 22, then potentially you have a lifelong welfare client, which costs the taxpayer an absolute bomb.”)

The Inheritance Tax

There is talk of the introduction of an IHT. To many this sounds like the old Probate Tax which was much hated......or of taxing the family home in some way. This is dangerous political ground. “MyPlan” can serve much the same purpose in that the value of the estate is put to direct use for the benefit of the homeowner and is not lost in the morass of public spending. It is a matter of CHOICE for the homeowner and therefore politically palatable.

What are the risks?

There are 2 key elements:

Will house prices keep increasing at the projected 5% per annum?

Obviously house values growth varies across the nation from town to town, city to country, year on year. An growth factor of 5% p.a. has been selected after perusing several analysis's obtained from the Internet. Although there will be swings and roundabouts a trend factor of 5% seems reasonable.

Will the so-called property bubble burst? There are many opinions and published papers on the topic but facts speak louder than words. Historical prices on a logarithmic scale show Sydney property prices have been remarkably consistent at around 9% per annum for the last 55 years. Prices for Australia overall show a similar trend, with average prices over the six major capital cities growing at an average of 8.6% since 1955. This proposal uses a 5% average growth factor.

Economists don't seem to think so. Saul Eslake, well known economist who also advises the Bank of America Merrill Lynch cites four reasons why not in an article by Ross Gittins in The Age of November 26th headed “Housing market bubble is one that's built to last”. The key argument revolves around the urbanisation of Australian cities and many of us prefer to spend a higher proportion of our incomes on our houses than in other countries. Compounding this is the lag in housing supply v.a.v. demand and the effect of tax incentives such as negative gearing. Developers are not going to risk building new homes if demand is not inherently strong.

Consider too, if the Government were to allow working couples to use their 9% super contribution to instead pay off their mortgage provided they had agreed that house was to be their future retirement fund (as per this scheme) then this would further underpin the strength of the housing market.

Observe that the ratio between rise in house prices and the level of dividends/annuity paid is geared to generate a surplus residue when the house is finally sold. **This is intended as a built in safety factor.**
The starting value of a house is taken from the Capital Improved Value (CIV) established by local councils and verified by the Valuer General. CIV's are updated every two years. Thus the increase in pensions to cover CPI increases will be calculated every two years. In any event the increase in any one year should not exceed 3% even though a house in a particular area may increase at 10% or more.

How would the scheme be administered?

- It would be managed by Centrelink; its offices cover the nation.
- Applicants would be sent a form (or done on-line) which among others things would require the applicant to obtain a copy of their local Council rate notice which would reveal the Capital Improved Value of their house and from which the historical average annual increase can be seen. This is the only approved source of house value as legislated and controlled by the Valuer General.
- Centrelink can then verify the eligibility of the applicant v.a.v. current pension status etc.
- ***The ratio of an annuity paid must be geared to the projected future value of the house which can be compared to the historical trend in value obtained from the CIV past values...........(test for optimum fit ratio on spreadsheet supplied.)***
- Centrelink would draw up the necessary contract.
- Houses would be sold by Government appointed accredited real estate agents.

How to stop the system being rorted.

- Annuity would be limited to $120,000 based on a house valuation of $2M or part thereof using 2015 as the benchmark. Income from a SMSF is allowed to be added to the annuity. Income from all other sources will reduce the annuity on a $ for $ basis.
- Must be citizens of and resident in Australia. (If after the payments have started, they wish to leave the country then all payments stop, the house is sold, the Government recoups its outlays and retains half the balance of the residue.)
- Must have an Australian passport.
- Must have an Australian tax file number and be registered with Centrelink.
- Must show proof of ownership of house and be resident in the house. i.e not an investment property.
- Only applies to unencumbered properties in Australia.
- Not available to those with Trusts or other corporate entities. i.e. keep it transparent.
- Must agree to ad hoc Centrelink audits including all banking transactions.
- Prevent house values being overstated by using CIV's (see above)

How many will take it up?

Traditionally it is believed people want to leave their estate to their children or wider family but surprisingly a survey by REST Super Fund found that only 30% of people over 55 have any such desire. However in this instance that can be automatically taken care of because the 6% annual dividend payment will continue on after death and will instead be paid to the beneficiaries of the estate OR to a nominated charity agreed to with the Government. (e.g. homeless children)

- For some it will be “can I trust the Government – this is my house, it's all I've got.” The Government cannot take title until the owner is dead – as will be recorded in the Titles Office

- On the launch of a new product there are three phases of uptake; the pioneers, the adopters, the laggards. It is an S shaped curve. The rate of increase climbs as the adopters come on board especially if those still working adopt the scheme and plan to use their house as part of their overall retirement plan.
- There are some 1.3M pensioners with mortgage free homes. 1% is 13,000, 15% is 195,000. Even at these low levels the offset to the existing pension scheme is significant. *Every 1000 people can save $20M p.a. on pension payments and release $1B for nation building investments.*
- Colliers International forecast by 2021, 31,220 pensioners will sell-up their homes and downsize to factory built economy homes in converted caravan parks similar to American trailer homes. They would probably prefer to age at home.
- A recent article in The Australian stated 45,000 people have taken out reverse mortgages. This low number is not surprising considering the perverse nature of these products.
- An MLC Wealth survey in October 2014 said 11% of adults plan to sell the family home to fund their retirement. About 8% said they would draw down equity in their home to help fund their retirement.
- There are over 800,000 properties in Australia worth $1M+.

Is this system socially fair?

Yes. Clearly a retiree who owns a home worth $2M would receive a greater pension than a person with a home worth $800,000. The difference has not been created or influenced by any Government laws or policies, it is solely due to the outcome of each persons endeavours over the years. It matters not whether a house is worth millions or thousands the point is the retiree is better off and Government is not paying the pension out of the public purse and is gaining access to potentially $Xbillions for developing the nation.

Challenge

The Government has to decide how to fund old age pension: do we increase the amount of tax paid per taxpayer, or do we ask retirees to go with less in retirement, - or do we invite retirees to finance their own retirement income through this scheme proposed?

Conclusion:

- Offers a better and consistent monthly income to the retiree to maintain purchasing power and quality of life.
- Enables them to age at home, with dignity.
- Provides an alternative more affordable retirement plan for young working couples.
- Saves the Government money v.a.v. the current pension scheme.
- Means that people can retire at whatever age they choose if they think their house value will allow it. It's an easy calculation.
- Generates '000s more jobs both short and long term.

Winners all 'round:

The Government
The taxpayer
The retiree
The current homebuyer

"Quid pro quo"

EXTENSION of the system

The principles of MyPlan can be also applied to people with an acute need of welfare support and where the current Government subsidy is insufficient to meet their needs. Government could offer to increase the subsidy in return for equity in the house using the same rules as described in the main body of this document.

P.C. Hall
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Refer to financial projections.