Caring for Older Australians
Productivity Commission
PO Box 1428
Canberra City ACT 2601

This submission is made on behalf of FORTUS - a national association of Equity Release specialists – and the third party distribution channel of Reverse Mortgage products.

Equity Release is available in two forms

a) Reverse Mortgage – a loan to a borrower generally over the age of 63, using the equity in a residential property, and requiring no regular repayments until the death of the last remaining borrower, sale of the property, or 6 months after the last remaining borrower permanently leaves. Lenders have slightly differing versions of the above conditions.
b) Home Reversion Scheme – this is a partial sale of a residential property, requiring no regular repayments, and is repaid with a share of the capital growth.

Equity Release allows older home owners to use the equity in their home for any general purpose. All borrowers are required to seek independent legal advice on the terms and conditions. Some lenders also require independent financial advice.

The 65+ age group will double over the next 30-40 years. There are currently 5 tax payers for each person over the age of 65, and this will diminish to 2.5 tax payers in the same period.

Many reports have been released over the cost increases in meeting the needs of the elderly, either living in their own homes or in Residential Aged Care (RAC), and the need for alternate systems to address these issues.

This submission not only supports the appropriate use of Equity Release as a legitimate financial retirement tool, but wishes to present various recommendations arising from an understanding of the Australian seniors market, whereby changes to Government policies and the principle of the “user pay’ option will challenge existing concepts to produce an improved future for this sector.

Equity Release

Overseas Trends in Equity Release

USA – The Reverse Mortgage industry showed enormous growth from 2004-2007, volumes reduced in the following two years and is now returning towards former levels. The amount that can be borrowed is higher than in Australia and there are higher ingoing costs. These costs are reflective of the fee charged by the Housing and Urban Development Department (HUD) to cover the cost of the "No Negative Equity Guarantee". This guarantee ensures that the loan amount payable by the borrower or the estate shall never be greater than the security value. In a move to place better controls into the market and develop market usage, HUD is releasing a new product which has a lower borrowing ratio and minimises the upfront cost.

Seniors associations in the US have taken a more pronounced stance on Reverse Mortgages, in comparison to their Australian counterparts. Both the American Association of Retired Persons (AARP) and National Council on the Ageing (NCOA) have produced strategies for providing a "neutral advice" position on the product. HUD has recently legislated that the NCOA's booklet "Use your Home to Stay at Home" is now a mandatory issue to all borrowers before they proceed with an application.

In our submission to Treasury's consultation on Stage 2 of the National Consumer Credit Protection Bill, FORTUS recommended the Federal Government assess the US position of a lower ratio product, based upon

- A "No Negative Equity Guarantee" be introduced by Government, using a higher entry age of 72 years,
- A maximum borrowing of 20%, consisting of 7% lump sum and the remaining 13% for regular monthly supplement to retirement income.

The borrowings would be funded through current or future Equity Release lenders.

UK – The Joseph Rowntree Foundation conducted a research project in 2007/8 which indicated many seniors are unable to support themselves in retirement, particularly in terms of meeting the costs of repairs, maintenance, and health-care at home. Together with 3 Boroughs and an Equity Release specialist firm, they have commenced an 18 month trial program. This program has provided home-care and health-care workers at the 3 Boroughs with a general understanding of Equity Release and, if they believe a home-owner may benefit, provide a brochure of introduction for the owner's follow-up.

The overall industry is showing a 36% increase, as Equity Release is now being seen as a legitimate financial tool in retirement planning.

Australia

Income for a Modest Standard of Living and How much is needed

The full Aged Pension (Aug 2010) provides a single recipient, owning their own home, with approximately $18,200 per annum. The ASFA study into retirement standards estimates a required income of $19,980 for a modest living. The ASFA budget indicates a shortfall of $1780 per annum and does not include costs for such items as vet costs, animal food, internet and health insurance.

When a family home is valued at a base level of $300,000 (median house price is $457,000+ - RP Data) and has a capital growth of 3.5% per annum over a 10-20 year period, there is an increased value of $10,500 + per annum. A senior home owner taking up Equity Release would achieve a far better standard of living with an increase of $100 per week ($5,200 per annum) set over a 10 year period, whilst still having the same amount of dollar equity in the family home some 15-20 years later – based upon an average interest rate of 9.5% (currently 8.15%).

How Safe are our Seniors Homes?

An 8 year study of 37,170 homes in Victoria (mainly seniors) found the following faults by category –
Trip and Slip 26%, Cracking 14%, Fire Hazards 4%, Stumps/Piers 8%, Health Hazards 6%, Illegal Works 2%, Electrics 21%, Timber Rot 10%, Security 5%, Damp Mould 7%, Roof 11%, and Drainage 11%.
Whilst Governments are finding more reasons to support our seniors in their homes, how confident are we about the conditions in which they live, based upon the above.
The Harmer Review into the Age Pension indicated the Federal Government is not responsible for the repairs and maintenance of the family home.
The available options for many seniors are to sell and downsize (recent study indicated less than 10% favour this option), sell other assets, go back to work, borrow from family or friends, allow the home to deteriorate, or **access equity**.

Recommendations for Government Policy

Funding of Home and Community Care Program (HACC)

The 2009/10 expenditure for this program was just under $1.95b. We estimate $300m can be saved if the current HACC fee structure can be changed to be inline with the Aged Pension entitlements. For example to qualify for the medium fee for service, a senior couple can earn up to $95,374, before they move to the high fee rate. In comparison, the Aged Pension for a couple cuts out at $61,620. Additionally, when earning up to the $95,374 limit, a couple would only pay 57% of the Full Cost Recovery for Planned Activity Group costs, 15% for Allied Health Services, 46% for domestic services, 38% for property maintenance, 24% for personal care, 13% for respite, and 28% for nursing.

If HACC recovery costs are brought back closer to the Aged Pension structure, the $300m estimated savings could be transferred to the aged care sector. Based upon the 158,863 beds, the savings would relate to an increase of $5.13 per bed/day. A funding increase of this magnitude would assist many aged care providers to maintain profitability and improve services.

Accommodation Bonds

We have yet to see the promised legislation regulating aged care providers in terms of Accommodation Bond investment. Although the Federal Government is guarantor for $9.1b of Bonds, the industry and residents need guidance in this regard.

Not enough prior education is available to residents and their families in understanding Bonds. For example, many aged care providers recommend the family home is sold to pay for a lump sum Bond. Consumers are often unaware Equity Release can be accessed to pay for the lump sum and/or periodical payments. Additionally they are unaware that if all/part of the Bond is paid periodically and ongoing, the family home may be rented out and the house is exempt from the Assets Test and the rental income from the Income Test for the purpose of the Aged Pension.

The Investment of Accommodation Bond Funds by Aged Care Providers.

Of the estimated $9.1b of Bonds, it is estimated about 30% is retained in liquid assets for the return to residents at the time of their leaving the facility, or to their estate.

The balance of funds is invested and the return on the investment is required to be used for improvements to the facility or debt reduction.

For private providers it is recommended the income generated by the investments be deemed as non-assessable via amendment to the Tax Act. This amendment would provide private sector facilitators greater scope in remaining profitable and alleviating some of the funding pressures currently experienced. If private providers represent 35% of the industry but for say 40% of Bonds, the $2.54b invested at the Government Bond rate of about 4.95% is a return of $125.7m, of which 30% (company tax rate) is further retained under non-assessable income. This would equate to $4.30 per bed/day, for the 40% of Bonded beds.

Equity Release Legislation

In stage 2 of the NCCP legislation we recommend

a) all Equity Borrowers are required to seek the independent advice from a solicitor of their choice and address issues of “estate planning” (Wills and Enduring Powers of Attorney) as part of the process.

b) the use of Equity Release for funding investment into financial service products, such as annuities, be prohibited ie no crossing-selling using Equity Release.

Recent Paper

Access Economics Paper-

Access Economics recently completed a public policy discussion paper (The Future of Aged Care in Australia) prepared for National Seniors Australia. The paper examined the following categories

- Current arrangements
  "The government pays for residential and community aged care through general tax revenue". The ageing of the population makes this current arrangement impossible to continue in future years.
- Long term care insurance
  Premiums paid by future potential users (and subsidised by low-income earners) to private insurers, the capital resources would need to be considerable for possible claimants over the next 10-20 years
- Healthy ageing savings accounts
  Designed to contributing to a savings account throughout a income lifetime, and will take many years to build a sufficient base.
- Reverse Mortgages
  Certainly relevant to current senior home owners using their asset to meet aged care needs over the next 10-20 years before other options may become available.
- Vouchers
  Based upon government funding for seniors to pay for aged services of their own choice.
- Combinations
  Varying combinations were presented as a means to find an effective system, but seemed to have the overall positive effect for long-term policies.

The paper did not cover the use of Equity Release for the purpose of paying an Accommodation Bond, although Access Economics may be unaware of existing lenders and policies. When entering aged care (either low level or high level providing extra services) an ingoing resident may be asked to pay an Accommodation Bond, an amount which has no upper limit except that the resident must retain a net asset position of approximately $40,000.

Example

Recently a Melbourne couple (both aged pensioners) was due to enter aged care at the same time and both were asked to pay a Bond. The aged care provider asked their representatives for $750,000 – each, and it is believed that request was based upon knowing the couple had a family home valued at $2.3m+. They have now entered a facility asking for a $300,000 Bond each, and the sale of their family home has been saved through Equity Release. Additionally the bond was negotiated with a $280,000 lump sum and the balance to be paid periodically over a 5 year term. Under this arrangement, the couple is able to rent their family home, with the home being exempt from the assets test and the rental income exempt from the assets test.

Whilst the first aged care provider was within their rights to seek a total Bond of $1.5m, it seems to be a manipulation of guidelines, particularly as the wife was not as disabled as her husband and had some thoughts of returning to the family home in the future.

Although this may not be practical, having to sell the family home and potentially lose the Aged Pension, would have been a psychological blow to this lady.

The possible options discussed by Access Economics (except for vouchers) all relate to a “user pay” principle whether it is an insurance policy, savings account or reverse mortgage. A “user pay” system is the alternative to either an increase to the income tax rates (any increase is opposed by many economists) or the consumption tax (GST). For those who own residential security (owner occupied or investment) a reverse mortgage is seen as preferred option with an immediate action, and this would appear ongoing until other recommendations/options become financially viable.

Government Direction

The Finance Department's in-coming Government Brief of September 2010 made the following observations

" There will be a need to address whether the "comfortably off" in the community (and their inheritors) should continue to have their health and aged care services subsidised to the current extent by taxpayers, many of whom are in less fortunate circumstances"

With the government taking up the responsibility for aged care, it "represents a significant long-term fiscal risk to the budget".

"The government will need to consider co-contribution arrangements in this light, unless ways can be found to ensure users of aged care services make a fair and reasonable contribution to the costs of their care, and, in the case of residential care, their accommodation". .

We note that the Brotherhood of St. Laurence, in its submission to this Inquiry and also the Harmer Pension Review, called for "government legislation to protect older people, so that they could use their equity in their home to provide for their needs".

With over 75 % of senior Australians having equity in their own home, this represents an opportunity for Government to develop policies for aged care based more upon a "user pay" principle and allowing funding to be directed to areas of greater need such as rental subsidy and other assistance to those of low-income or disadvantaged environments.

On behalf of FORTUS we thank the Commission in accepting our submission.

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