TREASURY DRAFT LEGISLATION

Housing Affordability and Related Superannuation Measures

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ABOUT INDUSTRY SUPER AUSTRALIA

Industry Super Australia is a research and advocacy body for Industry SuperFunds. ISA manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of over five million industry super members. Please direct questions and comments to:

Stephen Anthony
Chief Economist
03 9657 4354
santhony@industrysuper.com

Phil Gallagher
Special Retirement Policy Adviser
02 6269 5708
pgallagher@industrysuper.com

Gary Lu
Financial Analyst
03 9657 4296
glu@industrysuper.com

ISA Pty Ltd ABN 72 158 563 270 Corporate Authorised Representative No. 426006 of Industry Fund Services Ltd ABN 54 007 016 195 AFSL 232514

HOUSING AFFORDABILITY AND RELATED SUPERANNUATION MEASURES

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KEY POINTS

- Housing affordability is an issue most acute in major capital cities such as Sydney, Melbourne and Canberra. It is largely attributable to a range of factors including antiquated zoning rules, significant population growth, overseas investor-student interest, untargeted tax concessions and low interest rates.
- The best policy approach to deal with the issue of affordability is to directly address the supply and demand imbalances in markets where they occur by encouraging more new dwelling construction via:
  - extending existing zoning rules to allow urban infill and via land sales;
  - discouraging demand side speculation by modifying the negative-gearing and capital-gains discount concessions to incentivise greenfield activity; and
  - restricting foreign investors-students to buy new property only.
- The proposed First Super Saver Scheme is inadequate in addressing the issue of affordability amongst first-home buyers. The proposal is likely to be counterproductive in that it could make housing less affordable and certainly sets a dangerous precedent of drawing upon superannuation savings for purposes other than retirement income. The Scheme is inconsistent with the Sole Purpose Test (Section 62 of the SIS Act 1993) and with the Government's own **Superannuation** (**Objective**) Bill 2016.
  - The scheme would deliver lower savings compared with a post-tax contribution towards a deposit account, partly due to the super contributions tax. The salary sacrifice contribution would be further reduced by the tax paid on withdrawal (despite the 30 per cent offset).
  - The scheme seeks to 'guarantee' returns through the use of the shortfall interest charge to calculate earnings rather than actual returns. This mechanism will require superannuation trustees to pay withdrawals from using superannuation guarantee assets if returns are low. Based on historical analysis more than half of savers would have their SG assets eroded due to scheme design.
- The proposal to encourage senior Australians to downsize by allowing additional non-concessional contribution towards their super will only benefit wealthy self-funded retirees. This does nothing to reduce other downsizing costs like stamp duty. Retirees relying on the age pension may see their entitlements decline as any gains from downsizing will not be exempt from pension asset test.

FIRST HOME SUPER SAVER SCHEME

1. Description

The First Home Super Saver Scheme (FHSSS) is a proposed scheme which uses the superannuation system to pool voluntary contributions for the purpose of funding part of a deposit on members' first home. The selling point of this arrangement is that it allows first home savers to enjoy the same tax advantages as superannuation members.

Under the policy, an individual will be allowed to make voluntary contributions of up to $15,000 per year after 1 July 2017 and up to $30,000 in total, which can be withdrawn along with earnings after 1 July 2018 and directed towards a deposit for a first home. Voluntary contributions are personal or salary sacrifice contributions, and the concessional contribution cap of $25,000 still applies, so, anyone earning over $106,000 cannot contribute the full pre-tax amount of $15,000 per year.

The policy does not directly apply to existing super balances, but there may be indirect effects if the Shortfall Interest Charge (SIC) exceeds the earning rate of the superannuation fund (see section 2.6.2). Member contributions are eligible for a deduction and deductible member and employer voluntary contributions will incur the 15 per cent contributions tax. Contributions could also be non-concessional, but few people are expected to do this as these savings will not enjoy tax-benefits associated with deductible superannuation contributions.

On withdrawal, the deductible contributions will be taxed at the marginal rates (depending on income level) less a 30 per cent offset. In calculating the amount to be withdrawn, the Australian Taxation Office (ATO) will deem earnings using the SIC, not the investment return rate of the fund.

The benefits of the policy depend on their taxable income and whether they have a HECS/HELP debt. Table 1 gives some estimates for different situations[1].

The vital lesson from Table 1 is that the scheme delivers lower savings for a given post-tax contribution because of contributions tax within a superannuation fund. To improve savings for retirement participates must invest any personal tax benefits gained from the scheme. It is highly unlikely that participants will understand or be able to calculate their personal tax benefits. The scheme could leave people with lower savings and frustrated about the contributions tax and the high level of tax paid on withdrawal.

The other implication is that participation can be used to reverse the effects of the 2017 Budget changes to the HECS/HELP thresholds.

The measure is expected to cost $250m[2] over the forward estimates period which implies annual participation of approximately 14,000 individuals per year on average[3], so a relatively limited take-up.

Both members of a couple can use the measure and there is no age limit. A spouse is still eligible to use the FHSSS for future first-home purchase even if his/her partner is not a first-home buyer.

[1] Assuming each participant with an annual pre-tax contribution of $15,000 for 2 years. Comparison is made against standard deposit account with interest rate fixed at 2 per cent per annum. SIC rate is assumed to be 4.78 per cent as of June 2017.

[2] The Treasury, 'Budget 2017-18 Budget Measures - Budget Paper No.2', Commonwealth of Australia, May 2017

[3] Assuming the 2019-20 numbers reflect a mature scheme with withdrawals.

Table 1: Benefits for different taxable incomes and situations – illustrative cases

CASE	2017-18 Personal Tax Difference	2018-19 Personal Tax Difference	Income Tax on withdrawal after Rebate	Balance difference compared to Savings Account	Net Benefit
Salary $105,263, No overtime, No HECS/HELP debt	$5,850	$5,850	-$2,462	-$3,549	**$5,689**
Salary $105,263, No overtime, With HECS/HELP debt	$7,953	$8,028	-$6,777	-$3,549	**$5,655**
Salary $56,000, No overtime, No HECS/HELP debt	$5,175	$5,175	-$1,231	-$3,549	**$5,570**
Salary $56,000, No overtime, With HECS/HELP debt	$7,415	$6,855	-$4,969	-$3,549	**$5,752**

Source: ISA Analysis on FHSSS Consultation Draft (2017)

2. Assessment

2.1 First best approach

First-home buyers are finding increasingly difficult to enter the housing market in certain major capital cities. Property price growth in key regional centres (particularly in Sydney and Melbourne) has been fuelled by inadequate zoning rules, significant population growth, overseas investors-student interest, flawed tax policy and low interest rates. When addressing housing affordability for first-home buyers, policy makers should target the supply and demand imbalance present in the current market. Federal, state and local governments have the means to adopt a multifaceted approach to reform existing rules to dampen investor (both local and foreign) demand, while encouraging construction of housing stock to meet the demand by first-home buyers.

At the core of this issue is the urgent need to boost supply of housing that is affordable for young families. Local zoning laws and access of government land should be relaxed to allow urban-infill with higher levels of housing density, particularly in areas with easy access to public transport. Planning and approval processes must be simplified whilst giving full regard to long term effects, community expectations, environmental and social values.

On the demand side, investors should not be in an advantageous position when it comes to tax treatment and ease of access to finance. It is unacceptable to allow speculators to contribute to price inflation, pricing first-home buyers out of the market.

Contrary to popular beliefs held by some market participants, negative gearing[4] fails to encourage the creation of new housing stock. Financing for new dwellings accounts for less than 10 per cent of the total funding for investment properties.[5] In conjunction with capital gains discount[6] and interest only loans, these concessions can encourage investors to rely too heavily on leverage and potentially distort the property market.

Therefore it is critical that the existing negative gearing and capital-gains tax discount arrangements which are distorting investment decisions be modified. Better alternatives would include limiting negative gearing to purchases of new dwellings and reducing the capital gain tax discount to a level commensurate with today's low inflation environment or eliminating both and targeting a revenue neutral investment allowance at new dwellings construction. Foreign investors should only ever be allowed to purchase new property and there should be no exception for students which enables rorting by parents or family groups. Investment properties should not be warehoused by leaving them empty for prolonged periods without significant penalty.

So the 'fix' for housing affordability can be wide-ranging, but in terms of the levers the Federal Treasurer has at his disposal, these are largely centred on the elimination of preferential tax treatments currently enjoyed by investors and incentivising the States to reform planning and land release arrangements via Commonwealth – State tied grant arrangements.

2.2 Counterproductive

Allowing individuals to dedicate voluntary super contributions towards a deposit for their first home will make no difference to housing affordability. The concept shares similarities to the previous First Home Saver Account (FHSA) introduced by the Rudd-government in 2012, which was abolished by Joe Hockey due to a lack of take up. But if the tax benefit associated with the FHSSS is sufficient to boost the purchasing power of first-home buyers, then on aggregate, it would boost demand in the low to middle income property segments, which has the potential to inflate already elevated price levels.

Although prospective home buyers in major capital cities would gain little from the FHSSS, banks, brokers and housing investors would benefit from mortgage growth and continued increases in house prices.

Governments must address the supply of housing, not simply offer first homeowners another handout to further inflate prices via the superannuation system. Such piecemeal demand-side support to the housing market is counterproductive. Presumably, the policy is not sufficient to significantly improve first-home buyer's purchasing power. It wouldn't be surprising if the small boost in deposit was diluted by higher house prices in couple years' time when contributions are eligible for release.

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[4] Negative gearing refers to the capacity under Australian tax law for losses on an income producing asset to be offset against taxable income, including income not related to that asset. It is a common investment approach for property because high levels of leverage are possible (which reduces the amount of capital required for investors and maximises tax losses) and maintenance costs are significant. Evidence suggests that negative gearing is an attractive proposition with the majority of investment properties being negatively geared. Tax deductions of $6.8 billion are made in relation to investment properties, and the Commonwealth budget cost of negative gearing is estimated at approximately $2.4 billion per year.

[5] Australian Bureau of Statistics (2017), '5609.0 - Housing Finance', available at: http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/5609.0Main+Features1May%202017?OpenDocument

[6] Capital Gains Tax (CGT) on property is applied to only 50 per cent of the appreciation (if held for 12 months or more), negative gearing allows for a permanent reduction in the tax on investment income.

2.3 Indirect impacts

Releasing any existing super savings for a deposit would have other potential harmful effects, including encouraging some Australian households to take on more debt at a time when the market is already fully priced, further concentrating asset risk into residential property. Any marginal improvement in borrowing capacity facilitated by the FHSSS is likely to lead to bigger mortgages, adding further pressure on families that were already marginal lenders. This is particularly the case given that savings inside the scheme could be lower than savings outside the scheme unless customers take expensive advice on the re-investment of their personal tax gains. In the short term the RBA is already signalling the need to transition from a low rate environment to normalise interest rates.[7] In the long term the FHSSS will make it harder to pay down debt before they reach retirement age.

2.4 Objectives and precedent

Whilst the FHSSS potentially exacerbates the housing affordability problem, it also undermines the goal of the superannuation system, as a provider of adequate retirement income. The scheme sets a dangerous precedent that Australia's $2.3 trillion retirement savings can now be accessed for any policy purpose, rather than exclusively for providing retirement income. Superannuation is a tax effective savings vehicle designed to help people fund their living costs in retirement and its purpose should not be deviated by to evolving fiscal conditions.

Although the costings imply take up of the scheme will be relatively modest, the main risk is that the measure could be used as a Trojan horse by some future government with the scope extended to allow higher withdrawal amounts and the possibility that Superannuation Guarantee balances might be included.

Additionally, we have an ageing society facing rising cost-of-living pressures and a structural budget[8]. Who can confidently say after setting this precedent, future governments won't free superannuation savings to pay for health-care, age-care or even medical expenses pre-retirement?

The legislation for the scheme does not change either the sole purpose test (Section 62 of the SIS Act 1993) or the Government's own Superannuation (Objective) Bill 2016. The scheme appears to be in conflict with the Government's sole purpose test and with its Objective of Superannuation.

2.5 Governance

The sole purpose test is intended to ensure that trustees maintain a superannuation fund for the purpose of providing benefits to its members upon their retirement (or attainment of a certain age), or for beneficiaries in the event that a member of the fund dies. The release of funds by a trustee for a purpose that is inconsistent with Section 62 of the SIS Act is a breach of the sole purpose test.

Contravening the sole purpose test has very serious consequences for fund trustees. In addition to the fund losing its concessional tax treatment, trustees could face civil and criminal penalties.

It is not clear how FHSSS oversight and administration within superannuation funds is consistent with sole purpose test of the SIS Act. The SIS Act will require modification to accommodate the FHSSS to deal with the restrictions imposed by the sole purpose test.

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[7] Baker P., 'The RBA signals higher rate path with 3.5pc 'neutral rate' game-changer', AFR, July 2017

[8] ISA Analysis on Table 9 – Statement 5, Table 3 & Note 12 - Statement 10, Budget Paper No.1, Commonwealth Budget 2017-18

In addition to changes to the sole purpose test, the SIS Act will require modification to alter the current preservation arrangements. Access to compulsory superannuation funds are restricted for good reason. Except where certain specified conditions of release or met, the existing preservation rules restrict member access to funds until a preservation age is reached. These rules will require alteration to facilitate early release of funds.

The sole purpose test and preservation arrangements are key components of the superannuation system and any changes should be undertaken with extreme care to avoid any unintended consequences.

2.6 Administrative burden

2.6.1 Separation of balances within a superannuation fund

All superannuation funds (and inevitably their members) will bear the direct administrative cost of administering the complex FHSSS scheme.

In addition the FHSSS places a liquidity burden on superannuation funds that may also affect gross rates of return. This is because a typical balanced superannuation portfolio would have members' contributions invested in a wide range of asset classes, from those that are liquid – cash, bond and equities, to those that are illiquid – infrastructure and property. The FHSSS has voluntary super contributions invested along with other member savings. This means that in order to meet the FHSSS withdrawal requirement after 1 July 2018, trustees will need to set aside additional liquidity - potentially altering the fund's investment mix and duration to accommodate the release of savings, making it difficult for trustees to invest for the long-term. However, trustees will not be able to judge the liquidity adjustment required until they have received release notifications from the Australian Taxation Office.

This is in contrast with FHSA established by the Rudd-government, where contributions were credited to a deposit account earning interest.

2.6.2 Calculating interest on withdrawals from fund

The FHSSS also requires guaranteed returns (earned interest) to be paid on withdrawal equivalent to the Shortfall Interest Charge (SIC), currently at 4.7 per cent (90-day bank bill rate + 3 per cent).

The 'interest' effect of the FHSSS will be profound during periods of negative and low returns (especially for funds with persistently low returns) and will presumably require trustees to dip into member's SG balances to meet the ATO calculated redemption requests.

- Over the last 10 years the average SIC rate using this formula was almost 7.0 per cent which exceeds the long-term average fund level returns of all APRA regulated funds except the Goldman Sachs staff fund.
- Table 2 demonstrates that in 4 of the 10 years from 2006 to 2016, the SIC exceeded the average returns APRA regulated funds. It was 5 out of 10 years for retail funds.
- Most funds will be invested for 3 years. Table 3 demonstrates that with a three year rolling return, all APRA fund types had lower 3 year returns in 5 of 9 years, and for retail funds it was lower in 6 of 9. So it is quite conceivable that FHSS payouts would require dipping into compulsory funds in the majority of years.
- Another concern is the transition issue regarding contributions made during financial year 2017-18 would be taken to be made on 1 July 2017. Meaning a lump sum deposit made on the 30 June 2018 is eligible to earn full annual SIC interest as if the amount has been in the account for the entire financial year. This implies the earned interest amount will be derived directly from members' SG

asset even if fund return in the financial year exceeded the SIC rate. In a sense, upon withdrawal, the earned interest amount at the SIC rate can only be realised if members have sufficient SG balances. For members with very low account balances (for example a newly opened account), the earned interest treatment during the transition period 2017-18 could earn interest amount less than the SIC rate due to insufficient SG balances, as the super account cannot be overdrawn.

The scheme also exposes voluntary contributions to market risks during the deposit period. Any losses incurred by the voluntary portion will be crystallised upon withdrawal and be compensated by deducting from member's compulsory contributions. This is highly inappropriate.

Table 2: Comparison of the shortfall interest charge and the earning rates of APRA regulated funds 2006-2016

Arithmetic Difference in Sectoral Super Fund Returns and SIC (SF - SIC)										
	Jun 2006	Jun 2007	Jun 2008	Jun 2009	Jun 2010	Jun 2011	Jun 2012	Jun 2013	Jun 2014	Jun 2015	Jun 2016
All	5.2%	5.4%	-17.5%	-20.8%	2.5%	0.0%	-7.3%	7.5%	6.0%	3.3%	-2.3%
Corporate	6.8%	6.5%	-14.9%	-22.1%	4.4%	1.0%	-7.5%	7.5%	7.3%	2.5%	-2.7%
Industry	5.4%	6.8%	-15.9%	-20.4%	2.0%	1.0%	-6.8%	8.1%	6.9%	4.2%	-1.1%
Public Sector	6.9%	5.9%	-15.7%	-21.1%	3.1%	1.2%	-6.0%	7.7%	6.4%	4.2%	-1.6%
Retail	4.0%	4.2%	-19.5%	-20.6%	2.2%	-1.3%	-8.4%	6.9%	4.9%	2.1%	-3.6%

Source: ISA Analysis on FHSSS Consultation Draft (2017)

Table 3: Average rolling 3 year returns - comparison of the shortfall interest charge and the earning rates of APRA regulated funds 2006-2016

	Jun 2008	Jun 2009	Jun 2010	Jun 2011	Jun 2012	Jun 2013	Jun 2014	Jun 2015	Jun 2016
All APRA Super	6.45%	-2.33%	-3.92%	1.15%	5.73%	7.26%	8.50%	11.48%	7.77%
Corporate	8.29%	-1.60%	-2.95%	1.54%	6.60%	7.52%	8.85%	11.64%	7.78%
Industry	7.56%	-1.22%	-3.37%	1.45%	6.07%	7.95%	9.16%	12.28%	8.78%
Public Sector	7.83%	-1.67%	-3.23%	1.59%	6.77%	8.18%	9.16%	11.99%	8.44%
Retail	4.94%	-3.30%	-4.63%	0.72%	4.82%	6.25%	7.56%	10.51%	6.57%
SIC	***9.27%***	***9.31%***	***8.45%***	***7.75%***	***7.40%***	***7.31%***	***6.58%***	***5.88%***	***5.49%***

Source: ISA Analysis on FHSSS Consultation Draft (2017)

2.6.3 Legislative changes

The new personal contribution deduction policy will create uncertainty about the motive for new contributions. This should require changes to conditions of release in the SIS Act sole purpose test and to the Superannuation Objective Bill or Act as mentioned previously.

The draft legislation excludes the payout from the scheme from being considered as income for means testing family payments, other payments and health cards. This is desirable.

2.7 Overall

The FHSSS is inadequate in addressing core issues of affordability in major capital cities for first-home buyers and will compromise the integrity of Australia's retirement savings system. The problem of affordability should be addressed via boosting housing supply while preferential tax benefits for investors should be reduced or eliminated. This requires a coordinated reform effort by various levels of government to form holistic solutions in tackling the problem and offer first-home buyers a fair deal. While we all agree that first-home buyers need to be supported, we should refrain from adopting piecemeal policies that contribute so little to sound economic and budget policy outcomes.

SENIORS DOWNSIZING SCHEME

1. Description

The proposed scheme intends to encourage senior Australians to transition from their existing family home by relaxing the non-concessional contribution rules introduced in the 2016-17 Budget. This will enable seniors to direct any gains from the downsizing transaction towards their superannuation account in the form of non-concessional contribution.

Under the proposal, the Federal government will allow a person over 65 years to make a non-concessional contribution of up to $300,000 from the sale proceeds of their home from 1 July 2018. These contributions will be in addition to those allowed under existing rules and will be exempt from existing age test work test, however the $1.6 million transfer balance cap will still apply (anything over the transfer balance cap will go to an accumulation fund). There is no exemption of the funds from the pension income or assets test, and current rules only provide short term relief. As such It seems likely that the measure will be used by self-funded retirees rather than age or veteran pensioners.

2. Assessment

2.1 First best policy

Addressing the issue of affordability in the current housing market and encouraging downsizing requires the removal of major impediment to the transfer of real estate by replacing stamp duties with rates like annual land taxes. This will free up the turnover of housing stock and directly lower the cost of buying and selling homes for many first home buyers. This is also the one of the most efficient way of raising revenue for state governments as noted by the Henry Tax Review.[9]

2.2 Expensive

The high cost of selling and buying a home can eat away any gains made from downsizing. High property prices in Sydney and Melbourne mean downsizers face high stamp duty cost when they buy into a new property. Stamp duty alone is one of the major deterrence for downsizing[10], along with various fees and charges associated with real estate purchases. Focusing on financial incentives also overlooks the fact that some retirees choose to stay where they are for other reasons such as the emotional attachment to an existing home or neighbourhood, the physical difficulty of moving home, and in some instances, the lack of assistance from family and friends for moving.[11] Hence it is not surprising that Treasury forecast the scheme will cost only $20 million by 2020-21, implying the expected take-up would be small.

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[9] The Treasury, 'Australia's future tax system – Report to the Treasurer', Commonwealth of Australia, December 2009

[10] Schlesinger, L., 'Stamp duty costs biggest impost to downsizing: report', AFR, July 2017

[11] Judd, B., Liu, E., Easthope, H., Davy, L. and Bridge, C., 'Downsizing amongst older Australians', AHURI Final Report No.214, January 2014

2.3 Assets test

The scheme will overwhelmingly benefit self-funded retirees who are not relying on the age pension. A retirees' principal home is currently exempt from the age pension asset test while financial assets such as superannuation (in pension phase) aren't. Therefore, pensioners participating in the downsizing scheme will essentially shift assets from the exempt category into the non-exempt category, reducing their pension entitlements. Depending on circumstances, this may not be the best outcome for retirees relying on full or part age pension.

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