Senate Community Affairs Committee

ANSWERS TO ESTIMATES QUESTIONS ON NOTICE

SOCIAL SERVICES PORTFOLIO

2015-16 Budget Estimates Hearings

Outcome Number: 1.6 Income Support for Seniors **Question No: SQ15-000819**

Topic: Age Pension

Hansard page: CA93, 4 June 2015

Senator Siewert, Rachel asked:

Are we able to give you some examples, which as I said you probably have – and they are quite complicated- that you could take on notice to say whether the assumptions are right?

Answer:

The cases provided by Senator Siewert included examples pointing out that, in pure income terms, the pension reduction under the new assets test taper is higher than the amount people may be earning on their investments and asserting that this will be a disincentive to save. Under the changes that will apply from 1 January 2017, annual pension will reduce by 7.8 per cent of the value of a person's assets over the new free areas (a taper rate of $3 a fortnight per $1,000 assets works out at 7.8 per cent).

The assertions do not take into account the capacity of people to draw down on their assets to support themselves in retirement. Those most affected by the assets test changes would only have to draw down a maximum of about 1.8 per cent of their assets to make up for the loss of their part pension. The pension system should not enable people to earn income from their superannuation and other retirement savings while maintaining their capital base intact, with the Age Pension operating as an income top-up. This would mean that the age pension system would support wealth maintenance, rather than savings (mostly from superannuation) being used for self-support in retirement.

Retirees affected by the changes can support a higher standard of living in retirement than the maximum rate of pension through a combination of investment earnings, capital drawdowns and eventual pension entitlements. For example, assuming the drawdown of investment returns and capital over a 35 year period, and long term investment returns averaging 5 per cent, a couple who own their home and have $825,000 assets could generate a total income (including investment returns, capital drawdowns and eventual pension entitlements) of over $58,000 a year in real terms, which is about $25,000 a year more than the full pension.

One of the cases suggests that the Government is encouraging retirees to spend their savings on a home upgrade or overseas trips.

Under the assets test changes, people with substantial savings will continue to be able to support a higher standard of living through a combination of earnings and capital drawdown than those solely reliant on the pension.
Pensioners are not better off if they rapidly reduce their assets. For example, a pensioner who reduced their assets by $50,000 to qualify for a higher pension payment would take more than 35 years to break even, assuming an investment return of 5 per cent.

- The most that spending $50,000 could affect a person's pension under the new $3 per $1,000 taper rate is $150 a fortnight or $3,900 a year. Based on long term returns of 5 per cent, the person would also forgo income of $2,500 a year that they could otherwise have earned. As such, the net benefit in pure income terms might be around $1,400 a year only. It would take over 35 years before the person regained their $50,000.

There is no evidence available that suggests that there is a widespread problem of people deliberately spending money or over-investing in housing in order to obtain a higher rate of pension.

- The available evidence suggests the great majority of retirees make prudent use of their superannuation and other retirement savings to support their standard of living over the long term.

One of the cases discusses the impact of the assets change on people who hold assessable real estate (i.e. not the principal home which is assets test exempt). Under the pension assets test, a person's assets are assessed at their net market value, less any valid charges or encumbrances, such as a loan secured against the asset. This includes real estate assets (excluding the principal home).

If affected pensioners have invested all or much of their funds in real estate and the returns are insufficient to meet their needs, they could chose to sell the property and invest the proceeds in financial products, to free up capital and support a higher standard of living in retirement. Alternatively, affected pensioners could consider the Pensions Loans Scheme, which would allow them to hold their real estate investments while receiving higher payment to support their current standard of living, with these additional amounts repaid on the sale of the asset or death.

Decisions about the most appropriate choice is a matter for individual pensioners. The Financial Information Service can provide factual information about options and the person can also seek independent advice.