Residential transition amongst the Australian elderly

Introduction

Households in which the household head is 65 and older move house much less frequently than younger households. This is despite the fact that evidence suggests that these owner-occupiers consume more housing services than they would ideally like. This brief looks at the possible reasons for this, arguing that it is economic considerations relating to age pension eligibility that underlie the decision to trade-down the family home and that a change made to policy, would not only increase the probability of post-retirement moves, but also help rationalise housing resource allocation nationally.

The elderly in Australia: income wealth and residential transition

The 2003-04 ABS Housing Expenditure Survey (HES) is used to provide information on the living, housing and wealth conditions of households where the household head is 65 years or above. More than 75% of people surveyed were found to own their house without a mortgage (see graph: ‘Tenure of the elderly’).
The family home is one of the most important assets for most age groups, the estimated sale price of the house representing at least 50% of a family’s net wealth. In addition, it attracts no income tax, no capital gains tax, and its value does not count in the age pension’s asset test.\textsuperscript{1}

This is very important for 65+ households for whom 50% of their income comes from government pensions, a finding that would indicate a far from lavish living standard. When interviewed, 54% of 65-69 households claimed that they just break-even most weeks and 19% say that they spend more money than they get. The just manage to break-even number is 54% for the 70-74 year age group, 51% for the 75-79 and 42.5% for the 80 plus age group. In each of the age groups, lone persons depend on government pensions and allowances to a greater extent than couple families.

Survey participants were asked about the adequacy of their house and the number of bedrooms they had to spare. It was found that people above the age of 65 had at least 2-3 bedrooms to spare. These findings were consistent with US studies (Reschovsky 1990) and indicate an overconsumption of housing services. This is despite the fact

\textsuperscript{1} While the assets test scales are different for owner-occupiers and renters, the value of the home does not itself enter into the assets test.
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that the majority of this group depend on the age-pension for most part of their income and about 50% of them only break-even most weeks.

More detailed information regarding residential transition has been taken from census data and the Household, Income and Labour Dynamics (HILDA) database. The graph below shows the movement of different age groups.

Of the people interviewed for this data most cited health or the desire to be close to friends and family as the reason for their decision to move. Half of these moves were within a radius of 10km of their original location. This is consistent with other published evidence (Olsberg & Winters 2005) in which it was found that 83% of respondents indicated that they were not necessarily attached to their own home but more to the local area in which they lived.

Financial Considerations

Our hypothesis is that the decision to sell their owner-occupied homes and trade down to something smaller is inhibited by financial considerations. For those aged 65+ home ownership has been a shrewd investment because of asset value appreciation and preferential tax treatment. In addition, home ownership provides accommodation services, insurance against rental fluctuations, a form of precautionary saving and has additional value as a bequest to children.

Trading down the family home has a significant impact on value and eligibility for the age-pension. Below we look at a hypothetical example of the impact trading down the residential home has on the age pension. Each of the following examples is based on a recently widowed woman who looks at trading down her house worth $1 million to one
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worth $500,000. The setting is an imaginary world where asset appreciation and returns, and other financial variables, are both known and fixed.

Currently, super offers the best investment opportunities for those like our sample case. As people aged 65+ can only invest a maximum of $150,000 into super each year, we will assume that the proceeds from the sale of the house were gained at age 64, when two years of contributions can be brought forward i.e. $450,000 can be invested in one transaction and then nothing invested for the next two years.

When investing in super there are two choices:
- Stay in accumulation mode, attracting an earnings tax of 15%.
- Move to pension mode, where the individual can draw down an income. For a 65 year old, the minimum amount that must be drawn down is 5% of the corpus. The corpus does not attract the 15% earnings tax.

In this example it is assumed that the pension mode is chosen.

The following examples compare the same situation for a woman receiving no age pension, full age pension and part age pension.

No age pension

Before trading down
- Fortnightly income = $1500 (this is above the cut-off of $1459.25 for even a part pension).
- 2% capital appreciation on $1 million home = $20,000

After trading down
- Transaction costs total $60,000, so the remaining $440,000 is invested in a super fund with 5% drawn down every year = $22,000 ($846.15 fortnightly)
- Total fortnightly income is now $2346.15
- 2% capital appreciation on the $0.5 million home = $10,000
- Net gain is $23,000 ($22,000 consumed plus $10,000 capital gain)

Full age pension

Neither the income nor the assets test binds. Assets must be worth more than $166,750 and the maximum fortnightly income is $132.

Before trading down
- Fortnightly income = $132 (plus full age pension)
- 2% capital appreciation on $1 million home = $20,000
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After trading down
- Remaining $440,000 is invested in a super fund with 5% drawn down every year = $22,000 ($846.15 fortnightly)
- Total fortnightly income is now $978.15 and so above the limit for receiving full age pension
- 2% capital appreciation on the $0.5 million home = $10,000
- Net gain is $18,347.40 ($22,000 drawn down from super + 2% capital gain of $10,000 - $13,652.60 that is lost from the age pension)

Part age pension
Does not meet either assets or the income test requirements. Assets are greater than the limit for the full pension (i.e. suppose they are $343,750).

Before trading down
- Part age pension = $259.60 per fortnight
- Income from other sources = $132
- Total fortnightly income = $391.60
- 2% capital appreciation on $1 million home = $20,000

After trading down
- Remaining $440,000 is invested in a super fund with 5% drawn down every year = $22,000 ($846.15 fortnightly) making her ineligible for the part pension
- Total fortnightly income = $978.15 ($846.15 + $132)
- 2% capital appreciation on the $0.5 million home = $10,000
- Total net gain is $25,250.40 ($22,000 drawn from super + capital of $10,000 - $6,749 that is lost from the age pension).

In these scenarios, where the individual has traded down 50% of the value of the house, we find that while her cash-flow situation improves, our representative individual loses her entitlement to the age pension, a more reliable source of income. For different scenarios however, there might be an optimal trade-down size.

The following table based on HES data is an estimation of the percentage of elderly who would not receive their age-pension after a trade-down of 40% i.e. Moving into a house that is 60% of the value of the former house. See table below.

<table>
<thead>
<tr>
<th></th>
<th>Lone Person</th>
<th>Couple</th>
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<tbody>
<tr>
<td></td>
<td>Before</td>
<td>After</td>
</tr>
<tr>
<td>65-69 years</td>
<td>19</td>
<td>30</td>
</tr>
<tr>
<td>70-74 years</td>
<td>11</td>
<td>16</td>
</tr>
</tbody>
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These numbers reflect the cases in which people would completely lose their pension. There would also be a significant number of people who would probably progress from a full pension to a part-pension status. It should also be remembered that loss of the age pension also implies a loss of other entitlements such as the many concessions given by state and local governments to pensioners.

Policy Implications

The above example suggests that even when twice as much housing services are consumed as are valued by the householder, the loss of the age pension will frequently lead to a decision against moving. Further, this affects well over half the 65+ population, a group that is steadily growing as the population ages and is likely a source of economic inefficiency in the important housing market. We believe that a change in policy where the assets from the sale of an owner-occupied house are not counted towards the assets test will motivate a significantly greater number of moves than are currently seen.

References
