The rising costs of the great Australian dream

8/28/2013

3429 words

National Affairs

28 August 2013

Without a change in policies, an ageing population is likely to reduce housing affordability and increase inequality, writes Peter Mares

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ONE of my regular neighbourhood walks takes me past a fine example of Queen Anne architecture. The elegant family home has three sculptural red-brick chimney stacks towering from its multi-gabled roof, its ridge lines capped with decorative terracotta ornaments. A fretwork verandah frames the generous curve of a bay window that greets the street. The house is well maintained, but its charms have begun to look slightly faded in recent years. The paint on the woodwork is no longer fresh and a front garden that was once cared for now looks as if it is simply maintained.

"Mary," who owns the house, is in her late eighties and has lived there alone since the death of her husband several years ago. In popular parlance, she is the archetypal little old lady rattling around in the old family home. In the language of public policy and economics, Mary is an “overconsumer” of housing and her choice of dwelling is “inefficient.” By living in a residence that could comfortably accommodate a family, Mary is contributing to the “underutilisation” of Australian housing. Put another way, she is helping to reduce supply and inflate prices.

The number of older Australians like Mary who live alone in large homes is startling. An analysis of 2011 census data reveals that of homeowners aged seventy and over who live alone, 62 per cent have a house with three or more bedrooms. That adds up to 238,078 houses with at least three bedrooms occupied by just one person. The situation is similar for houses owned by older couples (with at least one partner aged over seventy): 82 per cent of these dwellings – 332,752 houses – have at least three bedrooms.

The share of older people or couples living alone in large houses is generally higher in regional and rural areas than in capital cities; it is also noticeably higher in Western Australia and Queensland than in the other states. Older homeowners in the Australian Capital Territory are the real standout, however: more than three quarters (77 per cent) of older singles in the ACT reside in a house with three or more bedrooms, as do more than nine-out-of-ten older couples (93 per cent).

Given the way that ageing is transforming Australian society, the phenomenon appears certain to become much more pronounced. In its 2010 Intergenerational Report, Treasury projected that the share of the population aged over sixty-five would rise from 13 per cent to 23 per cent by 2050 (an increase from three million to more than seven million people). Within that group, the number of “very old people” – people aged eighty-five or more – is expected to more than quadruple, from 400,000 to 1.8 million. Since close to 80 per cent of Australians aged sixty-five or older own their own homes, that means legions of Marys are potentially “rattling around” in large houses.

In addition, the final act of the outgoing parliament was to pass the final legislative elements of the Living Better, Living Longer package, which will see the focus of aged-care policy and funding shift even further towards providing support to people in their homes rather than in residential facilities. In many ways this is a welcome reform, since most people want to remain living independently for as long as they can. It could have a downside, however, if it encourages older people to stay in houses that are too big for them and that they can no longer keep in good condition. If more and more older Australians end up living in unsuitable, poorly maintained...
housing, then the costs of delivering aged care to the home will rise rapidly as service providers, and by extension governments, are called on to provide more cleaning, repairs and modifications.

Not only that, but if the share of older Australians living alone or as couples in large houses continues to increase, then underutilisation will exacerbate the shortages and cost pressures that already strain our housing system. It will delay the redevelopment of the middle rings of Australian cities – the so-called greyfield suburbs – where there is great potential to increase affordability and sustainability by replacing ageing detached houses on large blocks with more diverse, medium-density dwellings.

But it would be highly presumptuous, even draconian, to insist that someone like Mary should downsize simply because she has grown older and now lives alone in an empty nest. People of all ages live in houses that have many more rooms than occupants. I could include myself in this category, along with numerous friends and acquaintances who might take offence if I were to tell them that their housing choices were “inefficient” and amounted to “overconsumption” or “underutilisation.” Those spare bedrooms are needed for visiting friends and family, as home offices, studios or music rooms, or to provide a refuge when sleep is impossible because a partner is snoring. The big backyard is needed for pets, for outdoor entertaining, for children to play in, or for growing vegies.

One other factor that we may fail to recognise, or at least admit to ourselves, is that an owner-occupied house in Australia is a highly tax-effective vehicle for accumulating, storing and passing on wealth. Under such conditions, it is hardly surprising that those who can afford to do so often buy houses that are larger than we might actually need.

The idea that it is inappropriate for older couples or older single people to continue living in large houses is known as “the mismatch argument.” Crudely put, it is an argument that denies agency to older people, especially older women, by suggesting that they don’t know what is best for them and have therefore become trapped in dwellings that are too large and too expensive to heat and cool, to keep clean and to maintain. The argument takes no account of how older people might use and enjoy their extra rooms for hobbies, professional activities, accommodating guests, study, entertaining or hosting family gatherings – activities that often make a major contribution to an older person’s physical and psychological wellbeing. The mismatch argument often has a moralistic undertone, a suggestion that by “underutilising” big houses, old people are denying others, especially young families, the chance to live in an ideal home.

On an individual level, Mary’s choices, like mine and like those of my friends and acquaintances, are entirely a personal concern. At a societal level, however, the sum of our private choices can add up to a major public problem. The point is not to tell Mary or anyone else how to live their lives, but to recognise that our choices are framed by policies that create incentives and disincentives that have a profound impact on outcomes. If these policies deter older homeowners from downsizing then this acts as a brake on supply and keeps housing costs high.

Nor is it being morally judgemental to acknowledge that housing purchased at a particular stage in life may no longer be suitable in altered circumstances. A freestanding three-bedroom home bought by a working couple to raise a family in is not necessarily ideal for a widow like Mary in her eighties.

If government policies deter older homeowners like Mary from downsizing, then their choices are potentially being constrained rather than expanded. As a result, their wealth will remain locked up in real estate rather than being used to make later years more comfortable. Someone who “overconsumes” housing is apt to “underconsume” other goods and services, particularly if he or she is on a fixed income like the pension, and could end up shivering frugally in a cold, rundown but spacious house, rather than turning on the heating or calling in a plumber.

A range of newer financial instruments – including reverse mortgages and partial sales – can enable older homeowners to convert some of their equity into cash to meet immediate needs without moving house. But in a paper for the Australian Housing and Urban Research Institute, or AHURI, Rachel Ong and her co-authors note that retired homeowners typically “appear to view housing wealth as precautionary savings that are only rolled out in extreme circumstances.” In other words, people are often reluctant to draw down on their housing wealth...
Evidence of this could be seen recently on another of my local walks, which took me past a house in a leafy street with a neatly made protest sign posted in the front garden. The sign criticised the local council’s refusal to offer discounted rates to the resident, a single pensioner. Given that the house was probably worth well over a million dollars, it was hard to feel a great deal of sympathy for the homeowner’s plight.

There is evidence that many Australians are open to the idea of moving into a smaller residence as they grow older. A detailed survey carried out by AHURI reveals that while the majority of us want to “age-in-place,” this doesn’t necessarily mean that we expect to stay in the same house. For most, attachment is less to a particular pile of bricks and mortar than to a local area – to the network of friends, services and familiar places that bind them to a community.

SO WHY don't more people downsize and either indulge in a bit more SKling (Spending the Kids Inheritance), or acting like OWLS (Oldies Withdrawing Loot Sensibly)? There are two answers to this question. The first has to do with the type of housing we build, the second with the way we tax it.

Almost three-quarters of occupied private dwellings in Australia have three bedrooms or more. As a result, people who want to move to a smaller house have limited options, especially if they want to stay in the same locality. Zoning and planning rules often exacerbate this situation by inhibiting the construction of more diverse housing stock. Under a new zoning system introduced in Victoria, for instance, local governments have been given extensive powers to determine what kinds of development can take place in different locations. The City of Glen Eira in Melbourne’s southeast is the first local government to implement the system. It has classified almost 80 per cent of the municipality as a Neighbourhood Residential Zone. This enforces a binding two-storey height limit on all buildings and a limit of two dwellings per lot. The aim is to protect the amenity and character of quiet residential streets and concentrate higher-density development along major roads, public transport routes and shopping strips. It’s likely that most Glen Eira residents are pleased with the immediate outcome, but in the long term the planning may not serve them so well. Any residents who want to transition in future from a freestanding family-sized home to something smaller will almost certainly find that they have to leave Glen Eira’s leafy streets behind.

But a lack of housing choice is not the biggest barrier to downsizing for older Australians. More important is the way we tax property and the way this interacts with pension payments.

Let’s return to the example of Mary. She has no economic incentive to move into a smaller residence. Quite the opposite: were she to downsize, Mary would be financially penalised. First there is the transaction cost of any move – particularly stamp duty, which would amount to tens of thousands of dollars. Second, because her home is her primary residence, it is exempt from the assets test for the aged pension; if Mary were to sell the house, though, the proceeds from its sale would not be exempt.

Given its location in a quiet, tree-lined street close to a park, shops and transport, Mary’s Queen Anne home would be worth more than a million dollars. If she swapped it for a $500,000 unit and saved the difference, then she might well find herself ineligible for the aged pension. For a single homeowner with assets worth up to $196,750, the basic pension is currently $733.70 per fortnight. For every $1000 in assets beyond that threshold, the pension reduces by $1.50. In other words, if Mary downsizes, then for every $100,000 that she puts in the bank she stands to lose $150 a fortnight, or about 20 per cent of her age pension.

The Productivity Commission recognised this problem in its comprehensive review of aged-care policy, Caring for Older Australians. Its recommended “first best option” was that the means test for the age pension should treat income and assets “in a consistent manner.” In other words, certain types of wealth such as a family home should not be excluded from the assets test or treated differently from other types of wealth, like bank deposits or shares. Recognising that this was unlikely to be adopted as policy, the Commission recommended a more politically palatable fix in the form of a government-backed Australian Age Pensioners Savings Account Scheme. Older Australians would be able sell their homes, and deposit the proceeds in the account, without affecting their government entitlements.
The government initially rejected this recommendation on the basis that it would increase pension outlays and would be expensive to set up and administer. In the most recent budget, however, the Gillard government announced that it would trial a similar but much more limited scheme over three years, beginning in July 2014. Under the trial, which is set to cost $112.4 million and benefit around 30,000 people, pensioners will be able to put up to $200,000 from the sale of their home into a special account that is exempt from the assets test. The trial is hedged with caveats. To be eligible, pensioners must have lived in their own home for at least twenty-five years. Funds are only exempt from the pension test if they remain in the account. This rather undermines the thrust of the Productivity Commission’s original recommendations, which were designed not only to encourage retirees to downsize but also to free up the capital in their homes so that they could use it for other purposes, including making a greater contribution to the cost of their own care.

There is a deeper and more fundamental objection to the pilot project – and to the Productivity Commission’s proposed Australian Age Pensioners Savings Account. Schemes like this will only benefit those who already have substantial housing wealth, and will exacerbate rather than redress inequality. They offer nothing to older Australians who live in rented accommodation or to those who own poorly located property that is not worth much money.

Given the potential value of her house, Mary could do well even without the Commission’s plan. If she were to downsize, by either purchasing or renting a smaller dwelling, then she could probably spend the rest of her days living comfortably on the proceeds from selling her house, without ever needing to draw a pension. The only loser in this case would be Mary’s son, who would see his inheritance gradually reduced.

AND this brings us to the nub of the issue. In Australia, the family home is exempt from any form of taxation except the stamp duty paid on purchase. It is exempt from both capital gains tax and land tax and is not included in the assets test for the age pension. As a result, we use the family home as the primary store of personal wealth to be passed on to the next generation.

In research commissioned by the Brotherhood of St Laurence, economist Judy Yates calculated that in 2005–06 owner-occupiers benefited from government tax expenditures (that is, revenue forgone) totalling $45 billion. In a background paper for the Henry Tax Review in 2010, researcher Gavin Wood and his colleagues showed how these substantial benefits to homeowners increase with age and wealth. They calculated that, in 2006, the tax treatment of the primary residence represented an annual average subsidy of more than $5000 to homeowners aged over sixty-five. The exemption of the primary residence from the pension assets test increased the subsidy, on average, by another $2500.

Older Australian homeowners have “huge incentives to stay put,” says Yates, because they are getting the equivalent of a tax-free income. “They have almost no housing costs and sit on an asset that has the potential to appreciate. Unless you start removing those kinds of incentives, there are not a lot of reasons to trade down, especially for people whose houses are already in good locations.”

A high rate of home ownership has enabled Australian governments to keep pension rates relatively low by international standards, because most retirees do not have to pay rent. In many ways, this has served the nation well, but the system is beginning to fray at the edges. The incentives to use the family home as a store of wealth contribute to house price inflation, and as Yates has shown, the decline in affordability is contributing to a decline in home ownership rates in younger age groups. Already there is a strong correlation between renting and poverty among older Australians. In future, an increasing number of pensioners might not have the traditional welfare buffer of owning their home.

Government now also offers huge tax concessions on superannuation, a second form of wealth accumulation that is meant to fund an increasingly long-lived old age. It is debatable how long the nation will be able to afford to maintain both schemes as the ratio of working-age adults to retirees declines. It is also questionable whether a better society will emerge from two tax concessions that increase inequality by offering disproportionate advantages to the wealthy and those on high incomes.

Once a benefit has been granted, though, it is very hard to take it away. The concessional tax treatment of the family home is so entrenched that it has become deeply embedded in our cultural assumptions. We feel that we
have a right to stay in our homes and pass them on to our kids. We worked hard to acquire property, doing it tough to pay off mortgages while riding the interest-rate roller coaster. The subsidies that support our home ownership remain largely invisible to us. To suggest that the family home should be taxed, or included in the pension assets test, is to risk being labelled unAustralian. There is no sign that either side of politics will be brave enough to canvass such radical ideas.

The one tax reform that could conceivably be implemented with bipartisan support would be the abolition of stamp duty and its replacement with a broad-based tax on the value of land. The ACT is the only jurisdiction in Australia currently moving in this direction. It is recognised across the political spectrum that stamp duty adds to Australia’s housing affordability problems and has other negative side effects, such as discouraging people from moving from regions of low employment to places where the job prospects are better. By reducing the transactional costs of moving house, the abolition of stamp duty would remove one significant impediment to downsizing with age. A land tax would also capture some of the windfall gains that accrue to home-owners from sitting on a well-located property, and from government investments in civic improvements and better infrastructure. And as Judy Yates points out, “the arrival of an annual land tax bill might also prompt some older Australians to ask themselves whether they really want to be paying for the privilege of living in such a large house.”

I don’t know why Mary has chosen to stay in a house that is much larger than her apparent needs. Perhaps it is because she likes the area. Mary is on friendly terms with her neighbours, who often phone or drop by to make sure that all is well. Perhaps she has never seen any reason to move. Perhaps she has considered moving but feared it would disrupt the network of friendships that anchor her in the community. Perhaps she likes to live surrounded by her memories in the home where she and her late husband raised a family. Whatever her reasons, Mary has every right to stay put. The question is whether the tax and pension systems should be encouraging her to do so, or whether it is time to change the policy mix in a way that might prompt her to consider other options and also help to make Australia’s housing more affordable and more equitable.