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Housing Would be a Super Asset

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Allowing owner-occupied housing to be a superannuation fund asset has much to commend it, and would not involve prohibitive regulatory or practical complications. Precluding this asset for super funds distorts the structure of individuals' life-cycle financing decisions and balance sheets and creates unnecessary barriers for potential first home buyers. Allowing it would increase the attraction of contributing to super for younger workers.

Relatively simple changes are required, although they will no doubt be vigorously opposed by financial institutions which are beneficiaries of the current arrangements. The principal change required is that individuals would be able to use their accumulated super fund balance towards the purchase of owner-occupied housing. This would take the form of a loan from the individual's account in the fund, secured against the property, with interest only repayments into the fund required until the house is sold (or no longer used as a principal residence) when the loan principal would be repaid to the fund from the sale proceeds. Voluntary principal repayments would also be allowed at any time.

In principal, there is no reason why individuals could not undertake such transactions several times during their lifetime, as they change residences or use super savings accumulated since the house purchase to pay down their outstanding mortgage to a bank or other financier. But to avoid unnecessary complications and highlight the merits of this proposal, the discussion here focuses solely on first home-buyers for whom there is a severe financial constraint partly created by current arrangements.

A young individual who has been contributing to super for seven or eight years could have a superfund account balance of close to the level of AWE (average weekly earnings). If she has saved the equivalent of 0.5 times AWE outside of super, and wishes to buy a house for a purchase price of 6 times AWE, it would be necessary to borrow 5.5 times AWE (over 90 per cent of the purchase price).

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If the super funds could be accessed, external borrowing would be reduced to 4.5 times AWE.

Because interest is paid on the loan from the super fund, the fund's balance would continue to grow (and also would increase from ongoing salary related or voluntary contributions and earnings on these). However, the super portfolio composition would have changed partly towards that of a fixed interest fund, so that it would be lower expected return and lower risk.

The benefit to the individual would be two fold. First, the interest rate charged by the super fund could be lower than that on the mortgage loan, reflecting the absence of intermediary profits. Second, the super fund loan would not require principal repayments, thereby reducing the cash outflows required from the individual's salary.

Those benefits assume no special tax treatment of interest payments, such that interest paid to the super fund is out of after tax income and taxed at 15 per cent on receipt by the super fund. However, since the loan is effectively from the individual (her super fund account) to herself as the home-buyer borrower, there would appear to be a case for removing such a double tax impost.

Treating the interest payments as equivalent to an undeducted contribution, and thus incurring no tax on receipt by the super fund, would have merit. This would enable the interest rate charged by the super fund to be correspondingly lower, increasing the overall benefit – particularly by reducing the cash flow constraint typically faced by potential new home-owners. Alternatively, providing a 15 per cent tax rebate to the individual for such interest payments, and leaving them subject to tax in the super fund, would achieve a similar result. Given the range of tax distortions currently existing in property and superannuation markets with which such a change would interact, its effects and merits warrant more attention.

However, a greater benefit would arise from the opportunity to motivate and facilitate increased super savings amongst younger generations. Even though super savings are tax advantaged, younger individuals are unlikely to take full advantage of this opportunity because of (a) the “lock-up” effect arising from inability to access those funds till retirement, and (b) the desire to save for other asset purchases such as housing. By providing for access to super savings for housing purchase, these deterrents to saving in a super fund are reduced.

One concern may be that allowing individuals to access super savings for housing purchase will reduce their overall wealth accumulation and provision for retirement. Requiring interest payments into the super fund reduces that effect, although the lower risk super fund asset portfolio does reduce the expected rate of portfolio return.

Also, by not requiring principal repayments on the super loan, the forced saving implied by this part of usual mortgage repayments is reduced. Whether individuals respond by consuming or saving in other forms is an empirical matter. More important however is the opportunity provided for younger generations to shift from renting to home ownership earlier in their life-cycle.

Another concern could be that individuals would respond to the greater funds available to them to take out the same size mortgage, buy a more expensive property, and thus generate upward pressure on housing prices. But this is largely overcome by two factors. First, requiring repayments to the super fund reduces ability to service the same size mortgage and thus would lead to lower mortgage size. Second, giving the super loan the first ranking claim against the property, would reduce the willingness of housing lenders to provide the same sized loan on the same terms.

How would existing mortgage providers react to such a change? If the superfund loan were given a priority claim over the house, mortgage lenders may charge higher interest rates. But given a lower mortgage loan size (such that total borrowings are constant) the average loan rate (from super fund and mortgage) should be the same (even without any tax changes).

More generally, financial institutions such as banks can be expected to be dismissive of this proposal. First, it creates potential inroads into the size of their mortgage business. Second, the greater incentives for super saving over deposits as a form of accumulating a housing deposit would also be seen as undesirable for business. Third, there would need to be some changes to creditor preference arrangements associated with owner-occupied housing where super-loans are involved, and this will evoke substantial opposition.

Opposition might also arise from the growing legion of fund management companies reliant on fees for managing investments under mandates from super funds. Providing an alternative popular investment class for super funds which does not require their services, reduces potential fee income available to them.

A further concern may be that individuals will utilise this super loan facility a number of times to trade up to more expensive houses such that they have less other assets in their super fund which can be used to provide pension income. With the advent and acceptance of reverse mortgages as a way of accessing equity in housing or the repayment of principal into the super fund when older homeowners sell existing houses to “downsize” their housing needs, this does not seem to be a major issue. If deemed to be a concern, a maximum limit (some multiple of AWE) could be set on owner-occupied housing loans out of super funds.

Finally, is this likely to create major administrative problems for superannuation funds? Undoubtedly there would need to be some changes to systems, but they

are unlikely to be insurmountable. Super fund collection of interest payments could be done concurrently with regular compulsory contributions, but there would also be a need for super funds to develop skills in managing aspects of the loan process, particularly for cases where member-borrowers subsequently find themselves in financial hardship.

In a world of super-fund competition, those funds which were able to implement such changes would potentially win business from those unable to do so.

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