# Super Mortgage Offset Accounts

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## Introduction

According to the 'Home Ownership and Superannuation' white paper from The Right Research in May 2011, in 15 to 25 years time it is likely that 25 per cent of retirees will not own their own home.

The Westpac 'Lost Super Report', released 4 July 2012, found 61.8 per cent of those surveyed under the age of 40 were likely to have lost super, compared to 41.4 per cent for those aged between 40 and 59.

These findings are not surprising when we consider that:

- The primary investment for most individuals and families, particularly those under 50, is their home.
- Superannuation serves as an impediment to home ownership, by prioritising saving for retirement over saving for a home.

This paper proposes that a new Superannuation investment referred to herein as ***Super Mortgage Offset Accounts*** will address the concerns flagged in these two reports, and provide a host of other benefits for Australia and its people, including:

- Retaining the integrity and preservation of superannuation savings
- Improving home ownership affordability
- Increasing awareness of superannuation investment - particularly for younger workers
- Providing additional incentive for younger workers to invest in superannuation
- Stimulating economic activity through the housing industry

## How They Work

Most banks in Australia offer mortgage offset accounts. A mortgage offset account is a deposit account that, in lieu of earning interest, is used to reduce the notional balance of a mortgage loan, and thereby reduce the interest charged on the loan.

A Super Mortgage Offset Account works just like a regular mortgage offset account, however it is owned by the superfund, not the mortgagor. The chosen superfund of the mortgagor (aka superfund member) invests the member's superannuation funds in the mortgage offset account.

In its simplest form, the member would not earn income on her superannuation investment (as has been the case for many members over the past few years!), but would benefit from reduced interest charges on the mortgage.

In a more complex form, which provides the mortgagor/member with maximum flexibility over how their super is utilised, the Super Mortgage Offset accounts could be structured so the member could choose whether they wanted the superfund to receive interest, up to their mortgage interest rate, on the offset account thereby choosing to receive the interest income into their superfund account, in lieu of receiving the reduced interest charges on their mortgage.

The superfund, and possibly the bank/mortgagee, would receive an administration fee for facilitating this arrangement. As the administration and management of this structure could be highly automated, and there are no costs associated with investment analysis, it is anticipated that such fee(s) would be fixed in nature, and considerably lower than current superannuation management fees.

## Analysis of Benefits

The manner in which Super Mortgage Offset Accounts would facilitate the objectives outlined above is explored below:

### Retain integrity and preservation of superannuation savings

A mortgage offset account has the same security as a regular bank deposit account, so it's hard to imagine a safer investment or better way of preserving superfund savings.

As the offset account is owned by the superfund, and managed by the bank/mortgagee, the "arm's length test" is met.

For SMSF's there may be a concern with regard to "in-house assets", however a supporting precedent exists to some extent in that a SMSF can invest in business real property (SMSFR 2009/1 - Self Managed Superannuation Funds: business real property for the purposes of the Superannuation Industry (Supervision) Act 1993, 2009) - the question would be whether owning a home is any less beneficial in preparing for retirement than owning a business property.

### Improve home ownership affordability

As the majority of home purchasers require a mortgage loan, it is clear that a mechanism that reduces the amount of interest they pay must improve the affordability of purchasing a home. This in turn should make home ownership more accessible to individuals and families that would otherwise have no choice but to rent.

The Super Mortgage Offset account could be structured in such a way that the superfund was prevented from withdrawing funds from the Super Mortgage Offset Account until the mortgage was below a specified level. This would reduce the bank/mortgagee's risk exposure in a similar fashion to the mortgagor providing a larger deposit. This would improve home ownership affordability by:

- Reducing the bank/mortgagee risk which should be reflected in a lower mortgage interest rate, and/or
- Making the mortgage more feasible for people struggling to save the required deposit amount.

According to the 'Home Ownership and Superannuation' white paper, commissioned by REST Industry Super and authored by Louise Southall from The Right Research in May 2011 (Louise Southall of The Right Research, for REST Industry Super, 2011), currently just 15 per cent of retirees do not own their own home, but in the next 5-15 years 20 per cent of individuals will be retiring without owning their own home, and in 15 to 25 years time that is likely to have risen to about 25 per cent. Super Mortgage Offset Accounts could redress this concern.

## Increase Awareness Of Superannuation Investment For Younger Workers

The Westpac Lost Super Report, released 4 July 2012, found 61.8 per cent of those surveyed under the age of 40 were likely to have lost super, compared to 41.4 per cent for those aged between 40 and 59, and 21.1 per cent for those 60 or over (Westpac Bank, 2012).

Such complacency is not surprising in a system that prevents young workers from gaining any benefit from their money till they are at least 60 years old. Considering the recommendation in 2009 by Treasury secretary Ken Henry of bringing the superannuation age into line with a higher pension age (Treasury Department, Commonwealth of Australia, 2009) by the time today's young workers turn 60, it's highly likely the rules will have changed such that they'll have to wait at least another ten years.

The response by REST Industry Super chief executive Damian Hill to the aforementioned 'Home Ownership and Superannuation' white paper his organisation commissioned, was that "Individuals will need to start showing an interest in their superannuation earlier, through strategies such as making extra contributions or changing their investments options". It's worth noting, and not surprising, that this response from a superfund executive participant, proposes extra super as an indirect "solution" to the home ownership issue, rather than exploring how superannuation savings could be utilised to address the problem directly - as Super Mortgage Offset Accounts do.

Providing a means for members to leverage their superannuation to improve their physical and financial security, not just in another 40+years but *now*, will surely increase their level of interest in, and awareness of, their superannuation savings.

## Provide additional incentive for younger workers to invest in superannuation

To encourage additional superannuation contributions, the government permits employees to pay "salary sacrifice" superannuation payments. These reduce the employee's taxable income, thereby reducing the amount of tax they would otherwise pay, and allowing them to contribute even more to their superfund than they otherwise would.

Salary sacrifice superannuation payments are more common amongst members of society that are older and no longer have a mortgage or earn sufficient income to put them in one of the higher tax brackets. On this basis, it is not unreasonable to assert that salary sacrifice super arrangements are prejudiced towards the older and/or wealthier members of society.

Indeed, until 1 July 2012, the concessional contribution cap for those 50 years and older was double that available to those younger than 50. It is anticipated that the reduction of the contribution cap for those 50 years and over, from $50,000 to $25,000, will result in many members paying excess contributions tax at the rate of 31.5% (in addition to the normal 15%). As this becomes more widely realised, it will be interesting to see whether the government yields to pressure to reinstate the discriminatory caps.

Whilst younger workers are also able to take advantage of the benefits of salary sacrifice super, it is a rare practice for the following reasons:

- They must wait till they are at least 60 to realise a benefit from the reduction in their accessible income.
- They have lower disposable income, relative to older workers, as a result of:
    - Lower wages and salaries as they become established in their careers
    - Education expenses, HECS tax and repayment of education loans
    - Higher mortgage repayments due to the higher cost of more recently acquired homes
    - Costs associated with supporting and educating a family
- The typically lower incomes mean the tax saving benefits are less attractive.

A Super Mortgage Offset Account makes the benefits of salary sacrifice super more accessible to the younger and less wealthy members of society. In so doing it encourages them to contribute more to their superannuation, thereby taking more responsibility in their retirement future. And most importantly, it facilitates a more equitable system.

## Stimulate economic activity through housing construction

Housing construction is widely accepted as a catalyst for economic growth. According to the Australian Bureau of Statistics, the total multiplier for output and employment in the construction industry is estimated to be 2.866. So, for every $1 million increase in construction output, there is an increase in output elsewhere in the economy of $2.9 million (Industry Information Unit, Business Competitiveness Division, Department of Industry, Science and Resources, 2007).

Overlay the construction industry's above average output multiplier with the following employment statistics for the construction industry taken from ABS stats for May 2012 (Australian Bureau of Statistics, 2012):

- The construction industry is the 3rd largest employment industry with just over one million employees (Healthcare employs 1.3 m, and Retail employs 1.2 m), underlining the reach it has throughout the economy and hence its ability to influence economic activity.
- The construction industry has 47500 unemployed workers, and 70200 under employed workers, indicating that it currently has excess capacity and hence the ability to efficiently absorb more activity.

It follows that an increase in housing construction will be an effective stimulant for economic activity. It is fair to expect that an improvement in housing affordability will increase housing construction. In this manner the Super Mortgage Offset Account will benefit economic activity.

Of course, if superannuation funds are to be diverted towards housing construction, they must be diverted from other investments/industries. Hence, it is appropriate to question whether the housing industry is an effective application of our retirement savings. Savings, be they superannuation fund accounts or bank deposits, are an important national resource. Just as we should strive for efficiency and effectiveness in how we utilise our labour resources or our agricultural and mining resources, we need to do likewise for our superannuation savings.

In 2011, Australian pension assets totalled approx $1.3 trillion, the equivalent of 96% of Australia's GDP. Australian funds have an allocation to equities of approx 50% (Towers Watson, 2012). Based on this, it would appear that superfund managers consider direct investment in listed companies to be a good use of our nation’s savings. Considering the performance of stock markets over the past 5 years, it is fair to question their judgment in this matter. Furthermore, in light of the magnitude of superannuation savings, it’s fair to question the role Australian superannuation fund managers played in the generation of the Australian stock market price bubble prior to the GFC.

In contrast to the Australian stock market, most house prices have risen or at worst held their value over the past five years. Most home mortgagors would now be better off financially had they been able to reduce their mortgage interest charges applying their superannuation savings against their home mortgage.

Considering the benefits of housing construction for the general economy, and the recent performance of the more traditional superannuation investments, it would appear difficult to argue that Super Mortgage Offset accounts are not a suitable application of our superannuation savings.

## Potential Concern

A potential effect of Super Mortgage Offset Accounts is a re-weighting of an individual’s net wealth from their superannuation savings to the equity in their home. This is because the forgone investment earnings on the superannuation savings are being realised as reduced interest charges on the mortgage.

Taken to an extreme, an individual that continues to upsize his home to maintain a mortgage and utilise the Super Mortgage Offset may retire asset (home) rich but cash (superannuation) poor. Considering the current capital gains tax benefits associated with selling one’s home, such a strategy may not necessarily be problematic, particularly compared to retiring homeless but with a somewhat larger superannuation investment.

Nevertheless, if such a practice was deemed a concern, it could be readily addressed by placing a cap on the value of Super Mortgage Offset Account balances.

In attempting to quantify the extent to which Super Mortgage Offset Accounts may reduce superannuation balances at retirement, it is worth considering the following factors:

- Once a home mortgage is reduced or paid off, the superannuation savings amassed in the Super Mortgage Offset Account will revert to a regular superannuation account.
- To the extent that Super Mortgage Offset Accounts offer a tax effective method of reducing their mortgage interest, a member’s contributions to their superannuation are likely to be increased thereby offsetting any foregone investment income, and potentially resulting in an even larger balance reverting to their superannuation account when the mortgage is paid off.

## Conclusion

This paper has explained many of the benefits that Super Mortgage Offset Accounts offer for all Australians.

Improved housing affordability for individuals and families that have a mortgage is a clear and direct benefit. Flow-on benefits that will benefit all Australians include:

- Improved economic growth through increased housing construction activity.
- Increased levels of home ownership – reducing the age pension and housing assistance burden.

Most importantly, Super Mortgage Offset Accounts make superannuation a more attractive proposition for Australia's younger workers.

In light of these benefits, it is hoped that Australia's superannuation and banking organisations can pick up the baton to make Super Mortgage Offset Accounts a reality.

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Craig Franklin studied Economics and Finance at Macquarie University, graduating in 1987. He is Managing Director of Intense Technology, an Information and Technology Consulting and Services company he founded in 1990.