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Parliament of Australia
Parliamentary Budget Office

Phil Bowen PSM FCPA
Parliamentary Budget Officer

Senator Jacqui Lambie
Senator for Tasmania
Parliament House
CANBERRA ACT 2600

Dear Senator Lambie

Please find attached a response to your costing request, *Pensioner Loans Scheme* (letter dated 25 June 2015).

As requested, this costing has been prepared on a confidential basis. The policy details that form the basis for the costing are as specified in your costing request. The PBO has not consulted with or drawn any policy details from a policy of any other political party or individual parliamentarian in the preparation of this costing. Accordingly, if you make this costing public, it would not be appropriate to attribute the costing to a policy of any other political party or individual parliamentarian.

If you have any queries about this costing, please do not hesitate to contact David Tellis on (02) 6277 9542 or Colin Brown on (02) 6277 9530.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Phil Bowen'.

Phil Bowen

12 October 2015

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COSTING – OUTSIDE THE CARETAKER PERIOD

Name of proposal to be costed:	Pension Loans Scheme
Summary of proposal:	<p>The proposal would modify the existing Pension Loans Scheme (PLS) as follows:</p> <p>Option 1: Increase the fortnightly rate of payment payable under the current PLS to up to three times the maximum fortnightly Age Pension rate.</p> <p>Option 2: Option 1 and extend the PLS to all retirees of age pension age.</p> <p>The proposal would have effect from 1 July 2016.</p>
Person/party requesting costing:	Senator Jacqui Lambie, Senator for Tasmania
Date costing request received:	29 June 2015
Date costing completed:	12 October 2015
Did the applicant request the costing be confidential?	Yes
Additional information requested (including date):	<p>On 30 June 2015, the Parliamentary Budget Office (PBO) sought clarification from the office of Senator Jacqui Lambie (the office) regarding the start date of the proposal and the population in scope.</p> <p>On 2 July 2015, the PBO sought further clarification from the office regarding the maximum amount payable under the proposed PLS.</p>
Additional information received (including date):	<p>On 30 June 2015, the office clarified that the start date of the proposal would be 1 July 2016 and the proposal would either cover current PLS recipients or all retirees of age pension age.</p> <p>On 23 July 2015, the office clarified that eligible PLS recipients could receive a payment up to three times the maximum fortnightly Age Pension rate in all options.</p>
Agencies from which information was obtained:	<ul style="list-style-type: none">• Department of Social Services (DSS)• Department of Veterans' Affairs (DVA)
Expiry date for the costing:	At the release of the next economic and fiscal outlook report.

POLICY COSTING – OUTSIDE THE CARETAKER PERIOD

Costing overview

Currently, the PLS provides eligible participants (around 800 in 2015) fortnightly loan drawdowns up to the maximum rate of the Age Pension. The loans are secured against real estate owned by the participants. A borrowing limit is set for each participant based on their age and equity at the establishment of the loan. Interest is accrued on the balance of the loan and is calculated fortnightly. The amount owed by the participant is repaid from the participant’s estate upon his/her death, or the sale of the secured real estate. An overview of PLS is included at Attachment A.

Option 1 – Increase the fortnightly rate of payment to up to three times the maximum Age Pension rate

Option 1 would be expected to decrease the underlying cash balance by \$30.8 million, the fiscal balance by \$22.7 million and the headline cash balance by around \$2.6 billion over the 2015-16 Budget forward estimates period.

The impact includes an increase in departmental expenses of \$39.6 million over the 2015-16 Budget forward estimates period. This reflects the costs of changes to IT systems, and operational cost associated with increased demand for the scheme.

Table 1: Option 1 - financial implications (outturn prices)^{(a)(b)}

Impact on	2015-16	2016-17	2017-18	2018-19	Total
Underlying cash balance (\$m)	-0.5	-10.5	-10.3	-9.4	-30.8
Fiscal balance (\$m)	-0.5	-29.3	-20.9	28.0	-22.7
Headline cash balance (\$m)	-0.5	-460.4	-998.4	-1,133.9	-2,593.2

(a) A positive number for the fiscal balance indicates an increase in revenue in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms. A negative number for the underlying cash balance indicates a decrease in revenue or an increase in expenses or net capital investment in cash terms. A negative number for the headline cash balance indicates a decrease in cash flow.

(b) Figures may not sum to totals due to rounding.

Option 2 – Option 1 and extend the PLS to all retirees of age pension age

Option 2 would be expected to decrease the underlying cash balance by \$31.5 million, the fiscal balance by \$23.1 million and the headline cash balance by around \$2.7 billion over the 2015-16 Budget forward estimates period.

The impact includes an increase in departmental expenses of \$40.6 million over the 2015-16 Budget forward estimates period. This reflects the costs of changes to IT systems, and operational cost associated with increased demand for the scheme.

POLICY COSTING – OUTSIDE THE CARETAKER PERIOD

Table 2: Option 2 - financial implications (outturn prices)^{(a)(b)}

Impact on	2015-16	2016-17	2017-18	2018-19	Total
Underlying cash balance (\$m)	-0.5	-10.8	-10.6	-9.7	-31.5
Fiscal balance (\$m)	-0.5	-30.2	-21.5	29.0	-23.1
Headline cash balance (\$m)	-0.5	-475.5	-1,030.9	-1,170.6	-2,677.6

(a) A positive number for the fiscal balance indicates an increase in revenue in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms. A negative number for the underlying cash balance indicates a decrease in revenue or an increase in expenses or net capital investment in cash terms. A negative number for the headline cash balance indicates a decrease in cash flow.

(b) Figures may not sum to totals due to rounding.

General commentary

When comparing the eligibility rules of options 1 and 2, the difference under Option 2 is the inclusion of other retirees who failed both the income and assets tests. An illustration of PLS eligibility under current policy, Option 1 and Option 2 is included at Attachment B.

The impact of the proposal on the fiscal, underlying cash and headline cash balances differs due to the treatment of PLS loans. These loans are treated as investments by the government, and transactions relating to investments do not have the same impact on the fiscal and underlying cash balances in the same financial year. A note on the accounting treatment of PLS loans is included at Attachment C.

For both options of the proposal:

- the fiscal balance impact becomes positive in 2018-19 due to the increasing interest income accrued on growing loan balances, offsetting the negative impact of concessional discount and departmental expenses
- the underlying cash balance impact would become positive beyond 2018-19 as more deferred interest payments are received at the time the loan is repaid in full
- the headline cash balance (HCB) impact beyond 2018-19 would gradually improve, but still remain negative over the medium term, due to a number of factors. In particular, new loans would worsen the HCB, while more people repaying their loans in full would improve the HCB. Similarly, as participants reach their borrowing limit, loan drawdowns would slow and this would improve the HCB.

The disaggregated impact for both options is included at Attachment D.

This costing is considered to be of **very low reliability**. This is due to the uncertainty on the take up of the PLS in response to the proposal. Due to the very low take up of the current PLS, there is insufficient administrative data to reliably inform behavioural assumptions. Similarly, survey data has small sample size constraints, which make it difficult to reliably identify the number and characteristics of small groups of people.

POLICY COSTING – OUTSIDE THE CARETAKER PERIOD

Key assumptions

In costing the proposal, the PBO has made the following assumptions:

- The characteristics of the target cohort under the proposed PLS was determined on the following basis:
 - people of age pension age
 - who own real estate in Australia
 - no existing mortgage
 - disposable income less than three times the maximum rate of Age Pension
 - liquid assets¹ less than \$10,000.
- On average, PLS participants would only borrow from the PLS up to what is required for a comfortable retirement for someone at the age of 65².
- Under Option 1, the demand for the proposed PLS is assumed to double the existing reverse mortgage market³ with 40,000 additional participants in 2016-17, adjusted by a take up profile of 75 per cent in the first year and 25 per cent in the subsequent year. The stock of participants then grows annually by the growth in the age pension population. Growth in participants is also affected by loans repaid.
- Under Option 2, the demand for proposed PLS is assumed to be an additional 1,000 participants in 2016-17 above Option 1.
 - The PBO has allowed a small increase above the take up of Option 1, assumed to be a subset of those who fail both the income and assets tests. In particular, people who fail the income test would have an annual income above what is assumed for a comfortable retirement.
- PLS participants would pay the upfront costs incurred by the Commonwealth in placing a charge or caveat on the property to be secured, rather than adding the costs to their loan.
- To ensure PLS participants have sufficient equity to drawdown, assets under the proposed PLS would be re-valued annually (a cost incurred by the Commonwealth under the current PLS).
 - At the higher loan drawdown rate under the proposed scheme, PLS participants are more likely to reach their borrowing limit.
- Participation in the PLS would have no impact on Australian Government pension payments as the principal home (currently exempt from the pension assets test) is assumed to be the only secured asset for the PLS.
 - If assets other than the principal home were used, participation in the PLS would reduce the net assets of participants for the purpose of the pension assets test. This may increase pension payments for some participants.

¹ Liquid assets include cash held at bank accounts, shares, trusts, bonds and debentures.

² Figure based on a quarterly publication by the Association of Superannuation Funds of Australia (ASFA), the ASFA Retirement Standard, June Quarter 2015.

³ Deloitte Access Economics, *Annual reverse mortgage report*, September 2015

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Methodology

To identify the characteristics of the target cohort who would be likely to take up the proposed scheme, the PBO used data from the 2011-12 Survey of Income and Housing (SIH). The dataset was used to identify persons meeting the criteria as outlined in **Key assumptions**. The number of persons and their characteristics within the cohort were then projected to future years based on parameters within the CAPITA model. CAPITA is a microsimulation model of Australia's personal income tax and transfer payment policies. The model was also based on the 2011-12 SIH with adjustments to allow for future growth in the income and number of recipients of age pension reflective of the 2015-16 Budget parameters.

The population participating in the proposed PLS along with their characteristics were then modelled as follows:

- Increase in PLS loans the government would issue: this was estimated by multiplying the number of retirees forecast to access PLS loans by the average payment required for a comfortable retirement. It has a negative impact on the headline cash balance, but no impact on the fiscal or underlying cash balances as PLS loans are treated as investments by the government.
- Increase in concessional loan discount expense: this was estimated as a proportion of new loans issued, decreasing the fiscal balance, due to the additional loans that would be issued accruing interest at a concessional rate.
- Increase in principal repayments by retirees: this was estimated as a proportion of the increased loan issued. The increase in principal repayment has a positive impact on headline cash balance, but no impact on the fiscal or underlying cash balances. The repayment also unwinds the concessional loan discount previously expensed, which has a positive impact on the fiscal balance.
- Increase in Government's interest income and receipts: this was estimated by multiplying the increase in the balance of loans outstanding by the relevant interest rate. The increase in interest income that would be accrued has an immediate and growing positive impact on the fiscal balance. The increase in actual receipt of interest income has a positive impact on the underlying and headline cash balances with the timing of the impact reflecting the expected time of payments.

Data sources

- Association of Superannuation Funds of Australia
 - *ASFA Retirement Standard*, June 2015.
- ABS
 - 2011-12 SIH.
- CANSTAR
 - *Compare Reverse Mortgages* – <http://www.canstar.com.au/home-loans/compare-reverse-mortgages/> (accessed on 22 September 2015).

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- Deloitte Access Economics
 - *Annual reverse mortgage report*, September 2015.
- DSS
 - Guide to Social Security Law
 - Basic operational information of the current PLS, including the number of participants.
- DVA
 - Basic operational information of the current PLS, including the number of participants.
- Department of Human Services (DHS)
 - Funding model – unit prices of payment processing.
- Productivity Commission
 - *An Ageing Australia: Preparing for the Future*, Commission Research Paper 2013.
- Treasury
 - CAPITA, 2015-16 Budget update.

POLICY COSTING – OUTSIDE THE CARETAKER PERIOD

ATTACHMENT A: OVERVIEW OF THE PLS

The PLS is only available to:

- people of age pension age (or the partner of someone who is of age pension age),
- who own real estate in Australia of sufficient value, and
- who receive or qualify for either:
 - Age Pension
 - Disability Support Pension
 - Wife Pension
 - Carer Payment
 - Widow B Pension
 - Bereavement Allowance
 - Service Pension
 - Partner Service Pension, or
 - Income Support Supplement.

To qualify for PLS, the person also needs to fulfil either of the following conditions:

- part rate pensioners of age pension age, or
- ineligible pensioners of age pension age, due to either the income or assets test.

The maximum loan available to a person depends on:

- the value of the real assets offered as security for the loan
- minus any agreed amount of equity that a person can elect to have kept aside from the total value of a secured asset
- the loan-to-valuation ratio (known as the age component) allowed under the scheme.
 - The participant's age (or the age of the younger partner in the case of members of a couple) determines the loan-to-valuation ratio and is adjusted upwards annually as the participant ages.

Source: *Guide to Social Security Law*⁴ for the PLS administered by DSS and *Factsheet IS116 – Pension Loans Scheme*⁵ for the PLS administered by DVA.

⁴ <http://guides.dss.gov.au/guide-social-security-law> (accessed 7 October 2015)

⁵ <http://factsheets.dva.gov.au/factsheets/documents/IS116%20Pension%20Loans%20Scheme.pdf> (accessed 7 October 2015)

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ATTACHMENT B: COMPARISON OF ELIGIBILITY UNDER CURRENT POLICY, OPTION 1 AND OPTION 2

Eligibility of cohort under PLS	Current policy	Option 1	Option 2
Ineligible pensioners ^(a)	✓	✓	✓
Part rate pensioners	✓	✓	✓
Max rate pensioners ^(b)	✗	✓	✓
Other retirees ^(c)	✗	✗	✓

(a) Refers to people who fail either the income OR assets test for the Age Pension. Under the current PLS rules, they can apply for fortnightly payments under PLS up to the maximum rate of Age Pension.

(b) Max rate pensioners are excluded from the current PLS as they do not receive any further top up from the current PLS. They would be able to participate under the proposed PLS as a higher payment rate applies.

(c) Other retirees refer to people who would fail both the income AND assets tests for the Age Pension. They would be eligible to apply for the proposed PLS under Option 2 as the scheme would be open to all retirees of age pension age.

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ATTACHMENT C: ACCOUNTING TREATMENT OF PLS LOANS

The issuing of PLS loans and repayments of principal are not included in either the underlying cash balance or the fiscal balance as they are treated as investments. However, the component of repayments that is considered interest is included as receipts in underlying cash balance terms.

PLS loans are concessional as they are indexed to a rate (5.25 per cent⁶) below the market interest rate (average of 6.49 per cent⁷). The Budget accounts for this concession as an expense in fiscal balance terms. As loans are repaid, this expense is “unwound”, having a positive impact on the fiscal balance. Interest is also accounted for in fiscal balance terms. This is the increase in the value of the debt due to interest accrued each fortnight.

The headline cash balance adjusts the underlying cash balance to include earnings from the Future Fund and the net cash flow from investments for policy purposes. An example of such an investment is the issuing of loans to achieve policy goals, as is the case with PLS.

The headline cash balance impact on PLS resulting from a policy change would be:

- the underlying cash balance impact
- **less** the positive impact on the underlying cash balance from interest
- **plus** the value of PLS repayments
- **less** the value of new PLS loans issued.

The fair value of the debt is a positive contributor to the government’s net financial worth.

⁶ For the PLS administered by DHS, *Pension Loans Scheme (Social Security)-Rate of Compound Interest Determination No. 2 of 1997*. For the PLS administered by DVA, *Pension Loans Scheme (Veterans' Entitlements)-Rate of Compound Interest Determination No. 2 of 1997*.

⁷ Based on a comparison of 10 reverse mortgage products by CANSTAR. <http://www.canstar.com.au/home-loans/compare-reverse-mortgages/>, accessed on 22 September 2015.

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ATTACHMENT D: DISAGGREGATED IMPACT OF PROPOSAL

Table D1: Option 1 – disaggregated financial implications^{(a)(b)}

(\$m)	2015-16	2016-17	2017-18	2018-19	Total to 2018-19
Headline cash balance					
Loan drawdown	-	-459.7	-1,043.2	-1,243.0	-2,745.9
Loan repayment	-	10.0	56.9	125.3	192.3
DHS Departmental	-0.3	-10.3	-11.8	-15.7	-38.0
DVA Departmental	-0.3	-0.4	-0.4	-0.6	-1.6
Total	-0.5	-460.4	-998.4	-1,133.9	-2,593.2

Underlying cash balance					
Interest received	-	0.2	1.9	6.8	8.8
DHS Departmental	-0.3	-10.3	-11.8	-15.7	-38.0
DVA Departmental	-0.3	-0.4	-0.4	-0.6	-1.6
Total	-0.5	-10.5	-10.3	-9.4	-30.8

Fiscal balance					
Interest accrued	-	9.1	52.1	113.4	174.6
Concessional loan discount (CLD)	-	-28.3	-64.2	-76.5	-169.0
Unwinding of CLD	-	0.6	3.4	7.3	11.3
DHS Departmental	-0.3	-10.3	-11.8	-15.7	-38.0
DVA Departmental	-0.3	-0.4	-0.4	-0.6	-1.6
Total	-0.5	-29.3	-20.9	28.0	-22.7

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A positive number for the underlying cash balance indicates an increase in revenue or a decrease in expenses or net capital investment in cash terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms. A negative number for the underlying cash balance indicates a decrease in revenue or an increase in expenses or net capital investment in cash terms. A positive number for the headline cash balance indicates an increase in cash flow. A negative number for the headline cash balance indicates a decrease in cash flow.

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Table D2: Option 2 – disaggregated financial implications^{(a)(b)}

(\$m)	2015-16	2016-17	2017-18	2018-19	Total to 2018-19
Headline cash balance					
Loan drawdown	-	-474.9	-1,077.2	-1,283.4	-2,835.6
Loan repayment	-	10.4	58.8	129.4	198.6
DHS Departmental	-0.3	-10.6	-12.1	-16.1	-39.0
DVA Departmental	-0.3	-0.4	-0.4	-0.6	-1.6
Total	-0.5	-475.5	-1,030.9	-1,170.6	-2,677.6

Underlying cash balance					
Interest received	-	0.2	1.9	7.0	9.1
DHS Departmental	-0.3	-10.6	-12.1	-16.1	-39.0
DVA Departmental	-0.3	-0.4	-0.4	-0.6	-1.6
Total	-0.5	-10.8	-10.6	-9.7	-31.5

Fiscal balance					
Interest accrued	-	9.4	53.8	117.1	180.4
CLD	-	-29.2	-66.3	-79.0	-174.5
Unwinding of CLD	-	0.6	3.5	7.6	11.7
DHS Departmental	-0.3	-10.6	-12.1	-16.1	-39.0
DVA Departmental	-0.3	-0.4	-0.4	-0.6	-1.6
Total	-0.5	-30.2	-21.5	29.0	-23.1

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A positive number for the underlying cash balance indicates an increase in revenue or a decrease in expenses or net capital investment in cash terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms. A negative number for the underlying cash balance indicates a decrease in revenue or an increase in expenses or net capital investment in cash terms. A positive number for the headline cash balance indicates an increase in cash flow. A negative number for the headline cash balance indicates a decrease in cash flow.

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