Willis Towers Watson

Retirement income adequacy

The impact of renting

About the research

John Burnett and Nick Wilkinson from Willis Towers Watson have conducted this research, which investigates the distribution of retirement income levels among singles and couples who are renters or homeowners, using a large representative sample of the Australian population. It helps understand which of these groups are on track to meet or exceed modest and comfortable levels, according to the ASFA Retirement Standard.

Data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey is used to carry out retirement projections based on the methodology of the Willis Towers Watson retirement planner engine that powers a number of the calculators available on ASIC's MoneySmart website.

The research uses data from the HILDA Survey which is funded by the Australian Government Department of Social Services (DSS) and is managed by the Melbourne Institute of Applied Economic and Social Research (Melbourne Institute). The findings and views reported in this paper, however, are those of the authors, and should not be attributed to either DSS or the Melbourne Institute.

Research by Willis Towers Watson looks at how retirement income adequacy differs for couples and singles who are either homeowners or renters, as JOHN BURNETT and NICK WILKINSON explain.

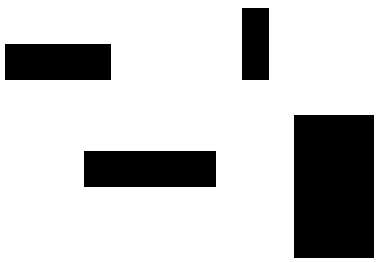
While superannuation is often the second most significant asset for homeowners, it may well be the number one asset for renters.

When measuring retirement income adequacy and setting target levels of income, it is important to allow for any rental payments required during retirement. This also applies to homeowners if they still need to make mortgage repayments when they retire

In this research, we've looked at the latest HILDA retirement savings data to assess the adequacy of expected retirement incomes for the 62% who are homeowners and the 38% who rent, taking these factors into account. We have projected the retirement income for each group (including superannuation, other savings and the age pension) which is then compared to both ASFA "Modest' and 'Comfortable', assessing whether these levels are reached or not.

Some key findings are:

- Homeowners (as a group) are projected to have higher levels of retirement income adequacy than renters. This is related to the current income levels of those surveyed.
- The highest levels of retirement income adequacy are projected to occur among homeowner couples with 94.7% expected to be on retirement incomes of at least the ASFA Modest level. This compares to 28.1% for renting couples.
- Single female renters are projected to have the lowest levels of retirement income adequacy with only 25.1% expected to be on retirement incomes of at least the ASFA Modest level. This compares to 38.9% for single male renters. The gender income gap has contributed to these results.
- Renters as a group are expected to be more reliant on the age pension, which forms a higher proportion of their post-retirement income.
- Rental payments are significantly over the level of rental assistance in most cases and this significantly reduces the post-retirement income of renters. To improve this situation, the level of Centrelink rent assistance should be reviewed to provide more support for renters on a means-tested basis.
- The projected retirement adequacy of all groups is very dependent on the level of future investment returns earned on superannuation. To the extent that higher mortgage rates require more significant drawdowns from superannuation at retirement, this will reduce the retirement income adequacy of homeowners.



HILDA data – homeowners and renters

Using the 2014 HILDA data released in December 2015, we have projected the retirement income for a representative sample of the Australian population covering 11,254 people aged 25 to 64. This comprises 4,077 couples, 1,396 single males and 1,704 single females as shown in Chart 1.

While 72% of this HILDA population are couples, this varies with each age band. The lowest percentage occurs in the 25 to 30 year old age bracket where 61% are couples.

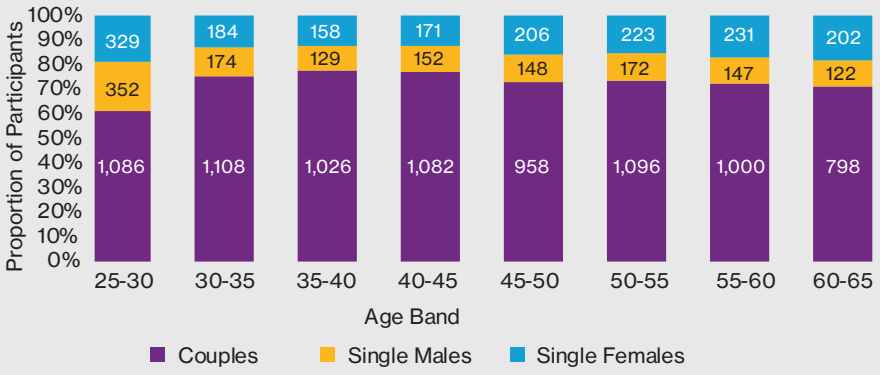
The proportion of couples who are homeowners is higher than for either single males or single females as shown in Chart 2. Reference to homeowners includes those who are repaying a mortgage as well as those who own their home outright.

Unsurprisingly, this shows that the proportion of home ownership is higher in the older age brackets. Among those approaching retirement age, about 90% of couples, 55% of single males and 65% of single females are homeowners.

What is unknown is whether these levels of home ownership will be lower in future generations, while home affordability in some capital cities remains very challenging.

We have maintained current status as a homeowner or renter throughout our projections but acknowledge that there will be some renters who may become homeowners in the future, although possibly less because of affordability issues.

Chart 1: Percentage and number of participants as couples or singles in each age band



Source: Willis Towers Watson analysis

Chart 2: Percentage of homeowners or renters in each age band split by couples and singles

Source: Willis Towers Watson analysis

What is unknown is whether these levels of home ownership will be lower in future generations, while home affordability in some capital cities remains very challenging.

Target retirement income – allowing for rent

While there are many ways to measure retirement adequacy, this research adopts two fixed dollar amounts as target retirement income measures, based on the ASFA Retirement Standard Modest and Comfortable levels in mid-2014.

At this time, the Modest level was $23,363 for singles and $33,664 for couples while the Comfortable level was $42,433 for singles and $58,128 for couples. We have indexed these targets in future years to allow for wage inflation so the same targets apply in real terms. We note that other targets may be applied in other circumstances, such as basing the target on a percentage of pre-retirement income.

These targets are based on budgets for retirees who are homeowners. To maintain the same targets for both renters and homeowners, we have reduced the retirement income of renters to allow for their current level of rental payments, net of any rental assistance. The range of rental payments is shown in Chart 3.

The median rental payment for couples is $16,800 per annum which is about $320 per week. For single males the median rent is $190 per week and for single females, $200 per week.

Where there is eligibility for rental assistance from Centrelink, we have determined net rent as the actual rent less rental assistance and allowed for this in our projections.

Mortgage repayment – will superannuation be used?

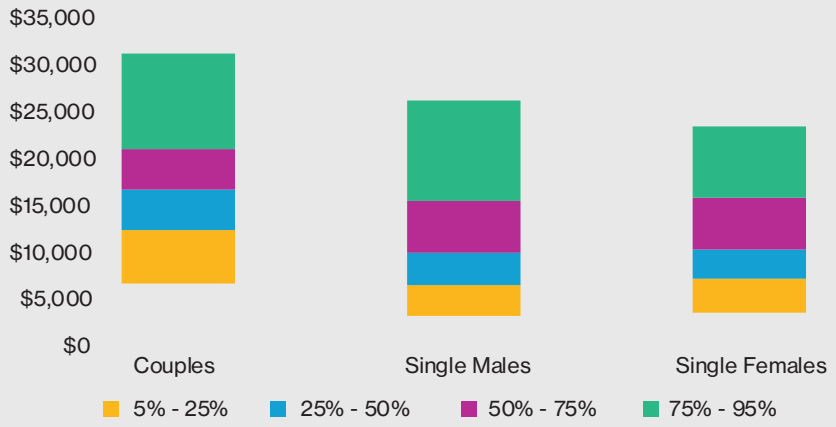
We have projected the current level of mortgage repayments within our HILDA population to assess if the mortgage will be fully repaid by retirement or an amount will be still outstanding.

The proportion of homeowners projected to have fully repaid their mortgage by retirement is shown in Chart 4 below:

The median unpaid mortgage at retirement for couples is projected to be $187,000. For single males and females it is projected to be $100,000.

In this scenario, we have reduced the homeowner's superannuation balance to pay the mortgage. This means that none of the target retirement income is then needed for ongoing payments.

Chart 3: Distribution of rent paid annually split by couples and singles

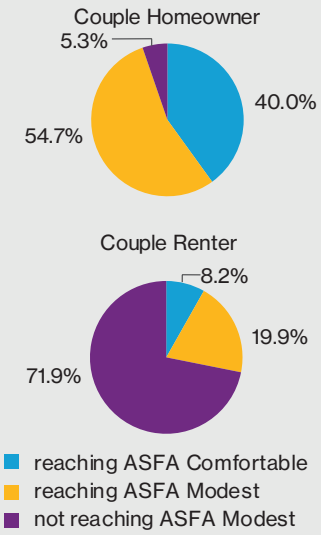


Source: Willis Towers Watson analysis

Chart 4: Percentage of homeowners fully repaying their mortgage by retirement split by couples and singles

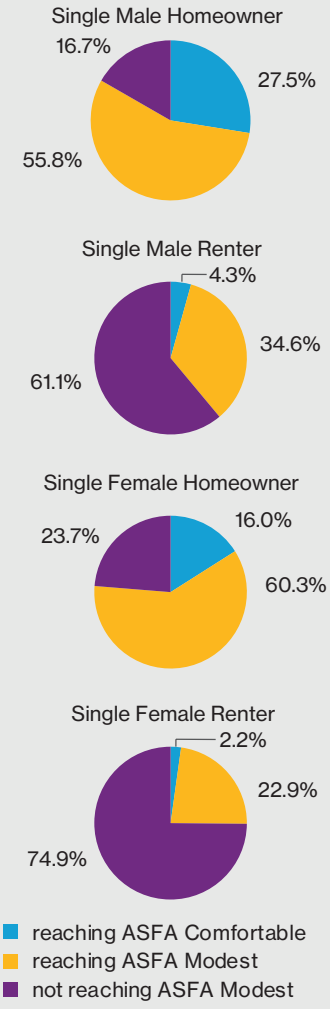
Source: Willis Towers Watson analysis

Chart 5A: Couples - percentage of homeowners and renters exceeding the ASFA Modest or Comfortable retirement income target



Source: Willis Towers Watson analysis

Chart 5B: Singles - percentage of homeowners and renters exceeding the ASFA Modest or Comfortable retirement income target



Source: Willis Towers Watson analysis

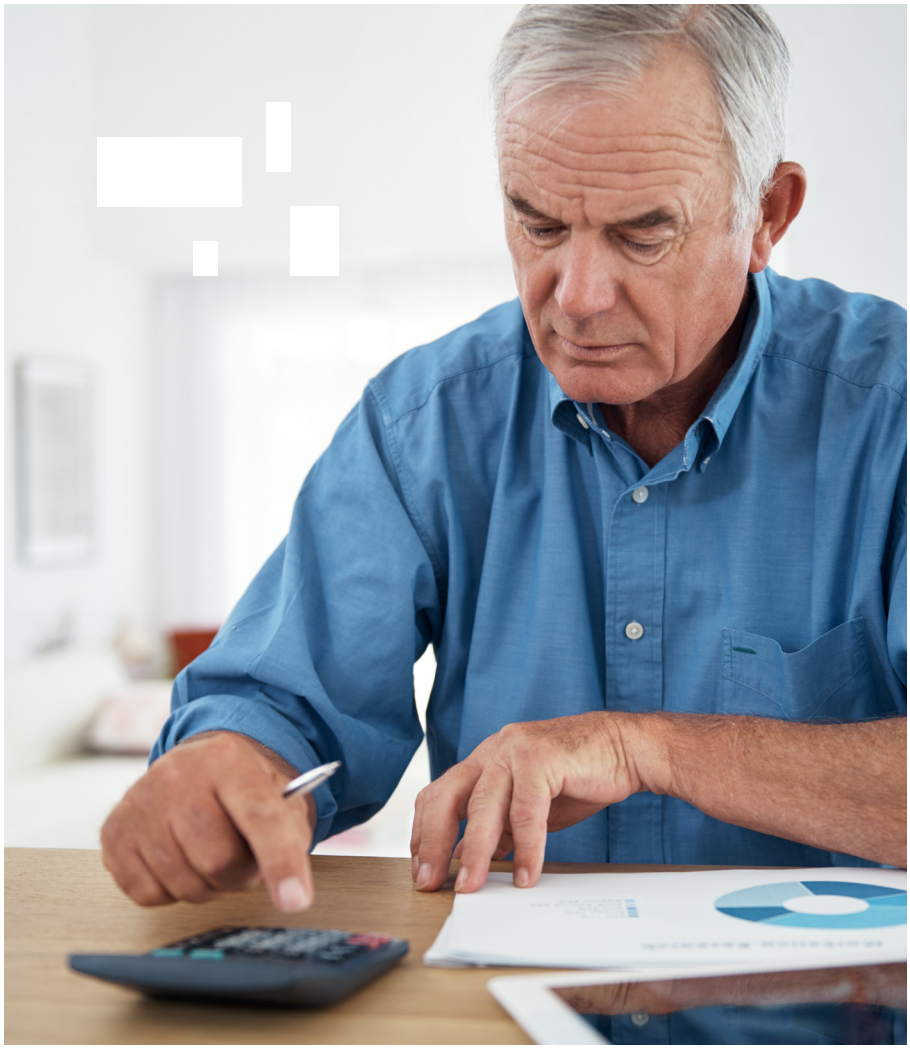
Adequacy of projected retirement incomes

Here, we compare projected retirement incomes to both the ASFA Modest and Comfortable levels. These projections allow for rental payments of renters during retirement and for repayment of mortgages on or before retirement by homeowners.

Chart 5A shows that 94.7% of homeowner couples should achieve at least the Modest target, including 40% of homeowner couples who should achieve or exceed the Comfortable level. In contrast, 28.1% of renting couples should achieve at least the Modest target with only 8.2% achieving or exceeding the Comfortable level.

Chart 5B shows for singles there are also significantly lower percentages of renters than homeowners reaching Modest or Comfortable targets, similar to couples.

Only 25.1% of female renters should achieve at least the Modest target of retirement income, including only 2.2% who should achieve or exceed the Comfortable level. The results for single female renters are below the other groups shown.



Relationship to income level

Not surprisingly, both the level of home ownership and the adequacy of projected retirement incomes is related to the current income levels of those surveyed as shown in Chart 6.

As the target retirement incomes we are using are dollar amounts, these are more readily achieved on higher incomes when the level of superannuation contributions being saved is income-based.

Reliance on age pension

We have looked at the proportion of the projected retirement income being provided by the age pension in Chart 7. This indicates that renters are expected to be more reliant on the age pension which represents a higher proportion of their overall projected retirement income.

How much does rental assistance help?

The level of rental assistance covers a relatively small part of the actual rent in most cases. As a result the 'net rent' payable is still a significant drag on the retirement income of renters.

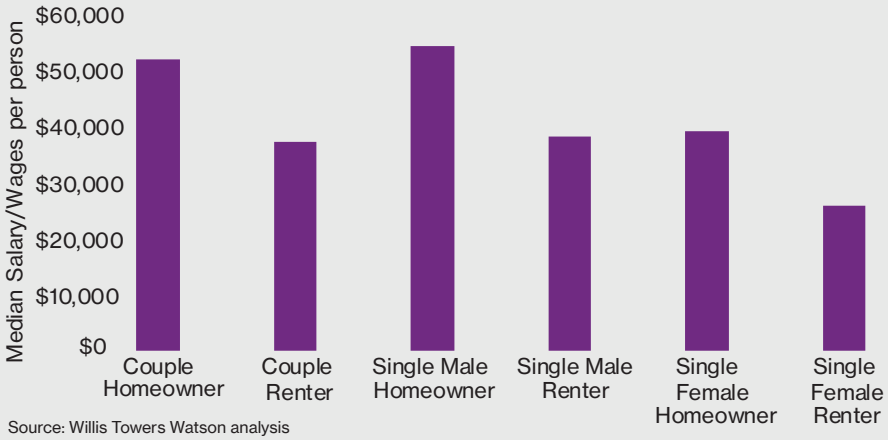
To demonstrate this, in Chart 8 we compare the projected retirement incomes for renters allowing for net rent with their projected retirement incomes if there was no rent payable.

The impact of rent on projected retirement incomes is significant. The percentage of those surveyed reaching the ASFA Modest level of retirement income reduces by 10-12% for singles and by 30% for couples as a result of the net rent they pay.

Centrelink rent assistance is indexed to CPI while actual rents have increased more strongly over the past decade, particularly in major capital cities.

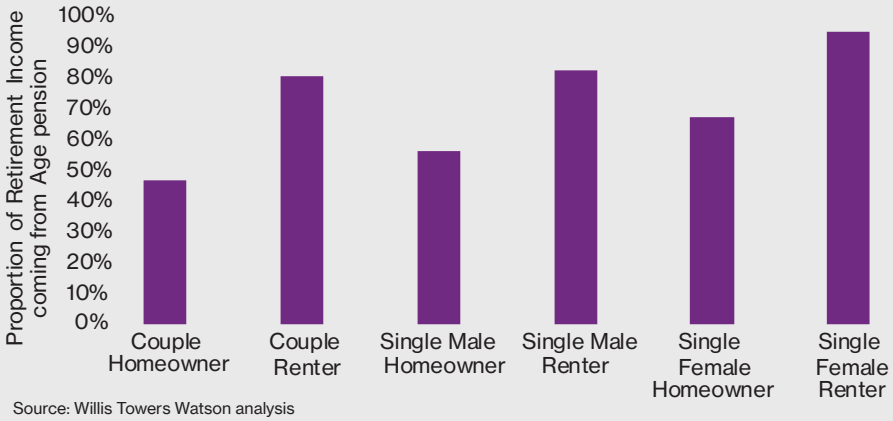
For a single renter living alone, the maximum Centrelink rent assistance is currently $135.80 per fortnight, while the median rent is nearer to $400 per fortnight.

Chart 6: Median salaries/wages of homeowners and renters for couples or singles, shown per person



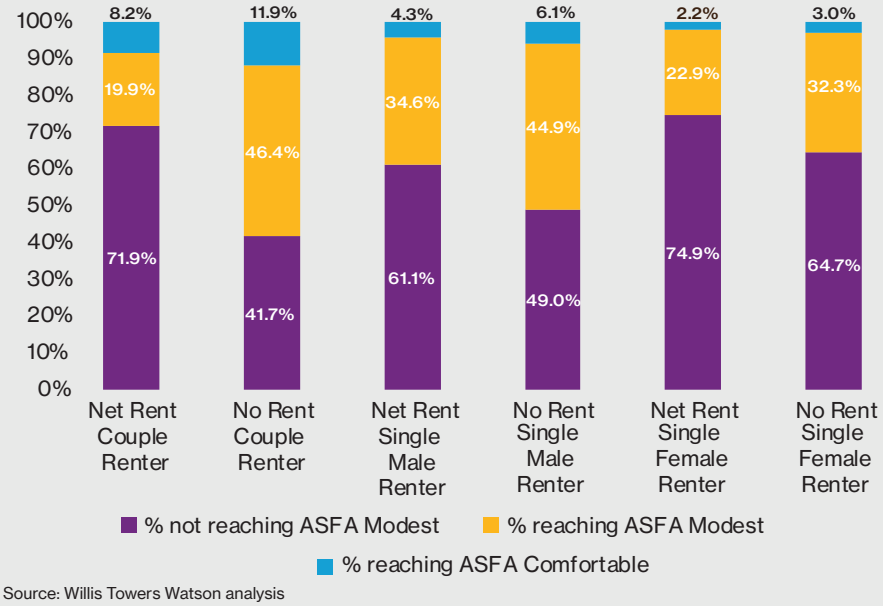
Source: Willis Towers Watson analysis

Chart 7: Proportion of median projected retirement income being provided by the age pension for homeowners and renters split by couples and singles



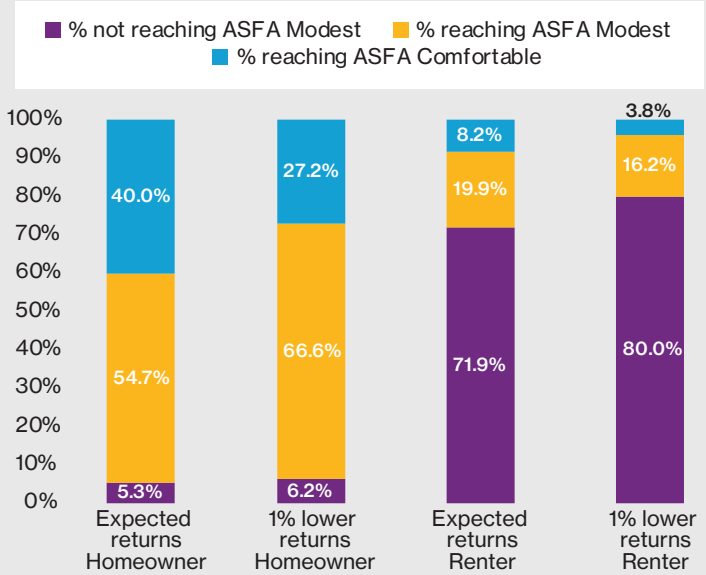
Source: Willis Towers Watson analysis

Chart 8: Impact on projected retirement incomes of paying net rent (actual rent less rental assistance) compared to paying no rent split by couples and singles



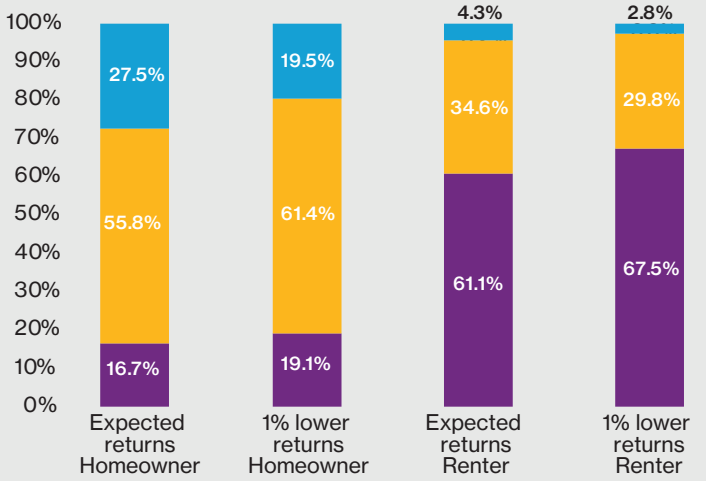
Source: Willis Towers Watson analysis

Chart 9A: Impact on projected retirement incomes for couples of a 1% p.a. reduction in future investment returns.



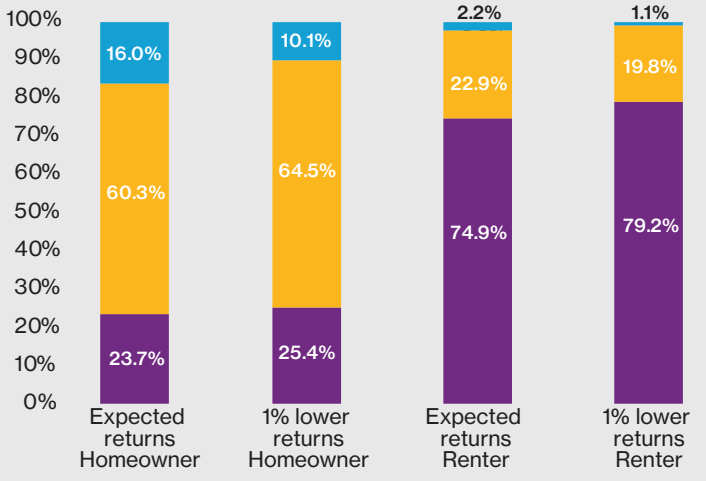
Source: Willis Towers Watson analysis

Chart 9B: Impact on projected retirement incomes for single males of a 1% p.a. reduction in future investment returns.



Source: Willis Towers Watson analysis

Chart 9C: Impact on projected retirement incomes for single females of a 1% p.a. reduction in future investment returns.



Source: Willis Towers Watson analysis

The shortfall has to be met from other sources of retirement income such as superannuation or the age pension, resulting in the remaining retirement income of the majority of renters falling below the ASFA Modest level.

To improve this situation, the level of Centrelink rent assistance should be reviewed to provide more support for renters on a means-tested basis.

What if future investment returns are lower than expected?

In projecting retirement incomes we have assumed future investment returns of 4.9% p.a. in the pre-retirement period and 4.3% p.a. after retirement.

While this is based on detailed investment modelling viewed over the longer-term, future investment returns could be higher or lower. If investment returns are 1% p.a. lower, then Chart 10 overleaf shows the impact this will have on the achievement of Modest and Comfortable target incomes in retirement. For example, if future investment returns are 1% p.a. lower:

- For homeowner couples, the proportion with projected retirement incomes of at least the ASFA Comfortable level will reduce from 40.0% to 27.2%.
- For single females who are renting, the proportion with projected retirement incomes below the ASFA Modest level will increase from 74.9% to 79.2%.

While future investment returns are driven by markets, they are also affected by the asset allocations adopted. It remains important that default superannuation settings do not adopt overly conservative asset allocations as this will both reduce retirement incomes and increase age pension usage. This is an important consideration both pre-retirement in MySuper settings and post-retirement as new products and services are developed.

What if mortgage rates are higher than currently?

In projecting retirement incomes for homeowners we have assumed mortgage interest rates of 4% p.a. and that these interest rates and repayments remain unchanged when calculating if the mortgage will be repaid by retirement or if superannuation will be drawn upon to repay the mortgage.

If, or more aptly, when mortgage interest rates rise, then repayments are also likely to increase in some cases. However if repayments do not increase when mortgage interest rates rise, then there will be more homeowners with mortgage remaining at retirement and the mortgage still to pay will be higher. Superannuation will be drawn on more heavily in this event.

Chart 10 models the impact of a 2% increase in mortgage interest rates on projected retirement incomes of homeowners, with mortgage repayments remaining unchanged. For example, for homeowner couples, the proportion with projected retirement incomes of at least the ASFA Comfortable level will reduce from 40.0% to 36.5% if an increase in mortgage rates of 2% p.a. results in more superannuation being drawn upon at retirement to repay the mortgage.

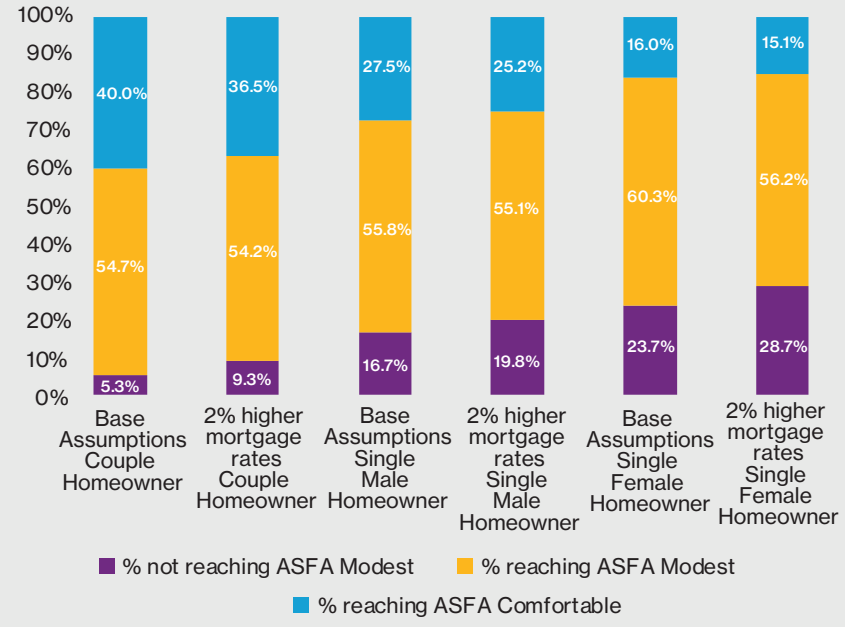
How the projections are conducted

The projections are based on the methodology adopted in the Willis Towers Watson Retirement Planner engine which powers a number of retirement income projector tools issued by super funds as well as a number of calculators available for public use through ASIC's MoneySmart website. The methodology has been extended in this research to incorporate the additional information on individual circumstances that is available from the HILDA Survey.

Using this model, we project the retirement savings to the assumed retirement age of the individual's age pension eligibility age and then the age pension is calculated in that year and in each subsequent year in line with both income and assets means-testing requirements. During this post-retirement period, superannuation and other retirement savings are then drawn down so that this wealth is exhausted by the individual's life expectancy. We calculate the level of retirement income that is maintained in real terms over the period from retirement to life expectancy.

The current status as either a home owner or renter is assumed to continue into retirement and is allowed for in the age pension means-testing. Where home ownership applies, we assume this continues to at least life expectancy and do not draw on this asset when projecting retirement income in this research.

Chart 10: Impact on projected retirement incomes of a 2% p.a. increase in future mortgage interest rates



Source: Willis Towers Watson analysis

Further information

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About Willis Towers Watson

Willis Towers Watson is a leading global advisory, broking and solutions company that helps clients around the world turn risk into a path for growth. With roots dating to 1828, Willis Towers Watson has over 40,000 employees serving more than 140 countries. We design and deliver solutions that manage risk, optimise benefits, cultivate talent, and expand the power of capital to protect and strengthen institutions and individuals. Our unique perspective allows us to see the critical intersections between talent, assets and ideas – the dynamic formula that drives business performance. Together, we unlock potential. Learn more at willistowerswatson.com.

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