THE 'NEW' PENSION LOAN SCHEME

What is it and How Does it Work?

From 1 July 2019, retirees looking for new ways to boost their retirement income or pay for expenses like home care have another option open to them following some big changes to the Commonwealth Government's Pension Loan Scheme (PLS).

The Scheme may be suitable for clients who want to keep their home, but need:

- extra income to pay for home care and support services or residential aged care;
- to keep their Age Pension but need more income; and/or
- other top-up income, such as rent or income to maintain a better lifestyle.

Keeping the home may protect a significant amount of assets from the Centrelink and Aged Care Means tests. There is a saving of the costs involved in selling the property, avoiding the inconvenience of moving, or parting with a home which might hold great sentimental value.

Although the PLS has been around for about 30 years, few retirees know about it and even fewer have used it due to some fairly restrictive eligibility rules. But all that changed from 1 July 2019, when new rules expanding its eligibility criteria and withdrawal amounts were introduced.

Under the new rules, many more people of Age Pension age can now apply to use this reverse mortgage style scheme to access extra income by borrowing against the equity they have in their home.

Note: A reverse mortgage works a little like a home loan in reverse. It is loan that allows you to borrow money against the equity (or value of a property less any mortgage debt) you have in your home. Borrowers are required to pay interest on the loan, but regular repayments are not required and instead, are added to the loan amount. You can remain in your home until it is sold, usually on your death.

Background to the PLS

The PLS was first established in 1985 when the Hawke Government re-introduced an Assets test for the Age Pension and other pensions. Take-up of the scheme has always been limited, despite the Keating Government broadening eligibility in 1996.

According to a Productivity Commission report in 2010, there were only 710 loans in place at that time, mainly to part Age Pensioners.

In the May 2018 Federal Budget, the Turnbull Government decided to significantly broaden eligibility for the PLS by allowing full Age Pensioners and more self-funded retirees to participate in the scheme.

From 1 July 2019, the PLS is available to all retirees of Age Pension age who meet the eligibility criteria.

How Does the PLS Work?

The PLS is a reverse mortgage style loan offered by the Commonwealth Government, which allows borrowers of Age Pension age to receive a fortnightly income stream by taking out a loan against the equity in their home. The expanded Scheme is a less expensive form of reverse mortgage. Some case studies will help illustrate the situation:

Case study 1 – Full rate single pensioner with $400,000 property

Mary is a 70-year-old single maximum rate age pensioner with a house valued at $400,000. Her Age Pension income is currently $908 per fortnight ($23,598 per year). Under the expanded PLS, Mary is now able to access some of the value in her home.

Mary chooses to receive an additional income stream of around $6,000 in the first year. Her income increases to $1,135 per fortnight ($29,497 per year), 125% of the maximum rate of the Age Pension. The value of the income stream increases over time in line with the indexation of the pension.

Mary continues to draw down a PLS income stream for 20 years at an interest rate of 5.25%. Mary passes away at age 90. Her family sell her house for $750,000.

The PLS loan owed to the government has increased to around $300,000, which is paid from the house sale proceeds. Around $450,000 remains in her estate. Over the 20 years, Mary receives around $170,000 in additional income to support her standard of living in retirement.

Source: Fact Sheet 3: Preparing financially for a longer and more secure life, Budget 2018, Treasury

Case study 2 – Full rate pensioner couple with $850,000 property

Tom and Pam are a 70-year-old maximum rate pensioner couple, with a house valued at $850,000. Their combined Age Pension income is currently $1,368.20 per fortnight ($35,573 per year).

Under the expanded PLS, Tom and Pam are now able to access some of the value in their home. They choose to receive $2,052 per fortnight ($53,360 per year), the full amount of 150% of the maximum rate of the Age Pension. The value of the income stream increases over time in line with pension indexation.

Over the next 20 years, Tom and Pam receive a PLS income stream at an interest rate of 5.25%. After 20 years, Tom and Pam sell the house for $1.6 million. While the balance of the PLS loan owed to the government has grown to around $900,000, Tom and Pam pay out this balance from the sale proceeds and retain $700,000.

Over the 20 years, Tom and Pam receive around $500,000 in additional income to support their standard of living in retirement.

Source: Fact Sheet 3: Preparing financially for a longer and more secure life, Budget 2018, Treasury

14 Important Facts About the New PLS

Here are 14 important points you need to know about how the Pension Loans Scheme (PLS) which operates from 1 July 2019.

1. You Must be Eligible

Under the new rules, all Australians who reach Age Pension age are able to access a PLS loan if they meet the eligibility criteria. (Previously, full Age Pensioners, most self-funded retirees and many part Age Pension were excluded from applying.)

You can apply if you or your partner are of Age Pension age and meet the Age Pension residence rules. That is, you must live in Australia and be an Australian citizen, permanent resident and/or special category visa holder for at least 10 years including five years of continuous residence.

In addition, you must be receiving – or qualify to get – an eligible pension. This includes those who are a maximum rate pension recipient. This particular qualification criteria is somewhat confusing, because the media release from the Minister Paul Fletcher said: "any eligible Australian of pension age who owns a home can participate in the Pension Loans Scheme *regardless of whether they would otherwise be eligible for a full pension, part pension or no pension".*

Note that under the old PLS a self-funded retiree had to pass either the Income test or the Asset test rules, to qualify - if you failed both tests, you could not apply. Under the new PLS rules, a fully self-funded retiree can now apply for the PLS, even if they are not eligible for a Centrelink Age Pension, because they fail both Income test and the Asset test.

Eligible pensions include:

- Age Pension
- Bereavement Allowance
- Carer Payment
- Disability Support Pension
- Widow B Pension
- Wife pension.

Note: To qualify for a loan under the PLS, you must not be bankrupt or subject to a personal insolvency agreement.

2. Income Stream Amounts are Limited

Under the expanded PLS, from 1 July 2019 borrowers are eligible to receive higher fortnightly payment amounts. The maximum fortnightly loan payment amount has been increased to 150% of your relevant pension entitlement (including supplements). This means:

- Full Age Pensioners can borrow up to 50% of the maximum rate of the fortnightly Age Pension (including supplements).[In other words, a couple receiving the full rate of Age Pension (currently ($36,301.20 per annum) could receive up to ($36,301.20 x 150%) $$54,451.80 per annum. A full rate Single Age Pensioner could receive up to ($24,081.20 x 150%) $36,121.80]
- Part Age Pensioners can withdraw fortnightly payments up to a maximum of 150% of the full Age Pension ***less*** the amount of their current fortnightly Age Pension payments.
- Self-funded retirees can now borrow up to 150% of the fortnightly full Age Pension.
- PLS borrowers can choose any payment amount up to the 150% full Age Pension threshold - they do not have to take the full 150%.

3. No Lump Sums

Income from a PLS loan is received as a regular income stream and you can choose the amount of the fortnightly payment, up to 150% of a full Age Pension. (Of course, this maximum payment amount includes your normal Age Pension payment).

Unlike normal commercial reverse mortgages, lump sums are not available under the PLS. If you need a lump sum, for more information about reverse mortgages, or other ways this might be achieved, ask Retirewell.

4. Loans are From the Government

The PLS is administered by the Department of Human Services and eligible retirees receive the loan payments from the Commonwealth Government.

The amounts received from a PLS loan are non-taxable and are not included as income under the Income test.

5. Existing Mortgages

Having an existing mortgage on the real estate you wish to use as security for a PLS loan does not automatically make you ineligible for the scheme, but many commercial mortgage contracts ban an additional charge being placed on the property.

An existing mortgage will also affect the value of the property when the maximum loan is calculated by Centrelink.

6. Age-Based Limits Apply

The amount you can borrow under the PLS is limited so you do not end up owing more than your home is worth. Your maximum loan amount is limited by:

- your age, and for couples, the age of the younger spouse or partner at the time the loan is granted
- how long you intend to receive payments
- whether you are single or partnered
- the value of your home
- the value of any life interest held by a person other than the property owner’s spouse
- how much equity you have in the property (i.e. value less any existing mortgage)

- any amount of equity you wish to exclude from the loan (perhaps as an inheritance for family members)

The maximum loan amount is calculated using the formula:

Age component amount *multiplied by* **value of real estate*** *divided by* **$10,000**

Example: A 70 year old single person offers a property valued at $180,000 as security for the loan but wishes to retain equity of $80,000. The maximum loan is calculated as follows:
$3,080 *multiplied by* ($180,000 *minus* $80,000, *divided by* $10,000) = $30,800

**The age component amount is defined in the Social Security Act, Subsection 1135A(3). The value of the real estate is rounded down to the nearest multiple of $10,000.*

7. Real Estate is Required as Security
To qualify for a PLS loan, you must have equity in a property you can use as security for the loan. The property owner must have title to the property, recorded in the Titles Office of an Australian State or Territory. The property can be your own home or home unit, an investment property (residential, commercial or industrial) vacant land or farmland and it must be located in Australia. If you own more than one property, you can nominate which property you'd like to use as security. The property can be owned by a trust or a private company, provided the borrower is a stakeholder in the entity which owns with the property and the trustee or company guarantees to pay the debt when it's due. If you move home, you can transfer the loan to another property, including your new home.

You are also required to have adequate insurance cover to protect the real estate asset you are using to secure your PLS loan.

8. Protecting the Government's Interest in the Loan Security
Unlike a commercial reverse mortgage, the government does not register a mortgage over the title of the real estate property. However, they do place a caveat or notice of charge on the property title, so that title to the property cannot be transferred without lifting the caveat - which will occur when the loan is repaid.

9. Retirement Village Units and Over 50s Manufactured Home Communities
Where the residence is a unit in a Retirement Village or a home in an Over 50s Manufactured Home development, ownership is by some form of contractual arrangement, under legislation that is different in every State and Territory. Particular legal structures and contractual arrangements may also attract the application of other legislation, such as strata title, community title, companies and securities, manufactured home or tenancy legislation.

The problem for these Retirement Village owners, is that the applicant for a PLS loan must own real estate in Australia that can be used as security for the loan. The usual basis of ownership in a Village is a 'right to occupy' or a 'right to reside'; in an Over 50s community, the occupier buys the house or dwelling unit but leases the land on which the home sits or is built. The freehold interest is usually held by the trustee of a trust in which the resident holds an interest, or a corporation, in which the resident holds shares. In such cases, the resident does not hold personal title to the land, registered in the Titles Office, in their own name - thus the Commonwealth cannot register the caveat or place a notice of charge on the property title, which is required to provide security for the loan.

We have discussed this situation with the Department of Human Services. They have confirmed that a Retirement Village unit owner's 'right to reside' or the leasehold situation in an Over 50s community, does not constitute a real estate asset. The PLS loan is only available to eligible retirees who hold freehold title to their real estate property.

All PLS loan applications are assessed by Centrelink when the application is submitted, so Centrelink will be able to confirm what is or what is not acceptable.

10. Low Interest Rates

At present there is a lower interest rate (5.25%pa compound) for PLS loans than for comparable reverse mortgages, which typically charge interest rates 1% to 1.25% higher than the PLS loan rate. The interest rate for PLS loans has remained the same since December 1997.

Interest is added to the outstanding loan balance fortnightly until the loan is fully repaid, which normally occurs when the property is sold, or from the borrower's estate.

11. Applications Can be Made Online

You can apply online for the Pension Loan Scheme using a Centrelink online account through the website of the Australian Department of Human Services at https://my.gov.au

12. Repayment of the Loan

While a person can choose to repay the PLS loan in full or part at any time, it must be repaid when the property is sold, or after the person dies, as part of the winding up of the estate. If the surviving partner qualifies for the Scheme in their own right, repayment of the loan can be deferred until they also die. If the surviving partner does not qualify for the Scheme, the loan must be repaid after the 14-week bereavement period.

13. No Age Pension Impact

PLS payments are not counted towards the Age Pension Income test. The only exception is if you save your PLS payments rather than spend them, which could result in the saved amount being means tested under the Asset test.

Although normal reverse mortgages can affect the amount of Age Pension you receive because an income stream is assessed under the Income test, PLS payments are not counted under the Income test.

14. No Fees

There are no establishment fees or monthly account fees with the PLS, which compares with around $1,000 for a normal home loan mortgage. Centrelink may however, charge costs including legal fees. The Centrelink costs are determined after the loan application is made and can be paid immediately, or added to the outstanding loan balance.

Setting up a PLS loan will require valuation of the property by a licensed valuer, but there will be no cost to applicants for this valuation.

If you are interested in the PLS, it's definitely worth taking a look at the Department of Human Services online information about the scheme. Click on https://www.humanservices.gov.au/individuals/services/centrelink/pension-loans-scheme

Financial Health Warning

The PLS (or any form of reverse mortgage) is a complex financial borrowing arrangement that will reduce the amount of equity you have in your home and will reduce the amount you are able to leave to your beneficiaries.

It is important that you seek independent financial or legal advice from a qualified professional before making any final decisions about the PLS. If you think you would benefit from applying for a PLS loan, please do not hesitate to give Retirewell a call on 07 3221122.