# Two Examples of how the New Pension Loan Scheme (PLS) may apply in Practice

## First the Disclaimer

The following two examples represent our best current understanding of how the new Pension Loan Scheme (PLS) will operate with effect from July 1, 2019. At this stage, we cannot provide any warranties regarding the accuracy of the figures or of the commentary, and it is up to individuals to discuss the situation in detail with Centrelink, and their financial advisors, before making any commitment to the PLS. These examples are simply intended to provide individuals with a working understanding of how the PLS will operate in practice, and what it might mean in terms of their own liabilities over time. It uses pension and other figures applicable as at April, 2019.

Please note that these examples focus on individuals of Age pension age; although the PLS is also available to individuals of "income support supplement qualifying age" and "service pension age".

## Example 1: Bob and Alice

Bob and Alice are a couple living in regional New South Wales; Bob is currently 70 years of age whilst Alice is 68 and they currently receive the full couples age pension.

They own their home completely, with no mortgage applying, and it is currently valued at $500,000.

They are seeking some extra income simply to allow them more flexibility to travel and to see their grand children in Sydney on a more regular basis.

Consider first the maximum amount of additional income they can access under the new PLS, and then consider the maximum loan amount available.

The **maximum income stream** available to them under the new PLS is 150% of the maximum pension rate - $2094.30 per fortnight (pfn) - less their current pension payment - $1396.20 pfn. So, the maximum that Bob and Alice can receive on a fortnightly basis is **$698.10** ($2094.30 - $1396.20).

The **maximum loan amount** available to them is a function of their age and the value of their equity in their property. In terms of the age component, this is determined by the youngest member of the couple; Alice at 68 years of age. Looking up the age component table, this gives an age component of 2850 for age 68. The calculation now proceeds as follows, given that the couple does not want to nominate any amount to be excluded from the calculation.

The maximum loan amount =

$$\frac{\text{Age Component x Value of real estate equity}}{10{,}000}$$

Which in this example translates to:

$$\frac{2850 \times \$500{,}000}{10{,}000}$$

**= $142,500**

Bob and Alice decide to opt to receive a $500 pfn income stream, which is below the maximum available - partly because they don't think they need the full amount available, and partly because they are cautious. They are aware that they can increase or decrease this amount as they choose and that, subject to property prices not decreasing, they will have additional headroom in the future to further increase the amount because of an increase in the value of their property and the age pension.

**How does this translate into what Bob and Alice will owe the Federal Government when it comes to them opting to pay out the loan, sell their property or on their death?**



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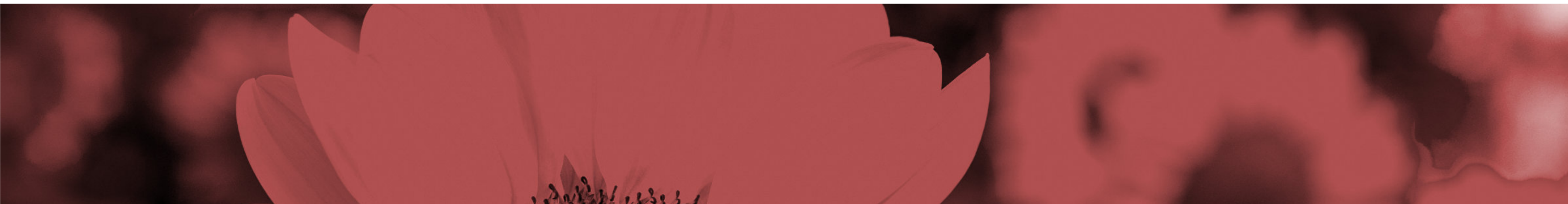
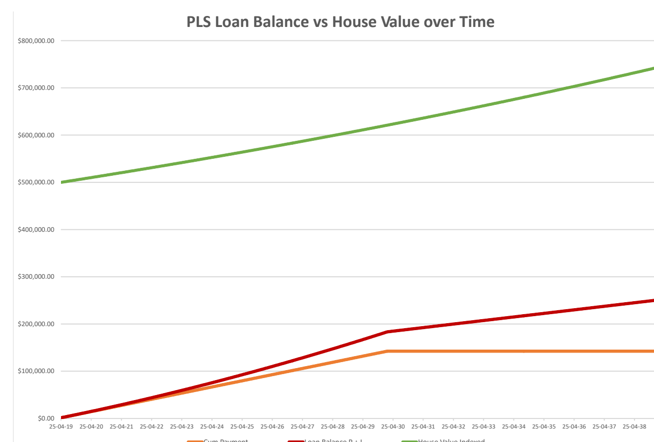


There are a number of “moving parts” when it comes to this calculation, and much depends upon how long they have been in receipt of their income stream. But, for illustration purposes, let's assume that Bob and Alice do not adjust their income stream over time and it remains $500 per fortnight until they reach their initial loan maximum of $142,500. Looking at our calculator:

- Bob and Alice would receive an additional $500 pfn for nearly 11 years before the loan limit of $142,500 is reached.
- At that stage the accrued interest on the loan would be $40,938.19, and the total loan amount repayable would be $183,4538.
- Bear in mind that the value of the house should also have increased - applying a conservative 2% p.a. increase the house would be worth $621,000.
- For comparison, if the loan simply continued in place for 20 years until paid out then the total value of the loan - with everything, including interest rates remaining static - would be $251,771, and the house value projected forward at a 2% p.a. Increase would be $745,224.

You might look at the last figures and say, well they started off with $500K of house equity, and that’s what they still have after 20 years! That’s correct, and that’s a function of the earning power of the house, but remember that the real value of $500,000 in 20 years time will be significantly less than the value today - but that itself is a function of the value of the income stream Alice and Bob received for 11 years.




## 2. Example 2: Eileen

Eileen is 77 and has lived in inner city Melbourne in the same house for over 40 years. She receives a partial age pension, because of a small investment property she owns and would like to retain within the family.

She has never had the funds to maintain her house properly, but it has nevertheless increased substantially in value over the last few years and is now valued at $980,000 without any mortgage secured against it. She would like to stay in the house as long as possible, as comfortably as possible.

Eileen could apply for the PLS using the value of her investment property as security for the loan, rather than her own home - and this would have the advantage of the PLS value being subtracted from the value of the investment property for the pension asset test - but Eileen may want to transfer the property to a family member at some stage and she prefers to use her own house as security. Alternatively, had Eileen needed money to make substantial improvements or changes to her home a reverse mortgage would have been the “best fit” because a lump sum would have been available.

The **maximum income stream** available to Eileen under the new PLS is 150% of the current maximum pension rate (1.5 x $926.20 pfn) = $1,389.30 - less her current pension payment of $460.20. So, the maximum that Eileen can receive on a fortnightly basis is **$929.10** ($1389.30 - $460.20).

The **maximum loan amount** available to Eileen is, as described earlier, a function of her age and the value of her equity in her home. In terms of the age component,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Eileen's age of 77 generates an age component of 4050. The calculation is as follows, given that Eileen does not want to nominate any amount to be excluded from the calculation. The maximum loan amount =

$$\frac{\text{Age Component x Value of real estate equity}}{10{,}000}$$

Which in this example translates to:

$$\frac{4050 \times \$980{,}000}{10{,}000}$$

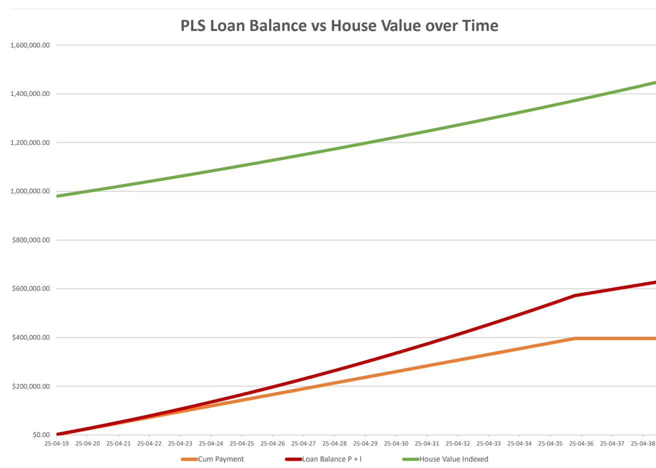
**= $396,900**

Eileen decides to opt to receive a $900 pfn income stream, which is just below the maximum available.

**How does this translate into what Eileen will owe the Federal Government when it comes to them opting to pay out the loan, sell her property or on her death?**

As previously, let's assume that Eileen does not adjust their income stream over time and it remains $900 pfn until she reaches the loan maximum of $396,900. Looking at our calculator:

- Eileen would receive an additional $900 pfn for nearly 17 years, and Eileen would be 94, before the loan limit was reached.
- At that point the accrued interest on the loan would be $175,956, and the total loan amount repayable would be $572,056.
- Bear in mind that the value of her house will also increase in tandem over the period - applying a conservative 2% p.a. indexation the house would be worth $1,372,441.




If Eileen needed to go into aged care at any stage, there appears to be more than adequate equity to pay for a refundable accommodation deposit (RAD) or, perhaps just as feasibly, she could use the PLS to pay her aged care accommodation costs as a daily accommodation deposit (DAP). We are critical of the sometimes zealous focus placed by some advisors on the need to have enough capital to pay for a RAD, given that the average stay in aged care is typically three years, but specific advice must be sought in relation to this decision.

## 3. Finally

Bear in mind that some parts of the PLS are not static; interest rates could change and even the age component amounts are, "sensitive to PLS interest rate and assumptions around growth in property values".

Consequently, although the PLS is constructed on quite a conservative basis, it still remains the case that any adoption of debt in retirement needs to be very carefully considered, and individuals and couples should take advantage of any professional advice provided as much as possible, prior to participating in the PLS and deciding on loan and income levels.

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