Older People's Poverty

Drivers and policy options

THE STRATEGIC SOCIETY CENTRE
ANALYSIS • EVIDENCE • POLICY

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1. Introduction

1.1. Background to this report

Average retirement incomes in the UK have increased over the last decade, and the link between being a pensioner and living in poverty has weakened substantially compared to previous eras.

The Institute for Fiscal Studies notes that median income among pensioner households after housing costs overtook that of working-age households in 2009-10, for the first time since records began in 1961.[1] By 2012-13, it was 5% higher, having been 5% lower in 2007-08 and 20% lower as in 1992.

Nevertheless, retirement income poverty in the UK persists. To ensure pensioners have adequate incomes, around 2.26 million pensioners receive a means tested income top-up to the State Pension called ‘Pension Credit’, which is paid by the Department for Work and Pensions (DWP). However, according to the government’s own estimates, a further 1.3 million older people should receive Pension Credit but do not. This figure includes around 770,000 who are do not receive the ‘Guarantee Credit’ component of Pension Credit, and are therefore failing to achieve the government’s guaranteed minimum level of income for retirees.

1.2. An Anti-Poverty Strategy for all ages

As part of the development of its broad-based anti-poverty strategy, the Joseph Rowntree Foundation (JRF) commissioned the Strategic Society Centre to explore the underlying drivers of poverty among older people, and options for addressing these drivers. In relation to tackling income poverty among older people, this approach involves looking at the ‘life course’ drivers of retirement income poverty – i.e. factors that occur people reach the age of retirement - in addition to contemporary factors, such as gaps in the provision of state support for incomes.

To contribute to the JRF anti-poverty work, this report addresses several questions:

- What is the prevalence of retirement income poverty in the UK?
- Why does retirement income poverty exist?
- What are the ‘gaps’ in state and private pension policy in the UK that cause it?
- What interventions would eliminate retirement income poverty in the UK?

This report maps current and future retirement income poverty in the UK, analyses its causes and explores potential policy remedies.

[1] Belfield C et al (2014) *Living Standards, Poverty and Inequality in the UK: 2014*, Institute for Fiscal Studies, London

1.3. An Anti-Poverty Strategy for the UK: Older people

In the next chapter, the prevalence of income poverty in the older population is explored, using different measures of poverty.

Chapter 3 examines how the operation of the State Pension and means tested Pension Credit result in some pensioners experiencing inadequate incomes.

In Chapter 4, the gaps in private pension policy are examined, both in relation to the accumulation and decumulation phases, which lead some individuals to have little or no private pension income in retirement.

Chapter 5 explores how different types of housing costs during retirement – both rental and mortgage costs - can result in older people experiencing low incomes during retirement.

Chapter 6 chapter examines the issue of ‘asset rich, income-poor’ older households – what can be termed ‘liquidity poverty’ – individuals with low retirement incomes but high levels of housing wealth, who are not poor in terms of resources, but experience income poverty owing to their wealth being in illiquid form.

2. Mapping retirement income poverty in the UK

2.1. Introduction

This chapter reviews evidence on the prevalence of retirement income poverty in the UK based on different definitions.

2.2. Average incomes across the population

'Equivalisation' is a methodology for measuring household income adjusting for the number of people in the household, enabling comparison of households with different compositions. Equivalisation is widely used in studies investigating the prevalence of poverty.

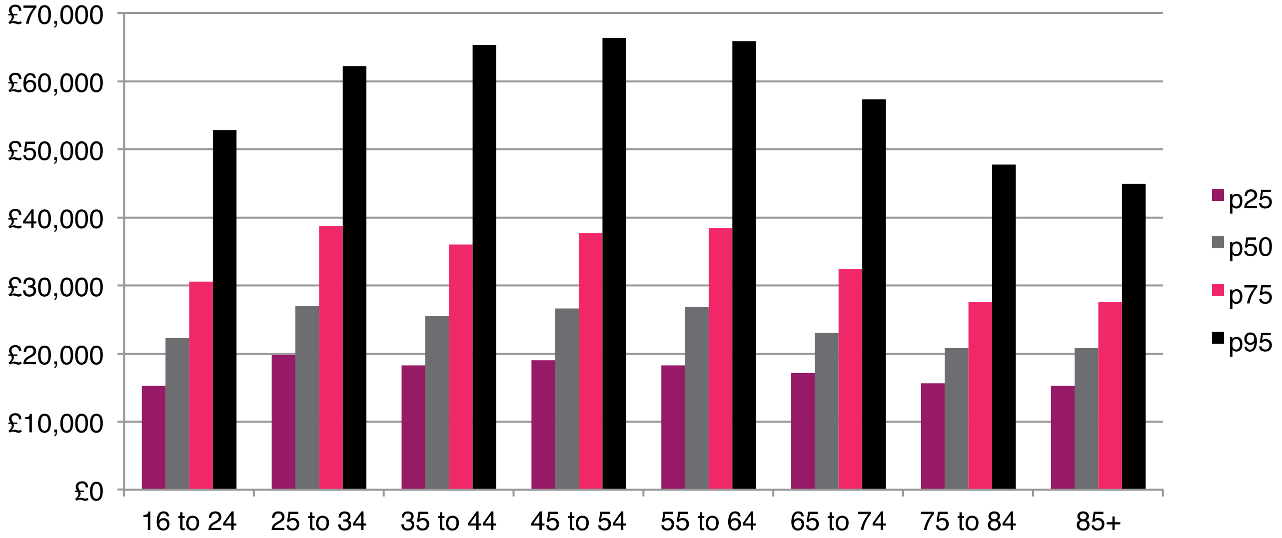
In a recent report, the Department for Work and Pensions (DWP) analysed data from the Family Resources Survey (FRS) for 2012-13,[2] and found that across the whole population, the average (median) equivalised household income Before Housing Costs (BHC)[3] – was £440 per week, having not changed from 2011-12.

However, reflecting rising housing costs for many households, the DWP found the average household income After Housing Costs (AHC) had continued to fall from 2009-10, and for 2012-13 was £374 per week.

Behind figures describing average incomes are substantial inequalities in income, which are observable across all age groups. For example, the following chart shows equivalised household income distribution, broken down by age group and percentile. The data, drawn from the Wealth and Assets Survey (WAS), includes all forms of earnings, pensions and benefits income, and measures total net income before housing costs. The 50th percentile in each age group is the 'median' (average).

[2] Carr J et al. (2014) *Households Below Average Income*, DWP, London
[3] 'Housing costs' include rent, water rates, mortgage interest payments, buildings insurance payments and ground rent and service charges.

Mean Household Net Annual income (equivalised), 2010-2012 (WAS, Wave 3)



Source: Lloyd J and Lord C (2015) Defined Capability

In relation to the older age group, the chart shows that 25% of individuals aged 75 to 84 have an equivalised household net annual income before housing costs (2012 prices) of £15,604 or less per year - or £42.75 per day. The incomes of the lowest-income quartile aged 65 to 74 and 85+ are broadly similar.

2.3. Defining income adequacy and income poverty

The definition of an 'adequate' level of income – and by extension income poverty - has long been a source of debate among academics and policymakers. Some principal measures of income adequacy used in the UK relevant to pensioners comprise:

- **Relative poverty**: individuals with an income proportionally below the median income of the population, for example, those with less than 60% of the median income in the population;
- **Absolute poverty**: incomes below a defined level considered essential for survival, or a basic standard of living;
- The '**Minimum Income Standard**' (MIS) developed by the Joseph Rowntree Foundation (JRF) based on what members of the public think is enough money to live on to maintain a socially-acceptable quality of life;
- The minimum guaranteed level of income for pensioners provided by **Pension Credit** and the State Pension, which in theory ensures a minimum income floor below which no UK pensioner will drop.

2.4. Relative Poverty: Pensioners

The principal UK measure of relative income poverty in the UK is 'Households Below Average Income' (HBAI), specifically, households with incomes below 60% of the median.

The DWP uses this measure of relative income poverty to define low income. In relation to older people, the DWP notes that because a relatively high proportion - around three-quarters

- of this group own their home, their preferred measure of low income for pensioners is based on incomes measured after housing costs (AHC).[4]

In its 2015 report on households below average income, the DWP found there had been no significant change in the percentage of pensioners in low-income households from the previous year. It noted that in 2013-14, 14% of pensioners were in relative low income AHC – around **1.6 million people**.[5] It found the proportion of percentage with a low income saw large falls from 1998-99 to 2005-06, and after an increase in 2006-07, continued to fall.

Nevertheless, it is important to note that for HBAI, disability benefits such as Disability Living Allowance and Attendance Allowance are included as income because they provide a cash contribution to the incomes of disabled older people. Such payments may be worth up to £82.30 per week, and in 2013-14, there were around 1.5 million older people in receipt of Attendance Allowance, and 1 million in receipt of Disability Living Allowance.[6]

However, in the calculations for HBAI, no adjustment is made to disposable household income to take into account any additional costs that may be incurred due to the illness or disability in question. As such, this measure of relative income poverty may underestimate the prevalence of poverty since it does not take account of additional, disability-related costs to households.

2.5. Absolute Poverty: 'Material Deprivation'

In addition to relative income, research from the DWP on households below average income also includes a subjective measure of absolute poverty called 'material deprivation'.

The measure is comprised of a suite of 15 questions based on access to specific goods, services and experiences. It is used to explore a broader definition of poverty and captures both financial and non-financial reasons for being in material deprivation. Inability of individuals or households to afford particular goods and activities that are typical in society at a given point in time is self-reported, and such items are included irrespective of whether individuals would choose to have these items, even if they could afford them.

Using this definition, the DWP found that **9% of pensioners** were in material deprivation, or around **1 million people**.

2.6. Income Adequacy and Pension Credit

The government provides a means tested 'top up' to the State Pension for low-income pensioners, called Pension Credit. The 'Guarantee Credit' component of Pension Credit should ensure a weekly income (after housing costs) of at least £151.20 for a single person, and £230.85 for a couple.

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[4] Carr J et al. (2014) *Households Below Average Income*, DWP, London
[5] Shale J et al. (eds.) (2015) *Households Below Average Income*, DWP, London
[6] Source: DWP (2015) Benefit expenditure and caseload tables 2015

Financial support for rental costs is provided separately in the form of Housing Benefit based on individual household assessments. Means tested financial support for council tax bills is also available.

As such, by setting the value of Pension 'Guarantee' Credit, the government defines what it believes is the minimum income level that every retiree should attain – in effect, a statutory threshold of income adequacy.

Since this income level is significantly higher than the value of working-age income support, Pension Credit cannot be considered the threshold for income poverty for pensioners.

Nevertheless, it is important to note that some would argue that £151.20 for a single person after housing costs – representing £21.60 per day to cover food, fuel, transport, clothing, entertainment – is inadequate, and therefore individuals on this income are in fact experiencing income poverty.

For example, the Joseph Rowntree Foundation's 'Minimum Income Standard' (MIS) for a pensioner couple in 2015, excluding rent and childcare costs, was £264.04, i.e. around £34 per week more than the Pension Credit level.

Crucially, despite the availability of Pension (Guarantee) Credit, not all individuals who would be entitled to this benefit actually receive it. The DWP estimates that take-up of Pension (Guarantee) Credit overall among those entitled to it is around 70%, meaning that around **770,000 pensioners are failing to achieve what the government considers an adequate income**.[7] The reasons for this are explored in subsequent chapters.

2.7. Retirement income poverty in the UK

This chapter has reviewed evidence on the number of older people living in absolute and relative poverty in the UK:

- Around 1.6 million older people live in relative income poverty after housing costs;
- Around 1 million older people experience material deprivation;
- Around 700,000 older people experience inadequate incomes, reflecting non-take up of means tested Pension (Guarantee) Credit.

What are the causes of retirement income poverty in the UK? Two types of explanation can be identified for a typical pensioner:

- Gaps in the operation of the '**safety net**' of welfare support relating to the State Pension, non-receipt of means tested Pension Credit, Housing Benefit, etc.;
- **Life course factors** that result in older people having little or no private pension income during retirement.

7 Johnson P et al. (2015) *Income-Related Benefits: Estimates of Take-up - Financial Year 2013/14 (experimental)*, DWP, London

In addition, retirement income poverty may result from some individuals having higher income needs, which are not adequately captured in the safety net of welfare support or funded through private pension provision. These may include some rental costs, social care costs and, potentially, fuel costs.

The rest of this report explores a range of different drivers of retirement income poverty related to:

- State Pension
- Private pension saving
- Housing costs
- ‘Liquidity poverty’

Defining income adequacy

As noted above, the level of Pension ‘Guarantee’ Credit – currently £151.20 per week for a single person - is below what some stakeholders would consider to be the minimum income necessary to live on.

As such, this report examines why some individuals - such as retirees with a private pension income who rent, or those who experience drops in retirement income owing to various factors – may experience incomes just above this level. In short, the report uses a flexible definition of the income poverty threshold for pensioners, up to a level just above the value of Pension ‘Guarantee’ Credit.

3. The State Pension

3.1. Introduction

Despite the vast majority of pensioners being entitled to a contributory State Pension income, retirement income poverty exists in the UK according to the government's own definition of income adequacy in retirement.

This chapter describes the operation of the basic State Pension, means tested Pension Credit and why take-up of Pension Credit is incomplete. The chapter also reviews the forthcoming New State Pension and what this will mean for the prevalence of retirement income poverty in the long-term.

3.2. Basic State Pension

The United Kingdom operates a non-means-tested basic State Pension, which can be claimed by anyone reaching State Pension Age, which is currently 65 for men, but is increasing gradually to 65 for women by November 2018. From December 2018 the State Pension age for both men and women will start to increase to reach 66 by October 2020.

To claim the full basic State Pension (currently £115.95 a week), a person needs 30 qualifying years of National Insurance contributions or credits, obtained through:

- Being in work and paying National Insurance Contributions;
- Receiving National Insurance Credits for unemployment, sickness, or as a parent or carer;
- Paying voluntary National Insurance contributions.

Individuals with fewer than 30 years of qualifying years may opt to pay voluntary, additional National Insurance Contributions subject to time limits.

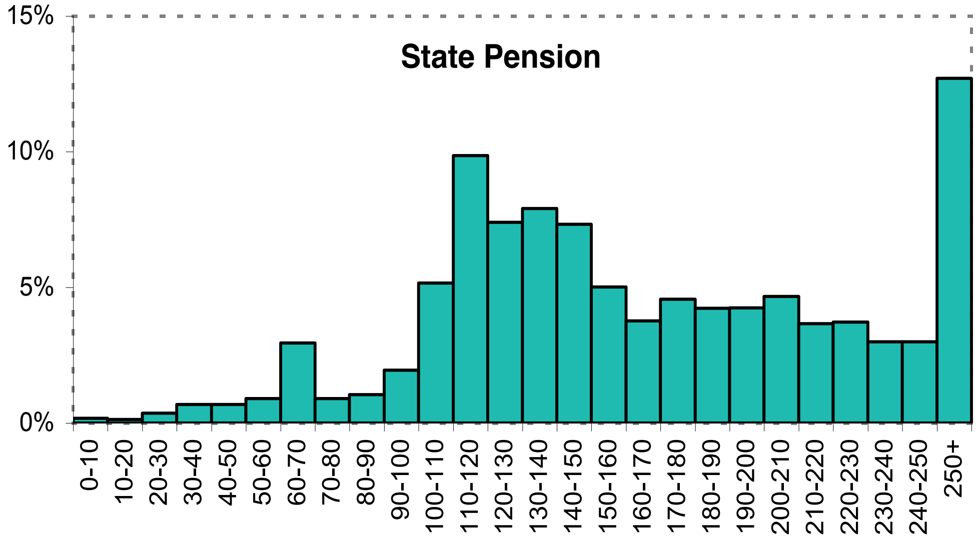
Individuals who are married or in a civil partnership, but not eligible for the basic State Pension or the full amount, may be able to qualify, or 'top up', to £69.50 per week through their partner's National Insurance contributions if:

- Both have reached State Pension age;
- Their spouse or civil partner qualifies for some basic State Pension (even if they haven't claimed it);
- Their spouse or civil partner was born on or after 6 April 1950.

According to the DWP, 97% of pensioner units received some State Pension income during 2013-14.[8] Within this group, the vast majority of pensioners receive an amount of at least the level for a single pensioner.[9]

[8] Ali R et al. (2015) *The Pensioners' Income Series*, DWP, London
[9] Ali R et al. (2015) *The Pensioners' Income Series*, DWP, London

Distribution of income from State Pension for all pensioner units in receipt, 2013/14 (£ per week, 2013/14 prices)[10]



Source: Ali R et al. (2015) The Pensioners' Income Series, DWP, London

The 'triple lock'

The value of the State Pension is currently £115.95 per week for a single person, and is typically revised upward by the government each year to take account of inflation. Indeed, the level of the State Pension has increased steadily in recent years owing to the so-called 'triple lock' introduced by the Coalition Government in 2010, which guarantee to increase the basic State Pension every year by the higher of inflation, average earnings or a minimum of 2.5%.

As the triple lock does not apply to the level of means tested Pension Credit, since 2010 the application of the triple lock has seen the basic State Pension increase at a faster rate than Pension Credit.

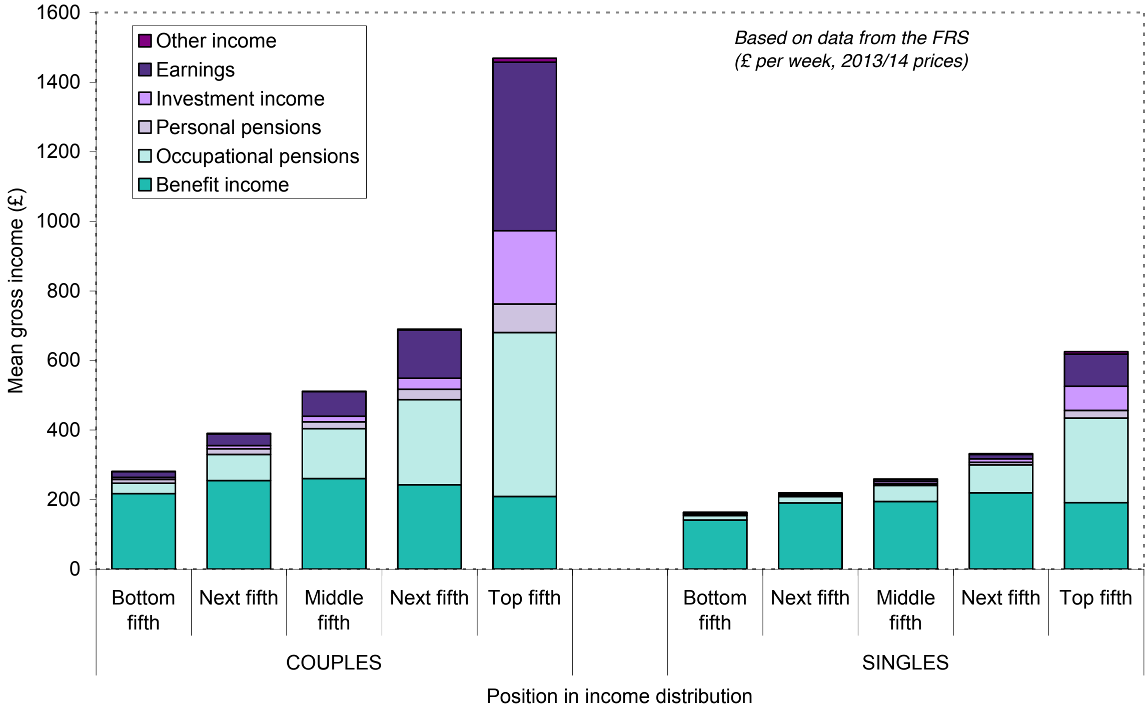
3.3. The State Pension, Pension Credit and retirement income poverty

Many individuals in the UK retire with little or no private pension income, so may be (almost) entirely reliant on the State Pension to fund their retirement income.

Indeed, as the following chart shows, for pensioners units in the lowest income quintile, 'Benefit income' – i.e. the State Pension and income support - comprise the vast majority of their income.

[10] The State Pension for a single pensioner in 2013-14 was £110.15 per week.

Sources of gross income of pensioner units by quintile in the net income (AHC) distribution, 2011-14



Source: Ali R et al. (2015) The Pensioners' Income Series, DWP, London

The government recognises that the full basic State Pension of £115.95 per week is inadequate to live on, and operates a means tested income top-up, Pension Credit, to guarantee that older people have access to a higher minimum income to live on, after housing costs.

The operation of means tested support for housing costs is explored in subsequent chapters.

In means testing to determine eligibility for Pension Credit, the DWP examines both basic and additional state pension income, private pension income, any income from jobs, and a 'notional' income from savings above the level of £10,000.

Pension Credit has two components:

- 'Guarantee Credit' tops-up older people's weekly income to £151.20 for a single person, and £230.85 for a couple;
- Savings' Credit' effectively functions to reward those who have saved for retirement.

There are also additional elements for some carers and severely disabled people.

To qualify for Savings Credit, an individual must have an income between £126.50 and £188.25 per week, and a couple must have an income between £201.80 and £274.32 per week – i.e. the basic State Pension plus a small amount of private pension income. For every

£1 a household's income exceeds the savings credit threshold, the household receives 60p of Savings Credit, up to a maximum of £14.82 for a single person and £17.43 for couples.

Public spending on Pension Credit was £7.159 billion in 2013-14, compared to £84.5 billion on the State Pension.

By setting the level of the State Pension below Pension 'Guarantee' Credit, the government is reliant on individuals who only have the basic State Pension claiming Pension Credit. However, not all who would be entitled to take Pension Credit do claim.

The following chart shows that in 2013-14, although 2.26 million pensioners did claim Pension Credit, around 1.34 million older people were entitled to Pension Credit but did not claim, according to DWP estimates.[11]

Table of caseload take-up of Pension Credit by entitlement to the Guarantee Credit

	Year	Guarantee Credit[1]	Savings Credit Only[2]	Pension Credit Overall
				(Thousands)
Number of Recipients	2009/10	2,030	560	2,590
	2012/13	1,850	520	2,370
	2013/14	1,760	500	2,260
Range of Entitled Non-Recipients	2009/10	880 (820, 950)	760 (700, 820)	1,640 (1,550, 1,730)
	2012/13	800 (730, 870)	640 (580, 700)	1,440 (1,340, 1,540)
	2013/14	770 (690, 840)	570 (510, 630)	1,340 (1,240, 1,430)
				(Percentages)
Take-Up Ranges	2009/10	70 (68, 71)	42 (40, 44)	61 (60, 62)
	2012/13	70 (68, 72)	45 (43, 47)	62 (61, 64)
	2013/14	70 (68, 72)	47 (44, 49)	63 (61, 64)

[1] This caseload is where there is entitlement to Guarantee Credit, and includes some elements of Savings Credit combined with Guarantee Credit.
[2] Where there is only entitlement to Savings Credit.

This figure includes an estimated 770,000 older people who were eligible for Pension 'Guarantee' Credit, and were therefore likely to have income below £151.20, i.e. the level of income that is supposed to be guaranteed by Pension Credit. This represents a take-up rate within this low-income group of around 70%.

According to DWP figures, of 2.3 million older people in receipt of Pension Credit in 2013-14, around 500,000 were in receipt of Savings Credit only; however, the DWP estimates that a further 570,000 people were eligible for Savings Credit only, but did not claim.

As such, using the level of Pension Credit as the threshold of income adequacy, the principal driver of retirement income poverty in the UK appears to be the combination of an inadequate State Pension coupled with a 'voluntary' means tested income top-up – Pension Credit - which is not fully taken up by those who would be entitled to it.

[11] Johnson P et al. (2015) *Income-Related Benefits: Estimates of Take-up - Financial Year 2013/14 (experimental)*, DWP, London

3.4. Why do people not claim Pension Credit?

Qualitative research undertaken for the DWP in 2006 suggested there were three primary barriers preventing older people from making a claim for Pension Credit:

- A lack of awareness of Pension Credit;
- A belief that they are not eligible; and
- A concern about how the receipt of Pension Credit would interact with other benefits that they are currently receiving. [12]

The authors noted that the most common of these primary barriers was perceived ineligibility. Older people felt that they would not be entitled to Pension Credit for a wide variety of reasons including that they were working, that they were receiving a (small) occupational pension, that they were able to 'manage' and that they had been turned down for other benefits in the past.

A 2012 survey by DWP of 'eligible non-recipients' (ENR) of Pension Credit found that while awareness of Pension Credit was high (at 72%), knowledge was lower, with 54% only knowing the name.[13] Individuals were found to have limited knowledge of who to contact if they required information about the State Pension or other benefits. Only 1% of ENR respondents said that they were not claiming because they felt bad asking for benefits or help from the government. The primary reason given for not claiming was perceived ineligibility, with 65% saying that they did not claim because they did not think they were eligible/no longer eligible/have too much money.

The DWP has trialled various options for improving take-up of Pension Credit. For example, a 2012 pilot paid Pension Credit automatically for a period to individuals estimated to be eligible, but still resulted in only 8.6% take-up.[14] Key barriers to claiming Pension Credit among participants in the study included: feeling that they did not need or were not entitled to Pension Credit; negative experiences of claiming Pension Credit or other benefits in the past; concerns about the claims process and personal circumstances at the time.

Ultimately, the complexity of means-tested benefits and limited take-up of Pension Credit and resulting income poverty were important reasons – alongside incentives to save - that the Coalition Government introduced the 'New State Pension', which is being fully implemented for new retirees from April 2016 onward.

3.5. New State Pension

The New State Pension will be introduced for people reaching State Pension Age from 6 April 2016 onward.

The actual value of the full New State Pension will be finalised in Autumn 2015, but will be set

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[12] Bunt K et al. (2006) *Understanding the relationship between the barriers and triggers to claiming Pension Credit*, DWP, London
[13] Radford L et al. (2012) *Pension Credit eligible non-recipients: Barriers to claiming*, DWP, London
[14] Maplethorpe N (2012) *Qualitative evaluation of the Pension Credit study – Research Report 795*, DWP, London

above the level of basic means-tested support, i.e. the Pension Credit standard minimum guaranteed level of income. In this way, the positions of Pension Credit and the full basic State Pension will switch: **individuals entitled to the full New State Pension will receive more than those individuals in receipt of the standard amount of means tested Pension Credit**.

To receive the full weekly rate of the New State Pension, an individual will need **35 qualifying years of National Insurance contributions or credits**. However, for individuals, the level of their New State Pension will take into account their individual National Insurance record, so until fully introduced, people may receive less than the full amount. A person will usually need 10 qualifying years to get any New State Pension.

The introduction of the New State Pension leads to a reduction in the scope of Pension Credit for two reasons:

- A higher basic pension means that fewer pensioners will require Guarantee Credit to top up their income to the level of the Pension Credit minimum income guarantee; and
- Savings Credit will no longer be required to ensure that people benefit from additional saving, as someone on a full New State Pension will already be above the level of means tested Guarantee Credit.

The New State Pension brings several benefits to the state pension system.

First, the New State Pension will be simpler overall, such that individuals are more likely to understand what they will receive at retirement. The DWP estimates that by the mid-2030s, over 80% of people will receive the full weekly amount of New State Pension, narrowing the range of pension outcomes in comparison to the current system and improving certainty.[15]

Second, the implementation of the New State Pension will bring forward by over a decade the point at which men and women achieve equal state pension outcomes. To take account of growing self-employment, the National Insurance contributions of the self-employed under the New State Pension will be treated in the same way as employee contributions for state pension purposes.

Third, the new State Pension will reduce the number of people entitled to means tested Pension Credit, potentially improving incentives to save. However, this reduction in Pension Credit entitlement will mainly be due to loss of savings credit, i.e. a less generous means tested system.

Even without the New State Pension, the combined effects of the triple lock, automatic enrolment, women's labour market employment and previous state pension reforms were set to reduce the percentage of pensioners entitled to Pension Credit in future.

Under the current system, eligibility for Pension Credit (or Universal Credit where only one member of a couple is above the qualifying age for Pension Credit) amongst those retiring after April 2016 was projected by DWP to peak at around 15% around 2030 and fall to below

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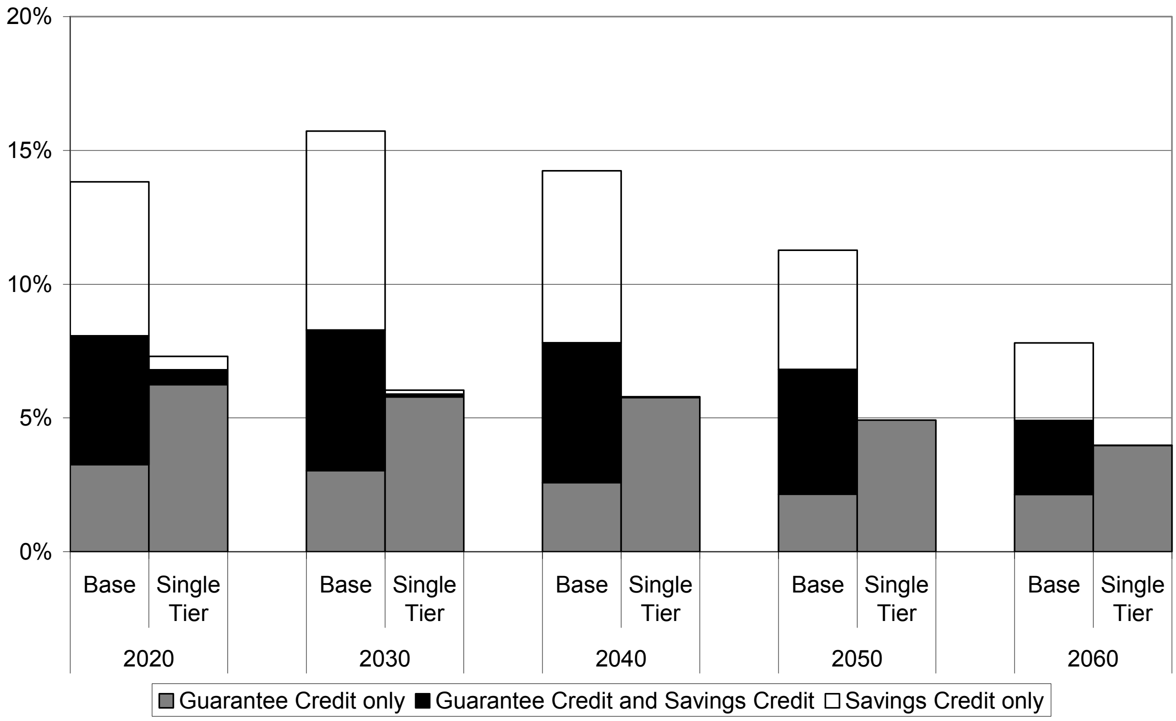
[15] DWP (2013) *The single-tier pension: a simple foundation for saving*, DWP, London

10% by 2060.[16] The impact of the New State Pension will be to further reduce the proportion of pensioners eligible for Pension Credit. The DWP projects that under the New State Pension, eligibility for Pension Credit will be halved compared to the current system in the first few years following implementation, and ultimately fall to around 5% of the older population by 2060.[17]

The differences in the proportion of the older population eligible for means tested Pension Credit under the old and new systems are shown in the following chart:

Eligibility for Pension Credit amongst the population reaching State Pension age after implementation of the new State Pension



Source: DWP (2014) *Updated impact of the single-tier pension reforms*, DWP, London

According to DWP, around 650,000 women reaching State Pension age in the first ten years of the New State Pension will receive an average of £8 per week (in 2014-15 prices) more due to the New State Pension valuation of their National Insurance record.[18]

3.6. Analysis

The decision to introduce Pension Credit by the then Labour Government in 2003 reflected a judgement about targeting and the distribution of public spending. Confronted with both pensioners in poverty and pensioners with significant private pension incomes, the government opted not to increase the value of the contributory non-means tested state pension - which is paid to all pensioners including those with high private pensions - and

[16] DWP (2014) *Updated impact of the single-tier pension reforms*, DWP, London
[17] DWP (2014) *Updated impact of the single-tier pension reforms*, DWP, London
[18] DWP (2014) *Updated impact of the single-tier pension reforms*, DWP, London

instead increase targeted spending on low-income pensioners via means tested Pension Credit.

However, in addition to undermining incentives to save for retirement, the introduction of Pension Credit did not lift all pensioners out of income poverty owing to the fact that not all entitled to the benefit went on to claim it.

The introduction of the New State Pension in 2016 will ultimately see the proportion of older people entitled to means tested Pension Credit dropping to 5% by 2050. This 5% will comprise individuals without sufficient National Insurance contributions to achieve a New State Pension above the level of Pension Credit, and without sufficient private pension income to do this. It may also include some people with higher incomes who are entitled to Pension Credit due to the additional payments for carers/sever disability and some housing costs

However, even in this scenario, take-up of Pension Credit will be voluntary. If take-up rates of Pension Credit among this 5% remain consistent with current observed take-up rates of around 65%, it can be estimated that in 2050 (when the State Pension Age will be 68),[19] around 1.75% of the older population will not receive the full New State Pension and not receive Pension Credit, i.e. they will experience income poverty.

According to the DWP, there will be 15.6 million people of pensionable age in the UK in 2035. Using this figure as a baseline, we can estimate that even with the New State Pension operating alongside means tested Pension Credit, there will be around 270,000 retirees with incomes below the level of the minimum income guarantee, by 2050, through non-take of Pension Credit.

In this way, the decision to retain an opt-in means tested income top-up alongside the New State Pension will ensure that pensioner poverty in the UK continues, given some individuals with inevitably have inadequate National Insurance Contributions for a full New State Pension.

3.7. Policy Options

The introduction of the New State Pension in 2016 will not fully eliminate retirement income poverty. To achieve this, the government has several options:

- **Increase generosity of the triple lock**

Among current pensioners with inadequate incomes, the triple lock is pulling individuals reliant on the State Pension, but not in receipt of Pension Credit, toward the level of income guaranteed by Pension Credit. This process could be enhanced, for example, by the government increasing the uprating of the triple lock by the higher of inflation, average earnings or a minimum of **3.5%**.

Such a change would prove effective at increasing the incomes of pensioners in poverty toward the level of Pension Credit, albeit limited by the fact that some pensioners do not receive a full State Pension owing to their contribution history.

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[19] DWP (2013) *The single-tier pension: a simple foundation for saving*, DWP, London

‣ Improve take-up of Pension Credit

Despite unsuccessful policy pilots to improve take-up of Pension Credit, the government could explore additional measures to improve take-up, particularly around improving knowledge of Pension Credit.

However, considerable resource and effort has already been expended by the DWP over a number of years in improving take-up of means tested Pension Credit, and it is unlikely that a breakthrough is achievable. Effective interventions could also represent poor value-for-money in terms of expenditure on administration, particularly given non-take up will be ultimately observable in relation to a group numbering only hundreds of thousands, as Savings Credit is phased out under the New State Pension.

‣ Widen eligibility for the New State Pension

Eligibility to the New State Pension could be widened, thereby reducing the number of people who receive a State Pension below the level of Pension Credit, and who will therefore have to rely on means tested Pension Credit to achieve an adequate income.

For example, the number of years of National Insurance contributions required for a full New State Pension could be reduced from 35 to 20, and the criteria for receiving National Insurance Credits could be eased, i.e. relating to unemployment, sickness, being a parent or carer.

This option would likely be highly effective at reducing pension income poverty and pose little additional administrative costs, but would cost more to the Exchequer, and potentially introduce some inequities in entitlement among those receiving the State Pension under more generous arrangements than preceding cohorts already retired.

‣ Non-contributory 'Citizen's Pension' at level of Pension Credit

On the government's projections, only 5% of the older population will be entitled to Pension Credit by 2050. Instead, over 80% will be entitled to the full New State Pension.

Instead of the full New State Pension set above the Minimum Income Guarantee level, there is a compelling rationale for lowering the expected value of the full New State Pension to the current Pension Credit guaranteed income level, and using the savings to fund a single, universal, non-contributory 'Citizen's Pension' at this level. By basing entitlement to this state pension on citizenship factors, rather than National Insurance Contributions, the government could ensure that everyone receives the full amount, considerably simplifying the administration of the state pension.

Such a policy would ultimately eliminate all retirement income poverty, and would also release savings from reduced means testing.

The principal issue for such an approach as an alternative to the New State Pension, would be the reduced value of the pension payable to retirees with sufficient National Insurance

Contributions for the full New State Pension. In addition, this option would not reward or incentivise additional National Insurance Contributions in the same way as the New State Pension, which was one of the principal aims of the policy.

If introduced for current retirees, the policy would eliminate current retirement income poverty in a stroke, in effect, replacing means tested voluntary Pension Credit, with a universal, non-contributory state pension.

- **Universal 'Citizen's Pension' + New State Pension**

A further option would be to operate a universal, non-contributory Citizen's Pension at the level of Pension Credit, but to offer a higher, additional State Pension to individuals with the most National Insurance contributions, in order to incentivise employment and saving.

Such a move would eliminate retirement income poverty completely with associated administrative savings, but reward greater National Insurance contributions with a higher state pension. However, it would also likely be the most expensive of all the options considered here, despite the availability of administrative savings.

3.8. Conclusion

This chapter has reviewed the operation of the State Pension and Pension Credit, why retirement income poverty persists and the limits to the New State Pension.

As described, the level of the New State Pension will be finalised during Autumn 2015, at a level expected to be above standard Pension Credit guarantee. However, even at such a level, the New State Pension may be considered by many to be inadequate to prevent retirement income poverty, and it does not seek to address the issue of poverty among current retirees.

Besides further increases to the level of the New State Pension – which would impose significant pressure on public spending – the principal alternative policy intervention would be to use private pensions policy to increase private pension incomes, so that individuals use their own private resources to avoid income poverty during retirement. This is the topic of the next chapter.

4. Private Pensions

4.1. Introduction

Private pensions policy exists to enable and encourage individuals to make their own private provision for retirement income. It aims to help people smooth their income over their lifetime, and to avoid relying solely on the state pension, which for most individuals would represent a significant drop in income at retirement, relative to their previous earnings.

In contrast to 'gaps' in state support reviewed in the previous chapter, inadequate private pension incomes can be considered the principal 'life course' driver of retirement income poverty, i.e. individuals with an insufficient private pension income – or none at all - to be able to adequately supplement the State Pension. Indeed, as the previous chapter noted, some individuals in receipt of Pension 'Guarantee' Credit may also receive a small private pension.

Alternatively, an inadequate private pension income may result in a retiree having a total income just above the level of means tested Pension Credit, at a level which many stakeholders would nevertheless consider to be inadequate.

Significant reforms have been implemented in UK private pensions policy over the last decade, for both workers and those at retirement.

In this context, this chapter explores:

- What is the current prevalence of private pension incomes?
- What are the limits to current private pension policy in reducing retirement income poverty, e.g. inadequate average contribution levels?
- How can these limits be addressed?

4.2. Private Pensions: An overview

Most private pension saving occurs via the workplace, in the form of '**occupational pensions**'. Two basic types of pension scheme can be identified:

- Defined Benefit (DB) pension schemes promise to pay a secure pension income linked to the number of years a person has contributed, and their level of earnings either at the point of retirement or an average of their earnings;
- Defined Contribution (DC) pension schemes, which comprise pension 'savings accounts' that individuals pay into, and are used to fund an income at retirement. Up until April 2015, rules on DC pension savings required most retirees to derive a secure pension income through purchasing an annuity.

In addition, some individuals have **personal private pensions**, which are pensions that individuals have saved into privately outside of their workplace, and which are wholly DC.

However, most private pension saving occurs in the workplace owing to the availability of employer pension contributions.

DB and DC pension schemes allocate risk differently: among DC schemes, individuals take on more risk (investment, inflation, etc.) compared to DB schemes. In recent years, the government has sought to re-balance the allocation of risk away from the individual by encouraging 'hybrid', so-called 'Collective DC' schemes in the workplace. However, it remains to be seen whether such schemes are widely offered or taken up.

4.3. Private Pension Incomes: An overview

Individuals in retirement may have one or both of an occupational pension, a personal private pension, or may have neither.

Occupational pensions

The percentage of pensioners with an occupational pension income has remained broadly consistent over recent decades, being 59% of all pensioner units (i.e. households) in 1996-97, and 61% in 2012-13.[20] The equivalent figures for pensioner couples were 71% and 68%, and for single pensioners were 51% and 55%.

However, the median value of occupational pension incomes has increased. The median occupational pension income for all pensioner units was £82 per week in 1996-97, but £135 per week in 2012-13 (2012-13 prices). The equivalent figures for pensioner couples were £120 per week rising to £186 per week, and for single pensioners the equivalent figures were £58 per week and £95 per week.

Personal private pensions

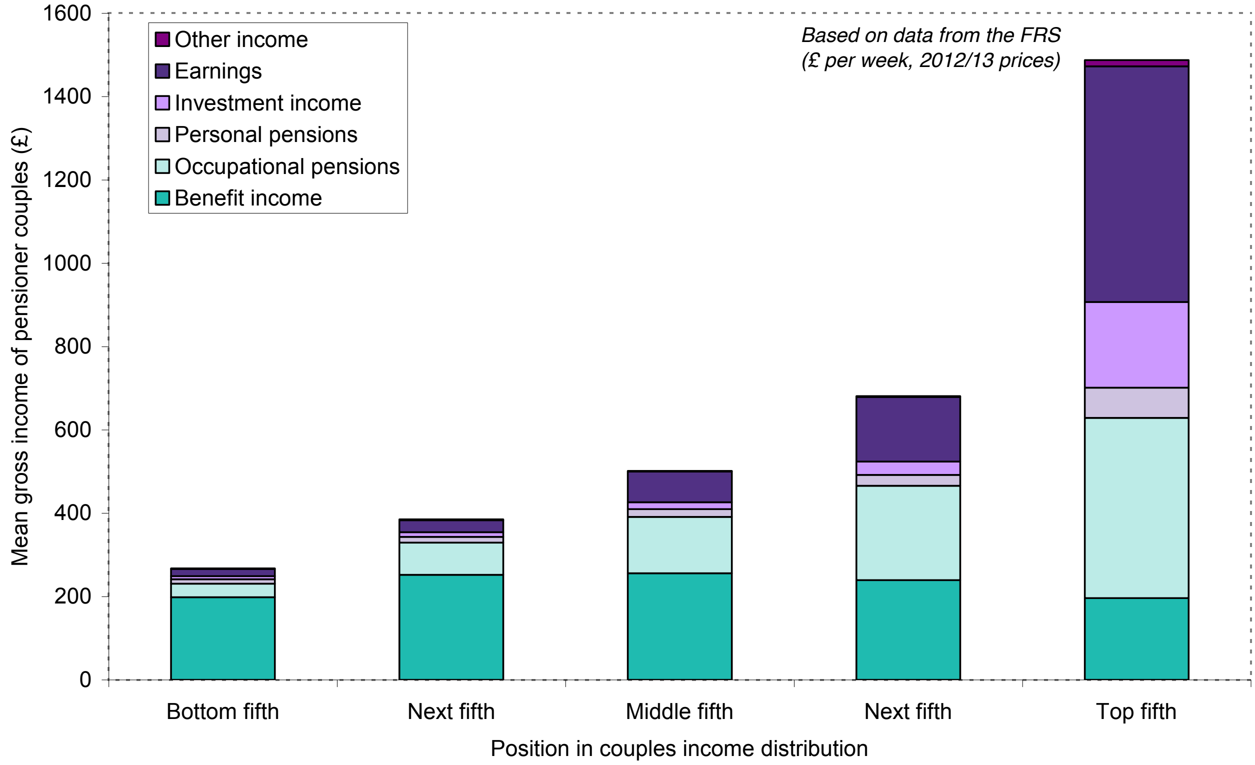
Fewer individuals have personal private pensions, although the prevalence has risen from 4% of all pensioner units in 1996-97 to 18% in 2012-13. However, the amount of income received from personal private pensions tends to be small. The median personal private pension income of all pensioner units was £39 per week in 1996-97 (2012-13 prices), and had risen to only £46 per week in 2012-13.

Distribution of private pension incomes

The following chart shows the distribution of net income by different types of incomes (per week), by total income quintile, for pensioner couples before housing costs.

[20] DWP (2014) *The Pensioners' Income Series*, DWP, London

Sources of gross income of pensioner couples by quintile in the net income (BHC) distribution, 2010-13



Source: DWP (2014) *The Pensioners' Incomes Series United Kingdom, 2012/13*, DWP, London

The chart shows that for pensioner couples in the bottom, fourth and middle income quintiles, the principal source of income is 'benefit income', i.e. the State Pension.

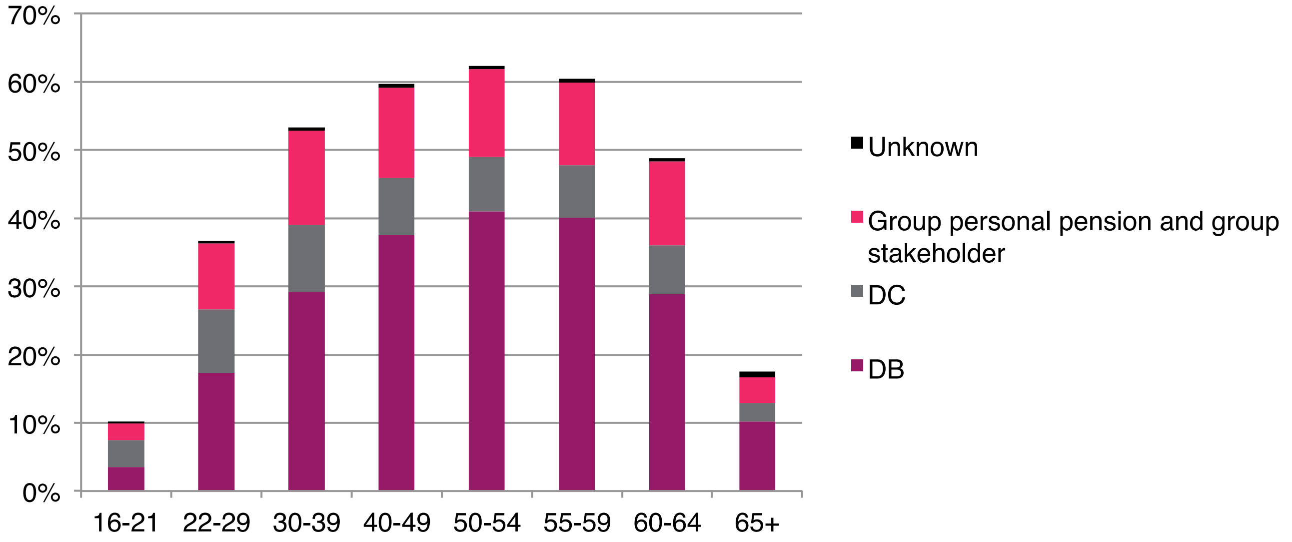
4.4. Participation in Private Pension Saving: The 'accumulation phase'

The percentage of employees – i.e. excluding individuals not in employment – across different age groups with a workplace pension of different types, is shown in the chart below.

The chart shows that the percentage of employees who were members of a workplace pension scheme in 2011 was 47.6%.[21] Around one-third (30.3%) were members of an occupational DB scheme, 6.4% were members of an occupation DC scheme and 10.2% were members of a group personal or group stakeholder scheme.

[21] Source: Annual Survey of Hours and Earnings (ASHE)

Percentage of employees with workplace pensions by age band and type of pension, 2013, UK



Source: ONS (2013) Annual Survey of Hours and Earnings: Summary of Pension Results, ONS, London

Individuals may not be contributing to an available workplace pension for a number of reasons, whether through choice (workers opting to allocate their earnings to other things) or individual circumstance (factors that affected earnings potential, such as long-term disability or low-level skills). However, the availability of workplace pension schemes is improving, as described in the next section.

Workplace pension reform

In order to improve participation in workplace private pension saving, the Coalition Government implemented the recommendations of the Pensions Commission, chaired by Adair Turner.[22] These reforms have three core components:

- Guaranteed **access** to a decent, workplace pension scheme for all 'qualifying' UK employees;
- Guaranteed **employer contributions** to a worker's pension scheme, to incentivise employee contributions;
- **Automatic enrolment** of new and non-participating employees, such that individuals have to actively choose to not participate.

Employers will automatically enrol workers into a workplace pension who are:

- Not already in a qualifying pension scheme;
- Aged 22 or over, and under State Pension age;
- Earn more than £10,000 a year (this figure is reviewed every year), and work or usually work in the UK. This is the salary 'trigger' level above which individuals are automatically enrolled.

[22] The Pensions Commission (2006) A New Pension Settlement for the Twenty-First Century, DWP, London

Automatic enrolment was launched in 2012, initially with the largest businesses enrolling their staff into a workplace pension scheme. By 2018, when the roll out is complete, it is expected that up to 9 million people will be newly saving or saving more. According to the DWP, around 9 out of 10 people who had been automatically enrolled in the first phase of implementation did not opt out of their workplace pension scheme.

From October 1st 2018, the minimum amount that any participating worker must contribute is 8% of their gross salary between £5,824 and £42,385, of which a minimum of 3% must be a contribution from the employer. The lower thresholds reflect a concern among policymakers with ensuring that individuals who are automatically enrolled can make reasonable savings to justify the administrative costs of a pension saving account, etc.

Individual contributions to workplace pension schemes under auto-enrolment remain free of income tax, i.e. a basic rate (20%) income tax payer effectively receives a contribution worth £0.20 for every £0.80 they contribute.

In addition to these measures to improve participation, the government has sought to improve the value-for-money of workplace pension schemes through a charge cap of 0.75% of funds under management in default workplace pension schemes.[23]

4.5. Private Pension Policy: Accumulation phase 'gaps' and how to fill them

The auto-enrolment reforms to workplace pension saving have already been successful in significantly improving the number of workers contributing to a workplace pension scheme.

However, once the phased introduction of auto-enrolment is completed in 2018, a number of key groups will still not be contributing to a pension.

- **Qualifying workers**

As described above, workers will only be automatically enrolled into their employer's workplace pension if they are aged over 22 and earn more than £10,000 per year, after which they must pay 8% of their gross salary between £5,824 and £42,385.

To increase the percentage of workers who qualify for auto-enrolment, this age limit could be lowered, and the earnings threshold reduced.

However, the principal argument made against enlarging the group of qualifying workers is that this would see some individuals saving very small amounts. For example, if the salary threshold was £9,000 per year, someone on this salary would be saving £254.08 per year, much of which may be used up by administrative 'sunk costs' and charges. If this salary was maintained over 35 years, a person would have saved £8,892 into a pension scheme, which some would consider too small for purchasing an annuity, as opposed to simply taking cash. Nevertheless, the £10,000 earnings threshold does risk excluding from automatic enrolment those individuals who are earning a lower salary for a limited period only; for example, parents of pre-school children working part-time.

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[23] DWP (2015) *The charge cap: guidance for trustees and managers of occupational schemes*, DWP, London

As such, the government could seek to extend duties on employers to assess people's individual circumstances, and automatically enrol individuals who appear to be earning a lower salary for a temporary period only, given it is likely to make sense for many individuals to save consistently even if they are experiencing a lower salary for a temporary period.

‘Opt-outs'

Following auto-enrolment, employees may opt-out of workplace pension saving for a variety of reasons, such as preferring to spend their earnings on entertainment, or choosing to save for a deposit to fund a home purchase. Even if such individuals subsequently choose to participate in workplace pension saving, for example, once they have bought their first home, they will nevertheless have missed out on several years of their employer's and their own contributions.

Previous research by the Strategic Society Centre on workers who withdraw from workplace pension saving found that the most powerful single predictor of being an ‘eligible non-saver' – who chooses not to save into a workplace pension scheme with employer contributions - was being a renter, in addition to being male, being younger and having a lower level of education.[24] Furthermore, a worker's attitudes (for example, to investing in property) and financial management (such as having money leftover at the end of the month) represented strong, independent predictors of being an ‘eligible non-saver'.

To minimize the prevalence of opt-outs following auto-enrolment, the Centre proposed:[25]

1. Regular statements of lost contributions for those who opt-out of their workplace pension to encourage participation;
2. Targeted financial management and advice for opt-outs identified as having poor financial management skills, for example, through a survey of employee confidence with financial matters;
3. Giving opt-outs the chance to reclaim lost employer contributions if they commit to re-join their workplace pension and remain in it for a defined period.

More widely, the Centre argued that policymakers should not see the decision of workers to opt-out as the ‘end of the story', but should use this self-determined status and growing evidence on why workers reject workplace pension schemes with employer contributions, to deploy targeted interventions that nudge workers to opting back in.

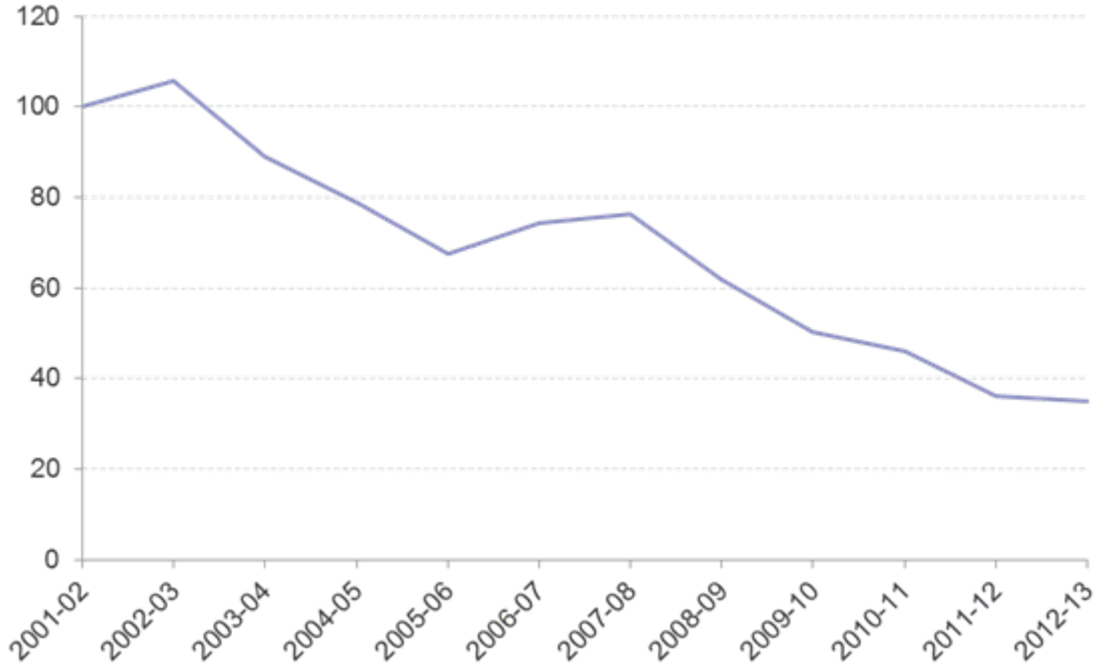
Self-employed

The auto-enrolment reforms to workplace pension saving will ultimately apply to any individual or organisation that has at least one member of staff who is paid via a PAYE scheme. The reforms therefore exclude individuals who are self-employed.

24 Bryan M et al. (2014) *Who Saves for Retirement 2: Eligible non-savers*, Strategic Society Centre, London
25 Lloyd J (2014) *Beyond Auto-enrolment*, Strategic Society Centre, London

The Resolution Foundation has estimated that among the 4.5 million self-employed workers in the UK – who may employ others, or be 'sole-operators' – the proportion saving into a pension has declined over the last decade by 60%, as the following chart shows.[26]

Index of percentage of self-employed people actively contributing to personal pensions (2001-02 = 100)



Source: Resolution Foundation (2015)

According to the Resolution Foundation, around two in five (41%) of self-employed workers without employees (who account for the vast majority of the self-employed workforce) say that they can't afford to save for a pension, which is higher than employees (33%) and self-employed workers with employees (28%). Importantly, this pattern is observed even among self-employed workers earning substantial amounts, such as £20,000 and £25,000.

Although self-employed workers do pay National Insurance contributions, and therefore build up entitlement to the State Pension, such low participation rates in private pension saving does suggest a significant amount of under-saving.

To encourage greater participation in private pension saving by the self-employed, the government could consider

1. Financial awareness campaigns, about both the importance of pension saving and the availability of income tax-relief;
2. Additional tax incentives;
3. 'Repackaging' income tax-relief as 'government contributions', given evidence that the key lever for encouraging participation in workplace pension saving is the availability of third-party (employer) contributions;[27]

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[26] D'Arcy C (2015) *The self-employed and pensions*, Resolution Foundation, London
[27] Bryan M et al. (2011) Who Saves for Retirement?, Strategic Society Centre, London

4. Free independent financial advice for starting a personal pension;
5. Personal pension schemes specifically targeted at the self-employed.

However, in the absence of pilot evidence, it is uncertain how effective each of these options would be.

‣ Contribution rates

As described above, under auto-enrolment the minimum total contribution rate is 8% of a band of earnings from £5,668 and £41,450 per annum, of which a minimum 3% must come from the employer. However, is 8% an adequate contribution rate?

Adequacy of contribution rates are evaluated in relation to the income 'replacement rate' they will likely achieve at retirement, with the target replacement income for a median earner being 67% of their pre-retirement earnings, and being dependent to a large extent on State Pension level and entitlement.

Two-thirds replacement rate

Private pensions policy in the UK has long incorporated the 'two-thirds replacement rate' measure as the target of pension policy, i.e. an income after retirement that is two-thirds of the value of someone's average pre-retirement earnings. Crucially, this rule-of-thumb measure assumes that individuals seek to smooth their income over their life course, and that housing costs – typically a mortgage paid off before retirement – comprise a third of person's pre-retirement expenditure, and this represents a potential flaw in the approach given the growing number of households living in the rented sector. On this basis, to smooth income, individuals are encouraged to aim for a 'replacement rate' in retirement of two-thirds of their average working-age income, and this has become the benchmark used in pensions policy development. Although someone who had not achieved a two-thirds replacement rate income in retirement might not be in relative or absolute poverty, they may nevertheless have experienced a significant drop in their standard of living.

However, it is important to note that individuals with low-earnings throughout working life may have saved consistently for retirement, but only been able to accrue limited pension saving, and experience retirement income poverty as a result.

To test whether 8% is an adequate contribution rate, the Pensions Policy Institute (PPI) modelled multiple scenarios – varying factors such as investment returns, inflation rates, etc. - to explore whether individuals would achieve an adequate replacement rate.[28]

The PPI found that in 49% of the cases generated in its modelling, a median earner could reach their target replacement income with private and state pensions income, if starting to save at age 22, retiring at State Pension Age (SPA), following a traditional lifestyle investment approach and contributing 8% of 'band (qualifying) earnings'. However, in 25% of scenarios,

[28] Redwood D and Carrera L (2013) *What level of pension contribution is needed to obtain an adequate retirement income?*, Pensions Policy Institute, London

projected income from state and private pensions was less than 75% of the target replacement rate.

Given the State Pension accounts for a larger proportion of their retirement income, lower earners actually have a higher probability of achieving their target replacement income than median or high earners.

To increase contribution rates, the government could increase the default contribution rate following auto-enrolment from 8%. However, the higher the default contribution rate, the more likely it may be that workers will opt-out as they notice a more significant segment of their earnings being removed at source.

Confronted with this dilemma, pension policy debate has featured discussion of so-called **auto-escalation**, in which individuals pre-commit to increases in their contributions, potentially linked to (annual) pay rises. Given such increases would only occur substantially later after they had adjusted to an 8% contribution rate, it is hoped that the small additional contributions would be unlikely to trigger withdrawals from pension saving.

However, auto-escalation may be limited in its effectiveness given labour market mobility, and employees changing jobs on a regular basis.

4.6. Private Pension Saving: The 'decumulation phase'

Individuals who have contributed to a DB pension scheme will begin receiving their DB pension when they retire.

Previously, for DC pension savings, at the point of retirement, individuals were effectively required to turn these savings into a secure retirement income, which for most involved purchasing an annuity.

However, since April 2015, individuals are able to drawdown or cash-in some or all of their DC pension savings from the age of 55, paying only their marginal rate of income tax on any withdrawals. In this way, the government has moved the UK from a system of 'mandatory annuitisation' of DC pension funds to a system of 'voluntary annuitisation', breaking with the so-called 'annuities deal' that has been the foundation of UK private pension policy since the Finance Act of 1921.

At the time of writing, there is no comprehensive evidence available detailing how DC pension savers are behaving in response to the April 2015 rule changes, and ultimately, the real effect on behaviours may only become clear over a number of years.

Nevertheless, independent research has highlighted the relatively low levels of financial capability of DC pension savers at retirement, and the risk of poor financial decision-making and individuals ultimately receiving lower incomes.[29] Indeed, such decision-making could result in increased retirement income poverty if retirees reliant on their DC pension pots

[29] Lloyd J and Lord C (2015) *Defined Capability: Pensions, financial capability and decision-making among retirees*, Strategic Society Centre, London

choose to cash-in or drawdown their value, spend this money, gift it to relatives or simply leave it in a savings account.

4.7. Private Pension Policy: Decumuation phase 'gaps' and how to fill them

How can policymakers minimise the prevalence of retirement income poverty resulting from the at-retirement decisions of workers retiring with DC pension pots.

In addition to the provision of financial advice, the Strategic Society Centre has argued for the implementation of a new default 'automatic income plan' for DC savers at retirement. Such an approach echoes the conclusion of the 'Murray Inquiry' in Australia,[30] and the blueprint for a core retirement income strategy published by Nest (National Employment Savings Trust).[31]

This default automatic income plan would provide a predictable, secure (guaranteed) and good-value income for DC retirees.[32]

By setting a secure retirement income as the default option for individuals accessing their pension DC savings, this approach would likely result in more people have a higher income in retirement than they would otherwise, thereby reducing retirement income poverty.

4.8. Conclusion

This chapter has reviewed how inadequate private pension incomes can contribute to the incidence of retirement income poverty, whether reflecting low contribution rates, low participation rates or the decisions of retirees.

Ultimately, however, the positive effects of pension saving for retirement income can be completely undermined if individuals rent in retirement. This issue is therefore explored in the next chapter.

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30 Murray D et al. (2014) Financial System Inquiry – Final Report, The Treasury, Australia
31 Nest (2015) The future of retirement - A retirement income blueprint for NEST's members, Nest, London
32 Lloyd J (2015) *Default Reform: Preventing low incomes with a default automatic income plan*, Strategic Society Centre, London

5. Housing Costs

5.1. Introduction

The previous chapters have explored the role of state and private pension incomes in ensuring that individuals have adequate incomes in retirement.

This chapter turns to focus on one of the potential expenditures that pensioners may have – housing costs – which may result in older people not having enough income.

Indeed, although the Pension Credit system should ensure that no individuals experience income poverty after housing costs, DWP data shows 24% of pensioners living in social rented housing and 35% of pensioners living in private rented housing experience relative income poverty, after housing costs.[33] Such poverty may not simply reflect incomplete take-up of Pension Credit.

This chapter therefore considers the different types of housing costs older people may have, how these costs may result in retirement income poverty, and what can be done to ameliorate this outcome.

5.2. Housing costs in retirement

Housing costs in retirement may comprise:

- Rental costs in the social rented sector (council housing, housing associations, etc.);
- Rental costs in the private rented sector;
- Mortgage repayment costs for homeowners;
- Maintenance costs, e.g. homeowners repairing 'wear and tear';
- Other housing-related costs, notably Council Tax.

What is the prevalence of housing costs in the older population? The following table shows the tenure of the 65+ population in England and Wales, derived from Census 2011 data.[34]

Tenure, 65+, England, Wales (Census 2011)

	England	Wales
All individuals	8,343,008	542,630
Owned outright	5,733,611	391,447
Owned with a mortgage or loan or shared ownership	774,656	46,523
Social rented	1,347,599	73,081
Private rented or living rent free	487,142	31,579

Source: Census 2011

33 Shale J et al. (eds.) (2015) *Households Below Average Income*, DWP, London
34 Living rent free refers to those living with family, friends or others who do not own the property, but do not pay any rent for living there.

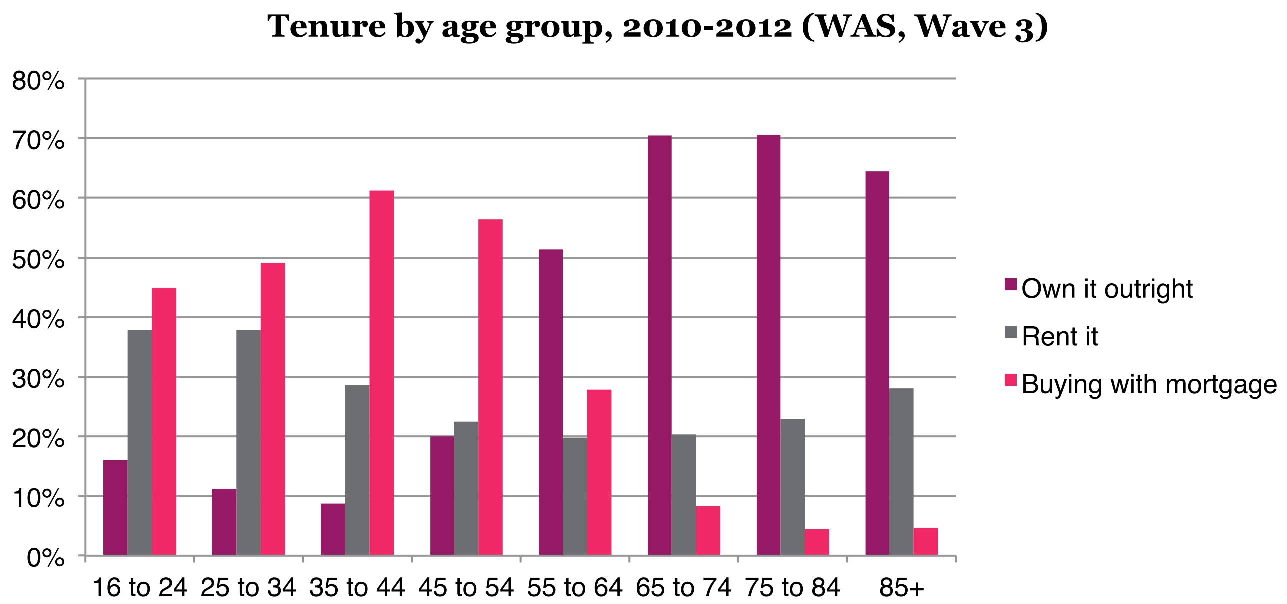
The table shows that there are around 1.83 million older people in England living in households with rental costs (social and private), representing 22% of the older population. A further 9% of the older population in England owned their property with a mortgage or through shared-ownership schemes. In total, this represents around 2.6 million people aged over 65 in England during 2011 living in households with housing costs (rent or mortgage).

In contrast, around 5.7 million older people lived in homes that were owned outright, so had housing costs limited only to maintenance and upkeep.

In addition, some individuals aged 65 or over living in rental accommodation may be living with relatives or a partner who is under 65, and therefore not have principal responsibility for meeting rental costs.

Tenure and age

Within the 65+ population, patterns of tenure vary, as shown by the following chart, comprising analysis of the Wealth and Assets Survey (WAS).



Source: Lloyd J and Lord C (2015) *Defined Capability: Pensions, financial capability and decision-making among retirees*

The chart shows the percentage renting in the 85+ age group is slightly higher than the 65-74 age group. In addition, the chart makes it clear that it is not only individuals who are just above the state pension age who still live in housing with outstanding mortgage debt.

5.3. State support for rental costs

Older people who rent their home but struggle to afford their rental costs may apply for state support in the form of means tested Housing Benefit - which for the private rented sector is called Local Housing Allowance.

There is no set amount of Housing Benefit that individuals are entitled to. In part, the amount will reflect a household's total income, including both state and private pension income. It will also be determined by: whether a household rents privately or from a council; their household circumstances; and, whether they have empty rooms. In fact, Housing Benefit may not cover all of a household's rental costs if deductions are made, for example, owing to non-dependents living there.

As with means tested Pension Credit, take-up of means tested Housing Benefit is incomplete. Although around 1.5 million pensioners were in receipt of Housing Benefit in 2013-14, around 260,000 eligible pensioners did not claim according to the DWP, representing a take-up rate of around 85%.[35]

5.4. Rental costs, retirement income poverty and private pensions

Rental costs may result in retirement income poverty, even when individuals have a private pension income – showing how tenure can affect the success of private pensions as a policy intervention to reduce poverty.

This is because older renters with a pension income would normally be expected to use most of their private pension income above the level of Pension Credit to pay their rent.[36] If there is still a shortfall in their income, means tested Housing Benefit – or Local Housing Allowance for those in the private rented sector - may be claimed to cover any outstanding rental costs.

According to official statistics, in February 2015, there were 1,277,111 Housing Benefit claimants aged 65 and over in Great Britain, and the average amount received £84.25 per week.

However, Census 2011 data indicates there were 1.8 million older renters in England alone, and 100,000 in Wales, suggesting many older renters do not receive Housing Benefit, and may be funding their rental costs using a private pension.

In fact, around one-third of retirement age renters receive a pension from a previous employer, as the following chart shows:

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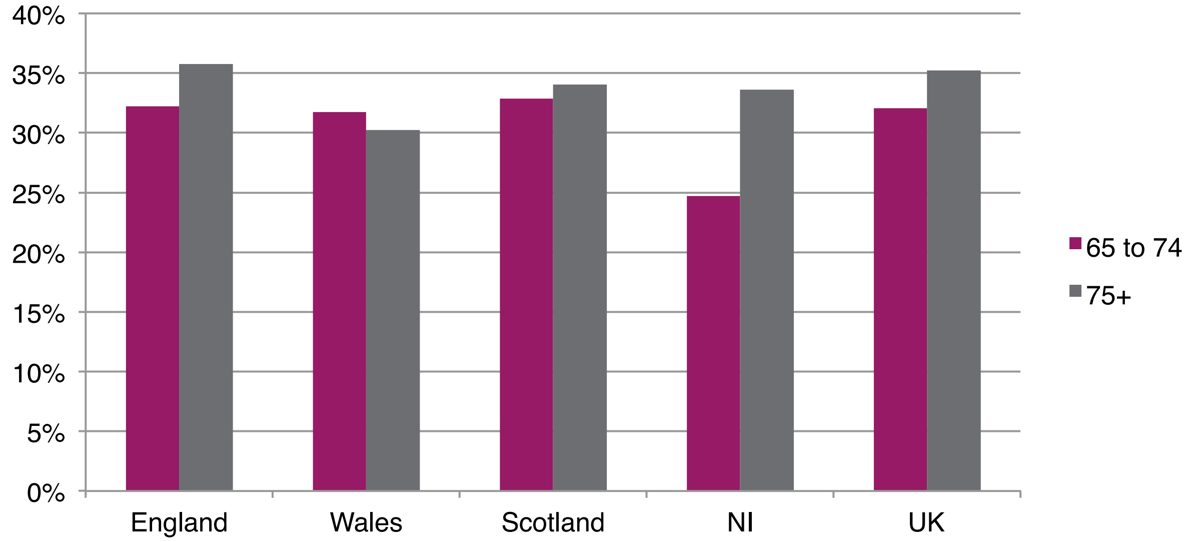
35 Johnson P et al. (2015) *Income-Related Benefits: Estimates of Take-up - Financial Year 2013/14 (experimental)*, DWP, London
36 Housing Benefit is subject to a taper.

Receives a pension from a previous employer, renters 65 to 74 and 75+, UK, 2011-12 (USoc)



Source: Lloyd J and Parry W (2015) Older Owners, Strategic Society Centre, London

Applying these proportions to Census data on tenure, we can estimate there are around 620,000 renters aged 65+ with an occupational pension in England, and 30,000 in Wales.

As noted above, the median occupational pension income for all pensioner units was just £135 per week in 2012-13 (2012-13 prices). This suggests that a significant percentage of pensioner households below the median may have occupational pension incomes that are below the average amount received in Housing Benefit.

In this way, we can assume that for pensioner renters with a private pension income, much of the real, net value of this income may be means tested away, i.e. the private pension income that they have saved for merely disqualifies them from receiving the equivalent amount of Housing Benefit from the state. Such individuals may as a result find themselves experiencing retirement income poverty with total incomes not much above the level of Pension Credit guaranteed level of income.

5.5. The future cost of Housing Benefit for older people

Importantly, the proportion of pensioners who rent is likely to grow considerably in future, from the historic lows observable in today's older cohort, with significant consequences for public expenditure.

Previous analysis by the Strategic Society Centre estimated what the implications of more retired renters in future would be for total public expenditure on Housing Benefit in the UK, - which cost around £21.4 billion in 2010-11.[37]

[37] Lloyd J (2012) *The Future Cost of Housing Benefit for Older People*, Strategic Society Centre, London

The analysis noted that in 2009-10, there were 1.48 million pensioners receiving housing benefit in the UK, out of a total of 4.07 million recipients across all age groups - suggesting that around 11.8% of pensioners receive Housing Benefit.

By 2030, the number of pensioners in the UK will have grown from 12.6 million to 15.9 million. However, by the time that someone aged 20 in 2010 has reached the age of 70 in 2060, the number of pensioners in the UK will have increased from 12.6 million to 18.8 million.

Crucially, the proportion of people living in owner occupied homes in England is projected to fall from a peak of 72.5% in 2001 to 63.8% in 2021. For example, in 1997 over 40% of those aged under 30 owned their own home and 30% rented private accommodation. In 2009, less than 30% owned their home and nearly 50% rented privately.

The analysis assumed that among today’s s 20-year olds, two out of five will rent for their whole life, and that by 2060, as now, around 50% of pensioner renters receive Housing Benefit.

On this basis, the analysis projected that by 2060, there will be 3.76 million pensioners claiming Housing Benefit, and the UK Exchequer will have to spend an extra £8.13 billion on Housing Benefit for pensioners compared to today, totalling around £13.45 billion each year.

This simple projection highlights the potential savings in long-term public expenditure that could be achieved through raising rates of owner-occupation among younger cohorts, thereby reducing future demand for Housing Benefit. Such analysis is important as it shows that public spending on measures to increase rates of owner-occupation for young and working-age individuals can be offset against higher future expenditure on Housing Benefit that will otherwise occur.

5.6. Rental costs and retirement income poverty: policy options

What can be done to reduce the prevalence of retirement income poverty owing to people renting in retirement?

- **Improve take-up of Housing Benefit**

As with Pension Credit, improving the take-up of Housing Benefit would reduce the incidence of retirement income poverty. However, no research is available on the incomplete take-up of Housing Benefit among older people specifically. Nevertheless, similar barriers to take-up of Pension Credit around knowledge and awareness may be relevant.

- **Disregard a greater amount of private pension income in Housing Benefit means tests**

The simplest way to prevent older renters with a private pension experiencing retirement income poverty would be to disregard a greater fixed amount of private pension income in the means test for Housing Benefit. This would allow individuals to keep a portion of their private pension, lifting their income above the Pension Credit guaranteed level of income. This may be particularly significant in the context of the New State Pension and the end of Savings Credit.

The principal issue for such a disregard would be the cost to the Exchequer.

- **Increase owner occupation rates**

To prevent retirement income poverty owing to rental costs, the government could ensure that more older people in future own their home, and have paid off their mortgage.

A broad range of policy interventions could be deployed to achieve this end:

1. Increasing housing supply would reduce the cost of purchasing a home, improving affordability;
2. Subsidising and underwriting mortgages for first-time buyers would help more people on to the property ladder.

As previous research by the Strategic Society Centre has noted, a considerable driver of declining owner-occupation among younger cohorts has been the growth in the size of the private rented sector, and the steady increase during recent decades in the number of private landlords.[38]

To increase rates of owner-occupation in the context of these changes, the Strategic Society Centre recommended the government:[39]

3. Implement a 'new-build buy-to-let mortgage moratorium', preventing the purchase of new- build homes with buy-to-let mortgages for the foreseeable future;
4. Implement a 'three-year rule', such that short-term tenancy agreements cannot be drawn up in relation to homes that are less than three years old;
5. Implement a 'buy-to-let lending cap' on the proportion of mortgage lending by banks that can be distributed as buy-to-let mortgages for purchasing owner-occupied housing;
6. Review the wider financial incentives and investment returns available to private landlords via the rental sector.

In addition to reducing retirement income poverty in future, such measures would also reduce the future cost of housing benefit to older people, bringing significant savings to the Exchequer.

5.7. Mortgage costs and retirement income poverty

This section turns from rental costs in retirement to looking at mortgage costs facing older people.

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38 Lord C et al. (2013) *Understanding Landlords: A study of private landlords in the UK using the Wealth and Assets Survey*, Strategic Society Centre, London
39 Lloyd J (2013) *Whose Home? Understanding landlords and their effect on public policy*, Strategic Society Centre, London

According to Census data, 774,656 individuals in England aged 65+ owned their home with a mortgage in 2011 (around 9.3% of the older population). As the chart above shows, 5% of those aged 85+ own their home with a mortgage.

Importantly, it should not be assumed that retirees with outstanding mortgage debt have arrived in this situation by accident, for example, because of early retirement through ill health or receipt of poor financial advice.

For example, some individuals may have mortgage costs in retirement as a result of choice, if they have substantial assets, and decided to exploit low interest rates to live in more expensive housing during retirement purchased using an interest only mortgage.

Alternatively, some individuals aged 75+ with a mortgage may have chosen to take out commercial ‘equity release’ products – reverse mortgages – against the value of their home, and these are explored in more detail below.

Nevertheless, some individuals in retirement may struggle to meet the cost of their mortgage payments.

Such individuals cannot claim any form of Housing Benefit. Instead, state support is limited to individuals on Pension Credit, and comprises Support for Mortgage Interest (SMI), for interest costs arising from no more than the first £100,000 of a mortgage loan. SMI is normally paid directly to a person’s mortgage lender. No data is available on claimants among the older population.

5.8. Mortgage costs and retirement income poverty: policy options

Where individuals do experience unplanned mortgage debt in retirement that they cannot afford, several policy options are available to prevent retirement income poverty:

- **Financial advice**

Retirees with mortgage debt and a low income could be guaranteed free financial advice, to help them plan their income, and if necessary, restructure their mortgage. For example, some individuals retiring with repayment mortgages may be best advised to simply re-mortgage and switch to an interest-only mortgage. Such a change would reduce their mortgage costs, although it would also ensure that an outstanding mortgage debt remained on their property for the rest of their life, before being repaid through the sale of the home on their death.

- **Shared ownership**

For some individuals, the government could encourage shared-ownership schemes for retirees, whereby housing associations take an equity stake in a retirees home, thereby removing their mortgage debt, and allowing them to remain living in the property.

5.9. Conclusion

This chapter has explored how renting in retirement can be a cause of retirement income poverty, underlining the importance and value of high rates of owner-occupation for reducing poverty.

Indeed, for older people who own their own homes, there may be an opportunity to prevent income poverty through the use of housing wealth, and this is explored in the next chapter.

6. ‘Asset-rich, income poor’

6.1. Introduction

Ultimately, poverty in retirement is a function of resources, not income. As such, individuals with substantial levels of wealth would not normally be considered as experiencing poverty.

Nevertheless, some pensioners with inadequate incomes are in possession of significant (housing) wealth. As such, these households could be lifted out of income poverty through their own resources, without additional public expenditure.

It is therefore worthwhile considering those individuals with retirement incomes at, or just above, the level of Pension (Guarantee) Credit who may in fact be ‘income poor, asset rich’, and experience a form of ‘liquidity poverty’. What can be done to help such individuals lift their incomes?

6.2. Exploring ‘liquidity poverty’

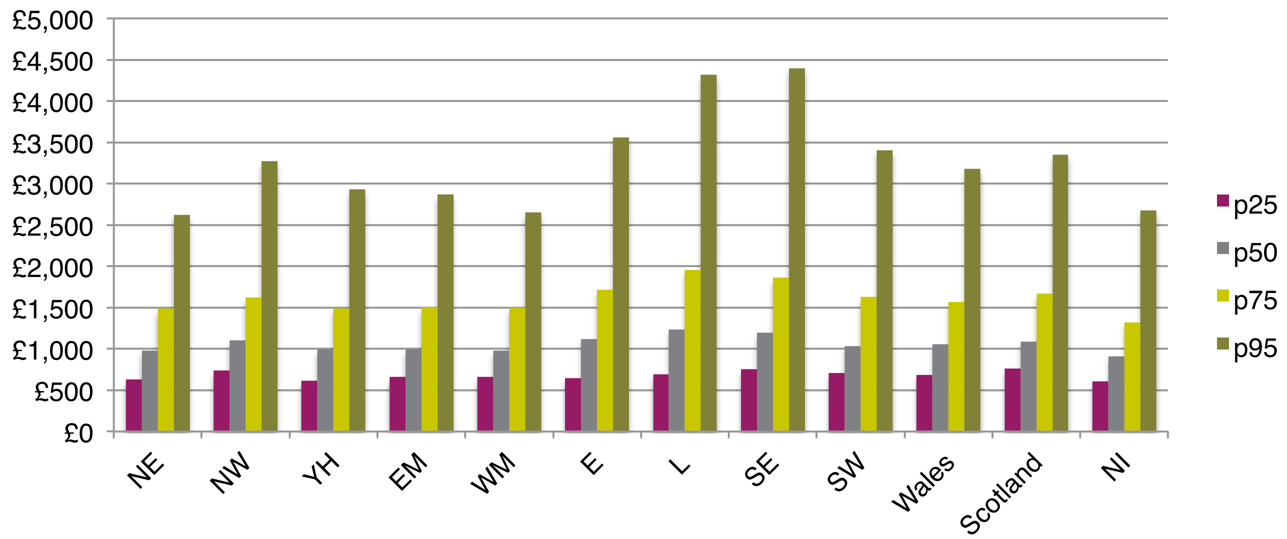
Most types of income and wealth are positively correlated across the population: individuals with higher incomes over their life course typically have higher levels of liquid (savings, investments) and illiquid wealth (property).

However, in the context of high levels of owner-occupation among the UK’s ‘baby-boomer’ generation, coupled with several decades of above-inflation house price increases, some retirees in the UK who experience inadequate incomes may nevertheless be in possession of significant housing wealth.

For these individuals – who may represent only a small proportion of the older population – the illiquidity of their overall wealth can be identified as a cause of their income poverty. Put another way, they have sufficient overall wealth to afford a better income so cannot be strictly defined as ‘poor’. However, the fact that their wealth is in the form of illiquid housing wealth means that it cannot easily be used to provide an income, and the person therefore experiences income poverty.

Levels of income among older homeowners vary significantly by area. Among the poorest 25% of older homeowners, total gross monthly personal income is between £650 and £750 per month (£22 to £25 per day), as the following chart shows:

Total gross monthly personal income by percentile, 65+ homeowners, UK, 2011-12 (USoc)

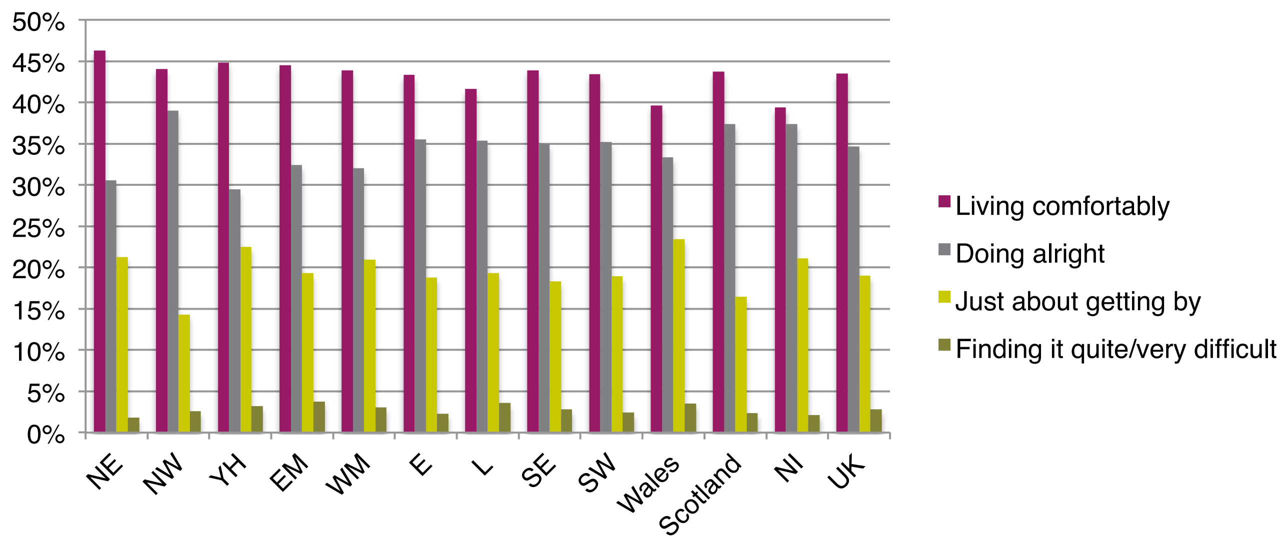


Source: Lloyd J and Parry W (2015) Older Owners, Strategic Society Centre, London

This suggests that many older homeowners do indeed have incomes around the threshold of income poverty.

Nevertheless, a feature of retirement is that many individuals adjust their expenditure to their income, with the result that few older homeowners report being in financial difficulty, as the following chart shows:

How managing financially, 65+ owners, UK, 2011-12 (USoc)



Source: Lloyd J and Parry W (2015) Older Owners, Strategic Society Centre, London

This suggests that although many older homeowners may experience a low income, they may not regard themselves as struggling financially, and may not therefore be motivated to use their housing wealth to improve their income.

6.3. Policy options

What can be done to lift retirees out of 'liquidity poverty', i.e. use their housing wealth to fund a higher income?

- **Help with downsizing**

Some low-income older people may not use their housing wealth to fund a better income, because they experience difficulties 'downsizing' their accommodation to release capital.

In this context, the government and older people's charities could provide help with downsizing, such as information and advice services, although no evidence is available as to the effectiveness of these options.

- **Increase supply of specialist accommodation**

A further reason that older people may not move home to release capital and fund their income is because of a lack of attractive homes they wish to move into. In this context, the government could implement measures to increase the supply of specialist accommodation, for example, through strengthened planning guidance to local authorities and tax-exemptions for developments.

- **Financial products**

An alternative mechanism to release housing wealth in retirement besides downsizing is to use equity release products offered by financial services providers.

However, usage of such products is low and tends to be focused on wealthier older households, as the findings of the Equity Release Council 2014 market report suggest:

- Over 10,000 equity release products were taken out during the second half of 2013;
- The typical equity release customer in 2013 owned property worth £254,943;
- The average size of equity release loans in 2013 was £56,917;
- Consumers choosing lump sum mortgages borrowed £61,351 on average in 2013, while those opting for drawdown mortgages on average released £54,546;
- On average, new customers released 22% of the equity of their home.

Ultimately, although equity release products do enable individuals to access the value of capital in their home, owing to interest costs and administration charges, individuals must pay for doing so, such that the products are not perceived as good value by some.

- **Disregard released housing equity from Pension Credit means test**

Some individuals who could use housing wealth to supplement their retirement income may be dis-incentivised from doing so, if they are in receipt of means tested Pension Credit. This is because housing capital released through downsizing would constitute liquid savings in the context of the means test for Pension Credit above a threshold of £10,000, so by releasing housing capital, individuals would in fact be reducing their entitlement to means tested Pension Credit.

In this context, there may be some arguments for the government to exclude capital released in this way from the Pension Credit means test, although there are also significant fiscal policy arguments for not doing so. However, over time, such an issue may decline in importance owing to the introduction of the New State Pension.

6.4. Conclusion

As this chapter has noted, inadequate retirement incomes among some pensioner households may not reflect inadequate resources, but the fact that people's wealth in retirement is locked in a non-liquid form, i.e. property. Improving how wealth is allocated in this way could be a direct lever to reduce retirement income poverty, but at relatively little cost to the state.

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