

# PUT IT ON THE HOUSE:

## *the promising, largely untapped potential for Australian home equity in retirement*

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*Concern for the financial welfare of Australian retirees is growing with the first of Australia's generation of baby boomers starting to retire and government and community resources for the aged being increasingly stretched. The financial wellbeing of some retirees may be tested even though most baby boomers own their principal place of residence. This paper examines the potential role that home equity can take in supporting retirement lifestyles in Australia, the present gap in appropriate financial products, decumulation phase planning and consumer awareness of the options in this area.*

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The purpose of this analysis is to provide insights into the current and potential utilisation of home equity in supporting retirement incomes and healthy ageing in Australia. The extant literature on Australian home ownership has identified that Australians have relatively high levels of home ownership, particularly among older age groups, when compared with other developed countries. The literature also shows that affordability of housing, both for purchase and renting, has continuously declined in Australia over the past three decades. Potentially, this can affect wealth accumulation over the lifecycle, thereby placing pressure on related housing sectors, including the rental market and public housing.

The biggest factor relating to this pressure on housing is the ageing of the Australian population, one of the most important systemic shifts and policy challenges for Australian public policy makers and private industry. From 2007 to 2051, the proportion of the Australian population aged 65 and over will increase from 13 per cent (2.8 million) to between 23 per cent and 25 per cent (7.8 million and 10.4 million) while that for persons aged 85 years and over will more than quadruple from 0.3 million in 2007 to 1.73 million in 2056 (ABS 2006). For the most part, discussion about retirement income has generally focused on Australia's three-pillar approach to retirement income, comprising: (i) a safety net consisting of a means-tested government-funded age pension system; (ii) private savings generated through compulsory contributions under the superannuation guarantee; and (iii) voluntary individual savings through superannuation and other investments (Commonwealth of Australia 2012a).

There may be potential for increased consideration by consumers of the phases of wealth and related strategies and products, that is, accumulation, holding and decumulation throughout the lifecycle, with particular focus needed after retirement (Spicer et al. 2013). A survey on the financial literacy of 2,200 Australians aged 40–74 years in 2011–12 found that financial knowledge is higher among people aged 50 years and over compared with their younger counterparts. Women were found to have lower levels of self-assessed knowledge than males. Professional financial advice was currently being accessed by 18 per cent of respondents and had previously been used by 41 per cent (Productive Ageing Centre 2013). While there is a large decline in the use of professional financial advisers once people reach retirement, this could be an area of potential growth for advice; that is, managing the decumulation phase of retirement, including assets such as housing.

While home ownership has long been considered a central pillar of Australian retirement planning in terms of its impact on wealth, reinforced by tax and benefit subsidies, housing equity has seldom been the subject of research in terms of the provision of retirement income (Bradbury 2010a, 2010b; Bradbury and Gubhaji 2010; Bradbury and Mendolia 2012; Productive Ageing Centre 2012a).

The question of how households may achieve decumulation of housing equity, particularly when faced with financial stress or a health shock, needs to take into account both the risk profile of individual Australian retirees and also the embryonic state

of large-scale management of the retirement decumulation phase.

As well as the option of downsizing, products such as reverse mortgages<sup>1</sup> and reverse annuity mortgages (RAMs)<sup>2</sup> already exist. But there are gaps in the options that are available to retirees when looking to decumulate housing equity. For instance, only a fraction of the 5.5 million baby boomers will have the option to downsize their property in terms of price. Recent research has turned to new financial instruments to increase options for funding housing, including 'housing supply bonds' which are designed to channel private investment into the affordable rental market in the form of an increased supply of community housing (Lawson et al. 2012).

The Productivity Commission report, which was released in November 2013, offered suggestions to ease the fiscal pressure of an ageing population such as increasing the age pension entitlement age to 70, and a housing equity release scheme targeted at older households. This equity release scheme would, for example, require individuals to contribute around half the annual real increase in their home values towards aged care services. However, this scheme would be less fair to those owners who became buyers late in their lifecycle and had not benefited from a lifetime of equity growth. Some older householders may have just paid off their mortgage or still be paying it off. There is also an assumption that house prices will keep going up. As recent fiscal crises have highlighted, there would need to be another option for when house prices are on a downward trajectory.

In 2013, a new 'fractional investment' product was launched enabling investors and property owners to trade fractional investments in real property represented by units in a fund linked to a specific property of their choice (DomaCom 2013). This type of product is perhaps an indication of other options for both investors and property owners that are likely to change the way housing equity is drawn down in Australia by an ageing population.

This work highlights the potential for new financial products designed for the decumulation of existing housing equity. However, as highlighted in the housing supply bond research, 'development of any new financial product needs detailed examination of the local regime influencing the flow of investment and pace of development. It also requires extensive consultation and awareness raising among key industry stakeholders' (Lawson et al. 2012).

In sharp contrast, the role of superannuation has been the subject of much policy, media and academic attention, as it represents a highly effective tool for accumulating savings and decumulating for income in retirement. Total superannuation assets

reached \$1.6 trillion as at June 2013 (ASF 2013), which is equivalent to estimates of Australia's gross domestic product (GDP) for 2013. The expectation is that Australia's superannuation assets will exceed 150 per cent of GDP by around 2040 (Productivity Commission 2012). However, considering that the value of Australian home ownership is currently more than \$5 trillion (ABS 2013), with one-third of Australian households owning their home without a mortgage (ABS 2009), further innovation may be necessary to develop products for decumulating housing equity to provide retirement income.

### Data analysis

We use data from the Household, Income, and Labour Dynamics in Australia (HILDA) Survey as the main Australian source of comprehensive, high-quality, longitudinal panel data on individual and household economic and social dynamics (Melbourne Institute of Applied Economic and Social Research, 2012). The HILDA data shows that primary home value represents in excess of two-thirds of all net worth for respondents aged 45 years and over.

Australia has a high rate of home ownership, particularly among retirees. What is of interest, and concern, is that while the proportion of Australian home owners aged 55 to 64 years has remained relatively stable between the 1994–96 period (80 per cent) and 2009–10 (82 per cent), the proportion of home owners aged 55 to 64 with a mortgage has tripled from 10 per cent to 30 per cent in that same time (ABS 2003–04, 2011).

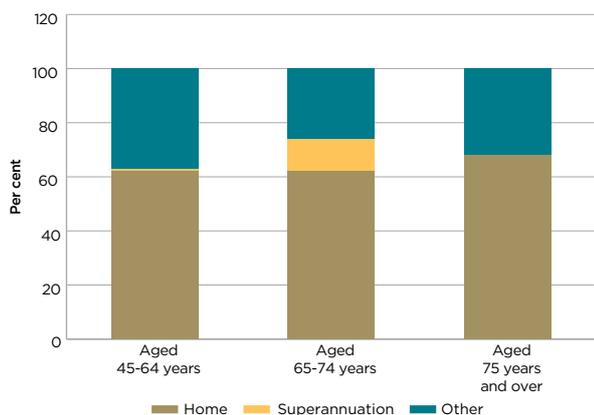
Another issue is that some of those older Australians approaching retirement with outstanding mortgage debt may be paying off their mortgage debt using lump sum superannuation payouts that become accessible on reaching the preservation age. Some may choose not to pay off their mortgage quickly and instead redirect funds into superannuation for personal tax effectiveness. Those who do not use their superannuation to pay off their mortgage in a lump sum at retirement will presumably continue making regular mortgage repayments after they retire (Ong et al. 2013).

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*Arguably then, the equity in the home should be viewed as accessible for income-generating purposes in retirement, just as a superannuation payout may be used to pay off a mortgage.*

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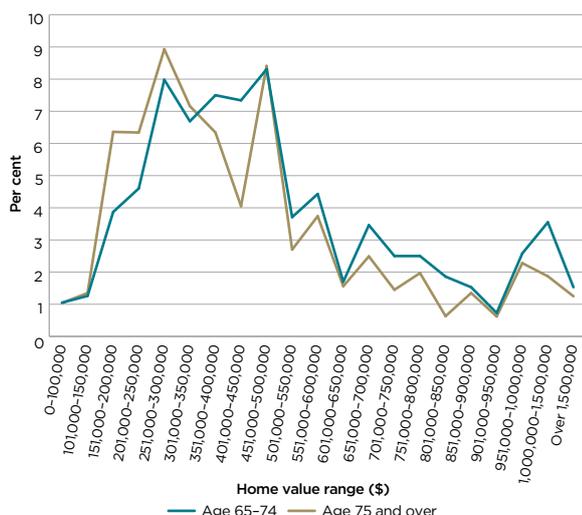
**FIGURE 1: Proportion of net worth comprised by home value, superannuation and other, by age, 2010**



Source: HILDA Wave 10 observations: 45-64 years (3,243), 65-74 years (980), 75+ years (673).

Figure 1 depicts the proportion of net worth comprised by home equity, superannuation and all other financial assets (including bank accounts, stock held outside of superannuation, insurance, bonds, fixed interest securities, value of own business, collectibles). As shown, home equity comprises a very high level of net worth. For instance, for respondents in Wave 10 of HILDA (collected in 2010), for persons aged 65 to 74 years, the median proportion that home equity contributes to overall net worth is 62 per cent, and 68 per cent for those aged over 75 years. This underlines the importance of home equity as a potential source of equity and income in retirement, particularly for Australians with lower superannuation balances.

**FIGURE 2: Percentage of Australian home owners aged 65-74 years and 75 years and over by home value, 2011**



Source: HILDA Wave 11 observations: 65-74 years (980), 75+ years (673).

Disaggregating this data further, Figure 2 details the proportion of Australian home owners aged 65-74 years and 75 years and over against the continuum of home value increments. As shown, the median home value is \$350,000 for persons aged 65-74 years and \$300,000 for those aged 75 years and over. In general, while the median home values are relatively modest, this remains the most significant component of household wealth which could potentially provide an income in retirement, particularly as the introduction of superannuation largely post-dated these retirees.

## Discussion

From a theoretical point of view, the choices of many Australians are at odds with behavioural lifecycle theory, which predicts that in the later years of life, individuals decumulate assets (including housing equity) to support future retirement consumption needs.

One response has been the growth of the reverse mortgage market in Australia. The industry peak group, SEQUAL, maintains a record of the activity levels of its members. As at the end of December 2011, SEQUAL estimated there were approximately 42,000 reverse mortgages on issue in Australia, with a total loan book size of \$3.3 billion (Bridge et al. 2010). While this represents 10 per cent growth in the value of new lending over the 12 months from 31 December 2010, it still represents less than 1 per cent of non-mortgaged retiree housing equity, which SEQUAL estimates at \$345 billion in 2005 (Moffat 2011) and is conservatively estimated at around \$500 billion in 2013.<sup>3</sup> Moreover, in a study conducted by the Productive Ageing Centre (2012b), less than 10 per cent of both retired and pre-retired respondents indicated that they had used or intended to use reverse mortgages or home financing.

In terms of financial stress in retirement, a 2008 study by the Australian Council of Social Service (ACOSS) found that the group most experiencing income poverty were single people over the age of 65 years, 47 per cent of whom were living under the poverty line in 2006. A more recent study shows that persons aged over 65 years in Australia have a 35 per cent risk of living in poverty (ACOSS 2012).

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*Critically, pressure on welfare systems is likely to exacerbate income poverty among older Australians. Such imperatives point to the need for more innovation in potential decumulation sources of income for ageing households to accommodate longer retirements, complex health issues and ageing in place.<sup>4</sup>*

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Decumulation of housing equity in later retirement may also place downward inflationary pressure on housing prices, therefore helping to achieve better housing affordability, albeit at the cost of some home value increases.

However, the move toward housing asset-based welfare draws on the assumption that investment in own-home wealth will yield sound returns as residential house prices continue to increase. Cyclical financial crises highlight the potential riskiness of housing as an investment vehicle, particularly when households do not plan the timing of equity withdrawal well. The subject of risk management in retirement is also growing in prominence. Research by Doran et al. (2012) notes that the retirement risk zone is commonly defined as the final 10 years of working life (the end of the accumulation phase) and the first 10 years of retirement (the start of the decumulation phase). This study also looks at the need for planning to manage risk beyond the first 10 years of retirement, particularly in later retirement following the potential depletion of superannuation assets.

### **Concluding remarks**

The data from HILDA outlined in this paper shows that the value of the primary home makes up over two-thirds of all net worth for respondents aged 45 and over. When coupled with the 35 per cent risk of living in poverty for those aged over 65 in Australia (ACOSS 2012), the potential for home equity to assist in periods of financial hardship becomes more evident.

Potentially, once in retirement, there could be a continuum of options where housing equity plays a role in assisting those living in poverty or responding to a financial crisis. The literature has already highlighted the potential for retirees to have sufficient assets, but not enough income, and it points to an increasing role for home equity in supporting retirement lifestyles and aged care.

Overall, however, both the research on housing equity liquidity for retirees in Australia and the place of homeownership in supporting retirement consumption have been judged as insufficient

by behavioural economists (e.g. Bradbury 2010a; Bradbury and Mendolia 2012; Munro 2011; Wood and Ong 2012), particularly in the context of supporting productive, healthy ageing (Courant et al. 1984).

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*The role of housing equity as a pillar of retirement income needs to be expanded. With the perfect storm of 5.5 million baby boomers turning 65 and entering retirement between 2010 and 2029, holding the bulk of their wealth in housing, and living longer due to health advances (at a cost), the significance of housing equity is apparent.*

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New housing equity decumulation products and more consumer support in planning for possible cash flow crises may help retirees 'keep the wolf from the door' in later retirement when other sources of income have been used.

### **Acknowledgement**

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### **Endnotes**

- 1 A reverse mortgage is a form of equity release (or lifetime mortgage), comprising a loan available to home owners of retirement age, enabling them to access a portion of their home's equity. The home owners can draw upon the mortgage principal in a lump sum, by receiving monthly payments over a specified term or over their (joint) lifetimes, as a revolving line of credit, or some combination thereof (SEQUAL: Senior Australians Equity Release Association).
- 2 Reverse annuity mortgages (also known as a reverse mortgage or home equity conversion mortgage) are an arrangement in which a home owner borrows against the equity in their home and receives monthly tax-free payments from the lender.
- 3 Authors' calculations based on 3.1 million Australians aged over 65 (ABS 2012-13 from Census 2011), with 56 per cent sharing the household with a spouse (ABS 2012-13 from Census 2011), resulting in approximately 2.2 million households, 82 per cent of which (1.8 million) are owner occupied (ABS 2011), with a conservative estimate of median house price of \$300,000 (HILDA) = \$540 billion in housing equity.
- 4 Ageing in place is the notion of the aged staying in the family home for as long as possible, with services coming to the home rather than moving the person to services (Judd 2012). This is also termed 'staying at home', that is, remaining in their own homes for as long as possible while their care needs increase (Commonwealth of Australia 2012b).

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