

Housing equity withdrawal in Australia

MORE AUSTRALIAN HOME OWNERS ARE USING HOUSING EQUITY WITHDRAWAL TO UNLOCK FINANCIAL RESOURCES TO FUND LIVING EXPENSES, ESPECIALLY IN RETIREMENT. POLICY IS NEEDED TO ADDRESS POTENTIAL ADVERSE CONSEQUENCES OF THESE STRATEGIES.

KEY POINTS

- The incidence of housing equity withdrawal (HEW) has increased from 13 per cent of older home owners in 2001 to 18 per cent in 2010.
- The majority (84%) of HEW is through mortgage equity withdrawal (MEW), but downsizing or selling up are more prevalent for those above pension age.
- Health concerns are a key driver of HEW, with downsizing and selling up commonly triggered by ill health.
- Repayment risk (inability to meet mortgage loan repayments when interest rates climb unexpectedly) is negligible for most older people using MEW since their financial and employment situation is relatively stable. However, repayment risks are heightened for those experiencing marital breakdown and unemployment.
- The risk of negative equity—when outstanding mortgage debt exceeds housing asset values—is negligible among MEW users but limited equity risk (defined as when the loan-to-value ratio rises to more than 60%) is more likely.

*This bulletin is based on research conducted by **Associate Professor Rachel Ong, Associate Professor Therese Jefferson and Associate Professor Siobhan Austen** at the AHURI Research Centre—Curtin University, **Dr Marietta Haffner** at Delft University of Technology (The Netherlands) and **Professor Gavin Wood** at the AHURI Research Centre—RMIT University. The research examined the uses, risks and barriers to various housing equity withdrawal mechanisms in later life.*

- Impediments to downsizing include high transaction costs and means test rules for pensions. There is also a stigma in having to take up a reverse mortgage.
- As governments may benefit from having home-owning retirees fund their health costs, they should consider ways to facilitate HEW through tax and other benefit settings. Providing good financial advice and improved financial literacy of home owners may reduce HEW risks, especially for those who use MEW. MEW products need to be regulated to limit the risks of negative or limited equity outcomes.
- Governments should consider the social impacts of HEW. Downsizers need to find suitable smaller properties close to their community supports thereby reducing social isolation, while those who are forced to sell up and rent in the private rental market may need greater tenure security.

CONTEXT

Housing is a significant source of wealth for home owners and purchasers, and many want to access that wealth to achieve other life goals including providing income in retirement.

Housing equity withdrawal involves one of three things:

- *Downsizing*, in which home owners move to a lower value property to unlock some equity in their former property.
- *Selling up*, in which their house is sold and they go into the private rental market.
- *Mortgage equity withdrawal*, where home owners increase the mortgage debt secured against their property without moving.

Policy-makers are interested in the capacity of HEW mechanisms to assist people manage their housing wealth and income through the life course.

RESEARCH METHOD

This project analysed data from the Household, Income and Labour Dynamics Australia surveys (HILDA) for 2001–10, as well as conducted qualitative interviews with older home owners and with service providers in areas of HEW policy and practice.

KEY FINDINGS

The extent of HEW in Australia

The incidence of HEW has increased from 13 per cent of older home owners in 2001 to 18 per cent in 2010.

In situ borrowing (MEW) was the dominant form of HEW (84% of all HEW) especially among those under pension age. Traditional forms of HEW—downsizing or selling up—were more prevalent for those above pension age.

Deciding to use HEW

People above pension age decided to use HEW due to concerns about health, with interviewees regarding HEW as useful to either finance ongoing health costs or transitioning to a nursing home.

Evidence from HILDA showed that private health insurance payments were higher for those using MEW than for home owners who didn't use MEW. This suggests housing equity may have played an insurance role with respect to potentially unexpected (in this case health) expenditures.

The typical MEW borrower had a relatively strong financial and employment position. In contrast, home owners who downsized or sold up commonly experienced unfavourable events, such as ill health, separation, divorce and bereavement prior to sale of the family home. Older home owners who sold up typically had very little income or non-housing assets to rely on.

The HILDA survey shows that older equity extractors tended to be in a more stressed financial position than those who do not use HEW.

Risks of using HEW in later life

Mortgage equity withdrawal involves higher mortgage payments for home owners, which may lead to an inability to meet mortgage repayments when interest rates climb unexpectedly.

Mortgage equity withdrawal alone did not increase repayment risk among older home owners as they generally had sound economic circumstances. However, repayment risk was highly correlated with adverse life events such as marital breakdown and unemployment.

Analysis showed that if house prices were to fall by 5 and 10 per cent, negative equity risk (i.e. when the value of the home falls below the outstanding secured mortgage debt) would be negligible among MEW users. However, limited equity risk is more likely. One in five older owners who released housing equity by borrowing more against their homes had housing equity that was less than 40 per cent of the value of their homes, compared to one in 10 other older mortgagors.

Interviewees believed inadequate or inappropriate financial advice adds to risks for those using MEW products. There was also a risk that adverse life events might pressure older home owners into

hasty sale of their properties, particularly as the risks of making unsound financial judgements are elevated during crisis events.

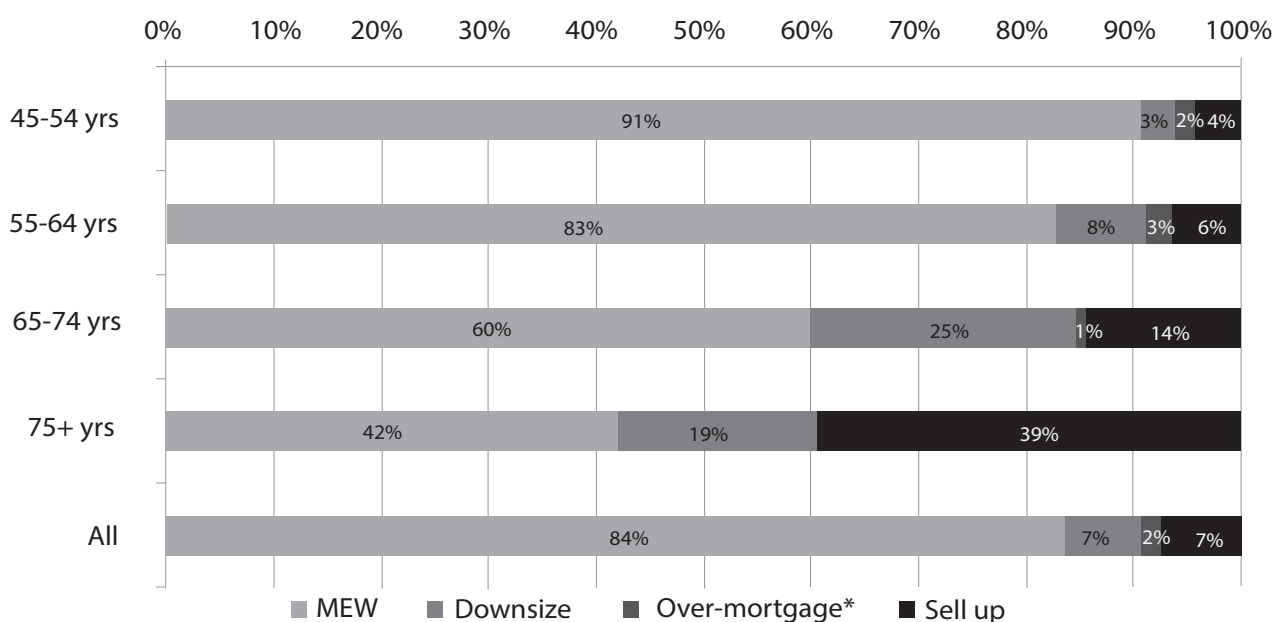
Impediments to HEW

Impediments to selling up a house included stamp duty and transaction costs, which typically consume 8–10 per cent of the equity released on downsizing.

When downsizing and selling up resulted in the unlocking of funds that might increase income, owners were concerned about HEW's negative impact on accessing aged pension benefits. In 60–80 per cent of downsizing and selling up episodes, means testing reduced the amount of income support entitlements for older home owners. Downsizers suffered a 17 per cent reduction in their entitlements, while those selling up suffered an even bigger loss amounting to one-third of original entitlements.

Although MEW products preserve pension entitlements, interviews with owners revealed there was a stigma attached to reverse mortgage products as many have read of bad experiences with such products.

FIGURE 1: DISTRIBUTION OF HEW TYPE AMONG OLDER HOME OWNER HOUSEHOLDS WHO ENGAGED IN HEW DURING 2001–10, BY AGE BAND, PER CENT BY ROW



Source: Authors' own calculations from the 2001–10 HILDA Survey

* Over-mortgaged households are those who sell up and move into a higher value home, and in the process take out a larger loan amount in order to release some of their existing housing equity.

POLICY IMPLICATIONS

Tax and benefit treatment of HEW options

As governments may benefit from having home owning retirees fund their health costs, they should consider ways to facilitate HEW through tax and benefit settings. Transaction costs (e.g. stamp duty) provide a strong disincentive to downsizing by reducing returns from HEW. Furthermore, householders often have a poor understanding of the income and wealth implications of means tests, resulting in ill-informed decisions about HEW mechanisms to support retirement. Governments could consider reforming stamp duty and means test regimes to reduce the amount of equity that would otherwise be eroded in the form of stamp duty payments and reductions in income support payments when older home owners withdraw equity through downsizing or selling up.

Information and financial literacy

Home owners in constrained financial circumstances who choose to sell up need to be aware of the consequences for income and wealth, including implications for income support entitlements and transaction costs. Older home owners would also be helped by being able to access affordable and relevant advice regarding MEW products, and by improvements in general financial literacy.

Risk mitigation in MEW products

Mortgage equity withdrawal products need to be regulated to limit the risks of negative or limited equity outcomes. Most products already have some conditions such as caps

on maximum loan advances, restrictions on particular geographic locations, and no negative equity guarantees. Equity finance is a new, potentially promising form of financial innovation that aims to mitigate some of the risks associated with debt-based forms of finance.

Addressing dislocation and insecurity from housing moves

Governments should consider the social impacts of HEW. Downsizers need to find suitable smaller properties close to their community supports thereby reducing social isolation. For those who are forced by adverse circumstances to sell up and rent, policies that offer ageing tenants improved tenure security in the private rental market will be critical.

FURTHER INFORMATION

This bulletin is based on AHURI project 81004, *Housing equity withdrawal: uses and risks of alternative options for older Australians*.

Reports from this project can be found on the AHURI website: www.ahuri.edu.au or by contacting AHURI Limited on +61 3 9660 2300.

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