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EXECUTIVE SUMMARY

Mortgage stress and precarious home ownership: implications for older Australians

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Executive summary

Key points

- Between 1987 and 2015, the real mortgage debt of older mortgagors aged 55+ blew out by 600 per cent. Real house price and income growth lagged behind, tripling and doubling respectively over the period.
- Older mortgagors' average mortgage debt to income ratio tripled from 71 per cent to 211 per cent between 1987 and 2015, reflecting a severe increase in repayment risk. In addition, repayment risk is correlated with mortgage payment difficulties.
- When older mortgagors face mortgage payment difficulties, males' SF-36 mental health scores are reduced by around 2 points and females' by 4 points. Late mortgage payments also raise males' K10 psychological distress scores by nearly 2 points.
- The budget share devoted to necessities increases as repayment risk rises. In the top MPIR quintile the budget share accounted for by necessities is around 3 per cent higher than in the bottom quintile, holding all other factors constant.
- Due to tenure and demographic change, the demand for Commonwealth Rent Assistance (CRA) is projected to rise by 60 per cent, from 414,000 in 2016 to 664,000 in 2031. The unmet demand for public housing from private renters aged 55+ is expected to rise by 78 per cent—from 200,000 to 440,000 households—between 2016 and 2031.
- The CRA budget cost is predicted to increase steeply, from $972 million in 2016, to $1.55 billion in 2031 (at constant 2016 prices).
- In the bottom two mortgage-payment-to-income ratio (MPIR) quintiles the odds of superannuation drawdowns are only around 60 per cent of the odds in the top quintile.
- Older retired mortgagors exhibit significant heterogeneity with respect to their wealth management strategies, as well as their consumption profiles.

Key findings

How significant are investment and repayment risks for older mortgagors?

Between 1987 and 2015, the growth in mortgage debt outstripped both house price and income growth among older mortgagors. Mortgage debt blew out by 600 per cent while house prices tripled. Income growth lagged even further behind, doubling over the same period. Investment risk increased for older mortgagors over the same period. The leverage multiplier rose from 1.15 to 1.4 between 1987 and 2015, indicating that a 10 per cent decline in house prices would wipe out 11.5 per cent of housing equity in 1987, but by 2015 that potential loss increases to 14 per cent. Investment risk is a serious concern for some older mortgagors. If house prices suddenly fall by 10 per cent (based on 2015 data), the share of older mortgagors that would hold only a 40 per cent or less equity stake in their family home would rise from 13.7 per cent to 17.5 per cent. There has been an even more severe increase in repayment risk. Older mortgagors' average mortgage debt to income ratio (MDIR) tripled from 71 per cent to 211 per cent between 1987 and 2015.

Our research shows tentative evidence that repayment risk, rather than investment risk, is correlated with mortgage payment difficulties. Biographical disruption (such as divorce), single status and economic disadvantage also contribute to failure to meet mortgage payments on time. However, net financial wealth (other than housing) is a buffer that can help those at risk of default to continue making payments.

What impacts does the level of mortgage indebtedness have on older mortgagors' personal wellbeing?

Older mortgagors report lower mental health and higher psychological distress scores than older outright owners. However, exposure to investment and repayment risk alone does not appear to have a strong bearing on older mortgagors' wellbeing. A rising mortgage payment to income ratio does not adversely impact wellbeing. A rising leverage multiplier has a mildly adverse impact on mental health and psychological distress, but for men only. It is when older mortgagors experience difficulty in meeting mortgage payments, that wellbeing declines. When facing difficulty in meeting mortgage payments, the SF-36 mental health scores for older men are reduced by around 2 points and 4 points for women. Late mortgage payments also raise males' K10 psychological distress scores by nearly 2 points.

Gender differences are quite pronounced. Amongst older mortgagors, women generally have lower levels of mental health and higher levels of psychological distress than male mortgagors. The K10 distress score for older female mortgagors is 15.9, compared to the 14.6 score for older male mortgagors. The average SF-36 score for older female mortgagors is 73.5, compared to 77.1 for older male mortgagors. Older female mortgagors' SF-36 mental health is also more sensitive to personal circumstances than older male mortgagors'. Marital breakdown, ill health and poor labour market engagement all adversely affect women's SF-36 mental health scores more than men.

How do older Australians in mortgage stress manage their superannuation wealth and consumption expenditure?

Older retired mortgagors that draw down superannuation balances seem to be re-orienting their portfolios toward property. As their average superannuation balances tumbled from $471,000 to $271,000 (a 42% decline) between 2010 and 2014, average equity stakes in property rose from $621,000 to $667,000 (a 7% increase). Over the same period, the property wealth strategies of those accumulating savings in superannuation are the mirror image of those drawing down superannuation. Among this subgroup, average equity stakes in property dropped by 8 per cent.

There is some evidence suggesting that the chances of superannuation drawdown by older retired mortgagors may increase with repayment risk. In the bottom two mortgage payment to income ratio quintiles, the odds of superannuation drawdowns are only around 60 per cent of the odds in the top quintile. However, the links between superannuation wealth management and investment risk are more complex, reflecting two major wealth management strategies, driven by different investor preferences. Every $10,000 decline in home value increases the likelihood of superannuation drawdown by 4 per cent, suggesting that for some mortgagors, the threat of housing equity being slashed leads to a strategy of dipping into superannuation to preserve as much housing equity as possible. On the other hand, every $10,000 increase in home debt means an 18 per cent lower chance of superannuation drawdown. Hence, other mortgagors may be more reluctant to draw down their superannuation in order to preserve as much non-housing wealth as possible.

In regard to consumption, the budget share devoted to necessities expands as repayment risk rises. A non-negligible segment of the mortgagor population is more prone to material deprivation than outright owners, despite the fact that the former also exhibit higher discretionary spending levels. Nearly 8 per cent of older mortgagors have been unable to pay their utility bills on time between 2006 and 2016, compared to around 3 per cent of outright owners.

The findings suggest that older mortgagors are a heterogeneous group in terms of wealth and consumption profiles, and they have varying preferences for asset and debt mix. Some are able to cope with mortgage burdens in later life, particularly those with higher educational qualifications. However, a separate subgroup must use most of their spending for necessities or suffer from material deprivation due to mortgage stress.

What are the implications of high levels of mortgage debt and falling home ownership rates for future national policy directions for retirement incomes and housing assistance in Australia?

Our modelling predicts an increasingly tenure polarised seniors population. Outright ownership status will be attained later in life and at lower real incomes. Mortgagors will have a relatively younger age profile and higher real incomes. Tenants will fall further behind in terms of employment, real incomes and health.

In 2031, we can expect that over 200,000 older Australians will be living in private rental housing and in need of assistance with one or more activities. This may in turn require the retrofit of family homes. Insecurity of tenure and lack of control over internal amenities could prevent a growing number of older tenants from meeting these needs.

The combination of tenure change and demographic change is expected to increase CRA eligibility among seniors aged 55 years and over; it is forecast to rise from 414,000 in 2016 to 664,000 in 2031, an increase of 60 per cent over the forecasting horizon. The population of seniors is expected to increase by a much lower 35 per cent, so a growing dependence on CRA is anticipated. The Australian Government CRA budget cost is predicted to increase steeply, from $972 million in 2016, to $1.55 billion in 2031 (at constant 2016 prices).

The unmet demand for public housing from private renters aged 55 years and over is expected to climb from roughly 200,000 households in 2016 to 440,000 households in 2031, a 78 per cent increase. Those 75 years and older are anticipated to push their share of unmet demand up from 27.5 per cent in 2016 to 34.2 per cent in 2031.

Our projections suggest that 1.88 million older Australians could be in before-housing poverty in 2031; but this count falls by 730,000 to 1.15 million on an after-housing cost basis. Outright ownership will remain an important but weaker pillar supporting living standards in old age.

Policy development options

The report’s findings present significant challenges for policy makers planning for an ageing population amidst increasing precariousness in the home ownership sector in Australia. Five broad streams of policy development options likely to be pertinent for forward-looking policy planning are:

- long-term planning for financial security in retirement
- limiting exposure to mortgage debt via innovations and regulations

- systemic reform to the housing sector to address the twin challenges of population ageing and precarious home ownership
- budgeting for housing assistance for the growing population of elderly low-income renters
- understanding substitution between two key pillars of the retirement incomes system—the family home and superannuation.

Long-term planning for financial security in retirement

Long-term financial planning strategies: Long-term planning for a mortgage debt repayment strategy over the life course is crucial in mitigating an increase in repayment risk as a mortgagor ages. Such financial planning needs to take into account net financial wealth (other than housing). Non-housing financial assets can potentially act as a buffer, helping those at risk of default to continue making payments. This may prove especially valuable for those particularly vulnerable to biographical disruption, or with weak labour market engagement. Obviously, higher levels of non-housing debt can adversely affect older mortgagors' ability to meet their mortgage commitments. This is complicated by the increasing fluidity of housing wealth, as financial innovations enable home owners to draw down on the wealth stored in their family home without moving, by taking on higher levels of debt throughout their life course.

Financial literacy needs: The budget share devoted to necessities grows as repayment risk rises. A non-negligible segment of the mortgagor population is more prone to material deprivation than outright owners. Those with low education qualifications are particularly susceptible to limiting their consumption to necessities as their repayment risk rises. Educational qualifications usually mean increased financial sophistication, therefore financial literacy programs are needed to assist older mortgagors, especially those with lower lifetime incomes, to better manage their mortgage payments and consumption of other goods and services.

Hedging exposure to mortgage payment difficulties: Those who are actively involved in the labour market in later life are less likely to have mortgage payment difficulties. While older Australians may be increasingly willing to extend working lives to pay down their mortgages, unexpected life shocks such as unemployment, ill health or marital breakdown are more common in later life, and can plunge older mortgagors with over-optimistic expectations into severe mortgage stress. It is therefore important for policy makers to consider measures to assist older mortgagors to hedge exposure to mortgage payment difficulties. For instance, one could impose a mortgage insurance requirement on those whose mortgage debt burden relative to income remains above a specified level after they pass a certain age threshold.

Gender equity considerations: The negative associations between mortgage indebtedness and wellbeing levels also raise gender equity concerns. Older female mortgagors generally have lower levels of mental health and higher levels of psychological distress than older male mortgagors. The former's personal wellbeing (as measured by the SF-36 mental health score) is also more sensitive to their personal circumstances. In addition, women have longer life expectancies than men, are more likely to experience career interruptions, and are less inclined than men to re-marry following a marital breakdown. Hence, ageing female mortgagors face multiple challenges, which signals a need to carefully design policies and programs that provide adequate support for women at risk of housing insecurity and poverty in old age.

Limiting exposure to mortgage debt via innovation and regulation

Equity-oriented funding solutions for owner-occupation: The negative association between mortgage debt and wellbeing presents a need to design innovative financial solutions for funding owner-occupation that do not increase the debt burden. Studies such as Smith, Whitehead et al. (2013) and Wood, Smith et al. (2013) have proposed equity-based solutions for funding owner-occupation, for example equity finance, but it has rarely been tried and the sector is small. Downsizing may also be an option for ‘empty nesters’ if it unlocks sufficient equity to reduce mortgage debt. However, downsizing is often hampered by barriers such as the lack of affordable and appropriate housing in the local area and the financial disincentive of stamp duties on the purchase of a new home.

Insurance instruments: While investment risk is not found to be a driver of mortgage payment defaults, it is nevertheless important because house price declines threaten the wealth holdings of older home owners. Those who have rebalanced wealth portfolios by substituting property wealth for superannuation are particularly challenged. Fears of a housing market-led recession are accentuated by the absence of insurance instruments that could enable mortgagors to hedge house price declines (Smith and Searle 2010). When house prices are ticking along nicely, the lack of such insurance products is rarely noticed. In the less secure housing market emerging, policy makers should consider whether product innovation along these lines is worth encouraging. If property owners could enter insurance contracts that hedge house price declines, better financial planning would be facilitated.

Monetary policy and prudential regulations: In terms of overall economic health, the findings are concerning. High levels of mortgage debt are likely to reduce consumption spending, particularly when house prices fall, and especially the spending of older mortgagors as they have fewer years of earnings ahead. Our findings confirm Ong, Wood et al.’s (2017) report on the links between housing and the economy, which show that the take-up of further debt by highly leveraged households exposes them and the macroeconomy to significant investment and repayment risks. Hence, though monetary policy levers are not directly housing related, they have significant influence on housing wealth-related consumption effects. Overall, policy makers need to carefully monitor the growth of household indebtedness and ensure robust prudential regulations that limit the exposure of the economy to unacceptably high levels of debt-driven consumption.

Systemic reform to the housing sector to address the twin challenges of population ageing and precarious home ownership

Housing design and planning systems: Demographic projections show an impending rise in the number of elderly Australians, many of whom will likely need various types of housing assistance. Mobility issues will generate a growing need for housing designs and planning systems that support retrofits that aid mobility in existing homes, as well as incorporate such amenities into new builds.

Barriers to downsizing: Because growth in the number of small households, and especially lone person households, is expected to accelerate, a stronger demand for smaller dwellings could emerge, and the kind of modifications to planning requirements suggested above might be better targeted to smaller houses and units. However, the stronger demand for smaller dwellings might not eventuate if impediments to downsizing are not addressed. Stamp duties, pension income and asset means tests that penalise downsizers, and a lack of suitable smaller dwellings in the neighbourhoods of older empty nesters and lone persons households, are all potentially important.

Private rental sector regulations: Over 200,000 older private rental housing tenants will need assistance with one or more activities by 2031. The presence of a growing number of elderly, and possibly frail, persons in private rental housing raises a different set of issues, especially if private landlords are unwilling to permit modifications that aid mobility around the home. The insecurity associated with private rental housing tenancies is also a concern because housing stability assists arrangement of support services. If social housing remains a small residual tenure, as assumed in the forecasts in this report, there will be growing pressure on governments to review tenancy regulations that impede tenant rights to install amenities to help infirm and immobile elderly people conduct daily activities.

Budgeting for housing assistance to cater for the growing population of elderly low-income renters

Commonwealth Rent Assistance (CRA): Housing assistance for older Australians will add to the fiscal pressures on government budgets even if there is no net increase in public housing, as has been assumed in this report. There is an important policy ramification. There will be rapid growth in real government outlays on CRA payments to older private renters. This is due to a combination of population ageing, a modest fall in projected home ownership rates and continued rationing of the public housing stock.

Public housing: Eligibility for public housing is expected to increase from 247,000 to 440,000 seniors over the period 2016–2031. Though not all eligible older Australians will join waiting lists, it is conceivable that many will. This will in turn put state housing authorities as well as community housing organisations under extreme pressure.

Understanding substitution between two key pillars of the retirement incomes system—the family home and superannuation

Retirement incomes adequacy: Older mortgagors seem prepared to run down their superannuation to bolster wealth stored in home equity when repayment risks are present. These findings are worrying from a retirement incomes adequacy perspective. If superannuation balances are being run down to pay off mortgage debt rather than to sustain spending in retirement, pressure on the age pension system will increase as growing numbers of baby boomers retire with mortgage debt owed against the family home. Another concern is that resulting wealth portfolios are dominated by property, and therefore more exposed to investment risks posed by falling house prices.

Asset substitution—preferences and strategies: The links between the value of the family home, mortgage debt and superannuation are complex. They suggest at least two major types of wealth management strategies by older mortgagors, reflecting different investor preferences, and varying degrees of asset substitution between superannuation and housing wealth. For one subgroup of older retired mortgagors, the threat of housing equity being slashed may prompt a strategy of dipping into superannuation balances to meet spending needs in order to preserve as much housing equity as possible. However the prospect of rising mortgage debt (or falling housing equity) deters ‘raids’ on superannuation funds by another subgroup, as these mortgagors seek to preserve their non-housing wealth buffers. Policy makers need to understand this heterogeneity, which will drive wealth management decisions by older Australians in regard to their two key assets in retirement.

The role of superannuation in housing decisions: There is a growing sense that an alternative housing solution is needed as a safety net to meet the housing needs of low-income seniors living in private rental housing. Given that the superannuation system will have matured by 2031, the accumulated superannuation wealth of future retired tenants could open up new housing opportunities, especially if governments assist with innovative programs such as shared ownership. These programs could permit seniors to use part or all of their accumulated superannuation balances to buy a share of their dwelling, and rent the remainder. A key criticism of such a measure is that it undermines a major aim of the Superannuation Guarantee, which is to promote financial independence in old age. However, this objection may carry less weight for a program targeted to seniors rather than younger people. The other more valid criticism is that it could undermine another Superannuation Guarantee aim, to curb growth in the budget cost of age pensions.

The study

This study is motivated by concerns regarding growing numbers of middle-aged Australians who are carrying mortgage debt into retirement and paying off higher levels of debt relative to house values and income. These trends have significant consequences for older Australians' wellbeing and affect the ways in which older home owners manage their wealth portfolios and labour market transitions. Mortgage indebtedness later in life also presents significant ramifications for retirement incomes policy and housing assistance programs. Home ownership has often been dubbed the fourth pillar of the retirement incomes system. However, this pillar may be crumbling due to rising mortgage indebtedness and threats to home ownership's status as Australia's majority tenure. While policy challenges abound, the international literature offers few studies that address the circumstances of older mortgagors.

These policy concerns and knowledge gaps motivated the following research questions in this study, which focuses on mortgagors 55 years and over:

1. How significant are investment and repayment risks for older Australian mortgagors?
2. What impacts does the level of mortgage indebtedness have on older mortgagors' personal wellbeing?
3. How do older Australians in mortgage stress manage their superannuation wealth and consumption expenditure?
4. What are the implications of high levels of mortgage debt and falling home ownership rates for future national policy directions in relation to retirement incomes and housing assistance in Australia?

This study therefore promotes forward-looking policy development and budget planning in an era of an ageing population and growing housing market volatility. It presents a comprehensive evidence base that examines whether home ownership offers less reliable support for retirement incomes policy, with post-retirement circumstances becoming more precarious as superannuation balances are drained to repay mortgages. It also provides a forecast assessment of the impacts of rising mortgage stress on future demand for housing assistance. Overall, it will inform efforts by policy makers and practitioners to sustain the elderly's wellbeing amidst more insecure home ownership. The findings of this report are highly relevant to a range of policies and programs that affect both home owners and renters, as well as ageing Australians in general.

We draw on three nationally representative microdata sources to undertake empirical analyses: the Survey of Income and Housing (SIH); the Household, Income and Labour Dynamics Surveys (HILDA); and ABS population projections. The SIH and HILDA Survey contain critical housing, wealth and income data that will enable us to draw population-wide conclusions. Both are staple Australian data sources that offer a comprehensive set of household and individual data covering a vast array of themes. The ABS population projections are crucial for projecting demographic change so as to generate forecast estimates that are especially helpful for government budget planning.

We apply a combination of econometric modelling, microsimulation modelling and projection techniques to generate a comprehensive evidence base pertaining to support the report's conclusions. Via econometric modelling we are able to isolate the independent effect that a mortgage stress predictor might have on an outcome of interest while controlling for other potentially confounding predictors. Microsimulation modelling is employed to estimate the demand for CRA and public housing by older Australians. This is combined with forecasting techniques developed in Wood, Cigdem-Bayram et al. (2017) to project forward the impacts of demographic change, mortgage indebtedness and falling home ownership rates on retirement incomes, and the demand for housing assistance.

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