POLICY EVIDENCE SUMMARY

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Examining the impacts of growing mortgage debt amongst older Australians

AHURi

Australian Housing and Urban Research Institute

Based on AHURI Final Report No. 319:
Mortgage stress and precarious home ownership: implications for older Australians

What this research is about

This research investigated the growing numbers of 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.

The context of this research

Over the period 1982–2013 the share of mortgagors increased in all age groups. The steepest increases are amongst middle-aged Australians approaching retirement. Mortgage indebtedness was uncommon among the 55–64 cohort as recently as the 1990s, however between 1996 and 2013 the proportion still paying off their mortgage climbed from under 20 per cent to 45 per cent.

The key findings

Between 1987 and 2015, the growth in mortgage debt outstripped both house price and income growth among older mortgagors. In this period, mortgage debt increased by 600 per cent (from $27,000 to over $185,000) and house prices tripled, while income growth doubled. Over the same period, the required average annual mortgage repayments more than tripled from $5,000 to $17,000 and the incidence of mortgage indebtedness doubled from 14 per cent to nearly 18 per cent.

Repayment risk

There has been a 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. While mortgage debt burdens were lower than annual disposable incomes in the late 1980s and early 1990s, they soared to nearly 200 per cent of income in the late 1990s and have remained stubbornly high at over 200 per cent since then. Back in 1987 these levels of indebtedness would be alarming, but mitigating such concern are lower interest rates in the 2000s.

As a result the mortgage payment to income ratio (MPIR) trend does not parallel the steep upward movements in the MDIR. While average MPIRs rose from 13 per cent to 33 per cent between 1987 and 1997, they declined to a more comfortable 19.6 per cent in 2015 due to relaxation of monetary policy following the GFC, causing home loan interest rates to fall to historically low levels during the 2000s. However, the average MPIR hides a sizeable cohort of older mortgagors who may be experiencing a degree of mortgage stress. At a home loan interest rate of approximately 6 per cent in 2015, around 27 per cent of older mortgagors had MPIRs greater than 30 per cent, that is, more than one in four older mortgagors were making mortgage repayment that exceeded 30 per cent of their disposable income.

Investment risk

Investment risk is the possibility that the investor might lose some or all of their original investment or that the investment may not perform as expected. Investment risk increased for older mortgagors over the period 1987–2015, 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. If house prices fall by 10 per cent (based on 2015 data), the share of older mortgagors holding 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.

The investment risk rose for older mortgagors over the period 1987–2015. Prior to the property boom of the late

1990s, the leverage multiplier sat at around 1.15 (meaning a 1 per cent decline in house prices would drive housing equity down by 1.15 per cent back then). This does not appear to represent a significant investment risk, however older mortgagors have become more exposed to investment risk in recent years with the leverage multiplier stretching out to around 1.4. Hence, in 2015, a 10 per cent decline in house prices would reduce older mortgagors' housing equity by 14 per cent. The incidence of negative equity is reassuringly low and has gradually climbed by 1–2 percentage points since 1987; though back then negative equity was entirely absent among older mortgagors. Furthermore, while the share of older mortgagors with limited equity was only 3 per cent in 1987, this has grown to 14 per cent.

These indicators suggest that while older mortgagors are carrying more mortgage debt than before, most have remained in positive equity territory, and the number that have negative equity (i.e. owe more on their dwelling than it is worth) is negligible. However, the number of older mortgagors who are moving close to the precarious edges of ownership is increasing. This is because house prices soared, but mortgage debts grew at an even faster rate.

Economic modelling of mortgage stress trends

The research differentiated between investment and repayment risks as measures of mortgage stress, and experimented with a range of mortgage stress indicators reflecting the investment risk and repayment risk measures. The leverage multiplier and MPIRs were chosen to represent investment risk and repayment risk in the modelling.

The modelling confirm the importance of biographical disruption (e.g. have dependent children, underemployed, divorce and single status), economic disadvantage and repayment risk (MPIR) as key drivers of difficulty in making mortgage payments on time. The odds of experiencing mortgage payment difficulties are twice as high for those who are divorced as it is for those who are legally married. The odds are even higher among the single never married at around 2.5 times those of the legally married. The absence of full-time employment is again correlated with higher odds of mortgage payment difficulties. An interesting finding is the role of net financial wealth (other than housing) which seems to act as a reserve allowing those at risk of default to continue making payments.

Impact of mortgage indebtedness on older mortgagors' personal wellbeing

The SF-36 Survey provides a measure of mental health derived from a short-form survey on health and wellbeing, while the Kessler Psychological Distress Scale (K10) is a score of non-specific psychological distress based on a questionnaire about negative emotional states, including tiredness, nervousness, restlessness and depression. In general, the Kessler Psychological Distress Scale (K10) measure suggests that mortgagors' average psychological distress level is higher than that of outright owners.

When older mortgagors experience difficulty in meeting mortgage payments, wellbeing declines: the SF-36 mental health scores for older men are reduced by around 2 points and 3.7 points for women. Late mortgage payments raise males' K10 psychological distress scores by nearly 2 points. These effects are comparable to those resulting from long-term health conditions. Hence, the rising trend in mortgage indebtedness in Australia will have negative impacts on the wellbeing of an increasing percentage of the population, as growing numbers of older Australians carry mortgages into retirement.

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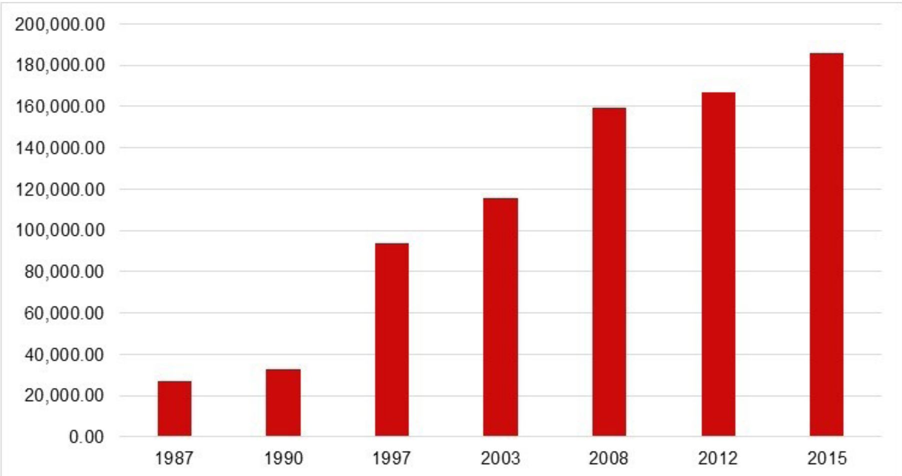
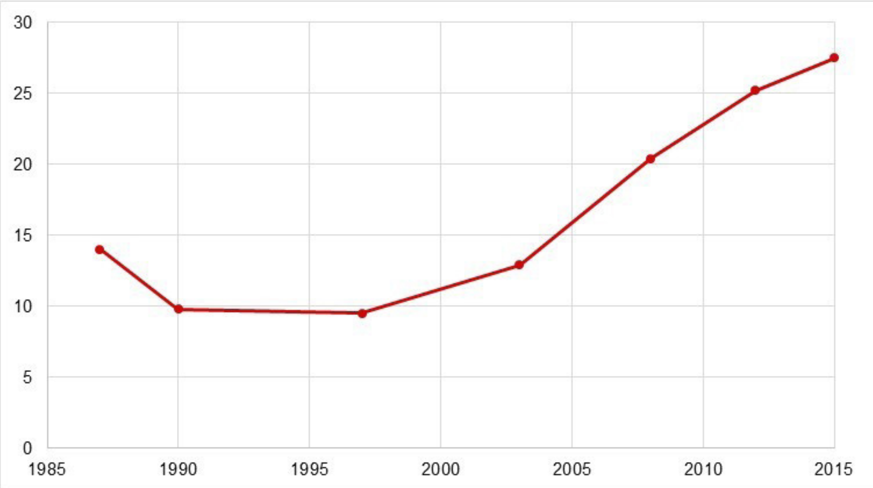
Figure 1: Mean trend in mortgage debt for mortgagors aged 55+, 1987–2015 (real $ in 2015 values)



Notes: Estimates are weighted using cross-sectional population weights provided in the SIH dataset.

Source: Authors' own calculations using the SIH 1987, 1990, 1997, 2003, 2008, 2012, 2015.

Figure 2: Incidence of mortgage indebtedness for mortgagors aged 55+, 1987–2015



Notes: Estimates are weighted using cross-sectional population weights provided in the SIH dataset.

Source: Authors' own calculations using the SIH 1987, 1990, 1997, 2003, 2008, 2012, 2015.

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. Policy makers need to note the interaction of these factors, which result in female mortgagors being more vulnerable to mortgage indebtedness problems as they age, and will likely have implications for the kinds of housing and financial support that older women will need.

Management of superannuation wealth and consumption expenditure

Between 2006 and 2016, nearly 8 per cent of older mortgagors were unable to pay their utility bills on time, compared to around 3 per cent of outright owners. Moreover, nearly 5 per cent of older mortgagors asked for financial help from friends due to a shortage of money, compared to under 2 per cent of outright owners. The share of older mortgagors suffering from other indicators of material deprivation is also higher than outright owners, including a higher percentage of older mortgagors reported having to pawn or sell something, go without meals or heating and ask for help from welfare or community organisations than outright owners.

There is some evidence in the post-GFC era that older retired mortgagors drawing down superannuation balances seem to be re-orienting their portfolios toward property. As their average superannuation balances reduced from $471,000 to $271,000 (a 42% decline) between 2010 and 2014, property holdings actually increased slightly from $798,000 to $810,000, and property debt was slashed from $177,000 to $143,000. As a result their average equity stake in property rose from $621,000 to $667,000 (a 7% increase). The average equity in the primary home rose by 5 per cent and by a stronger 16 per cent in other property. Over the same period, those accumulating savings in superannuation reduced their average equity stakes in property by 8 per cent. Retired mortgagors in the bottom two mortgage payment to income ratio quintiles (i.e. they are paying less of their income in mortgage repayments) are only around 60 per cent as likely to draw on their superannuation of those in the top quintile.

Higher home values and higher home debt are both associated with a lower likelihood of a superannuation drawdown. Every $10,000 increase in home value decreases the likelihood of superannuation drawdown by 4 per cent, and every $10,000 increase in home debt reduces the likelihood by 18 per cent. The findings in relation to debt are somewhat puzzling, and suggest that the relationship between investment risk and the probability of drawing down on one's superannuation is complex and requires further investigation.

A higher level of superannuation is also associated with higher odds of dipping into superannuation wealth. The model shows that every $10,000 increase in the level of superannuation wealth raises the odds of drawing down superannuation wealth by 18 per cent.

Impact on government

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. Renters will fall further behind in terms of employment, real incomes and health.

The combination of tenure change and demographic change is expected to increase Commonwealth Rent Assistance (CRA) eligibility among seniors age 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. 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 $2016).

In addition, eligibility for public housing is expected to increase from 247,000 to 440,000 seniors over the timeframe 2016–2031. Not all eligible older Australians will join waiting lists, but many will and state housing authorities as well as community housing organisations would come under extreme pressure.

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What this research means for policy makers

The policy implications are significant since the presence of repayment risk appears to prompt older mortgagors to draw down on their superannuation wealth. The rising trend towards mortgage indebtedness in later stages of the life course is therefore worrying from a retirement incomes adequacy perspective. If superannuation balances are being run down to pay off mortgage debt rather than meet spending needs in retirement, there will be growing pressure on the age pension system, as increasing numbers of baby boomers retire or are forced (by say ill health or redundancy) to withdraw from the labour force while mortgage balances are unpaid and secured against the family home.

It is also clear that some will find it difficult to cope with mortgage debts in later life, and material deprivation is then a hazard. There is already significant concern in policy circles about older people’s vulnerability to poverty, particularly single elderly women, who have longer life expectancies than men, but lower superannuation balances.

High levels of mortgage debt are likely to act as a drag on consumption spending, particularly when house prices fall, and especially the spending of older mortgagors, as they have fewer years of earnings ahead of them.

These concerns are accentuated by the absence of insurance instruments that could enable mortgagors to hedge house price declines, policy makers should consider whether product innovation along these lines is worth encouraging.

Other policy options include encouraging older mortgagers to downsize into smaller, less expensive dwellings through reductions in stamp duty and pension asset tests; improving tenants’ rights and ability to modify dwellings for mobility aids; and introducing innovative programs such as shared ownership.accumulating wealth for low-income renters unable to access home ownership.

Methodology

This research employs economic modelling and draws 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.

Further information

TO CITE THE AHURI RESEARCH, PLEASE REFER TO:

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