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Mortgage equity withdrawal in Australia: Recent trends, institutional settings and perspectives

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Abstract
Australian tax preferences and asset test concessions have traditionally favoured wealth accumulation in the primary home, with added impetus lent by a decade-long period of sustained house price appreciation prior to the Global Financial Crisis. The primary home is increasingly viewed by governments worldwide as a key store of wealth that can perform a welfare role in retirement in an era of population ageing. We assess whether the institutional environment in Australia encourages mortgage equity withdrawal drawing on a selective international survey focusing on mortgage equity withdrawal mechanisms in six developed countries. We find that Australia’s institutional settings offer a relatively favourable environment for mortgage equity withdrawal that has encouraged Australian homeowners to tap into their housing equity at earlier stages of the life course. To the extent that mortgage equity withdrawal is exercised over the life course (and not just post-retirement), more Australians will approach retirement carrying outstanding mortgage debt burdens. The implications of these findings for the effectiveness of retirement income systems and the role of housing wealth as an asset base for welfare in old age are discussed.

Keywords: Asset-based welfare, mortgage equity withdrawal, homeowners, institutional settings, owner-occupiers, reverse mortgages

1 An earlier version of this paper was presented at the 2013 ENHR conference in Tarragona Overcoming the crisis: integrating the urban environment
1. **Introduction**

Australian housing policy has traditionally promoted the accumulation of wealth in owner-occupied housing via the use of tax expenditures, concessionary asset tests governing eligibility to allowances and pensions and assistance to first homebuyers. These measures endure despite population ageing which is driving up the cost of providing age-related payments and services, and could threaten the sustainability of balanced government budgets. Thus, governments are beginning to view the owner-occupied home as a key store of wealth that can perform a welfare role beyond that of ensuring low housing costs in old age. This notion is encouraged by the fact that the majority of (older) homeowners in Australia and other Western countries hold most of their wealth in the primary home (Chiuri and Jappelli, 2010; Sierminska and Takhtamanova, 2012; Doling and Elsinga et al., 2013).

In Australia and the UK recently published reports have recommended financial mechanisms that promote housing equity withdrawal (HEW) to help pay for age care. In Australia, the Productivity Commission’s inquiry into the aged care sector argues that “many older Australians with low income have substantial wealth, which gives them the capacity to meet their lifetime accommodation costs and to make a modest contribution to the costs of their care” (Productivity Commission, 2011: xxvi). The Dilnot et al. (2011) report in the UK emphasises personal responsibility as the starting point for meeting the costs of care in old age, which can be paid from income, savings, housing assets or financial products that allow HEW.

Traditionally, in order to tap into one’s housing wealth to fund spending needs, a homeowner would have to sell the primary home. This is a costly and time-consuming method of equity extraction. However, in recent times, financial deregulation and mortgage innovation has spawned a plethora of financial instruments that facilitate in situ mortgage equity withdrawal (MEW) by any age group. In situ MEW is a relatively new low cost style of HEW that allows homeowners to draw down on their housing wealth by adding to their existing mortgages without having to move. MEW products encompass age-specific forms targeted at the elderly, reverse mortgages\(^1\) for example, as well as non-age-specific forms such as flexible mortgages, which all homeowners can access.

Whether Australians are inclined ‘to MEW’ in order to fund spending needs is the focus of this paper. There are two key research questions. Firstly, what are the recent trends in MEW amongst Australian homeowners, and how have these changed since the Global Financial Crisis (GFC)? Secondly, do institutional settings in Australia encourage or impede MEW by Australian homeowners? Answers to these questions are important as they shed light on the new welfare role of owner occupied housing.

The paper is structured as follows. Section 2 highlights the changing nature of homeownership asset-based welfare from the traditional pension role in old age, to flexible equity drawdowns across all stages of the life course. We show that Australian households in most age groups have a growing appetite for MEW. Section 3 documents how this ‘new’ welfare role of homeownership is associated with a rising indebtedness among all but the oldest age groups. This is followed in section 4 by a comparison of MEW-developments in Australia with five other developed countries. Section 5 examines the link between alternative institutional arrangements and the potential for MEW; it concludes that Australia provides an environment conducive to MEW. A final section draws implications for the role of housing wealth as an asset base for welfare and retirement incomes policy. We conclude that Australians make widespread use of MEW to help meet acute spending needs at all

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1 In the UK, reverse mortgages are more commonly known as lifetime mortgages.
stages of the life course, but this welfare enhancing role should be balanced by a careful consideration of the consequent repayment risks as retirement approaches.

2. The changing role of homeownership

Kemeny (1980, 1981) and Castles (1998) have proposed that there is a trade-off between the size of a country’s owner-occupied sector and that of its welfare state. Kemeny (1981) found that countries with relatively less developed welfare states have high rates of homeownership. Castles and Ferrera (1996) report an inverse relationship for many Organisation for Economic Co-operation and Development (OECD) countries in the 1980s. But the direction of causation is a matter of dispute.

Successive Australian Governments have promoted housing asset-based welfare by the use of tax expenditures, concessionary asset tests governing eligibility to allowances and pensions and assistance to first home buyers. These policy instruments and the high levels of homeownership they foster are an important pillar supporting welfare in old age. The assumption has been that older, low income outright owners will have negligible housing costs because they are no longer paying off mortgages, and can therefore get by on smaller pensions (Castles, 1998).

There is some evidence supporting the effectiveness of this strategy. Ritakallio (2003: 81) shows “that, instead of vast differences in inequality, poverty and, in particular, old-age poverty, the real differences between Australia and Finland are only modest when housing costs are taken into account.” On comparing six countries, Yates and Bradbury (2010) find that while Australia has the highest before-housing poverty rate among those aged 65 years or over, this same age group has one of the lowest after-housing poverty rates because of the low housing costs of older outright owners (see also Heylen and Haffner, 2012).

In recent times a more wide-ranging welfare role for owner-occupied housing has emerged. Financial deregulation and mortgage innovation spawned a plethora of financial instruments that facilitate in situ MEW. One of the more important innovations was the flexible mortgage—a secured loan that can be repaid in varying instalments, while at the same time allowing the borrower to access their housing equity up to some agreed limit. Flexible mortgages have grown in popularity in countries such as Australia and the UK. Their success was helped along by soaring house prices between the mid-1990s and mid-2000s, and historically low interest rates. Also there is no costly application process; these products turn housing wealth into an ‘ATM’ with borrowers drawing down or adding to their housing equity as and when they choose (Klyuev and Mills, 2010). Flexible mortgages can be accessed at any stage of the life course; the housing wealth of Australians is then much more liquid than that of their counterparts 30 years ago.

There are also MEW products, such as reverse mortgages, that are targeted at ‘elderly’ homeowners. Their market penetration has increased in some countries (Reifner et al. 2007a, b), but they remain a small share of the mortgage market. Reverse mortgages allow borrowers to draw on loans just like any other mortgage, but repayment is not required until the house is sold. Interest payments are deferred so the outstanding debt balloons over the loan term. This feature could be responsible for their low take up.

Toussaint and Elsinga (2009) distinguish between traditional and new forms of housing asset-based welfare. In the former, homeownership is a vehicle for the accumulation of housing wealth that can be tapped into as a last resort, and typically late in the life course. In its new

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2 Doling and Ronald (2010) report a significant positive correlation between before-housing poverty rates among over 65s and the rate of homeownership in a sample of EU countries.
role housing equity is a financial resource to be stored or released as needed over the life course. But there is a fear that growing numbers of homeowners will approach or even enter retirement with large outstanding debts. This would weaken the traditional asset-based welfare role of housing wealth in old age.

3. Mortgage indebtedness and MEW in Australia

In this section, we invoke repeated cross-section data from the ABS Income and Housing Surveys and panel data from the Household Income and Labour Dynamics in Australia (HILDA) survey to chart long-run changes in borrowing behaviour. The timeframe is 1982 through to 2009, and a period of significant change in financial markets following deregulation in the 1980s. The ABS Surveys of Income and Housing are deployed to address two questions. Firstly, are mortgagors increasingly common among homeowners? Secondly, are mortgagors more leveraged than they have been in the past? HILDA is used to measure mortgagors’ propensity to engage in MEW.

Figure 1 presents some striking trends for five age groupings. An increasing proportion of homeowners were mortgagors in all age groups other than those that had reached retirement age (65 years and over). The house price boom that began in 1996 is correlated with a rise in the proportion of homeowners securing debt against their homes. The relationship is most evident for the 45 – 54 years old age group where mortgagors were roughly 40% of all homeowners in 1996, but their share soared to nearly 70% in 2009. The GFC slowed but did not reverse the trend increase across our age groups.

Figure 2 compares the loan-value ratios (LVRs) of mortgagors in each of the same five age bands. With the exception of the post-retirement age group there is a rise in gearing; the increase in the youngest age band (25–34) is as much as 20 percentage points. Even those approaching retirement age (55–64 years) are gearing up with LVRs rising from 22 per cent to 28 per cent.
Figure 1: Percentage of homeowners with a mortgage debt, 1982-2009


Figure 2: Mean LVR of homeowners with a mortgage debt, 1990–2009

Source: 1990 and 2009 surveys of income and housing from the ABS

Note:
a. It is not possible to calculate LVRs for 1982 due to the absence of house value and mortgage debt data in the 1982 survey.
Table 1 considers the link between rising indebtedness and homeowners’ in situ propensity to add to their mortgages. Using the same five homeowner age groups we list the percentage of homeowners that MEW in each year from 2001-2010. The findings indicate that regardless of year, younger homeowners are more inclined to MEW. In the two youngest age groups (25-34 years; 35-44 years) between one quarter and one third of homeowners added to their mortgages in any one year. Even middle age groups are active; so, for example, the proportion of homeowners in the 45-54 year age group adding to their mortgages exceeds 20% in all but one year. But the oldest age band (65 years and over) are reluctant to borrow more. These levels of MEW activity correlate closely with the differential rise in indebtedness in our age groups.

<table>
<thead>
<tr>
<th>Year</th>
<th>25-34 yrs</th>
<th>35-44 yrs</th>
<th>45-54 yrs</th>
<th>55-64 yrs</th>
<th>65+ yrs</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>26.5</td>
<td>26.0</td>
<td>18.4</td>
<td>8.3</td>
<td>2.0</td>
</tr>
<tr>
<td>2002-03</td>
<td>33.3</td>
<td>30.3</td>
<td>24.9</td>
<td>10.5</td>
<td>3.8</td>
</tr>
<tr>
<td>2003-04</td>
<td>34.0</td>
<td>27.3</td>
<td>23.1</td>
<td>9.9</td>
<td>1.5</td>
</tr>
<tr>
<td>2004-05</td>
<td>34.0</td>
<td>33.2</td>
<td>25.8</td>
<td>12.7</td>
<td>3.7</td>
</tr>
<tr>
<td>2005-06</td>
<td>30.7</td>
<td>32.2</td>
<td>23.0</td>
<td>10.1</td>
<td>3.0</td>
</tr>
<tr>
<td>2006-07</td>
<td>28.8</td>
<td>33.7</td>
<td>28.8</td>
<td>14.3</td>
<td>2.5</td>
</tr>
<tr>
<td>2007-08</td>
<td>30.1</td>
<td>30.2</td>
<td>23.4</td>
<td>13.6</td>
<td>3.8</td>
</tr>
<tr>
<td>2008-09</td>
<td>29.6</td>
<td>27.3</td>
<td>22.4</td>
<td>15.1</td>
<td>3.1</td>
</tr>
<tr>
<td>2009-10</td>
<td>24.7</td>
<td>27.1</td>
<td>24.3</td>
<td>16.0</td>
<td>4.0</td>
</tr>
</tbody>
</table>

Source: Authors’ own calculations from the 2001-10 HILDA Survey
Notes:

a. Homeowners engaged in MEW if they did not move between year t and t+1 but increased mortgage debt secured against their primary home.
b. The age bands are defined contemporaneously. For example, in 2001 a 33 year old is assigned to the 25-34 years group, but by 2010 they are 43 and assigned to the 35-44 years age group.

The trends over the decade are interesting because a sharp decline in MEW was anticipated post-GFC. In fact the trends are mixed. The two youngest age groups enthusiasm for MEW did cool post-GFC (or increasing numbers found that borrowing constraints were binding). On the other hand, our oldest two groups of owners actually increased their engagement with MEW. It is possible that the over 55 year olds were more exposed to risks in the post-GFC era, and were therefore forced to unlock housing wealth more often to meet emergencies.

To sum up, Figures 1 and 2 and Table 1 reveal some important long run trends. Firstly, more Australian homeowners are securing debt against property later in their lives. Secondly, mortgagors are inclined to secure more debt against their housing wealth. Thirdly, this increase in indebtedness is correlated with widespread MEW. Curiously, persons 65 years and above are defying these long run trends. A much more conservative borrowing profile is

3 Mature age workers, especially the less educated are more vulnerable to job loss, and more likely to leave the workforce when an economic crisis hits near retirement (Coile and Levine, 2011) and/or have difficulty regaining employment after a period of job loss (Weller, 2007).
apparent; the proportion with outstanding mortgage debt has remained very low (below 10%) over the nearly 30-year timeframe, and in 2009 remained much the same as it was in 1990. Even those with a mortgage showed no inclination to gear up against their housing wealth. The divergent trends could be due to the use of lump sum superannuation pay outs to repay mortgages on retirement; if true this would have important implications for retirement incomes policy as it means that significant numbers of Australian homeowners are using mortgages to tap into superannuation balances before retirement.

4. The MEW market for homeowners in Australia

In this section, we provide a detailed examination of the Australian MEW market. We distinguish between age-specific-products targeted on seniors over 60 years of age (e.g. reverse mortgages), and non-age-specific products such as flexible mortgages that all homeowners can access. We round off this section by comparing the Australian MEW market with those in five other countries.

4.1 Styles of MEW in Australia

Age-specific products for the elderly
Reverse mortgages are the most common product used by older Australians (Australian Securities and Investments Commission (ASIC), 2005; Bridge et al. 2010, 2011). The Australian government pilot home equity conversion scheme was an early initiative in 1993, but was discontinued after only 3 years because of its low take-up (Dolan et al., 2005). Growth in the market for reverse mortgages began in the 2000s, a relatively late start compared to the UK and the US. Bridge et al.’s (2010) study identified seven Senior Australians Equity Release Association of Lenders (SEQUAL) accredited lenders marketing five reverse mortgage products in 2008. The Australian Securities and Investments Commission (ASIC, 2007) notes that the maximum loan is age-dependent, but usually leverages roughly 50 per cent of property value. The drawdown options include lump sums, regular payments, and lines of credit. Lenders typically offer no negative equity guarantees. Lines of credit allow homeowner-borrowers to make repeated income drawdowns up to an agreed limit (Deloitte Touche Tohmatsu and SEQUAL, 2011, 2012). According to research conducted by Deloitte for SEQUAL, the majority of reverse mortgage products in Australia (85% in 2010) are variable rate loans, and almost all reverse mortgages are taken out in the form of lump sum payments (95% in 2010). Despite a post-GFC credit crunch Australia’s reverse mortgage market continued to grow. Between 2005 and 2011 the number of outstanding reverse mortgage loans more than doubled (to 42,400). Meanwhile the average loan size also increased from A$51,100 in 2005 to A$78,200 in 2011. By the end of 2011, outstanding reverse mortgages loans had reached about A$3.3 billion, three times the figure reported in 2005. While this market remains small relative to conventional mortgages, it seems that older homeowners’ demand for reverse mortgages withstood the challenges posed by the GFC (Deloitte Touche Tohmatsu and SEQUAL, 2011, 2012).

4 Reverse mortgages originated since 2008 are only made available as variable rate mortgages.
4.2 How developed is Australia’s MEW market compared to other countries? A cross-country review

Next we contextualise our analysis of the Australian MEW market by comparing it with MEW markets in the UK, US, Netherlands, Finland and Germany. This comparison is instructive because there are considerable cross-country differences in the scale of MEW markets and the type of products offered to home owners. Figure 3 demonstrates that the UK and US are apposite benchmarks as these three countries have similarly high rates of owner-occupation (>60%), and very complete mortgage markets (>75% of GDP). The Netherlands has the biggest mortgage market relative to GDP (IMF, 2008) and an increasing rate of homeownership (closing in on 60%). To achieve diversity we include Finland and Germany. Homeownership is the majority housing tenure in Finland (almost 60%) as in the Anglo-Saxon countries, but its mortgage market is much smaller. Germany is an interesting contrast because it has a relatively low homeownership share, though its comparatively small mortgage market is a feature it shares in common with Finland.

MEW products have been available in the UK for roughly 30 years (ASIC, 2005). The UK has the most developed housing equity release market in Europe (Reifner et al., 2007b: 3). Reverse mortgages, more commonly known as lifetime mortgages in the UK, constitute the most frequently offered age-specific MEW product (Reifner et al., 2007b). According to the UK’s Equity Release Council reverse mortgages dominate sales in the UK market for equity products targeted on the elderly; in 2011 new loan originations amounted to £560 million, equivalent to a market share of 98%. However, the take-up of these age-specific products was

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5 An example is the ANZ equity manager loan, see <http://www.anz.com/personal/home-loans/choose-home-loan/equity-manager/>; last accessed on 22 August 2013.

6 The Equity Release Council is an industry body which ensures that reverse mortgages and home reversion products offered to homeowners aged 55 years and over are safe and reliable.
significantly higher pre-GFC, peaking at £1.1 billion in 2007 (The Wriglesworth Consultancy, 2011).

Figure 3: Homeownership rates and outstanding residential mortgage debt, most recent year available

Non-age-specific MEW instruments such as interest-only mortgages and second mortgages are also available (Reifner et al., 2007b; Reinold, 2011). UK mortgage providers have also launched flexible mortgage products that have increased their market penetration in line with trends in Australia. Indeed mortgage products that allow mortgagors to borrow up at a time of their choice (subject to credit limits) are now the most popular product in the UK (Reifner et al., 2007b; see also Klyuev and Mills, 2010). It is common for these flexible mortgages to also offer an offset facility whereby the balance stored in a savings account can be deducted from the outstanding mortgage debt for the purposes of calculating interest payments. When the savings account is merged with the mortgage account so that all banking transactions are conducted through the one account, the result is a current account mortgage.

There can be tax advantages. The interest that would have accrued on a traditional savings bank account would be reported as taxable income. The reduction in interest payments on offset mortgage accounts is not taxable income.

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Sources: EMF (2010); Australian homeownership rate from Oxley et al. (2010); Australian mortgage shares from IMF (2011)

Note: The countries that are reviewed in our study have been depicted using black diamonds. A cut-off rate of at least 40% for each axis was used for countries to be included. The average is the average of 27 countries of the European Union, when it consisted of 27 countries.
In the US, the most widely used age-specific MEW product is the reverse mortgage (ASIC, 2005). It was first introduced in 1961 (Wicke, 2008; see also Schneider, 2009). In 1987 the US Congress passed legislation authorising a Government backed Federal Home-Equity-Conversion-Mortgage (HECM) Program. Over 90% of all reverse mortgages are now originated through this initiative (see Bishop and Shan, 2008; Gotman, 2011). The US government guarantees fulfilment of the reverse mortgage contract if a lending financial institution fails. Outstanding debt is capped at the owner’s home value, but lenders are not exposed to negative equity risk as Federal government covers the lender’s loss in such circumstances. Despite these government guarantees, the Consumer Financial Protection Bureau (CFPB, 2012) notes that the reverse mortgage market remains very small, comprising two to three per cent of the 24 million homeowner households eligible to take-up reverse mortgages. The GFC also appears to have tempered older homeowners’ appetite for MEW. The origination of HECMs increased from less than 10,000 in 2001 to over 105,000 in 2007, but then growth slowed over the period 2007-09, originations peaking at almost 115,000 in 2009 before slumping to only 51,000 in 2012.

Alternatives to reverse mortgages include refinancing conventional fixed interest mortgages, and HELOCs. Older homeowners generally find these more difficult to qualify for because they require regular interest and principal payments (CFPB, 2012). While HELOCs offer flexibility in the timing of repayments, Do (2012: 301) argues that flexibility is effectively limited by pre-payment penalties and non-usage fees. However, HELOCs often carry an interest-only repayment feature with the principal repaid at the end of the loan term, and this is potentially attractive to older borrowers.

In the Netherlands, house price inflation accelerated in the late 1990s, sparking a surge in MEW across all age groups in the home-owning population. There are two distinguishing features of Dutch equity extraction; firstly, age specific products have generally not been offered by lenders. An exception is the Florius Verzilver Hypotheek (the brand name of a large Dutch bank); it offers a reverse mortgage which has a no negative equity guarantee but its market penetration remains small (Ong et al., 2013).

Secondly, MEW is commonly executed by borrowing more from an existing mortgage (Van den End et al., 2002). About one third of homeowners released housing equity of about 30 billion between 1996 and 2001, annual releases peaking at more than 10 billion Euro in 2000. Mortgage products geared to MEW include second mortgages that are lines of credit secured against a home that has already been used as security for a first mortgage (Reifner et al. 2007b). Rabobank, for example, offers a second mortgage product called KeuzePlus Hypotheek. Interest payments are charged on drawdowns using the line of credit, but repayment of the principal is deferred until the end of the mortgage contract.

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*8 Those reverse mortgage products not covered by the HECM program are known collectively as proprietary reverse mortgages (CFPB, 2012). Their market share has steadily declined since the introduction of HECMs, and proprietary reverse mortgages are practically non-existent in the US nowadays.*


*11 For more details, refer to [http://www.rabobank.nl/particulieren/producten/hypotheken/overzicht_hypotheken/keuzeplus_hypotheek#tab2]; last accessed on 22 August 2013; see also Taskforce Verzilveren (2013).*
MEW was encouraged by unlimited (until 2001) mortgage interest deductions from taxable income for any mortgage loan (Haffner and De Vries, 2010). Interest-only mortgages became popular as a consequence of this tax preference, resulting in increasing numbers of over-65 year old owners carrying outstanding mortgage debt into their retirement years (Haffner, 2008). In the new millennium a slower rate of house price appreciation, changes to the tax system (see below) and the GFC have deterred MEW.

In Finland, a reverse mortgage at a variable interest rate was introduced by the OP-Pohjola Group (a group of 200 cooperative banks) in 2007 (Reifner et al., 2007b). It is offered to elderly homeowners as a fixed term loan with a term of 10 years. However interest payments can be calculated as if the loan will run over the homeowner’s lifetime, which it will if it is renewed over the remainder of the owner’s lifetime. There are also balloon loans called Homeflex that were launched by the Nordea Bank Finland in 2005. This loan offers a line of credit facility up to a limit of 75% of home value. However, the customer pays interest during the course of the loan term and the loan principal must be repaid after ten years, unless the loan is refinanced or a longer amortisation period can be negotiated. The rather limited literature on Finnish MEW markets reflects their relatively undeveloped state.

Germany has, like Finland and the Netherlands, very few age specific vehicles for MEW and even second mortgages are uncommon (Reifner et al., 2007b). The total equity release market among elderly homeowners was estimated at less than 100 contracts in 2008, with only two products offered by financial institutions. There is only one reverse mortgage product. Wicke (2008) argues that attempts to launch reverse mortgages have failed because of their complexity and associated legal insecurities.

In summary we can draw a distinction between mortgages that allow equity withdrawal, but can only be accessed by older homeowners, and vehicles for MEW that are (in principle) available to homeowners in all age groups. The former age-specific mortgage products have remained a small segment of the market for home loans despite an ageing population, and even in countries where products have been offered with government backing. The most prevalent mortgage instrument has been the reverse mortgage. Though interest payments and repayment of principal are deferred, the compounding of interest that causes loans to ‘balloon’ is probably unattractive to older homeowners. Even caps on outstanding debts have failed to promote take-up beyond a small minority of eligible owners, and this could indicate that potential customers are disconcerted by the risk that housing equity will be depleted. Loan products that share risks more evenly between borrower and lender by linking repayment to future house price growth are at an early stage of development, but might appeal more in this market segment.

On the other hand, there are countries where equity withdrawal among pre-retirement owners has been vibrant, helped along by mortgage product innovations (second mortgages, line of credit equity conversion loans, current account mortgages). Unlike age-specific products, these MEW products have a normal contract term that is not reliant on sale proceeds to meet principal repayments. In the early 2000s the growth in MEW was particularly apparent in younger under 45 year age groups, but since the GFC those approaching retirement are an important source of growth (in Australia). In countries where home buyers’ mortgage interest payments for any mortgage loan are tax deductible (e.g. the Netherlands until 2001, and the US) there were particularly powerful incentives to MEW through into middle age and later.

12 For example, statistics on the size of the MEW market in Finland are not available (Reifner et al., 2007b).
In Australia, where interest payments cannot be deducted from assessable income, secured loans can nevertheless act as a tax shelter when used to finance investments in rental properties, shares or bonds.

In contrast, there are countries where MEW is uncommon across the life course because suitable mortgage products remain limited. Finland and Germany typify this country grouping. These observations deserve a more thorough consideration of the possible factors that might explain inter-country contrasts. In the next section, we dig deeper and examine a variety of market and institutional factors that could offer insights that advance our understanding of these inter-country differences.

5. Explaining MEW trends in Australia

In this section, MEW trends in Australia are compared and contrasted with those of the other countries under reviewed in this paper. We highlight five market and institutional factors; each one has a particular resonance in the Australian context, and a bearing on the relatively lively Australian management of housing equity over the life course.

Mortgage market development

Figure 3 compared the mortgage debt to GDP ratio, an indicator of mortgage market maturity, and rates of homeownership in the EU-27 group of countries. It shows that the mortgage debt to GDP ratio in the Netherlands, Australia, UK and US are all higher than the EU-27 average of 52%, but in Finland and Germany, the mortgage debt to GDP ratio is well below the EU-27 average. There is little correlation with homeownership rates, which suggests that well developed mortgage markets are not necessary for the support of homeownership. On the other hand, it seems that countries with deregulated housing finance systems have much higher debt to GDP ratios than those retaining more closed housing finance circuits. As Lowe (2012) argues those countries with liberalized housing and mortgage markets were quickest to change in response to the flood of global finance that securitization unleashed. Highly competitive housing finance markets pushed banks, building societies, credits unions and other mortgage providers to offer mortgages on ever more favourable and flexible terms that encouraged borrowers to become highly geared. Our description of mortgage products and innovation in mortgage markets confirms the association with market liberalisation. The deregulated mortgage markets in the US, Australia and UK pioneered MEW friendly products. In contrast Finland and Germany have largely retained regulated closed circuit housing finance systems that have been slow to innovate, and hence offer old and young homeowners few opportunities to MEW.

House price appreciation

Figure 4 profiles the growth in real house prices over the last 40 years. It shows that real house prices soared in those countries such as Australia and the UK where MEW products were most popular. The large real capital gains accruing to homeowners in these countries were a windfall. The resulting unbalanced wealth portfolios and wealth effects on consumption offered motives for equity withdrawal that flexible mortgages and other mortgage instruments were designed to meet. Germany stands out; it has both retained a relatively regulated mortgage market and is the only country reviewed where real house prices have in fact declined since the mid-1990s. It seems that stagnant real house prices may have helped to blunt financial institution incentives to introduce mortgage instruments tailored to MEW, as well as homeowner incentives to use them.
**Figure 4:** Real house price index\(^a\) of the six countries under study, 1970 to most recent quarter available

Source: OECD Economics Department house price database; for a description of sources see Girouard et al. (2006)

Note:
\(^a\) The common index base period across all countries is quarter 2 of the year 2000.

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**Taxation\(^{13}\)**

The tax treatment of owner-occupied housing has already been briefly mentioned as relevant to the level of MEW in a country; countries offering concessionary tax treatment tend to have homeowners that are relatively active ‘traders’ in housing equity. Australia offers tax preferences to homeowners, the principal ones being the tax exemptions granted to net imputed rents and capital gains. But the UK and US have traditionally offered even more generous tax concessions because homeowners’ imputed rents were exempt and mortgage interest payments were deductible to a certain extent. The Netherlands also had a favourable homeowner tax regime; capital gains tax do not apply to income generated from assets; but imputed rents, albeit relatively low, are subject to income tax with mortgage interest for any mortgage loan fully deductible before 2001.

\(~^{13}\) Except for the income tax aspects mentioned here, other tax rules can also deter or incentivise MEW. For example, the tax rules that apply to capital sums obtained as a result of taking out a reverse mortgage or trading on are relevant (Reifner et al., 2007a).
These tax provisions encouraged the accumulation of wealth in housing, but without a market in equity conversion the wealth stored in housing remained illiquid. The recent innovation in some countries’ mortgage markets helped owners to unlock this wealth as and when they elect to withdraw. In those countries with a mortgage interest deduction mortgage products geared to MEW became particularly attractive.

But governments have tightened or removed tax concessions to homeowners in most countries under study, so that once favourable tax environments could become muted or even unfavourable to MEW. In the UK mortgage interest deductions were phased out by 2001 (Haffner and De Vries, 2010). Imputed rent taxation in Germany was abolished in 1987, and mortgage interest deductions replaced by a homeownership grant in 1996. In Finland taxation of imputed rents was replaced by a municipal tax in 1993. In the same year deduction of mortgage interest was quarantined to capital income that attracts an average tax rate lower than that applied to income from employment (Haffner, 2002).

In the Netherlands gradual removal of homeowner tax preferences began in 2001 with mortgage interest deductions limited to that part of the mortgage financing house purchase (Haffner and De Vries, 2010). Furthermore, this deduction is restricted to a lifetime limitation of 30 years. Both changes blunt incentives to MEW in later life. From 2005 onwards, owners continue to pay income tax on imputed rents, but assessable imputed rents are capped at a value equal to mortgage interest payments. Once a mortgage is repaid and interest payments are zero, imputed rents become fully tax exempt. This last reform is an interesting and novel use of tax measures to deter MEW by motivating accelerated repayment of the principal.

More recently (1 January 2013) new mortgage loans must have a conventional amortised repayment schedule with a maximum term of 30 years in order to be eligible for the mortgage interest deduction (VVD-PvDA, 2012). Interest-only mortgages are expected to disappear and the opportunities to MEW in later life seem to be curtailed.

**Regulation of mortgage products**

Financial instruments designed to promote equity release expose borrowers to interest rate volatility and negative equity risks. These risks can deter their take up, a barrier to market penetration that is perhaps more significant among the elderly who have few if any working years ahead of them. Government regulation has a potentially important role in shaping the distribution of risk burdens between borrower and lender, and helping to build trust in new products where these risks are unknown. But we should also take note of self-regulation of which there are examples in our sample of countries.

In the US, the Federal Housing Administration (FHA) is responsible for accrediting financial institutions providing reverse mortgages, and the US also takes a guarantor-type role that could inspire confidence in government-backed mortgages. But the evidence for such claims is not apparent from their small market share. In the UK, standard contract and consumer protection laws offer borrowers protection from fraudulent practices, but certain equity release products (e.g. reverse mortgages) that are deemed to pose higher risks are subject to regulation by the Financial Services Authority (FSA)\(^\text{14}\). But government regulation can also be the source of impediments to market innovation. Reifner et al. (2007b) claim that in Germany there are legal barriers to the development of products that could ease MEW.

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\(^{14}\) The FSA is an independent non-governmental organisation that has statutory powers by the Financial Services and Markets Act 2000. While financed by the financial services industry, the FSA is accountable to Treasury Ministers and the UK Parliament. For more information, please refer to [http://www.fsa.gov.uk/about/who](http://www.fsa.gov.uk/about/who).
Financial institutions marketing equity release products will be adversely affected if one of their competitors markets products in an opportunistic fashion by exploiting ill-informed borrowers. These fears can motivate self-regulation. In the UK 90% of equity release business is with providers who subscribe to the Equity Release Council’s self-regulatory codes (Fox-O’Mahony and Overton, 2013). In Australia, SEQUAL is a peak industry body monitoring and policing professional standards of practice in the equity release market. SEQUAL’s code of conduct requires that all members include clear and transparent non-negative equity guarantees in the products they offer, as well as comply with other self-regulatory codes (SEQUAL, n.d.). These attempts at self-regulation have not overcome borrower resistance to the typical age-specific products offered in Australia and the UK.

Public Pension Systems

The coverage and generosity of public pension schemes might help drive HEW activity levels. Countries with means tests governing eligibility, and age pensions that are low relative to earnings when working might deter MEW during working lives. Repayment of mortgages by retirement is important because low housing costs are crucial to living standards in retirement when age pensions are low. On the other hand HEW in retirement might be encouraged as most wealth is held in housing, and its release in retirement can be a critically important buffer to income shocks. In countries with generous universal pension schemes these motives will be absent.

Australia has an active market in equity conversion, particularly among younger homeowners, but its public pension scheme is not universal and replacement rates are relatively low at 11.8% (OECD, 2011). Under Germany’s and Finland’s pension systems, universal replacement rates are relatively high (at 42% and 57.8% respectively, OECD, 2011). Hence, it is not surprising to find that Germany and Finland have relatively undeveloped markets in equity release products and low levels of MEW activity compared to the other countries reviewed.

It is noteworthy that Netherlands has a quasi-mandatory private pension system, under which pensions are provided by employers in industry-wide schemes. At the end of 2008, there were 656 pension funds covering more than 95% of the workforce (Trampusch et al. 2010). Australia introduced a mandatory private pension scheme in 1992 that compels employers to meet a superannuation guarantee contribution that is as a percentage of the employee’s salary (OECD, 2011; Ong et al., 2013). The wealth accumulated in these private pensions is typically locked into the funds until retirement, and cannot therefore be used to smooth consumption during working lives. As these mandatory private pension schemes mature they may motivate the use of MEW to effectively bring forward pension pay outs during working lives.

6. Discussion

The differences in market and institutional settings are summarised in table 2. There are at least two generalisations that we might draw. Firstly, in countries with buoyant markets in equity release through new mortgage products (Australia, UK, US and Netherlands), real house price growth has been strong or moderate, mortgage markets are relatively open and liberalised and tax regimes have offered generous concessions to homeowners. Secondly, though these features correlate with MEW activity, transactions in housing equity seem to have been largely conducted by households belonging to pre-retirement age cohorts. There are mortgage products specifically designed to appeal to retired homeowners, but they have remained a small segment of the mortgage market, even when (as in the US) government
back the product with a guarantee.

What might be wider implications for Australian public policy and its welfare system? A key issue is whether the primary home will continue to serve as a cornerstone of the Australian welfare system by smoothing consumption in retirement. Outright ownership in old age means that lower incomes in retirement are matched by lower housing costs, and retirees can therefore maintain consumption on smaller pensions (Castles, 1998; Baxter and McDonald, 2005). But in Australia owner-occupied housing equity is increasingly used to smooth consumption earlier in the life course as owners release equity using the flexible mortgage products promoted by liberalised housing finance markets. The result is a growing number of middle aged Australians that are approaching retirement with outstanding mortgage debt, a trend that (on early indications) has not been reversed by the GFC. Moreover mortgagors in these age groups are now more geared than at any other time over the last 30 years or so.

These developments threaten the assumption that owner-occupied housing will guarantee a secure and satisfactory standard of living in retirement despite a relatively parsimonious public pension system. But Australia has a mandatory private pension programme that will arguably replace homeownership as a pillar supporting retirement incomes. It could be that we are witnessing a transformation in old age welfare provision, and it is this that explains the low take up of age specific mortgage products. They are not needed as private pensions spread to a growing share of the retiree population. However higher debt burdens later in life must nevertheless be paid off. The rising indebtedness of pre-retirement age groups is not accompanied by a corresponding increase among retirees. There are two possibilities; other assets could be cashed in or private pensions drained to repay mortgage debts that are still outstanding as retirement approaches. Both tactics will increase pressure on public pensions and undermine attempts to increase self-reliance in old age. The revolution in Australian mortgage markets and the emergence of housing equity as a liquid store of wealth that can be rolled out at any stage of the life cycle, could pose serious challenges for retirement incomes policy. These challenges are the unintended consequences of deregulation, tax preferences and a house price boom that other countries with closed circuit housing finance circuits and less generous homeowner tax concessions have avoided.
Table 2: A cross-country comparison of institutional settings that affect older homeowners’ propensity to use MEW products, latest year available

<table>
<thead>
<tr>
<th>Institutional setting</th>
<th>Australia</th>
<th>UK</th>
<th>US</th>
<th>Netherlands</th>
<th>Finland</th>
<th>Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>Degree of mortgage market development</td>
<td>Well-developed mortgage markets</td>
<td>Well-developed mortgage markets</td>
<td>Well-developed mortgage markets</td>
<td>Well-developed mortgage markets</td>
<td>Relatively regulated mortgage markets</td>
<td>Relatively regulated mortgage markets</td>
</tr>
<tr>
<td>House price movements (based on figure 4)</td>
<td>Strong long-run growth in real house prices</td>
<td>Strong long-run growth in real house prices</td>
<td>Moderate long-run growth in real house prices</td>
<td>Moderate growth in real house prices, followed by strong growth in the last decade</td>
<td>Moderate long-run growth in real house prices</td>
<td>Decline in real house prices</td>
</tr>
<tr>
<td>Mortgage interest tax deduction, Exemption of imputed rent</td>
<td>No mortgage interest deduction on home loans</td>
<td>No taxation of imputed rent*</td>
<td>No taxation of imputed rent*</td>
<td>No taxation of imputed rent*</td>
<td>Imputed rent taxation converted to local property tax*</td>
<td>No taxation of imputed rent*</td>
</tr>
<tr>
<td>Exemptions capital gains from taxation</td>
<td>No capital gains tax*</td>
<td>No capital gains tax*</td>
<td>No capital gains tax*</td>
<td>No capital gains tax*</td>
<td>No capital gains tax*</td>
<td>No capital gains tax*</td>
</tr>
<tr>
<td>Regulation of age-specific MEW products for the elderly</td>
<td>Industry regulation via SEQUAL</td>
<td>Government regulation via FSA regulation and extensive industry self-regulation</td>
<td>Government regulation through FHA; government guarantee for consumers and financial institutions</td>
<td>No special market regulation</td>
<td>No special market regulation</td>
<td>No special market regulation</td>
</tr>
<tr>
<td>Institutional setting</td>
<td>Australia</td>
<td>UK</td>
<td>US</td>
<td>Netherlands</td>
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</tr>
<tr>
<td>Generosity of pension system</td>
<td>Low gross replacement rate from public pension schemes, though mandatory private pension scheme in place since 1992</td>
<td>Moderate gross replacement rate from public pension schemes</td>
<td>Moderate gross replacement rate from public pension schemes</td>
<td>Moderate gross replacement rate from public pension schemes, plus a quasi-mandatory private pension system, under which pensions are provided by employers or industry-wide schemes</td>
<td>High gross replacement rate from public pension schemes</td>
<td>High gross replacement rate from public pension schemes</td>
</tr>
</tbody>
</table>

Sources: ^Wood et al. (2010); *Yates (2012); +Oxley and Haffner (2010); ??Reifner et al. (2007b); †European Commission (2012); ‡Haffner (2002); all other details from Ong et al. (2013)
Acknowledgements

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