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The Fourth Pillar – The Role of Home Equity Release in Retirement Funding

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ABSTRACT

This paper provides an overview of the home equity release market in Australia today, and highlights the potential for home equity release to become a more meaningful fourth pillar of the Australian retirement incomes system. The pillar exists today but does not currently play a significant role in retirement funding. There are challenges to be overcome in addressing this. Releasing more of the equity that senior Australians hold in their homes, whilst they still live in their homes, could allow a more comfortable retirement for many, would help to address the issue of sustainability of the age pension system and would improve intergenerational equity.

Keywords: equity release, retirement, age pension, longevity, home reversion, reverse mortgage

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Christine Brownfield is employed by Homesafe Solutions. The opinions outlined in this paper are her own and do not necessarily represent the views of her employer.

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1. INTRODUCTION TO THE FOURTH PILLAR

This paper considers the role that home equity release could play in the retirement funding of senior Australians. The retirement income system is often viewed as comprising three pillars. These are the government pension, a retiree's compulsory superannuation savings and a retiree's voluntary saving for retirement, including assets held outside of the superannuation system.

With residential property being the largest asset class in Australia[i] and a high proportion of Australian seniors owning their own homes, home equity should be more widely recognised and utilised as the fourth pillar. It exists already but there are challenges in accessing this fourth pillar during retirement.

Issues around funding the retirement of an ageing population, particularly the impact of increasing longevity, have received a lot of publicity in recent times. Much of the commentary relates to savings/contribution rates, financial advice, asset allocations, retirement products and the cost to government of an ageing society. There is not a lot of focus on the store of wealth represented by the homes of senior Australians and the role that this wealth could play in retirement funding.

The topic of intergenerational equity flares up from time to time in the media but discussions have a long way to go. With the family home's complete exclusion from the age pension assets test being seemingly sacrosanct in Australia, it will be a brave government that addresses this in the short term. But allowing an increasing number of retirees to receive taxpayer funded pensions, while they hold substantial property wealth, and then bequeath that wealth to the next generation, is not equitable. Over time it is unlikely to be sustainable.

On the other hand, a hasty and poorly thought through inclusion of the family home in the assets test would not be ideal either. With pressure on government budgets and contributing factors including the growing number of age pension recipients and increasing longevity, this is an area worthy of consideration sooner rather than later.

The role that home equity release can play in retirement funding as a meaningful fourth pillar is a topic that warrants further debate in Australia. Policy development must take into account time horizons that stretch for decades, complex issues, equity considerations and a range of factors around which there is plenty of uncertainty and often little experience.

The purpose of this paper is to increase awareness of the issues involved in unlocking the fourth pillar of retirement funding, and to highlight why overcoming these issues is important.

2. HOME EQUITY RELEASE IN AUSTRALIA TODAY

Releasing the equity in the home generally means retaining the right to live in the home but releasing some of the value stored in it. Owner-occupied residential property is a unique asset in that it is both a home and an illiquid and concentrated store of value. Home equity release removes some of this lumpiness and enables home equity to be accessed whilst the homeowner remains in the home.

Senior homeowners today utilise equity release products for a variety of reasons, including:

- Supplementing retirement savings;
- Making home alterations to cater for reduced mobility;
- Paying for medical treatment, or nursing or support services;
- Repaying debt; and
- Providing financial support to family members.

2.1 Established Home Equity Release Products

The equity held by a senior Australian in their home can be released either via debt, with the home used as security against the debt, or by selling a portion of the equity in the home. Tailored products are required to facilitate this.

2.1.1 Reverse Mortgages

In Australia, debt products which release equity to senior homeowners are known as "reverse mortgages". A reverse mortgage is currently the most common equity release product used by seniors in Australia.

A loan is taken out with a home as security, and the principal accumulates with interest until settlement, which occurs no later than when the home is sold either by the homeowner or the estate. The loan can be taken as a lump sum, an income stream, a line of credit or a combination of these.

Unlike a "normal" home loan, there are no regular repayments; homeowners do not require an income to qualify. All reverse mortgages written in Australia today must include a "no negative equity guarantee" meaning that the loan provider takes on the risk that the outstanding amount when the loan is repaid is higher than the sale price of the home. This protects against negative equity but there is uncertainty about how much equity, if any, will be left at the end of the contract[ii].

This uncertainty arises from a combination of "unknowns" in relation to:

- future house price movements;
- long term interest rates; and
- the length of time for which the contract will be in place, which depends on longevity and other factors that are difficult to predict.

Eligibility criteria vary by lender and have been tightened in recent years.

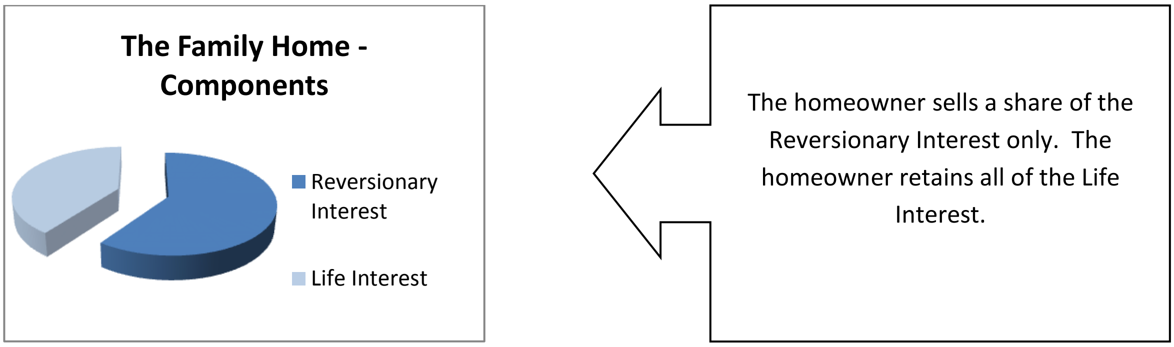
According to Infochoice[iii], reverse mortgage products are currently offered by:

- Australian Seniors Finance (recently purchased by Heartland Bank (NZ));
- Bank SA and St George (both part of Westpac);
- Bankwest (part of CBA) and CBA;
- p&n bank (Western Australian member owned bank); and
- Transcomm Credit Union (Victorian member owned credit union).

2.1.2 Home Reversion Products

Home reversion products involve a proportion of the home equity being sold and the senior homeowner retaining the right to continue living in the home. The homeowner sells a share of the "reversionary interest" in the home, but retains 100% of the "life interest." The life interest is the right to use the home (or the income produced by the home) until the homeowner(s) die or sell the home.

Figure 1: Family home components



The homeowner has certainty about the share of the home that will be retained when the home reversion contract completes; for example if 60% of the reversionary interest is sold, then at the end of the contract the homeowner/estate will be entitled to 40% of the sale proceeds.

The product offers a homeowner a form of longevity protection as the right to continue living in the home has no end date. From a product provider perspective, the longevity risk exists but is partially "hedged" in that if the contract continues for longer than expected, there will be more years of property appreciation than expected. In this way it differs from the longevity risk taken on in providing some other retirement products, such as lifetime annuities.

Home reversion products are not widespread in Australia. There is currently a single established product available, the Homesafe Debt-Free Equity Release (HDFER) product offered by Homesafe Solutions. The product has strict eligibility criteria, including that homeowners must reside in specified postcodes in greater Melbourne and Sydney, which limit its availability.

The overview below provides a brief description of the HDFER product as an example of a home reversion product. There is potential as new products are developed for quite different offerings, and probably more variation between product providers than exists between reverse mortgage providers.

Overview of the HDFER Product

On entering into a contract with Homesafe in respect of a specific percentage of their home, a homeowner receives a cash advance, in exchange for that percentage of the sale proceeds when the home is sold ("the future sale proceeds"). The cash advance paid to the homeowner for a share of future sale proceeds is not equal to that share of the face value of the home today, as what is being sold is a share of the reversionary interest, but not the life interest.

The proportion of the home represented by the reversionary interest is, naturally, higher for single life contracts than for joint life contracts (of the same age), and for older homeowners than for younger homeowners.

The homeowner(s) retain the right to live in the home for life, i.e. the life interest. The contract is completed when the house is sold, either when the homeowner chooses to sell, or when it is sold by their estate. There is also a "buy back" option.

The product provides certainty around the minimum amount of equity that will be received by the homeowner or the estate when the home is sold. This certainty is marketed as a key feature of the product as the retained share is not impacted by interest rates, the level of property appreciation, or longevity – these risks are taken on by the product provider.

The HDFER product includes two rebates which are intended to be "fair". When a property is sold, Homesafe's share of the sale proceeds will be reduced by the amount of the rebates. The rebates mitigate the risk for the homeowner of:

- a windfall loss where a contract completes in the early years (given that the cash advance represents a material discount to face value); or
- very strong property appreciation.

The operation of the rebates differentiates the HDFER product from pure home reversion products, as the payoffs to the product provider are quite different.

An article in Actuary Australia (Brownfield, 2012) provides further background on the HDFER product, and the operation of the rebates.

2.2 Market Size

The main source of publicly available information on the home equity release market in Australia is an annual Deloitte survey of reverse mortgages. The most recent survey (Deloitte, 2012) included the following:

- At 31 December 2012 there were around 42,000 reverse mortgages with an average outstanding amount of $84,000, giving total debt of $3.5 billion which was a 7% increase over the year.
- In 2012, there were 4,400 new borrowers and $305 million of new borrowings – this includes drawdowns on facilities established in prior years.
- Loan to valuation ratios increase with age but not as steeply as maximum loan to valuation ratios on offer increase with age. Borrowers aged less than 65 averaged ratios of 15% and borrowers aged 80 and over averaged 20%.
- For 2012, the number of new settlements and loan discharges were of similar magnitude, so growth in total debt came mostly from the accumulation of interest.

The size and growth rates of the reverse mortgage market, measured by outstanding debt, have been:

Table1: Size and growth of reverse mortgage market in Australia

Date	Debt $ billion	Year on Year Growth
12/05[iv]	0.85	-
12/06	1.51	78%
12/07	2.02	34%
12/08	2.48	23%
12/09	2.71	9%
12/10	3.01	11%
12/11	3.32	10%
12/12	3.56	7%

Source: Deloitte (2012)

The rate of growth in the mid-2000s was significantly higher than it has been in more recent years, which is related to a reduction in market capacity.

In addition to the reverse mortgages outstanding, the HDFER home reversion product has been available since mid-2005. Assuming some increase in reverse mortgages outstanding, and allowing for the HDFER product, an estimate of the number of retiree households living today in homes where a portion of the equity has been released is, say, 45,000.

ABS figures[v] suggest that in 2011-2012 there were around 1.89 million households (single and couple) where the age of the reference person was 65 or over. Applying home ownership rates from Section 3.3.1 below suggests around 1.58

million senior home-owning households. This figure would be slightly higher by the end of 2013. Assuming around 45,000 outstanding equity release contracts, market penetration of home equity release products is less than 3%.

By definition this figure does not take into account any equity released via downsizing/sale of the family home.

2.3 Market Developments

Over the last decade there have been a handful of companies which proposed to enter the home reversion market, but in most cases products were not ultimately launched. In some instances this was due to the product being developed in the lead up to the Global Financial Crisis, after which funding sources no longer existed.

Similarly, funding for reverse mortgages has been withdrawn in recent years with only five active lenders today compared with more than fifteen in the lead up to the Global Financial Crisis (Deloitte/SEQUAL, 2013). The current market participants do not generally appear to be actively promoting their reverse mortgage offerings.

There have been three other market developments more recently, not all of which have been launched yet, which have the potential to grow the equity release market for seniors.

POPI Australia has developed an arrangement called POPI[vi] ("Property Options for Seniors, Pensioners and Investors") under which a senior homeowner grants an investor the right to buy their home in the future at a pre-agreed price. The investor's right to buy is triggered by the homeowner's death or decision to relocate. In exchange for that right, the investor makes a monthly payment to the senior homeowner. The homeowner is effectively exchanging (unknown) future capital growth for (known) income. This can be in respect of 50%, 75% or 100% of the home. The first POPI contract was written in mid-2013.

In 2013, Domacom announced the development of a home equity release product, in conjunction with a platform allowing fractional investment in property. The fractional property investment platform was launched in February 2014. The equity release product was deferred, with the Domacom website[vii] stating that the product will be pursued in 2014. It will be interesting to watch this space as the fractional property investment platform could potentially provide the funding for an equity release product that is likely to differ significantly from current offerings.

A significant difference between the POPI and Domacom approaches to equity release, and more traditional home reversion schemes, is the one to one relationship between a homeowner and an investor. These approaches essentially match up individual homeowners and investors, rather than building a diversified pool of property exposures into which one or more parties can invest.

Finally, in March 2014 Macquarie Bank announced that it would soon launch a reverse mortgage product[viii].

2.4 Government Backed Equity Release Schemes

Whilst there is no government backed equity release scheme that is widely available to Australian retirees, there are some existing schemes with limited accessibility. Most of these have been designed to help retirees fund the cost of services traditionally provided by government. A description of existing schemes is provided in the Productivity Commission's 2013 Research Paper "An Ageing Australia: Preparing for the Future" and the schemes outlined include:-

- Pensions Loan Scheme – an older Australian can borrow against their home to top up their part pension to the level of a full pension or, if they are not eligible for the pension, to provide an income stream equivalent to the full pension. The scheme includes a no negative equity guarantee and is available Australia wide. In 2010, there were 710 loans outstanding under the scheme. The low take up rate can be linked to the eligibility criteria rather than the design of the scheme and the Productivity Commission's paper notes that "... the scheme demonstrates [that] it is practical to develop models in which governments provide loans secured against housing equity for social welfare purposes".

  More recent information on the number of loans outstanding under the Pensions Loan Scheme could not be sourced; however the loan amounts outstanding in mid-2013 were in the vicinity of $30 million.[ix]

- South Australia's Seniors Rate Postponement Scheme – this scheme was introduced in 2007 and allows eligible ratepayers to postpone all but the minimum payment of their rates. The postponed amount acts as a reverse mortgage, with the deferred amount plus interest due on the sale or transfer of the property. The interest rate is favourable. Debt is capped at 50 per cent of the value of the property.

- ACT's Rates Deferment – as under the South Australian scheme, eligible homeowners can defer their rates using a mechanism akin to a reverse mortgage.

- Other Rates Postponement Schemes – some Australian councils offer schemes similar to the rates postponement schemes in South Australia and the ACT, but these schemes apply significantly higher interest rates to withdrawn funds and so are less attractive to ratepayers. An example is the Gympie scheme where the same interest rate applies as is levied on overdue rates.

2.5 Overseas Markets

A detailed overview of overseas equity release markets is beyond the scope of this paper; this section touches on key markets and notes references which are available to provide further information.

According to Hanewald et al (2013), "markets for equity release products exist in [a number of] countries including the United States, the UK, Australia, Canada New

Zealand and several countries in Europe". Reverse mortgages are the most common products internationally and dominate the United States market. There have been private home reversion arrangements in some European countries. Commercial home reversion is available in Australia, France, Finland, New Zealand and the United Kingdom.

In the United States, the Home Equity Conversion Mortgage (HECM) program accounts for nearly all loans and is insured by the US Federal Government. A lengthy 2012 report by the Consumer Financial Protection Bureau in the United States "Reverse Mortgages: Report to Congress" contains a history of the development of the reverse mortgage market, including issues that have arisen in recent years, and considers historical and emerging consumer protection concerns. The number of new loans has fallen in recent years from a peak in 2007-08 (Consumer Financial Protection Bureau, 2012).

In the United Kingdom a mix of reverse mortgages, home reversion plans and other equity release products have been available for decades, but the mix has changed significantly in recent years. In 2004 around 75% of equity release products written were reverse mortgages and 25% were home reversion plans (ASIC, 2005). By 2009 the home reversion proportion had fallen to 2%, and in 2013 it was less than 1% (Equity Release Council, 2014).

In the late 1980s there were issues in the United Kingdom with mis-selling. Homeowners were sold a package whereby they borrowed against the equity in their homes and invested the loan proceeds on the basis that the investment would cover the interest and provide surplus income. When interest rates increased and investment markets collapsed, homeowners were left with negative equity. There have been significant reforms since this time and the United Kingdom equity release market (see www.equityreleasemarket.com) provides a valuable point of reference in considering any change to regulatory frameworks for equity release products in Australia. The United Kingdom equity release market is significant in size and growing with more than 10,000 new customers aged 55 and over releasing equity for the first time in the second half of 2013 (Equity Release Council, 2014.)

A 2013 report "Equity Release: Accessing Housing wealth in retirement" includes an overview of European equity release markets (Towers Watson, 2013.)

3. A COMPELLING CASE FOR CHANGE

This section outlines why home equity release should become a fourth pillar of retirement funding. There is a substantial fourth pillar of savings in existence but - as outlined in Section 2.2 - for the most part, it is not being accessed to fund retirement.

Section 3.1 considers the important role that home equity release can play for retirees, from an individual perspective, in funding a dignified retirement.

Section 3.2 looks at the importance of home equity release from a societal perspective, particularly in considerations of intergenerational equity.

Section 3.3 contains background information highlighting:

- The high rates of home ownership by senior Australians, with 85% of retirees aged 75+ owning their own homes;
- That the wealth tied up in owner-occupied housing represent a significant portion of household wealth for senior Australians;
- The increasing proportion of Australians ceasing work before their housing debt is extinguished, with the proportion of people aged 60-64 with housing debt doubling between 2002 and 2012;
- That Australia's population is ageing and the ratio of working age people to retirees has fallen in recent decades and will continue to fall;
- That compared with when the age pension was introduced, most people now can expect to live until the age pension eligibility age, and to spend more years in retirement;
- That the majority of Australian retirees receive a full or part pension; and
- That housing inheritance of tens of billions of dollars per annum is projected to form part of record intergenerational wealth transfers in the coming decades.

Each of these points supports the argument that home equity is already a meaningful pillar of savings and that there are benefits to individuals and society in utilising it to fund retirement, rather than (often) bequeathing it to individual members of the next generation.

3.1 Using Home Equity Release to Fund a Dignified Retirement

There is a significant subset of retired Australians for whom the main (or sole) asset is the family home. This means that, other than the first pillar (access to the age pension), the fourth pillar is the only pillar of the retirement income system that these people have access to.

Many retirees today are financially dependent on the age pension, which provides almost the amount needed to fund a modest lifestyle in line with the ASFA Retirement Standard[x]. The standard benchmarks the amount needed by Australian retirees to fund either a modest or comfortable standard of living, and is updated quarterly.

Table 2 shows the amounts required to provide for a basic and a comfortable lifestyle in retirement, alongside maximum age pension payments. The age pension falls well short of the amount required to fund a comfortable lifestyle in retirement.

Table 2: Retirement living standards

Lifestyle	Budget Per Year	Maximum Age Pension
Modest – Single	$23,175	$21,973
Modest – Couple	$33,358	$33,126
Comfortable – Single	$42,158	$21,973
Comfortable – Couple	$57,665	$33,126

Source: ASFA Retirement Standard, December 2013

These figures assume that retirees own their own homes outright and are relatively healthy.

There would be a wide range of spending patterns amongst retirees. Spending patterns for an individual or couple are likely to vary year by year and by stage of retirement. There are various interpretations of what "modest" and "comfortable" retirements entail but the ASFA standard provides a useful benchmark. It suggests that retirees require a significant level of income in addition to the age pension in order to achieve a comfortable standard of living.

In the early years of retirement, there may be some superannuation or savings available for a pensioner to supplement the pension. But as time goes by, the age pension will be the only source of income for an increasing proportion of retirees.

In addition to the age pension not funding a "comfortable" lifestyle, one-off costs and unexpected costs may be problematic for pensioners.

For many of the Baby Boomers, and those who retired before them, the home was their main form of saving until their children left home. Later generations will have more substantial superannuation savings due to compulsory superannuation being in place for most/all of their working lives. Borrowing to buy a home is effectively buying a lumpy asset "brick by brick" as each mortgage repayment contains a principal component. This builds a pillar of savings. It would be unfortunate if this pillar cannot be drawn upon to fund a more dignified retirement than can be derived from the age pension alone, without selling the home and no longer being able to live in it.

Home equity release products can be life changing for pensioners who own their own homes and are able to access a portion of the equity tied up in the home for reasons such as unplanned medical expenses, home modifications, a new car, replacing whitegoods or simply supplementing income to live more comfortably.

For retirees with a reasonable amount of superannuation, home equity release might be useful later in retirement, once their superannuation has run out.

For the subset of retirees who stop working before they have extinguished housing debt, releasing home equity could make the difference between being able to stay in the home or having to sell it to extinguish the debt.

Downsizing is an option often put forward as the solution for retirees who are asset rich and cash poor. Whilst this is a suitable option for some retirees, it is not a solution for others, for a range of reasons. The costs of downsizing can be significant – stamp duty is particularly problematic but there are other costs such as sale and relocation costs. It is often very important for seniors to remain part of their community; sometimes there may not be suitable housing stock in the vicinity of the family home to downsize into.

There can also be a problem when the price of recently developed units/ townhouses for example may be similar to the amount that can be realised from the sale of a family home that has not been renovated for many years and may have most of its value in the land. There is a risk that the house size is downsized but not the market price. Little equity may in fact be released.

Where downsizing can be utilised to release equity, the proceeds are in a form that is no longer exempt from the age pension assets test, which can lead to a reduction in age pension receipts. This can also be a problem with equity release products which release a lump sum, but the problem can be solved with products that allow a gradual release of equity as an income stream.

A well-regulated home equity release market with a range of products on offer, and plenty of capacity, could make a big difference for many senior Australians. The ability to access the equity in their homes (often effectively their life savings), whilst still living in their homes, can facilitate a more dignified retirement than would otherwise be experienced.

3.2 How Releasing Home Equity Can Improve Intergenerational Equity

Whilst enabling senior homeowners to access the equity they hold in their homes is important at an individual level, the concept of releasing home equity has wider application as a societal issue, including in the context of intergenerational equity.

There are a number of ways in which intergenerational equity might be defined; a simple definition is that it is fairness between older and younger, or current and future, generations of society. In the context of this paper, the issue is predominantly around people of working age being taxed to fund (amongst other things) the payment of the age pension to retirees.

Whilst in Australia there is a slowly growing focus on intergenerational equity, it has not yet become a "barbeque stopper"[xi]. In the United Kingdom, an Intergenerational Fairness (IF) foundation has been set up to promote the interests of younger and future generations in government policy making. The foundation is non-partisan and was established to research fairness between the generations. A key principle is that, whilst increasing longevity is welcome, government policy must be fair to all generations – whether old, young or those to come. The website (www.if.org.uk) contains a lot of interesting and thought provoking material. The issues in the United Kingdom are different to those in Australia, but there are many parallels.

In Australia there is growing recognition of, and a range of sources highlighting, the fiscal challenges arising from an ageing population, longer life spans, decreasing ratios of workers to retirees and inadequate levels of superannuation savings. Headlines such as "We simply can't have our cake and eat it too"[xii] are becoming more common and life expectancy and longevity feature regularly in the media.

The system historically has been one of "pay as you go" - each generation pays taxes which fund (amongst many things) the pensions of the previous generation, on the basis that the next generation will fund their pensions. Changing demographics and a lack of policy response have weakened this system and could continue to do so.

3.2.1 Intergenerational Reports

Under the *Charter of Budget Honesty Act 1998* an Intergenerational Report is required every five years. An intergenerational report assesses the long term sustainability of Commonwealth finances. It examines the impact of current policies and trends, including population ageing and slower population growth, on the Commonwealth's budget in 40 years' time. Treasury released the first report in 2002, and the second and third followed in 2007 and 2010.

The intergenerational reports make for interesting reading and show that an understanding of issues relating to increasing longevity and population ageing should be clearly on the radars of Treasury and Government in general.

For example, in addition to points relating to population ageing and worker to retiree ratios referenced in Section 3.3.4, the following points are drawn from the overview of the 2010 intergenerational report (The Treasury, 2010):

- "Australia faces significant intergenerational challenges. Population ageing will mean that there will be fewer workers to support retirees and young dependents. This will place pressure on the economic growth that drives rising living standards. At the same time, the ageing population will result in substantial fiscal pressures from increased demand for government services and rising health costs."

- "Population ageing will increase spending on health, age-related pensions and aged care. Escalating health costs associated with technological enhancements, such as new medicines, and increasing demand for higher quality services, will add to fiscal pressures from ageing."

- "Today, around a quarter of total spending is directed to health, age-related pensions and aged care. This is expected to rise to around half by 2049-50. As a result, total spending is expected to grow to around 27 per cent of GDP by 2049-50, around 4¾ percentage points of GDP higher than its low-point in 2015-16."

- "Australian Government spending on age-related pensions currently represents more than 10 per cent of total government expenditure, and is the largest component of payments to individuals. Spending on age-related pension payments are projected to increase from 2.7 per cent of GDP in 2009-10 to 3.9 per cent of GDP in 2049-50 due to demographic change."

There were similar themes in the 2002 and 2007 reports.

3.2.2 Actuaries Institute – Public Policy

The Actuaries Institute White Paper "Australia's Longevity Tsunami: What Should We Do?" (Actuaries Institute, 2012) suggested that policy making in the area of assessing the implications of longevity should be guided by three principles, one of which is:

- "The need to encourage intergenerational equity whereby, to the extent possible, each generation funds their own costs of retirement."

Given the demographic outlook for Australia, it is difficult to see how the third principle can be adequately addressed by public policy without bringing the significant amount of home equity held by senior homeowners into the debate.

3.3 The Case for Change – Supporting Information

3.3.1 Home Ownership

The majority of Australians own the home that they live in. As well as being a store of wealth, a home provides a place to live with security of tenure and enables people to stay long term in a neighbourhood. For some people there may be a level of comfort derived from investing in a "bricks and mortar" asset that is tangible and secure. There are also incentives from government such as capital gains tax exemptions when a home is sold and the exemption of the home from the assets test when assessing pension eligibility.

Rates of home ownership are shown below, split by age band from age 45, where "age" is the age of the Census reference person for the household.

Table 3: Rates of home ownership

Age	**45-54**	**55-64**	**65-74**	**75+**	**All**
Proportion of homeowner households	74.6%	80.1%	82.8%	85.2%	67.5%

Source: ABS Survey of Household Wealth and Wealth Distribution, 2011-12, Table 25

The increase by age is interesting. There is perhaps a generational element here – it is unlikely that people transition from renting in their 60s to 70s – which might suggest that the home ownership rate amongst senior Australians, whilst high, is slowly falling.

3.3.2 Asset Holdings of Retirees

Whilst much attention is given to superannuation and other investment holdings, the family home represents a significant portion of net wealth for many retirees. The following table shows mean household net worth by age group.

Table 4: Retirement asset holdings

Household Mean Values ($000s)	**Age of reference person**			
	55-64	**65-74**	**75+**	**All**
Financial assets	108	114	140	86
Superannuation assets	242	201	57	132
Value of own dwelling	468	439	431	370
Value of other property	191	151	78	129
Other assets	176	125	81	132
TOTAL ASSETS	**1,185**	**1,031**	**788**	**850**
Debt – own dwelling	(45)	(11)	(2)	(75)
Other liabilities	(66)	(22)	(4)	(55)
NET WORTH (NW)	**1,074**	**998**	**782**	**720**
Own dwelling as % NW	**44%**	**44%**	**55%**	**51%**
Own dwelling (asset less debt) as %NW	**39%**	**43%**	**55%**	**41%**

Source: ABS Survey of Household Wealth and Wealth Distribution, 2011-12, Table 24

It is clear from this data that the wealth tied up in owner-occupied housing represents a significant portion of household wealth for senior Australians and on an overall basis is more significant than either the superannuation or voluntary savings pillars of the retirement income system. The use of mean values does not however provide insight into the distribution of wealth – it is likely that the significance of owner-occupied housing would vary across the distribution.

Table 4 excludes the first pillar of retirement funding, which is the age pension. This has been estimated as being worth $685,000 for a couple both aged 67 or $403,000/$462,000 for a single male/female aged 67 (Rice and Blair, 2012). Of course the true value of the first pillar will vary by individual and can only be determined retrospectively. The estimated value at a certain age will increase over time with indexation and longevity improvements.

3.3.3 Retiree Debt

A combination of drivers has led to an increasing proportion of Australians having housing debt outstanding at retirement. These drivers include:

- Increased house prices (and housing debt) relative to incomes;
- Families being started later leaving less years for "serious saving" once children are no longer dependent;
- Periods of unemployment;
- Involuntary retirement;
- A desire to retire relatively young; and

- A tendency in some cases to own bigger and more expensive homes than can be paid off by retirement.

The following table shows the share of homeowners with housing debt, by age group. From 2002 to 2010, an increasing proportion of homeowners have housing debt and the largest increases are for the age groups approaching retirement.

Table 5: Proportion of homeowners with housing debt by age group

Age of homeowner (Person 1 in household)	**2002**	**2006**	**2010**
	%	%	%
<30	77.8	76.3	82.5
30-39	84.5	85.2	88.3
40-49	67.6	74.9	77.4
50-54	49.7	59.8	63.7
55-59	33.4	40.7	48.4
60-64	16.5	22.4	30.7
65-69	8.9	12.3	18.0
70+	3.8	5.2	6.2
All	48.4	51.6	54.3

Source: Kelly Research, Report on Household Savings and Retirement: where has all my super gone? For CPA Australia (2012)[xiii]

The 60-64 age group would mostly be either close to retirement or retired; in 2002, one in six had a mortgage whereas by 2010 this had almost doubled.

It is not surprising that some retirees use a lump sum superannuation payout to pay off housing debt. This negates the intended purpose of superannuation which is to fund retirement, but would be preferable to many retirees than the alternative of selling their home to extinguish a debt they can no longer service.

There have also been other factors at play in recent years. For example one wealth creation strategy has been to maximise savings directed towards superannuation in order to maximise tax deductions, with the intention of redirecting those contributions to housing debt post-retirement on receipt of a superannuation lump sum. With maximum contributions being cut in 2013, the extent of this can be expected to fall.

Looking forward, levels of housing debt at retirement might be expected to stay at similar levels to the 2010 level. The 2013 RaboDirect National Savings and Debt Barometer[xiv] found that "(29%) of the Baby Boomer generation expect to have a mortgage when they retire. A large proportion are banking on super to repay this debt (25%) and for a further 33%, downsizing will hold the key to clearing their current mortgage and allowing them to enjoy their retirement mortgage free."

An alternative to using superannuation or downsizing to extinguish housing debt is to utilise some of the wealth stored in the home.

3.3.4 Ageing Population and Years in Retirement

Australia has an ageing population. Between now and 2050 the number of people aged 65 to 84 years old is expected to more than double, and the number aged 85 years old and over is expected to quadruple (The Treasury, 2010). A range of societal issues flow from this, but one issue is the cost to government of continuing to support retirees with age pensions paid at meaningful levels, particularly if current eligibility criteria continue to be applied. Similarly, there are big implications for health costs.

Not only will the number of retirees grow, but the proportion of retirees to working age people is set to change dramatically. The number of working age people to support each retiree is expected to fall from 5 people today, to 2.7 people in 2050. In 1970, there were 7.5 working age people for each person aged over 65 years (The Treasury, 2010).

The following table looks at historical life expectancies from birth and from age 65.

Table 6: Life expectancies from historical life tables (age nearest)

Life Tables	Males Life Expectancy From Age 0	Males Life Expectancy From Age 65	Females Life Expectancy From Age 0	Females Life Expectancy From Age 65
1901-1910	55	11	59	13
1920-1922	59	12	63	14
1932-1934	63	12	67	14
1946-1948	66	12	71	14
1960-1962	68	12	74	16
1975-1977	70	13	77	17
1990-1992	74	15	80	19
2005-2007	79	19	84	22

Source: Australian Life Tables 2005-2007[xv]

In the early 1900s the life expectancy for a boy/girl at birth was 55/59 years. Only the minority would have been expected to live to an age at which the pension could be accessed. From the 2005-2007 Life Tables, life expectancy at birth is 79/84 years. So even at birth, the pension might be "expected" for 14/19 years assuming eligibility at age 65 or, going forward, 12/17[xvi] years assuming no further increase in eligibility age from 67, which is perhaps unlikely.

In the early 1900s a man retiring at 65 could expect, on average, to live for a further 11 years. This has increased to 19 years, significantly increasing the average period of retirement. Women retiring at 60 in the early 1900s could expect, on average, to live for 16 more years. This has risen to 26 years today. Whilst the increase in retirement age from 65 to 67 reduces the average period of retirement, it is not a dramatic reduction.

The figures above are all based on historical mortality rates. Past mortality improvements, but not future mortality improvements, are captured. Future mortality improvements are of course difficult to predict. Analyses presented by the Actuaries Institute (Actuaries Institute, 2012), which allow for mortality improvements on a cohort basis, suggest that life expectancy might be more like 86/89 for retirees aged 65 (in 2010) and that by 2050 this will have increased to 92/93. Life expectancies at these levels have dramatic implications for the cost of funding retirement.

Even the figures on a cohort basis do not take account of what we don't know and there is potential for life expectancies to increase even more. Medical improvements are continual and significant resources are applied to medical research globally. A significant medical advance such as a cure for cancer or Alzheimer's disease could materially increase life expectancies.

3.3.5 *Inheritance*

A study in 2010 by Bankwest suggested that the combination of rising property prices, an ageing population and high rates of home ownership would lead to Australian households soon benefiting from record levels of intergenerational wealth transfer, or inheritance.

Bankwest estimated that housing inheritance in Australia was $16 billion in 2009 and projected that this would increase to $31 billion in 2025. The total value of housing assets to be inherited between 2010 and 2025 was projected to be in excess of $400 billion.

Record levels of intergenerational wealth transfer will not be evenly distributed across the inheriting generation and are likely to lead to increased intragenerational inequity.

Many of those bequeathing the housing wealth will have received a part or full age pension during retirement, regardless of the value of their homes. There is no claw back to government in relation to the age pension payments received by the retiree. Intergenerational wealth transfer is not taxed.

3.3.6 The Age Pension

The age pension provides income support and access to a range of concessions for eligible older Australians. There are differing views in society as to whether the age pension is a safety net for retirees without the means to support themselves, an entitlement for the majority of people reaching retirement age, or perhaps something in between.

The maximum age pension amounts at March 2014 for homeowners, including the maximum pension supplement[xvii] and the clean energy supplement, convert to annual figures of $21,973 for a single pensioner and $33,126 for a couple.

3.3.6.1 Eligibility Age

When the age pension was introduced in Australia in the early 1900s, it was paid to men from age 65 and women from age 60. This did not change until 1994 when the pension eligibility age for women started increasing progressively to reach age 65 in mid-2013. From 2017 the age pension eligibility age for men and women will increase by six months every two years to reach 67 in 2023.

Section 3.3.4 outlined the implications of increasing longevity on the number of years spent by senior Australians in retirement. In light of this, the changes in eligibility age from 65/60 (men/women) in the 1900s to 67 in 2023 are modest.

3.3.6.2 Assets and Income Tests

An assets test and an income test are applied to assess age pension eligibility. The rate of payment is calculated under both tests and the test that results in the lower rate (or nil rate) is used.

The following table provides the level of assets, excluding the principal residence, above which a retiree is not eligible for a full or part age pension.

Table 7: Age pension assets tests

	Full Pension		**Part Pension**	
	Homeowner	**Non-Homeowner**	**Homeowner**	**Non-Homeowner**
Single	$196,750	$339,250	$758,750	$901,250
Couple	$279,000	$421,500	$1,126,500	$1,269,000

Source: Department of Human Services website[xviii]. Figures at March 2014.

The difference between the limits for homeowners and non-homeowners effectively only takes into account the value of the residence up to $142,500.

The income test reduces the age pension to zero once annual "income" reaches $48,013 for a single retiree and $73,448 for a couple. (There are transitional arrangements in place with higher limits.) "Income" calculations are based on deemed income on certain assets, rather than actual income[xix].

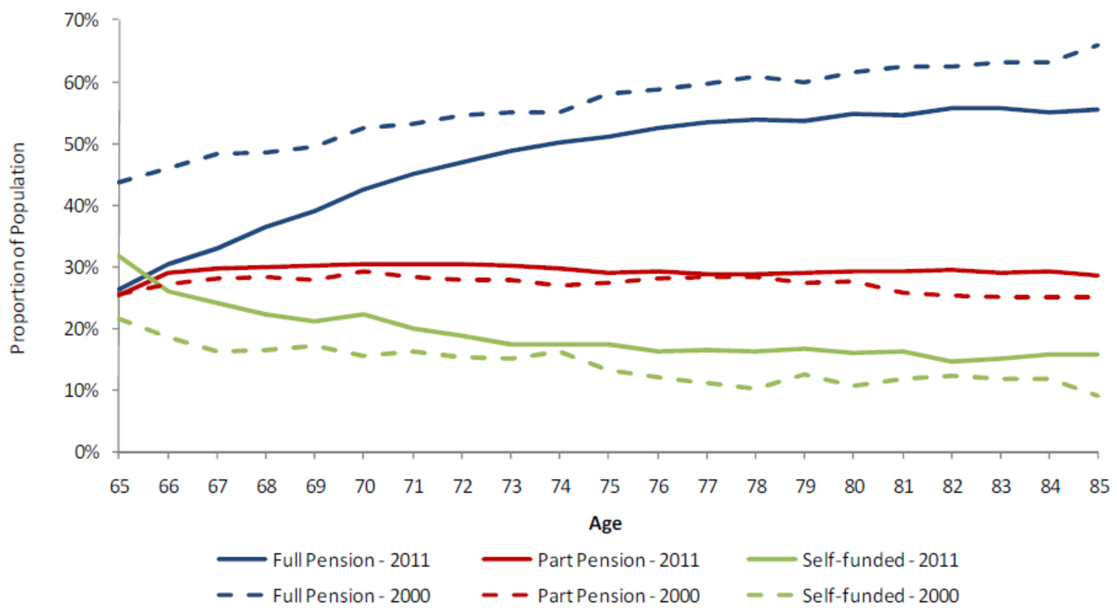
In some cases a retiree's financial situation is engineered in order to allow at least the part pension; there are benefits that flow from this which may be worth more than the part pension itself, particularly the health care card. Specialist financial advice may be sought to achieve this outcome.

Holding substantial wealth in the family home is advantageous for the income test as well as the asset test, as no income is deemed to be earned on that asset.

3.3.6.3 Proportion of Retirees Receiving the Pension

In 2011, 75% of Australians aged 65 and over received a full or part pension[xx]. This proportion varied by age and the following chart shows the proportions of retirees receiving a full pension, part pension or no pension (self-funded) in 2000 and 2011, by age. The proportion of self-funded retirees and part age pension recipients has increased from 2000 to 2011, and the proportion of full age pension recipients has fallen. The changes are most pronounced for younger retirees where compulsory superannuation has had an impact over the ten year period.

Figure 2: Proportion of the population receiving the age pension and self-funded



Source: Rice Warner Actuaries (2012)

It might be expected that over time, the proportion of self-funded retirees will be higher in the early years of retirement then fall more dramatically by age as people outlive their retirement savings. Retirees are likely to increasingly start out on the part pension rather than the full age pension, and then migrate to the full pension as they run down their assets. Utilising home equity as a fourth pillar of retirement funding could defer the time when retirees who start out as self-funded retirees start receiving the age pension, and also reduce the number of retirees commencing retirement on a pension.

Even with widespread utilisation of home equity in retirement funding, there will always be a subset of retirees who live long enough to extinguish their assets and will then have to rely on the age pension. This is an important role of a safety net age pension.

3.3.6.4 The Family Home Exemption from the Assets Test

The component of the age pension framework that is most relevant to this paper is the family home exemption from the age pension assets test. This contributes to:

- the high proportion of retirees able to access the age pension; and
- the small proportion of senior homeowners who have taken out an equity release product.

The exemption provides an advantage in directing savings towards owner-occupied property, above and beyond the benefit of putting a roof over one's head. Similarly it may be a deterrent to reducing the amount of wealth held in owner-occupied property.

For other types of assets, the pension assets test leads to a draw-down of assets from the second and third pillars of retirement savings, before the age pension (the first pillar) can be accessed. Because the assets test limits are non-zero, a complete draw-down is not required but for some retirees there would have to be a substantial draw-down before the full age pension could be accessed.

Analysis contained in Daley et al (2013) suggests that almost $20 billion of annual age spending today goes to households with more than $0.5 million in net wealth, and that most households with $1 million in net assets still receive a welfare benefit. The inequities between retirees who hold most of their wealth in their home and those who hold their wealth in other forms (including super/pension accounts) are noted.

Removing, or capping the value of, the exemption has been proposed in the past, but dismissed. Responses to the proposal are often emotionally charged. The proposal tends to be viewed by some individuals and lobby groups as "penalising" those who have saved hard to own their homes, or "taking away" pension payments to which they are entitled. There may be comparisons to "bludgers" who spent all their money rather than buying a home. The arguments are strongly made from individual/cohort perspectives, rather than a societal perspective, and are often one-sided due to the high proportion of current and "almost" retirees who own their homes.

From the perspective of sustaining a welfare system which provides an adequate income to those who need it, it is hard to argue against removing the family home exemption from the pension assets test, at least in part. This would improve equity between homeowners and non-homeowners, and between taxpayers and retirees. There would be vocal retirees up in arms about such a change, and the change would certainly be adverse for many retiree homeowners who currently receive the pension. If the pension is intended to be a safety net to ensure that those who retire without the means to support themselves are supported by the state, then some current age pension recipients are not the intended recipients.

The issues involved in removing all or part of the family home exemption from the age pension assets test would be complex. These are briefly outlined in Section 6.

4 WHY HASN'T THE FOURTH PILLAR ALREADY BEEN UNLOCKED?

There are a number of impediments to growth in the home equity release market, and these exist on both the demand and the supply sides. Without some form of government intervention/involvement it is unlikely that the proportion of seniors using equity release products will exhibit meaningful growth in the short to medium term.

Demand challenges include:

- There is little advertising by product providers, particularly for reverse mortgages.
- Lack of "known" brands offering home reversion products. Because equity release products are not widely offered they may not be available from the institution a senior has a long-standing relationship with.
- People who retire with debt today may be able to extinguish the debt via a lump sum superannuation payout, so superannuation is addressing one of the "needs" that home equity release can help meet – this would change if some form of annuitisation of superannuation becomes compulsory.
- Lack of understanding of the reversionary interest and the life interest components of a home. Under a home reversion scheme the cash advance represents a substantial discount to the face value of the home. Whilst this is economic/rational, it is also unpalatable, particularly if not understood.
- Products do not provide "cheap" housing debt. Drawing on family might be effective in preserving value across generations.
- For reverse mortgages, the interest rate uncertainty is problematic given the potentially long term nature of the debt. At points in the interest rate cycle a fixed rate product could be attractive, but historically these have been challenging due to break costs where a loan ends prior to the fixed term. Publicity around this is potentially brand damaging.
- There is some consumer negativity around the impact of compound interest on reverse mortgages, although rationally this is an obvious outworking.
- Emotive issues around the family home, and a desire by older generations to "leave something for the children/grandchildren".
- Financial literacy – equity release products are not simple; retirees may be reticent to consider them if they cannot understand them.
- No compulsion/government encouragement. In fact the exemption of the family home from the age pension asset test may act to discourage senior Australians from accessing the equity in their homes to help fund retirement. Replacing an asset excluded from the assets test with an asset that will be included in the asset test could reduce the amount of age pension that is received.

Supply challenges include:

- A big drop in reverse mortgage capacity with the number of reverse mortgage providers falling from 15 prior to the Global Financial Crisis to 5 today.

- A lack of market entrants offering home reversion products, likely due in part to challenges in securing funding. As well as providing the framework for an equity release product, substantial capital is needed.

  A home reversion offering creates a diversified pool of interests in residential property, which does not fit into an established asset class. There is uncertainty over the timing of income, as it is not possible to predict exactly when the homes of retirees will be sold and a share of the proceeds received by the pool. It would take time for a secondary market to develop. The asset pool created by a home reversion offering is therefore illiquid and unusual.

  A 2011 article[xxi] in The Australian newspaper by economist Ian Harper concluded:

  "The government needs to consider how best to encourage private investors, including superannuation funds, to invest in diversified claims on the future sale proceeds of people's houses. It may simply need to prime the pump, as it has done in the market for residential mortgage backed securities, to encourage the private sector to step in.

  An active market in debt-free equity release offers greater choice to older Australians in retirement and advanced age, as well as creating a new asset class for Australian institutional investors. The government stands to gain from a reduced call on public funds, which is why the Productivity Commission calls on it to make the first move."

- For home reversion schemes, the operating environment is complicated. The product does not "fit" clearly under existing legislation, some of which is state-based.

- Funding reverse mortgages and/or home reversion schemes may not represent an efficient use of capital for some of the "obvious" product providers.

  A 2013 Towers Watson report on equity release in Europe outlined a concern that Solvency II requirements severely limit the attractiveness of equity release products for insurers, and that this could stifle supply in the established United Kingdom equity release market and damage potential for growth in other European countries.

- Loan to Valuation Ratios (LVRs) on offer are low. Research published by Alai et al (2013) indicated that at the levels of LVRs on offer in Australia, the interest rate premium over other forms of housing lending may not be required and lenders could afford to either increase LVRs or decrease the interest rates on reverse mortgages.

In mid-2013, reverse mortgage legislation[xxii] was strengthened and changes included the introduction of a presumption that reverse mortgages are unsuitable if LVRs are above prescribed levels of 15% for age 55, increasing by 1% for each year that the borrower is older than 55. The Deloitte (2012) findings on LVRs suggest that market LVR levels are already below the legislative parameters, particularly at the older ages.

- Longevity risk may concern potential product providers.

- No government involvement/encouragement.

5 RECENT PUBLIC POLICY DEVELOPMENTS

The topic of home equity release and debate around the exclusion of the family home from the age pension assets test are not new. But there has been a renewed focus on each of them in the context of discussions on population ageing and related areas. It is easy to the link the two. For example under a hypothetical scenario where the family home was suddenly included in the assets test, there would be a strong need for retirees to access the equity in their homes by selling their homes or drawing on home equity release products.

It is not necessary though to link home equity release and changes to the age pension assets test. There could be an increased role for equity release even with the family home exemption remaining, for example:

- Home equity could be released to pay for specific services, along the lines of rates postponement schemes currently operating in some parts of Australia.

- If compulsory annuitisation of superannuation rendered it impossible for people retiring with housing debt to use a lump sum superannuation payout to extinguish their debt, home equity release could be utilised to enable people to stay in their homes.

There could also be an increase in home equity release if society as a whole started viewing home equity as the fourth pillar of retirement funding, available to facilitate a more comfortable retirement as well as to provide a place to live. It is not obvious how societal views might shift in this regard but government could play a role in promoting the concept, alongside promotion by product providers.

In recent months home equity release has been considered in a number of public policy discussions, but has not received the same level of attention in the media as some other considerations such as retirement age or welfare payments in general.

5.1 Productivity Commission Research Paper

In November 2013, the Productivity Commission published a research paper entitled "An Ageing Australia: Preparing for the Future". The paper was intended to contribute to the next Intergenerational Report, and also to "the sweeping question of how Australia copes with an ageing population."

The paper contains a significant amount of information and outlines research in areas including Australia's demographic future, productivity, revenue and expenses and also a section covering "Income poor, asset rich: overcoming rationing and financing constraints." This section contains research on wealth and income distributions, housing wealth, and housing inheritance. Possible financing options are outlined, to facilitate user co-contributions for a range of services, including aged care and health services, which might be funded by home equity. Some of the challenges in designing policies around these financing options are investigated.

The paper notes that in the equity release market, a government scheme may be warranted "from an overall efficiency and welfare perspective". This may change over time as private sector offerings mature. An initiative is suggested whereby if individuals contribute half the annual real increase in their home values towards aged care services, government expenditure in this area could reduce by 30%.

There is reference also to the Productivity Commission's earlier aged care report, published in 2011, which proposed an equity release scheme to improve individuals' access to aged care services. Government did not support the recommended scheme at that time.

The November 2013 research paper provides a lot of background material which could support future research including into home equity release.

5.2 Grattan Institute Paper

In November 2013, the Grattan Institute released a report entitled "Balancing budgets: tough choices we need" (Daley et al, 2013). The report assesses options available to Australian governments to address potential budget deficits in the coming years – and suggests that on our current trajectory, budget deficits at around 4% GDP by 2023, or $60 billion in today's terms, are possible.

The report assesses "all realistic proposals" that would have annual impacts of at least $2 billion and do not have unacceptable economic and/or social impacts. The following points are taken from the overview of the report:

- "Tough choices cannot be put off indefinitely. Deficits impose heavy costs on the next generation in terms of debt and high interest payments."

- "Structural reform of benefits and tax exemptions for older Australians offer many of the best opportunities for budget reform. They are the least-well targeted parts of our tax and welfare system, with some benefits going to people that don't need them."

- "Sustainable budgets depend on governments making tough choices. None will be politically easy, but making some of them is vital to Australia's prosperity."

In all the report examines 20 "budget repair choices" including initiatives around superannuation/pensions, around housing and capital gains, changes to tax rates, the introduction of new taxes and a reduction in spending in a number of areas.

One of the choices highlighted is to include owner-occupied housing in the assets test applied in determining a retiree's eligibility for the age pension. It is estimated that this would contribute around $7 billion to the budget in accrual terms and $5 billion in cash, annually. These are described as being the most conservative of several estimates. The report suggests that the impact on low-income retirees with high-value houses could be mitigated by allowing them to claim the pension and then repay the value of the pension drawn when the house is eventually sold.

Tightened pension eligibility would also reduce government costs of concessions available to full or part pension recipients including car registration, utilities costs, property rates and health expenses. At the current time, the majority of senior households are eligible for these concessions.

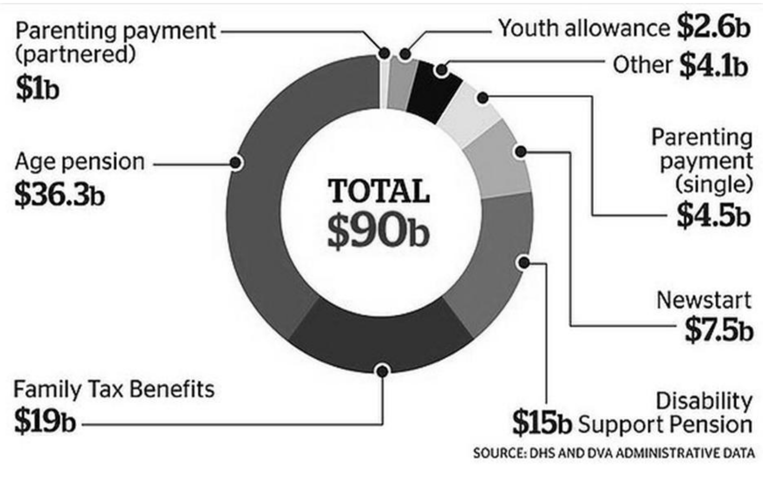
5.3 2014 Welfare Review

In January 2014, the government announced a review of the welfare system, noting that the current rate of welfare payments in Australia is "unsustainable and relentless". The review will cover a range of income support payments, including the Disability Support Pension and the Newstart Allowance. The age pension is excluded from the review.

When interviewed, the Social Services Minister has made comments along the lines that the review is about the long term sustainability of the welfare system. He noted the "very significant demographic change which is occurring in Australia, the rapid ageing of the population, the fact that there will be more older dependants in particular in 10-15 years' time and the very significant shrinkage in the growth of the workforce."[xxiii] It is difficult to understand the logic of explicitly excluding the age pension from the welfare review, particularly in light of reports such as the Grattan Institute report referred to above.

An article in The Age newspaper[xxiv] provided a breakdown of annual welfare payments as at mid-2013:-

Figure 3: Annual welfare payments 2013



These figures further highlight the merits of a welfare system review being extended to include age pension payments, with the age pension costing substantially more than any other component of the welfare system. Further, the age pension component is the fastest growing component[xxv] both in terms of numbers of recipients and cost.

6 POLICY OPTIONS

Any change to the status quo, in terms of encouraging home equity to become an accessible fourth pillar in the retirement funding of senior Australians, will raise a myriad of issues. This should not stop it from happening.

Potential options, together with some of the associated issues, could include:-

OPTION A:	Status quo
Societal Impact:	Nil. Inequities between homeowners and non-homeowners, in terms of pension accessibility, would remain.
Issues:	Long term sustainability of age pension (and health) costs and ongoing intergenerational inequity.

OPTION B:	Small tailored schemes along the lines of the existing Pension Loan Scheme, perhaps for areas such as (Australia wide) rates, to access in-home care services or to pay private health insurance premiums.
Societal Impact:	Small, a step in the right direction and could make a meaningful difference for some seniors. A cost such as annual rates can be a significant outlay in the context of a maximum age pension of less than $22,000 for a single homeowner. Targeting of the scheme to something like private health insurance premiums could push a portion of health costs to the private system from the public system.
Issues:	Does not address the big issues.

OPTION C:	No change to pension assets test. Encourage private sector equity release market, possibly in conjunction with removal of ability of retirees to take lump sum super. Encouragement would be in the form of education/promotion.
Societal Impact:	Low budget impact. Low social impact. Use of equity release to pay off housing, rather than using superannuation, defer when some retirees start taking an age pension. More retirees could use equity release funds to live a more comfortable retirement.
Issues:	Uncertainty around whether the private sector would increase capacity dramatically, without some sort of government intervention.

OPTION D:	Remove exemption of part or all of the family home from pension assets test. Encourage private sector equity release market.
Societal Impact:	High budget impact. High social impact. A significant number of retirees would become ineligible for the age pension. The current inequities between retirees who own homes and those who do not would be reduced.
Issues:	Impact could be severe for retirees who lose access to the pension but cannot source an equity release product. This may be due to eligibility criteria around location or housing type, or capacity of product providers. The outcome could be retirees needing to sell their homes. This would be an undesirable outcome, particularly if it happened en masse. For this option to work without undesirable outcomes, government intervention would be needed, both to encourage capacity but also as a provider of last resort where there are issues with eligibility. There would need to be consideration of the amount of equity that products allow to be released. Reverse mortgages have maximum loan to valuation ratios and the HDFER product has a 65% limit on the share of the future sales proceeds than can be exchanged for a cash advance. Financial literacy initiatives would be important as seniors would be "pushed" towards equity release and so need to know more about it. Adequate regulation would also be crucial to ensure that products are "fair" with reasonable outcomes. Major societal change. Probably requires a bipartisan approach from a political perspective.

OPTION E:	Remove exemption of part or all of family home from pension assets test. Introduce a universal government scheme to allow retirees to access the pension, despite failing the assets test, and run up a debt against the home that is payable when the home is sold. This is essentially the proposal by Daley et al (2013.)
Societal Impact:	High impact. Only retirees who own their own home would be eligible for such a debt facility, however this should be acceptable as all other retirees would be treated in a manner consistent with the current arrangements.
Issues:	Major societal change. Probably requires a bipartisan approach from a political perspective.

There would be many issues to consider in policy, scheme design and operations for the options outlined above, or variations of them.

Some of the issues that could arise are noted below. It is beyond the scope of this paper to provide solutions for each of the issues, but the issues noted illustrate the importance of policy changes being made with careful planning and long implementation timeframes. The list is not intended to be exhaustive.

Anti-Avoidance – In changing rules around pension eligibility, thought will need to go into the measures people might take to circumvent the rules (for example, shifting property into family trusts) and designing a framework that prevents this. Ongoing refinement of the framework may be required as anti-avoidance measures evolve.

Capacity – The home equity release market today does not have the capacity to fund a significant jump in the number of retirees seeking to release home equity. Deloitte/SEQUAL (2013) touched on the reasons for this and suggested that "the primary reason for the reduction in lenders [since the Global Financial Crisis] was not the lack of demand by senior Australians, but the inability of many of the former non-bank, second tier banks, and credit unions lenders that previously focused on equity release products, to find available funding supply".

Equity Already Released – Rules must allow for equity that has already been released. The assets test needs to take into account any existing reverse mortgages or home reversion schemes, without opening up avoidance mechanisms.

Financial Literacy – It is important that homeowners fully understand any equity release arrangements that they enter into, including their obligations. For many seniors the concept of releasing equity in the home is complicated and confusing. Resources will need to be applied to clearly explaining the new rules and how individuals will be impacted.

Interest Free or Not? – A government scheme would need to consider what the appropriate interest rate is. It should not be a penalty rate but perhaps a market rate, or a CPI-like rate. There might be an argument for a zero interest rate (if zero then by definition a person would always retain net equity in their dwelling equal to at least the asset test threshold less the value of other assets held) although this would effectively close down the private sector market.

Politics – Removing the family home exemption from the age pension assets test would bring short-term pain to the government of the day, in order to achieve long term objectives around sustaining the welfare system. One consequence of the increasing proportion of society being retirees - 14% aged 65+ in 2010, growing to 23% in 2050 (The Treasury, 2010) - will be the increasing voting power of this group. This could hinder good policy. In an ideal world, a bipartisan approach to the issue would be developed.

Property Valuations – For some or all of the family home to be included in the assets test, a value would need to be ascribed to it. Property values are challenging to determine objectively – compared with values of assets such as shares, managed funds and bank deposits. There are a number of ways this could be approached, and a detailed discussion of property valuation is beyond the scope of this paper. Rules around valuation costs and rights of appeal would be required.

Regulation – Appropriate regulation is critical as retirees may be at a vulnerable stage of life and the area of home equity release relates to their main asset which is also their home. The right of senior homeowners to remain in their property for life must be sacrosanct. Learnings from issues that have arisen in overseas equity release markets could be applied in developing regulation.

Zero Equity – Under some options there may be concerns around having some money left to pay for a funeral, for example. Perhaps equity release could be restricted to say 90% of value or have a fixed dollar amount excluded.

7 CONCLUSION

Given the high rates of home ownership by senior Australians, the family home is a significant pillar of savings. For the current cohort of retirees, superannuation was not compulsory for most of their working lives and so the home may represent all/most of their savings.

Demographics are changing and the ratio of working age people to retirees is materially less than it was, and will continue to fall. The ageing population presents a fiscal challenge for a number of reasons, one of which is the increasing cost of age pension payments.

Many senior Australians who own their own home have little income. Products that enable them to access the equity they hold in their homes can be life changing. These products make possible a more comfortable retirement than can be afforded on the age pension alone, and provide a buffer for unanticipated expenditure. Products are available today but the equity release market in Australia is small, with less capacity than existed several years ago. Not all seniors are eligible for the products currently on offer.

If the capacity issue will not be addressed by the private sector alone, then there is a role for government to play in addressing some of the supply challenges, particularly if there is a desire for products to be available to everyone. Appropriate regulation is also important.

Increasing the extent to which senior Australians access the wealth tied up in their homes will also have societal benefits. The complete exemption of the family home from the age pension assets test is something that today's generation of senior Australians is accustomed to, but it can act as a disincentive for home equity release. The exemption adds to the cost of the age pension and leads to it being a poorly targeted component of the welfare system. It is problematic from an intergenerational equity perspective. This has been exacerbated by the strong appreciation of Australian residential property in recent decades, leading to high amounts of home equity held by many senior Australians.

The issues raised in this paper are complex and there are no quick fixes. The issues will not go away, but are likely to become more pronounced over time whilst the status quo continues. There are, and have been for some time, public policy contributors suggesting that government should encourage senior Australians to utilise home equity. However the nature of politics can render good public policy difficult to introduce, where there are hard decisions to be made by government and lots of vested interests.

This paper highlights the importance of the fourth pillar of retirement funding - home equity - and the challenges in utilising it. Holistic considerations of retirement funding should take home equity into account.

8 REFERENCES

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[i] ABS figures (ABS, 2014) show that the total value of dwelling stock in Australia reached $5 trillion at the end of December 2013. By comparison, the market capitalisation of the ASX is around $1.5 trillion (http:/www.asx.com.au)

[ii] A minority of products allow "ring-fencing" whereby an agreed portion of the home equity cannot be accessed by the lender. In these cases, Loan To Valuation ratio limits apply in relation to the equity that can be accessed by the lender

[iii] See www.infochoice.com.au

[iv] 2005 figure sourced from the 2009 Deloitte survey

[v] ABS figures compiled from the 2011-12 Survey of Income and Housing (SIH)

[vi] Details sourced from www.popiaustralia.com.au

[vii] Details sourced from www.domacom.com.au

[viii] http://www.brokernews.com.au/news/breaking-news/reverse-mortgages-back-in-vogue-185344.aspx

[ix] Source: Department of Families, Housing, Community Services and Indigenous Affairs: Annual report 2012-13 page 216

[x] ASFA Retirement Standard sourced from www.superannuation.asn.au

[xi] A barbecue stopper is a topic of conversation that is interesting or controversial enough to halt proceedings at a barbecue (Oxford University Press)

[xii] Comment, The Age, November 26 2013 by economics editor Tim Colebatch

[xiii] Using data sourced from HILDA (Household, Income and Labour Dynamics in Australia survey) waves 2, 6 and 10

[xiv] http://media.rabodirect.com.au/rabodirect-news/baby-boomers-claim-changes-super-wont-make-difference/

[xv] http://www.aga.gov.au/publications/life_tables_2005-07/

[xvi] Also from ALT 2005-2007 using figures for life expectancies from age 67. Similarly, numbers in the next paragraph use figures for life expectancies from age 60.

[xvii] This includes the GST supplement and allowances for utilities, telephone and pharmaceuticals

[xviii] http://www.humanservices.gov.au/customer/services/centrelink/age-pension

[xix] The deeming rates from November 2013 are 2% p.a. for the financial assets up to a specified limit, and 3.5% p.a. thereafter. The limits are generally $46,600 for a single retiree and $77,400 for a couple.

[xx] Source: Rice Warner Actuaries (2012)

[xxi] See http://www.theaustralian.com.au/opinion/unlock-home-savings-to-fund-old-age/story-e6frg6zo-1225993848749

[xxii] See http://www.comlaw.gov.au/Details/F2013L00814/Download

[xxiii] Transcript "Welfare System" Sky News 21 January 2014
http://kevinandrews.dss.gov.au/transcripts/42

[xxiv] http://www.theage.com.au/nsw/kevin-andrews-welfare-review-aims-to-cut-cost-of-pensions-20140124-31e2b.html

[xxv] As noted in the same article