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The European Commission's Green Paper: reverse mortgages as a source of retirement income

This article is based on research projects funded by the Economic and Social Research Council and Age UK, and by the EU under FP7 (SSHT-CT-2008-216865). There is already considerable,though not full, agreement about the main solutions that will need to be pursued, central to which are that Europeans are going to have to get used to working until an older age and to save more for their retirement. But, while the potential of housing equity, as a means of meeting people's income needs in old age, may form a relatively minor part of the overall policy package under discussion, it has actually long been discussed within the European Union. Insofar as the general pattern within member states is of a positive correlation between income (both pre and post retirement), and both housing and non-housing wealth, for many of those most in need housing equity is not a relevant solution. An important conclusion from the evidence of the uses made of housing equity, however, is that the factors influencing individuals and households are different from the factors driving government interest. The findings from the survey, however, suggest that governments may need to do more to encourage and enable lower-income home-owners to draw on their housing equity. Extending the market for reverse mortgages, then, is likely to require considerable cooperation between all stakeholders – governments, civil societies and institutions.

Introduction

The European Commission's Green Paper on adequate, sustainable and safe European pension systems, while recognising that competence in the area of pensions lies with the member states, considers whether the "Internal Market could ....be helpful in extending access to additional sources of retirement income beyond pensions, such as reverse mortgages" (European Commission 2010:11).

This is of course only one of a number, and by no means the most fundamental, of the questions posed in the Green Paper, where the central issue concerns how the member states are going to rise to the challenge of meeting existing pension entitlements, given the rapidly changing dependency ratios resulting from demographic ageing and the consequences of the current economic and financial crisis. There is already considerable, though not full, agreement about the main solutions that will need to be pursued, central to which are that Europeans are going to have to get used to working until an older age and to save more for their retirement. But, while the potential of housing equity, as a means of meeting people's income needs in old age, may form a relatively minor part of the overall policy package under discussion, it has actually long been discussed within the European Union. In 1999, for example, the housing ministers of all the then EU member states concluded their meeting with the statement that:

"In most EU Member States, older people live in owner-occupied housing. This means that many older people possess capital in the ownership of their homes. The Ministers were aware of the need to explore new ways of helping older people to safely utilize their capital, for example, to obtain the housing and support services they need, to repair or adapt their existing homes or to release income to cover the costs of support services or to purchase new accommodation with support services available (Finland 1999; para 9)."

Underlying these propositions are many questions. Is there really so much housing equity held by older people in Europe that its realisation could make a significant contribution to raising their income position? What is a reverse mortgage, how does it work, how does it differ from other ways of realising housing assets, and, across member states, what is the pattern of availability of reverse mortgage products? Where reverse mortgages are available and used on a large scale, how do they contribute to retirement income? The objective of this article is to provide some answers using the results of published and ongoing research. The main part reports some of the findings of a survey of the take up of reverse mortgages in the UK – which, within the EU, currently has the most extensive market – in order to provide indications of how more generally they might contribute. Specifically, it provides evidence of what sorts of people – defined by income and wealth – are using equity release products and what they use the money for.

The scale of housing equity within the eu

The total amount of housing equity held by European households is founded on two trends: increasing home ownership rates and increasing house prices. In the case of many of the newer member states the increase in the first of these, home ownership rates, has occurred particularly since 1990, with the privatisation of their housing stocks, whereas, in many of the older member states, it has been a long-term trend, stretching back over the last 50 years. The home ownership rate across the fifteen, pre-2004, member states is currently around 64 per cent, and in the ten member states joining in 2004 around 67 per cent[1]. In addition, once age-related tenure rates are taken into account in many member states even higher proportions of older people are owners so that by the time they reach retirement age perhaps some three quarters of European households own their own homes.

While the current economic and financial crisis has had a downward impact on house prices throughout Europe, the long run trend over recent decades has been for

1. J. Doling, J. Ford, Editorial Introduction to special edition on home ownership in Europe, *European Journal of Housing Policy,* December 2007.

substantial real increases everywhere. What this translates into, in terms of an exact amount of housing wealth in each member state, is unknown. Rough estimates, however, indicate that the net value or equity of home owned properties, that is the gross value less outstanding loans, may currently be around 13 trillion euros in the 15 older member states, and almost 2 trillion euros in the 10 member states joining in 2004. Over the EU25 as a whole, housing equity is some 40 per cent higher than total GDP. While the total amount of net equity held in home ownership is considerable in all member states, it is particularly large in the newer member states[2].

Whereas the amount of housing equity is clearly considerable in all member states, its amount relative to other sources of wealth is known for only some. A number of studies of some of the higher GDP *per capita* countries, using data for the late 1990s/early 2000s, for example, indicate that in France, Germany, Italy and the UK housing wealth amounted to between a third and a half of total personal wealth. A survey of households in which the head is aged over 55 years, however, does indicate for a number of the older member states that the proportion of their personal wealth accounted for by housing equity is even higher[3].

It is clear, then, that many older European households have considerable savings tied up in their housing arrangements. Given the fiscal difficulties faced by member state governments, combined with the fact that for most spending on the elderly will be the largest single item of public expenditure, it is not surprising that many have an eye on the possibility of drawing on housing equity.

The availability of reverse mortgage products

In practice, housing equity can be, and is, accessed in a number of ways. Many European households, approaching or during retirement, move home either to a cheaper one, thus realising some of the equity, or to rental accommodation, thus realising all of it. These strategies depend on the alternative housing options that, nationally, regionally and individually, are available to each household, but they clearly require the household to move.

In some countries, however, there are also arrangements that allow people to remain in their home until death and allow them to realise its equity. In some the legal framework allows the sale of a property to a buyer who then rents the property back to the seller for life: in France, the Viager system allows the householder to sell the house to a third party; this may often be a member of the family; the product of the sale is a lump sum or annuity with a legal entitlement to remain in the home until their death.

Further, in some countries some financial institutions have developed products that provide similar benefits. In detail, these take many different forms but most can be categorised as either equity withdrawal or reverse mortgages, which are fundamentally different in terms of their technical characteristics as well as the risks they present to both pro-

2. *Ibidem.*
3. S. Lefebure, J. Mangeleer and K. van den Bosch, *Elderly Prosperity and Homeownership in the European Union: New Evidence from the SHARE Data*, Paper to the 29th General Conference of the International Association for Research in Income and Wealth, Joensuu, Finland 2006.

vider and consumer. Equity withdrawal products are generally aimed at households who already have a housing loan: they increase the size of the loan; this provides them with a lump sum; it also requires some change to the existing repayment amount and structures. For their part, reverse mortgages do not generally require an owner to have an existing loan: the owner sells the home, or some proportion of it, to a financial institution; they may continue to live in the house; they receive a monthly payment from the institution, or a lump sum with which they may purchase an annuity. Even with the general category of reverse mortgage there are different products with some being loans to be repaid when the house is eventually sold and others involve selling the house at the time of taking a reverse mortgage, while the original occupant is allowed to go on living in it. In either case, the home owner effectively receives an income for the rest of their life, while the institution is repaid from the proceeds of selling the home.

In the case of reverse mortgages, providers face considerable risks for example those associated with the future trajectory of house prices, inflation and the life span of the home owner. Quite simply, if house prices do not increase as much as expected, if inflation is high and the owner lives longer than expected, the provider may lose money. These risks of course have to be reflected in the cost of the product and the size of the annuity and have the effect of depressing the attractiveness of taking a reverse mortgage. One consideration for governments is therefore whether they want to stimulate the market by offering providers some protection against these risks.

With the major exception of the UK where the trade body (SHIP[4]) collates statistics, there is no central collection of data, either within or across member states, even about the scale of lending, let alone about the characteristics of the consumers or the use to which the income or capital is put. One of the consequences is that across Europe as a whole as well as within individual member states there may be relatively little known about both the actual and potential reverse mortgage markets. What we do know – from a major study conducted on behalf of the European Commission[5] as well as research by the European Central Bank[6] – is that there is considerable variation across member states: some offer reverse mortgage products, some do not; in some they are available, but not greatly used. Only in a few – Ireland, Spain and the UK – could the market be said to be large, with the latter accounting for, in the order of, three-quarters of the entire business. Further, when all the reverse mortgage business is aggregated it accounts for less than 1 per cent of the total mortgage business across the member states.[7] So, any expectations held by European policy makers that reverse mortgages might make a contribution to meeting pension needs will need considerable development not only in extending the list of member states with appropriate legal frameworks but also extending the interest of providers and consumers in all member states.

4. Safe Home Income Plans (SHIP), *Facing the Future: Redefining equity release to meet today's social and economic challenges*, London 2009.
5. U. Reifner, S. Cierc-Renaud, E. Perez-Carrillo, A. Tiffe, and M. Knobloch, *Study on Equity Release Schemes in the EU*, Part 1 General Report, Institut fur Finanazdienstleistungen, Hamburg 2009.
6. ECB, *Structural Factors in the EU Housing Markets*, European Central Bank, Frankfurt 2003.
7. U. Reifner, S. Cierc-Renaud, E. Perez-Carrillo, A. Tiffe, and M. Knobloch, *Study on Equity Release Schemes in the EU op.cit*.

The UK experience of reverse mortgages

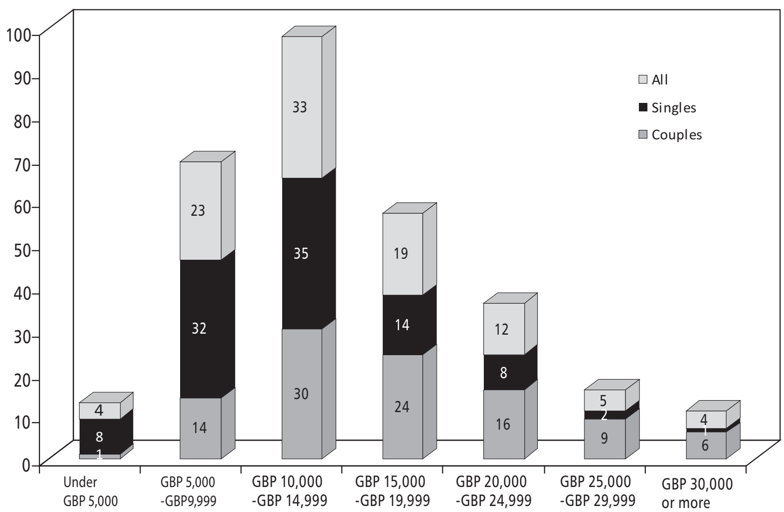
Against this background, the present paper is intended to provide evidence of the take up of reverse mortgage products within one member state. Specifically, it details some of the findings from a survey, carried out in 2009, of 553 existing reverse mortgage customers in the UK. It focuses specifically on respondents' financial circumstances and how they used the money from the products, giving some indication of how reverse mortgages may be used, and by whom (A full report of the survey is provided in Overton 2010[8]).

THE FINANCIAL CIRCUMSTANCES OF REVERSE MORTGAGE CUSTOMERS

Income

Chart 1 shows that a third of respondents reported a gross annual income of between GBP 10,000 and GBP 14,999 (excluding income from their reverse mortgages) while almost a quarter (23 per cent) received between GBP 5,000 and GBP 9,999 (note: GBP 1 is equal to approximately 4.7 zloty or 1.2`euro). However these figures mask differences between single respondents and those living as a couple. When broken down in this way we can see that the incomes of couples tended to be clustered in the middle bands while single respondents had lower incomes. Indeed they were more than twice as likely to report that they were living on less than GBP 10,000 per annum (40 per cent compared with 15 per cent).

Chart 1. Household income (per cent)



Source: L. Overton, "Housing and finance in later life: a study of UK equity release", University of Bormingham, For Age UK, London 2010.

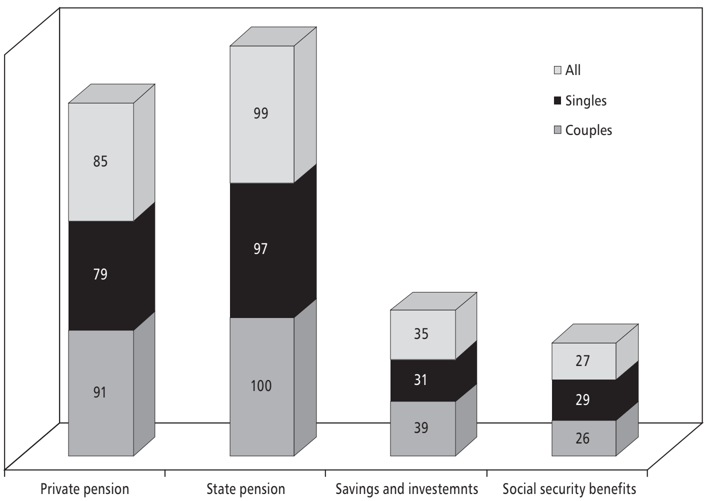
But how do the respondents' incomes fare in comparison to those of older people more generally? It might be assumed that those who take out reverse mortgages have

8. Overton, L. *Housing and Finance in Later life, A study of UK equity release customers*, Age UK, London 2010

lower incomes, on average, than the wider pensioner population but the differences appear to be fairly small. The Pensioners Income Series[9] shows that median net income (before housing costs) in 2008-09 was GBP 19,396 for couples and GBP 10,712 for single pensioners. Overall, then, the sample households might be considered to be cash-poor, rather than being either very cash-rich or in cash-poverty.

Chart 2 provides further information regarding respondent's financial situation and it also gives some indication of the role that reverse mortgages play. In the UK almost all people over state retirement age are eligible to a state pension. Many will also have a pension built up through their employer, which for some will be further augmented by personal savings which can take many different forms including bank deposits and shares. Some, generally those with the lowest incomes, will also be eligible for a variety of social security benefits. The fact that the majority of the sample had a private pension (85 per cent) in addition to a state pension, suggests that the money from their reverse mortgage has been a compliment to, rather than substitute for, pension income. They have taken the reverse mortgage, not because they are otherwise living in poverty, but because they want to further enhance their income. The corollary is that, whereas those with only state pension income may be considered most in need of additional income, at present, reverse mortgages seem to be play little role in providing this.

Chart 2. Sources of income



Source: L. Overton, Housing and finance in later life: a study of UK equity release, University of Bormingham, For Age UK, London 2010.

A general interpretation of this is that it points to the relationship that, in general the poorest older people, which are those who rely solely or mainly on a state pension, will also be most likely to rent a home. In the UK around 70 per cent of households are

9. Department for Work and Pensions (DWP), *The Pensioners' Incomes Series 2008-09*, London 2010.

home owners, but the high costs of housing mean that they generally have, or when they were working had, middle or higher incomes.

Chart 2 also shows that only 35 per cent of the sample said that they had income from savings and investments (compared with 68 per cent of pensioners overall (DWP, 2010). This seems to support the view that people only consume housing assets if they do not have alternative means of obtaining the money or if they have already used up other, more liquid, assets (for example Levin 1998[10]). But it is also possible, of course, that the comparatively low figure is due to under-reporting.

Housing wealth

Given the conditions in relation to reverse mortgages in the UK one would expect that the majority of customers own homes above GBP 100,000 and we can see from Table 1 that this is case. Whereas the majority of the sample owned homes that were above the average national house price which currently stands at GBP 167,953[11], the survey respondents were under-represented in the higher housing value categories compared with older home-owners generally. This suggests, then, that reverse mortgage customers are, on the whole, neither asset-rich nor asset-poor. Rather, they might be considered 'asset-average'.

Table 1. Housing wealth of survey respondents and home-owners aged 65+ (per cent)

House value	Survey respondents (per cent)	Home-owners aged 65+ (per cent)
Under GBP 100,000	7	9
GBP 100,000-GBP 149,999	19	18
GBP 150,000-GBP 199,999	29	21
GBP 200,000-GBP 249,999	19	14
GBP 250,000-GBP 299,999	11	11
GBP 300,000-GBP 349,999	6	9
GBP 350,000-GBP 399,999	2	6
GBP 400,000-GBP 449,999	2	3
GBP 450,000-GBP 499,999	0	3
GBP 500,000 or more	5	6
Total	**100 (N=543)**	**100 (N=2265)**

Source: L. Levin, "Are assets fungible? Testing the behavioural theory of life savings", Journal of Economic Behaviour and Organisation, 1998, Vol. 36 pp. 59-83.

10. L. Levin, *Are assets fungible? Testing the behavioural theory of life savings*, "Journal of Economic Behaviour and Organisation" Vol. 36, pp. 59-83, 1998.
11. Halifax House Price Index (2010) http://www.lloydsbankinggroup.com/media1/research/halifax_hpi.asp .

House-rich, income-poor?

The potential for reverse mortgages to make a contribution to pension income is often said to be greatest for those that can be classed as 'asset-rich, income-poor' (for example Sodha, 2005[12]). But using an income of GBP 15,000 as the dividing line between income-rich and income-poor, and GBP 200,000 as the dividing line between asset-rich and asset-poor, we can see from the table below that the current reverse mortgage market in the UK is not focused exclusively on the asset-rich, income-poor. Indeed this group accounts for less than a quarter of the total with the majority of customers being spread across income and wealth classes. This potentially means that for more than a quarter (26 per cent) of customers, at least, reverse mortgages are adding to the security and consumption possibilities of the better off.

Table 2. Income and wealth combinations

	Assets		
Income	Asset-poor	Asset-rich	Total
Income-poor	38	22	59
Income-rich	14	26	41
	52	48	100

Source: Own calculation based on L. Overton, Housing and finance in later life: a study of UK equity release, University of Bormingham, For Age UK, London 2010.

Reverse mortgage money: How is it used?

Chart 3 indicates that the income or capital from reverse mortgages is used in a variety of ways but, typically, to enable people to maintain or improve the home (79 per cent) to go on holiday (36 per cent) and to help clear debts (35 per cent). These findings are consistent with research carried out by UK providers which also shows that maintaining or improving the home, clearing debts and using the money to go on holiday feature in the top four uses for released equity[13].

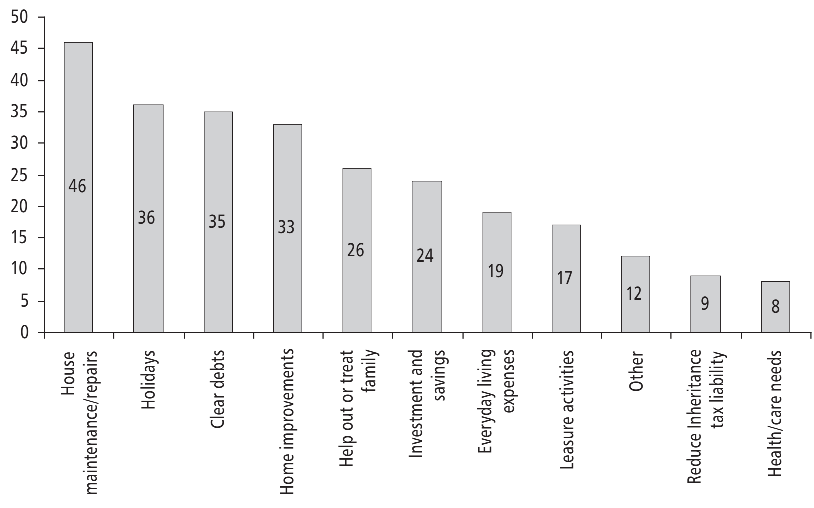
The findings suggest a number of other things. One is that home ownership in later life may be a mixed blessing. Although it can reduce living costs through rent free living it might also be a financial burden, particularly for lower-income home owners. Another is that there is seemingly an increase in the number of home owners moving into retirement with outstanding debt, mortgage or otherwise. It has been reported elsewhere that reverse mortgages are increasingly being used to service debt[14] and one leading UK provider reported an almost 40 per cent increase in the number of those aged 65 and over who used reverse mortgages to relieve the burden of mortgage debt in 2008 compared to 2007[15]. This trend may reflect changing lifestyles and attitudes to consumption, ease of access to credit (with the exception of the last year or so) and/

12. S. Sodha, *Housing-Rich, Income-Poor – The potential of housing wealth in old age*, IPPR, London 2005.
13. Home Income Plans (SHIP), *Facing the Future... op.cit.*
14. *Ibidem.*
15. (KRS, April 2009 Press release).

or divorce and family break up, causing more people to retire with outstanding debt[16]. It may also reflect the failure of an investment vehicle, such as an endowment policy, to meet the total repayment balance of a mortgage. But while reverse mortgages can offer a solution, or at least a partial solution, to this problem, such a strategy might leave people with little, if any, housing wealth later on when, for example, pension lump sums have been used up and there is a need for additional income or capital to meet other welfare needs. As McKay et al (2008) have argued, therefore, it seems there is a need to ensure that older people are included in strategies to raise levels of financial capability providing more information on the dangers of over-borrowing and the potential problems they face if they move into retirement with outstanding debt.

Similar concerns arise in relation to the use of reverse mortgages for lifestyle purposes, such as taking holidays. While an increasing use of reverse mortgages in this way is seen in a positive light by customers and, providers, who have been keen to eschew the image of equity release as a last resort, from the point of view of policy makers, wanting to reduce the fiscal pressures inherent in pension systems, this might represent a worrying trend, particularly if it becomes more widespread. The same can be said of passing on wealth to younger generations which is, and may continue to be, an increasingly popular use for reverse mortgages. As people live longer they may see more value in passing on their housing sooner, rather than later. Waiting until death might mean that their children are likely to be more financially secure with (unmortgaged) homes of their own.

Chart 3. Ways in which reverse mortgage money was used



Source: L. Overton, Housing and finance in later life: a study of UK equity release, University of Bormingham, For Age UK, London 2010.

16. Safe Home Income Plans (SHIP), *Facing the Future... op.cit.*

Reverse mortgages: Different purposes for different people

The wide variety of uses for the money that reverse mortgages provide and the fact that this seems to have changed over time (i.e. some years ago these products were more commonly taken out by lower income groups for everyday living costs[17] suggests that there is likely to be increasing diversity, also, in the kinds of people who take out reverse mortgages. Analysis of the survey findings, especially questions that had been asked about people's views of why they had taken a reverse mortgage, confirmed that this was the case and identified three types of customer. This means it makes more sense to talk of reverse mortgage markets in the UK rather than the reverse mortgage market[18].

TYPE 1

Among this group, the large majority (97 per cent) were already 'doing alright' or 'living comfortably' before taking out a reverse mortgage and most (68 per cent) disagreed that they couldn't do without the money. Furthermore, the decision to take out a reverse mortgage was not considered to be a last resort but neither did it seem to enable a more enjoyable retirement. This seems to be because it was not used for personal gain; rather, it was primarily used to enable the transfer of wealth to other family members, frequently children and grandchildren. The fact that housing wealth tended to be passed on by this group can be explained, in part, by their financial situation. Table 3 shows that that they were financially better off than those in other groups. Not only were they more likely to have higher incomes and more valuable homes, but they were also more likely to have a private pension and income from savings and investments. In short, they were more likely to be asset-rich, cash-rich.

TYPE 2

The members of this group were generally not 'finding it very difficult' to manage before taking out a reverse mortgage but neither were they 'living comfortably' (just 7 per cent agreed that they were). The decision was not an absolute last resort, rather a way of using their most valuable asset to improve their standard of living. The additional income or capital appears to have enabled them to have a more enjoyable retirement (92 per cent agreed with this statement) and to maintain the lifestyle they had when they were working by allowing a wide range of non-housing consumption.

TYPE 3

The majority of respondents in this group (89 per cent) were 'finding it difficult' to manage or were only 'just about getting by' before taking out their reverse mortgages which suggests that they were in financial difficulty and perhaps had no other option. Indeed 80 per cent agreed that the decision was a last resort and, as Table 3 indicates, they tended to have lower incomes, lower levels of private pension wealth and were least likely to have income from savings or investments compared with those in the other two groups. For this group, reverse mortgages were not used to make the most of retirement; instead, they were used to reduce financial difficulty often caused by problem debt.

17. *Ibidem*.
18. *Ibidem*.

Table 3 Groups by socio-economic variables (column percentages)

	Group 1 n=99	Group 2 n=190	Group 3 n=123
Income			
Under GBP 10,000	13	23	29
GBP 10,000 - GBP 14,999	23	37	40
GBP 15,000 - GBP 19,999	31	20	13
GBP 20,000 or more	33	20	18
Income source			
Private pension	93	87	82
State pension (ns)	100	100	98
Social security benefits	22	24	41
Savings and investments	52	44	14

Source; L. Overton, Housing and finance in later life: a study of UK equity release, University of Bormingham, For Age UK, June 2010.

Conclusions

So, what does this survey tell us that might usefully inform discussion about the future of pension policy in the EU, especially the possibility of drawing on housing equity through reverse mortgages? Any answer to this must start from the recognition that the survey has been carried out in one country only. It may be the European country with the largest reverse mortgage market, but it is a single country (of 27 EU member states) with some quite distinct features, so that the results cannot simply be generalised to the rest of the EU. Nevertheless, the findings can offer some pointers to the potential of drawing on housing equity.

The first and perhaps obvious point is that housing equity can be drawn upon by people who own housing. Whereas increasing numbers of older Europeans do so, there remain significantly sized groups in all member states who do not. Insofar as the general pattern within member states is of a positive correlation between income (both pre and post retirement), and both housing and non-housing wealth, for many of those most in need housing equity is not a relevant solution.

Where housing equity is relevant to people's consumption needs and aspirations, the evidence of the UK survey is that reverse mortgages are used in different ways by different groups with some using them for lifestyle purposes, some to pass on wealth to children while others are having to use them to increase their financial security and relieve financial difficulty. There is no reason to believe that market segmentation would not also be significant in other national settings and this could bring challenges as well as opportunities to providers in terms of product design and the provision of appropriate information and advice.

An important conclusion from the evidence of the uses made of housing equity, however, is that the factors influencing individuals and households are different from the factors driving government interest. So if governments are keen for housing wealth to be used more widely by those who rely primarily on state pensions for meeting welfare needs rather than conspicuous consumption or early bequests, then the extension of a legal framework alone seems unlikely to bring about this change. In the UK there is, of course, an appropriate legal framework and the market is regulated but this represents the extent of government involvement in the industry. The findings from the survey, however, suggest that governments may need to do more to encourage and enable lower-income home-owners to draw on their housing equity. While there are undoubtedly important questions to be asked about whether it is right that low-income home-owners should have to utilise housing wealth for welfare needs, the concern here is how, in the event that this becomes inevitable, it can be made more progressive and one way would be for governments to share the costs. This might involve some sort of subsidisation of the relatively high start up costs involved in taking out reverse mortgages, the costs of information and advice and/or the no negative equity guarantee that ensures consumers will never owe more than the value of their home.

These features are among the more costly features of reverse mortgages but are also some of the more important ones in terms of ensuring that consumers are able to release equity safely and in a way that is suited to their needs. But it means that the costs are typically reflected back in the pricing of the equity loan making them less accessible to those who might benefit most.

In the current climate these features are also proving quite costly for providers, particularly the no negative equity guarantee and so without some sort of support from government there is increasing risk that this safeguard will no longer be offered by the majority of providers. But government support for reverse mortgages, in the form of subsidies, might serve to subsidise home-owing pensioners who are not necessarily the poorest pensioners and such a move could face disapproval among those who do not own their own homes. Extending the market for reverse mortgages, then, is likely to require considerable cooperation between all stakeholders – governments, civil societies and institutions.

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Zielona Księga Komisji Europejskiej: odwrócony kredyt hipoteczny jako źródło dochodu emerytalnego – Streszczenie

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