



REVERSE MORTGAGES: MAKING ASSETS A TOOL AGAINST POVERTY

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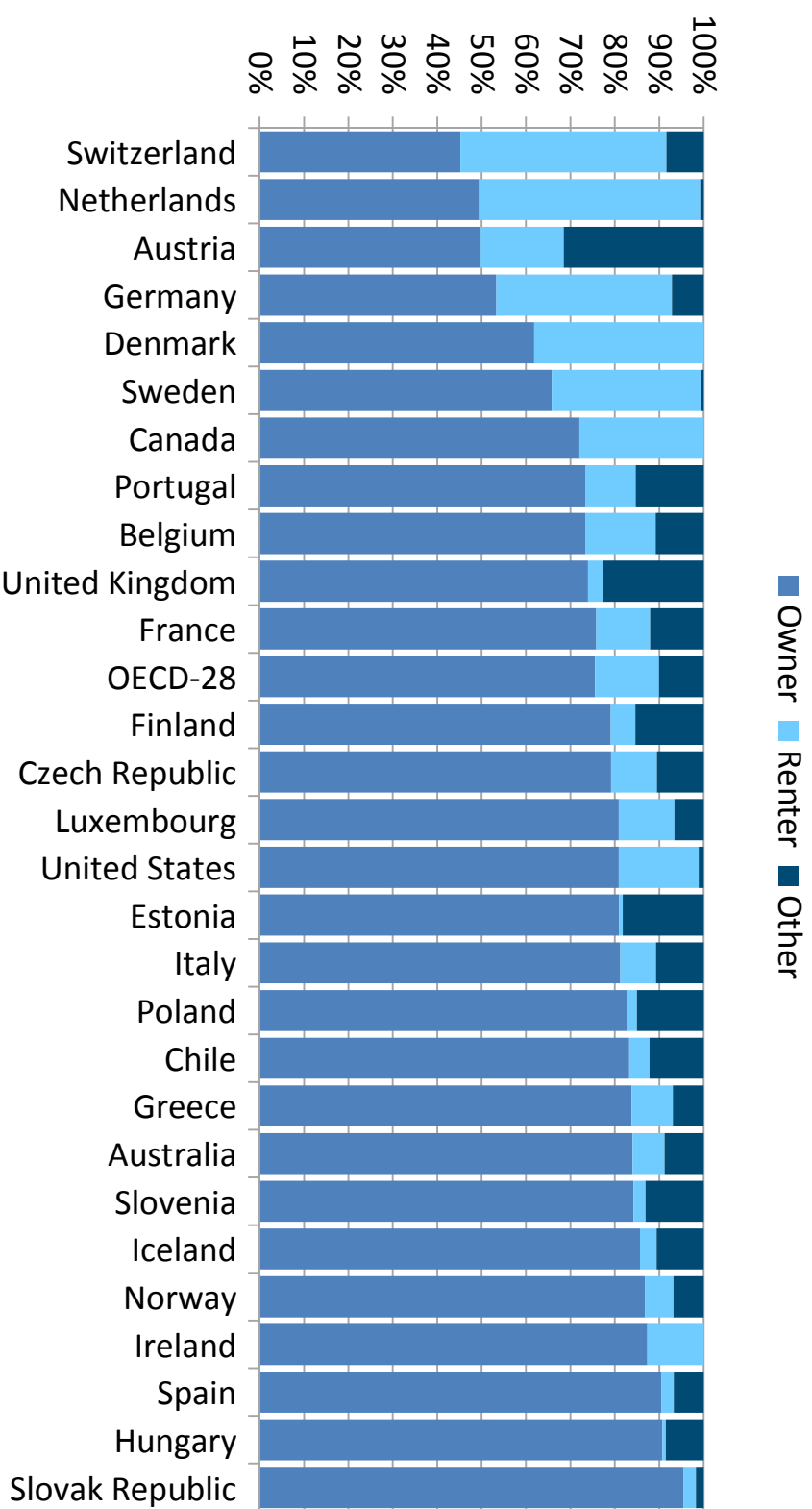


Outline

- Introduction
- Literature review
- Some facts on housing equity release schemes
- Data and methodology
- Converting housing equity into annuity
- Effects on poverty
- Conclusion



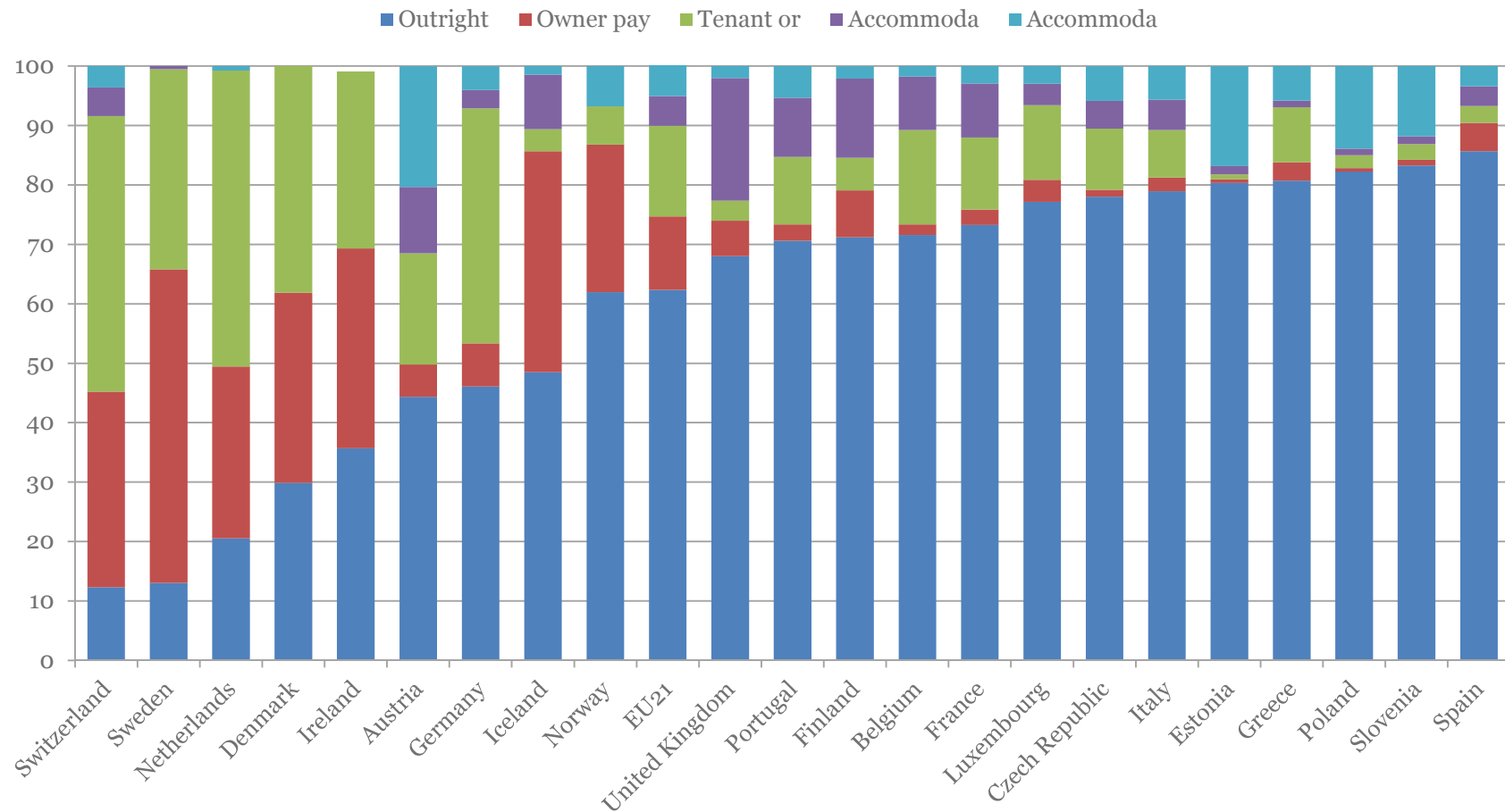
The majority of the over-65s are home-owners in the OECD



Source: OECD Pensions at a Glance 2013

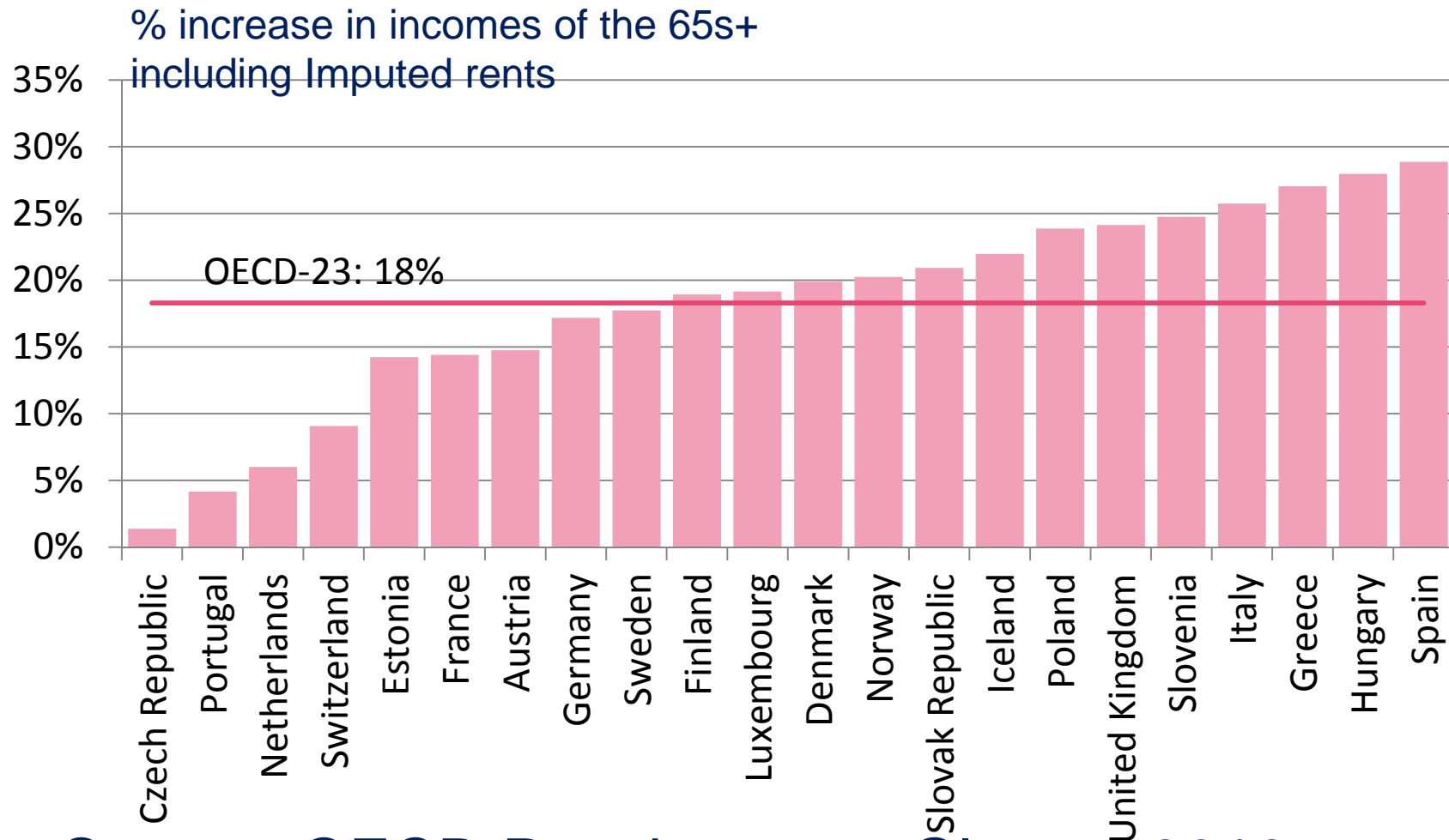


But some are still repaying their mortgages in old-age...





Home-owners may have an income advantage over renters



Source: OECD Pensions at a Glance 2013



A literature review: lack of decumulation among the elderly

- Venti and Wise [1989] showed that the elderly in the US were as likely to move into a larger house as to move into a smaller one. (Cf. also Merrill [1984]; Feinstein and McFadden [1989]).
- Absence of a significant relationship between changes in housing equity and whether the family has children (Venti and Wise [1989]).
- People tend to sell their house or move to a smaller one only after serious shocks such as illness or death of a spouse (Sheiner and Weil [1992]; Venti and Wise [2002]; Chiuri and Jappelli [2010]) and only after having decumulated financial wealth (Smith [1998]; Rosen and Wu [2004]; Berkowitz and Qiu [2006]; Cardak and Wilkins [2009]).

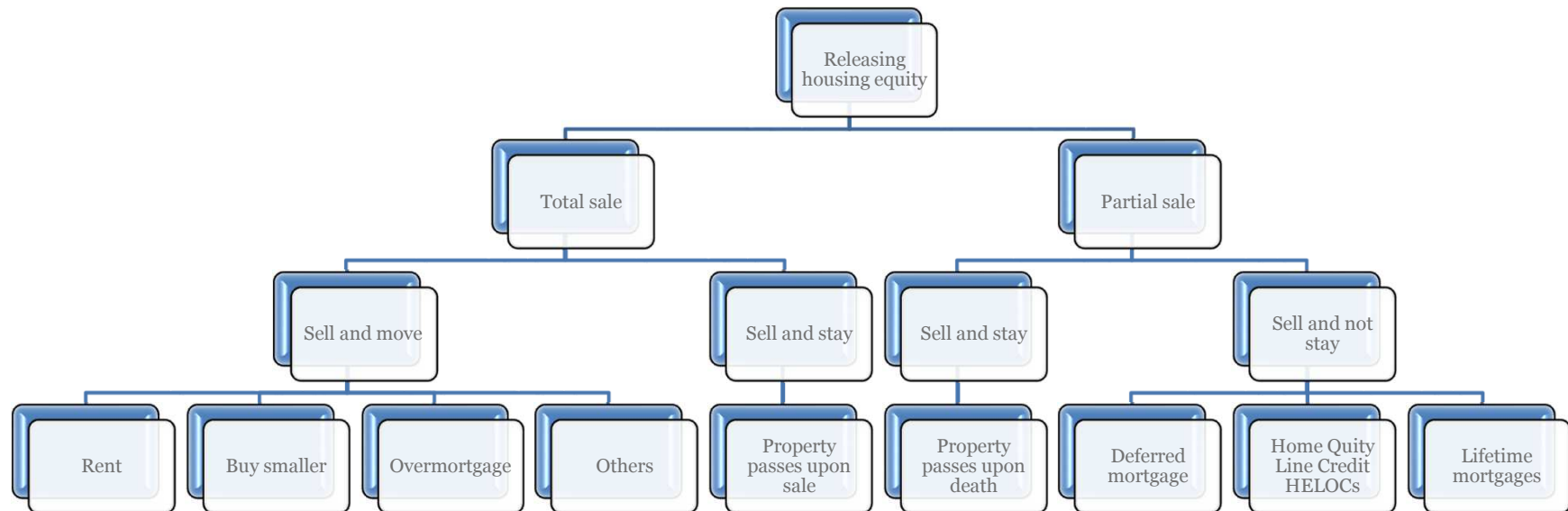


A literature review: lack of decumulation among the elderly /2

- Despite being illiquid, house wealth is often seen as a buffer stock, not as a tool to boost consumption (Venti and Wise [2004]).
- Market regulation and financial market development may also play a role. (Angelini, Brugiavini, and Weber [2009]; Chiuri and Jappelli [2010])
- Increasing interest in financial literacy: being financially illiterate could help explaining the reluctance to use debt instruments or the failure to use them properly (Behram, Mitchell, Soo, Bravo [2010]).



Releasing housing equity





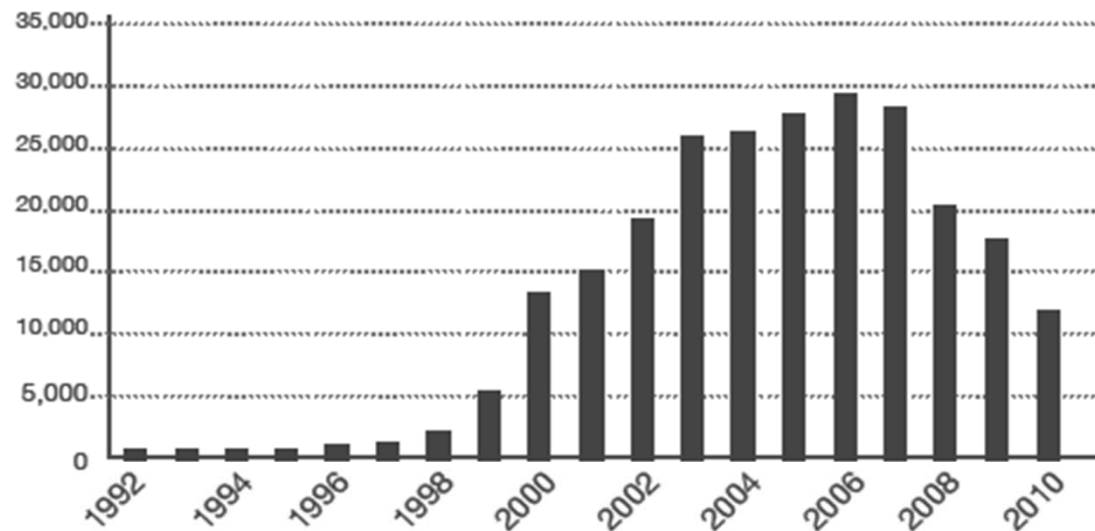
The Market for Equity Release Schemes

- Development of housing and deregulation and innovation in financial markets have fuelled ERS in Europe, North America, Australia, and New Zealand (Springer, 1985; Leather, 1990; Jacobs, 1985; Wilson, 1988; Carter, 1985),
- younger cohorts, in particular, are increasingly willing to use equity release schemes in, for example, the United Kingdom (Smith, 2004), Australia (Ong *et al.*, 2013a,b), and New Zealand (Davey, 2007).
- the use and number of schemes vary widely across countries.
 - Reifner *et al.* (2009a,b) find that in Europe the total worth of equity release mortgages was about EUR 3.31 billion with an estimated 45 238 contracts in 2007. Yet they still accounted for only around 0.1% of Europe's overall mortgage market.
 - In Australia, the number of loans under equity release schemes more than doubled between 2005 and 2011,
 - substantial growth was also recorded in the United Kingdom between 1992 and 2011, both in value and number.
 - New Zealand saw more than 4 500 ERS-related loans issued in 2006 for an overall value of NZD 227 million, twice as high as in the previous year.
 - In the United States the number of loans issued under the Home Equity Conversion Mortgage (HECM) program for people aged 62 and over peaked in (fiscal year) 2009 at 115,000 and fell to 72,000 by (fiscal year) 2011. In total, 740,000 loans were initiated under the HECM program; about 582,000 are still outstanding. The size of the market is, however, relatively small (Bowen Bishop and Shan, 2008).



Reverse mortgage: UK has the largest market in Europe

VOLUME OF PLANS ADVISED ON (1992 – 2010):



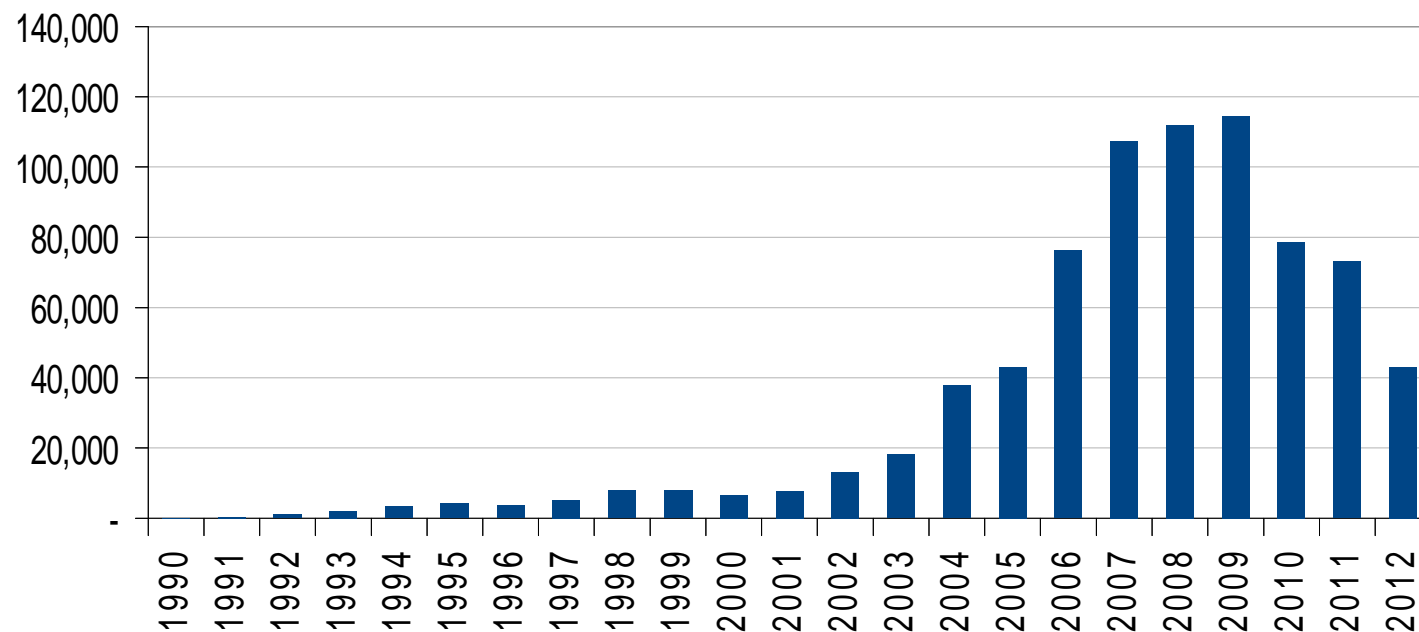
Popular Uses for Equity Release:

59%	Home and / or garden improvements
31 %	Pay debts (e.g. loans, credit cards)
30%	Go on holiday
23%	Treat or help family and friends
20%	Clear outstanding mortgage
16%	Help with regular bills
1%	Reduce IHT Liability



Reverse mortgage market in the US

Chart 3. Number of HECM in the US, 1990-2012

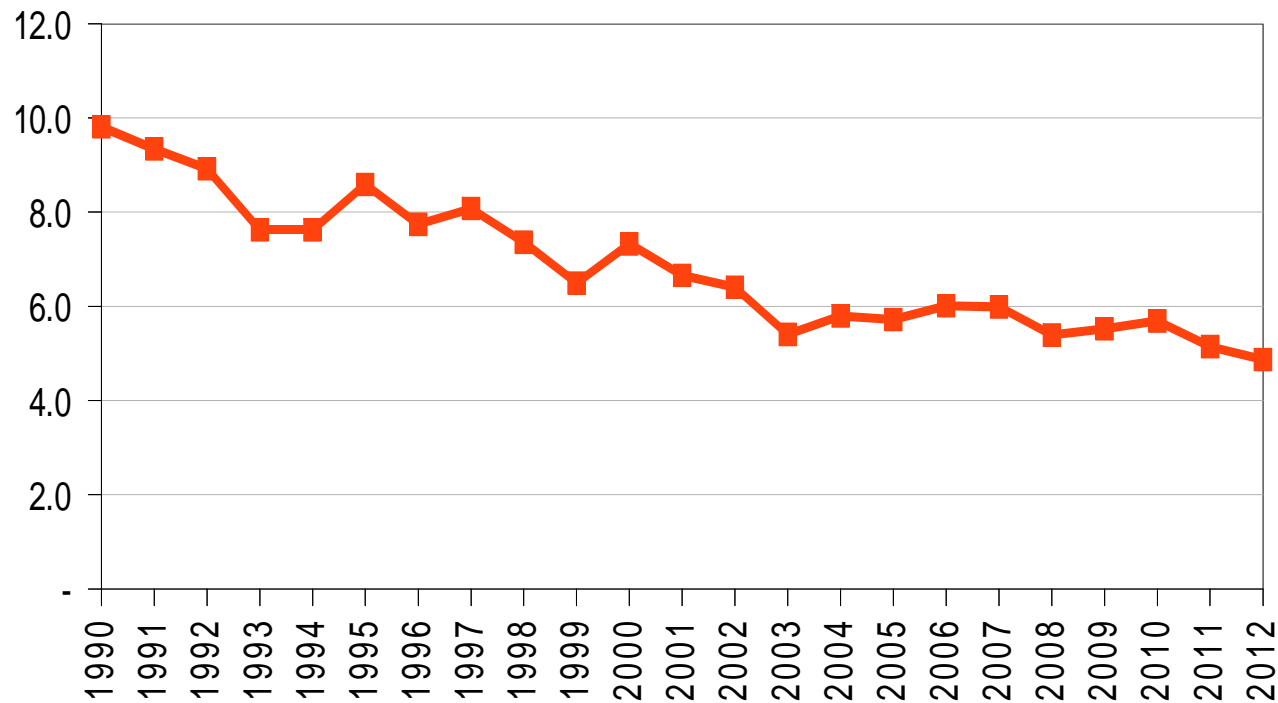


Source: HUD, June 2012



Trend in interest rate for HECM, US

Chart 4. Average expected interest rate for HECM in the US, 1990-2012



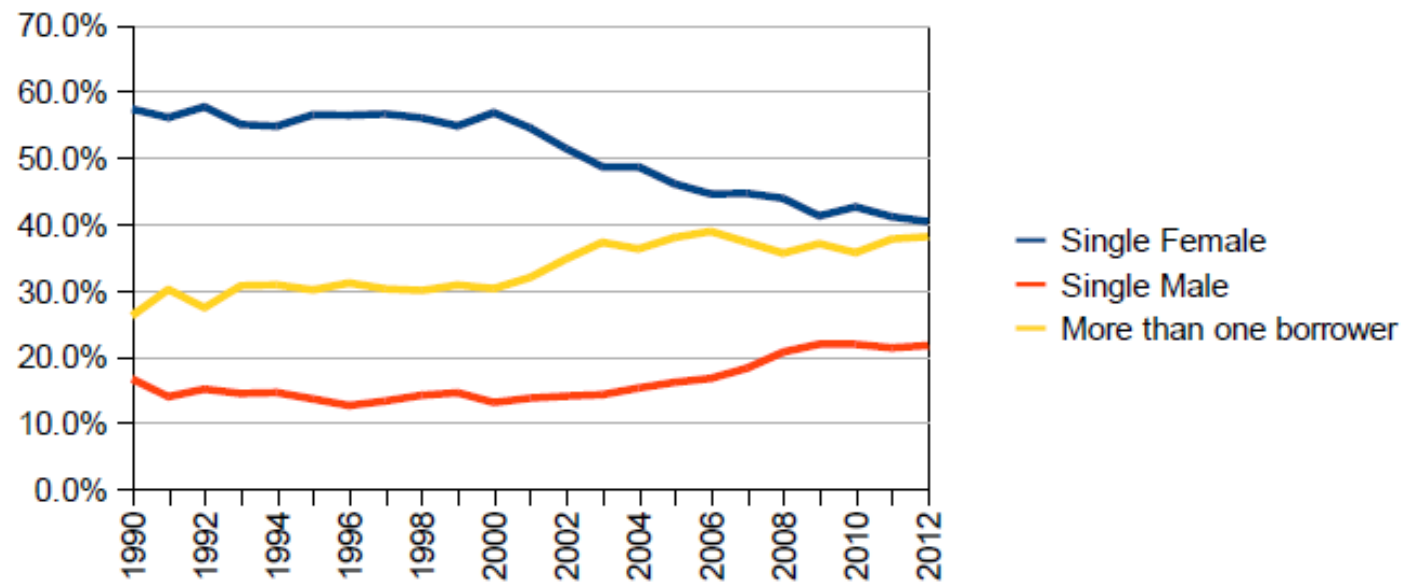
Source: HUD, June 2012



Reverse mortgages

- Different kind of payment plans: lump sum, line of credit, or annuity
- In the US: decline in the average age. Decumulation or poverty?
- Mainly used for home improvements, to pay back debts, to help family

Type of borrowers in the US



Source: HUD, June 2012



Data and Methodology

- 11 countries considered. All those countries took part to both waves of SHARE.
- Housing wealth converted into annuity using the following formula:

$$\text{Annuity} = \text{House value} * \frac{r}{(1 + r)^{\text{life expectancy} + 5} - 1}$$

- Life expectancy is the one of the youngest member of the household.
- Life expectancy increased by 5 years because of imperfect competition and life tables do not take into account cohort effect.
- It has been assumed that house values do not increase neither decrease over time.



Poverty rates

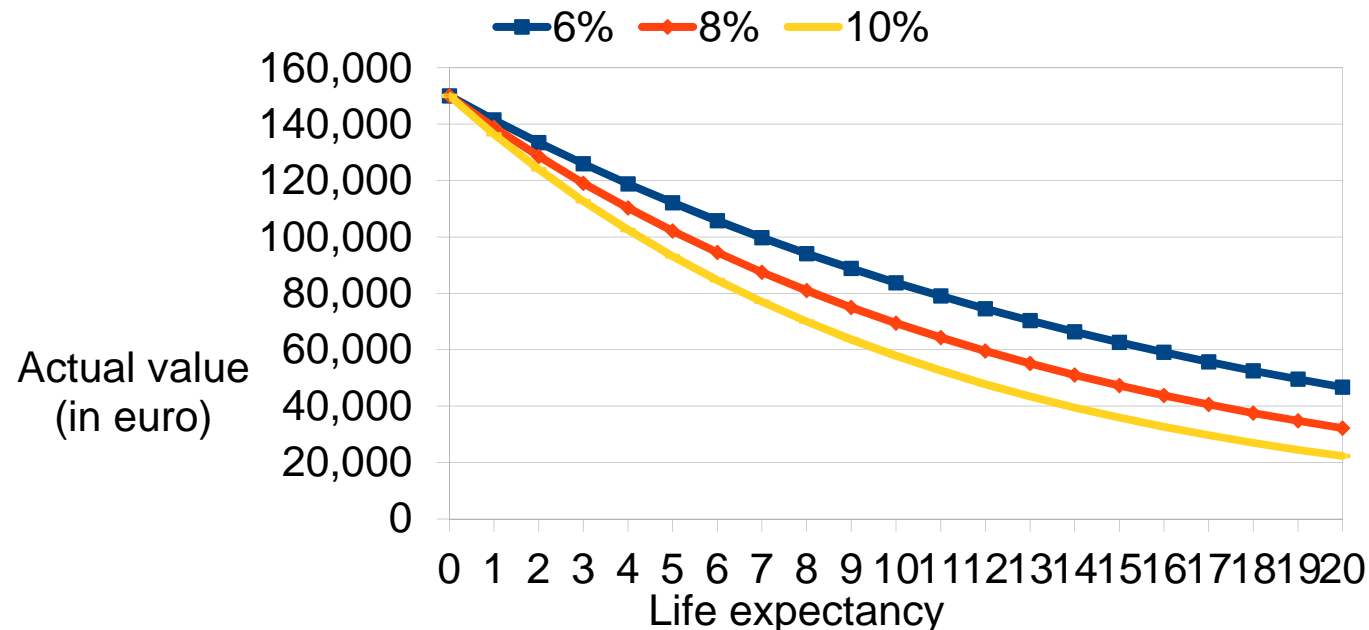
- Threshold: 60% of income per capita.
- Two poverty thresholds: one based on SHARE and the other on Eurostat
- In SHARE, two different lines of poverty in 2004 and 2007 since definition of income changed between waves in SHARE.
- Note: we are interested only in relative changes.



One Euro today is worth more than one Euro tomorrow

- What if house is converted in a lump sum?
- Be aware of life expectancy and compound interest rate

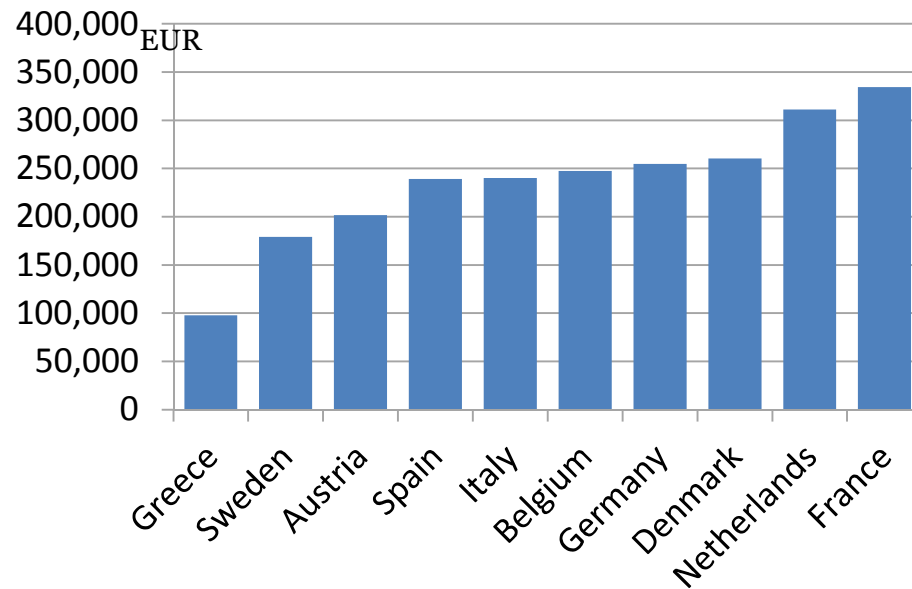
Actual value of 150,000



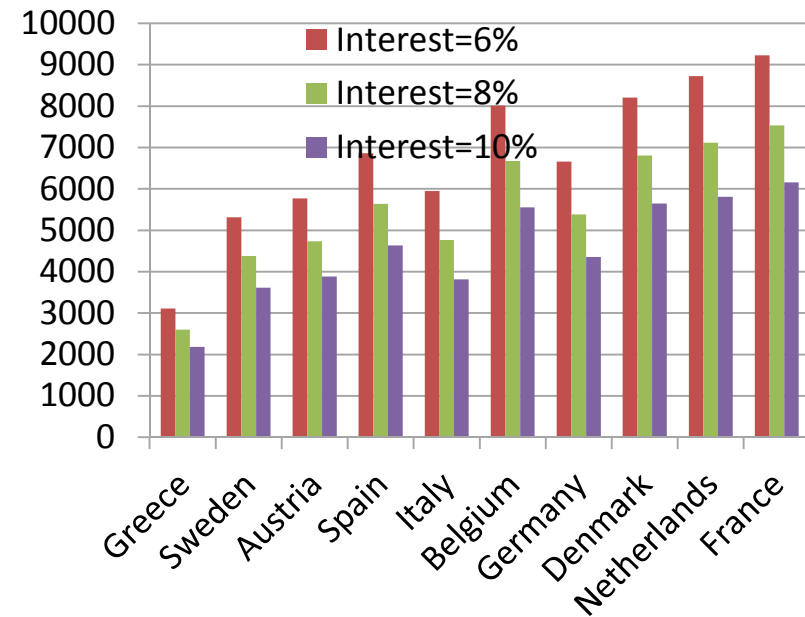


Making 100% of housing equity liquid gives relatively high annuity....

Average house value, EUR

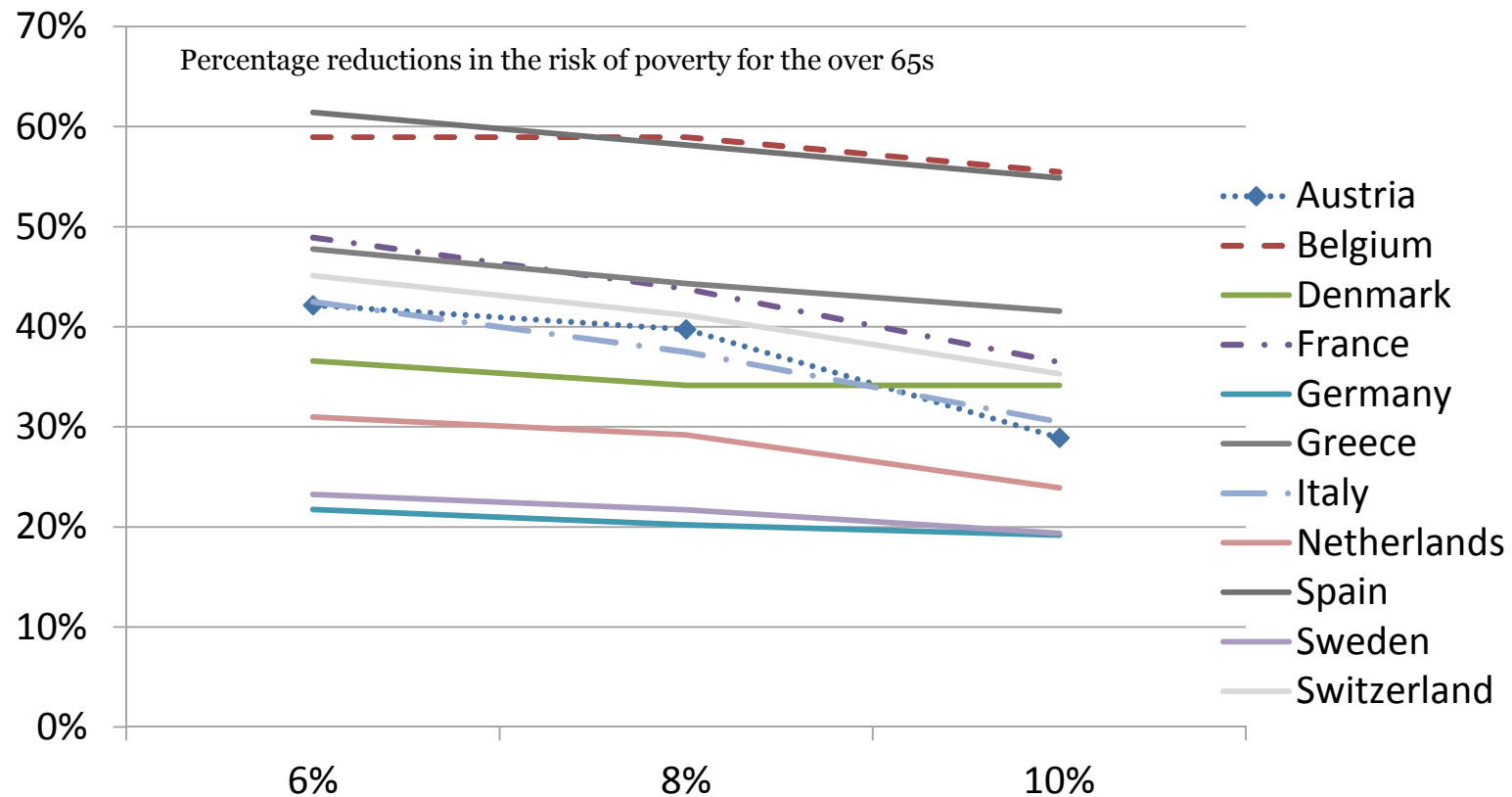


Average equity value, EUR





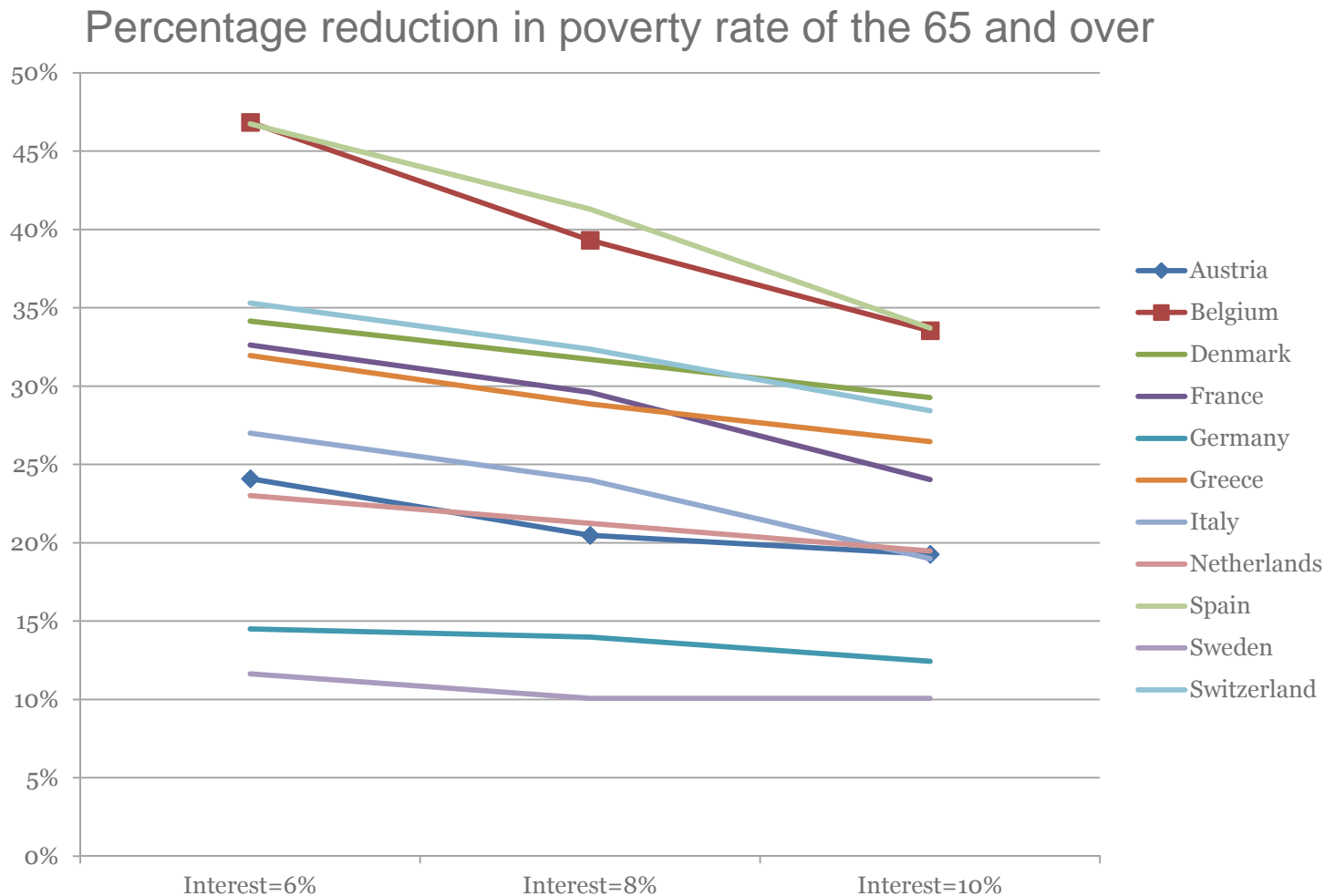
A full conversion of house equity into annuity would contribute substantially to poverty reduction. But it is unlikely ...



- Large effects also with high interest rates.



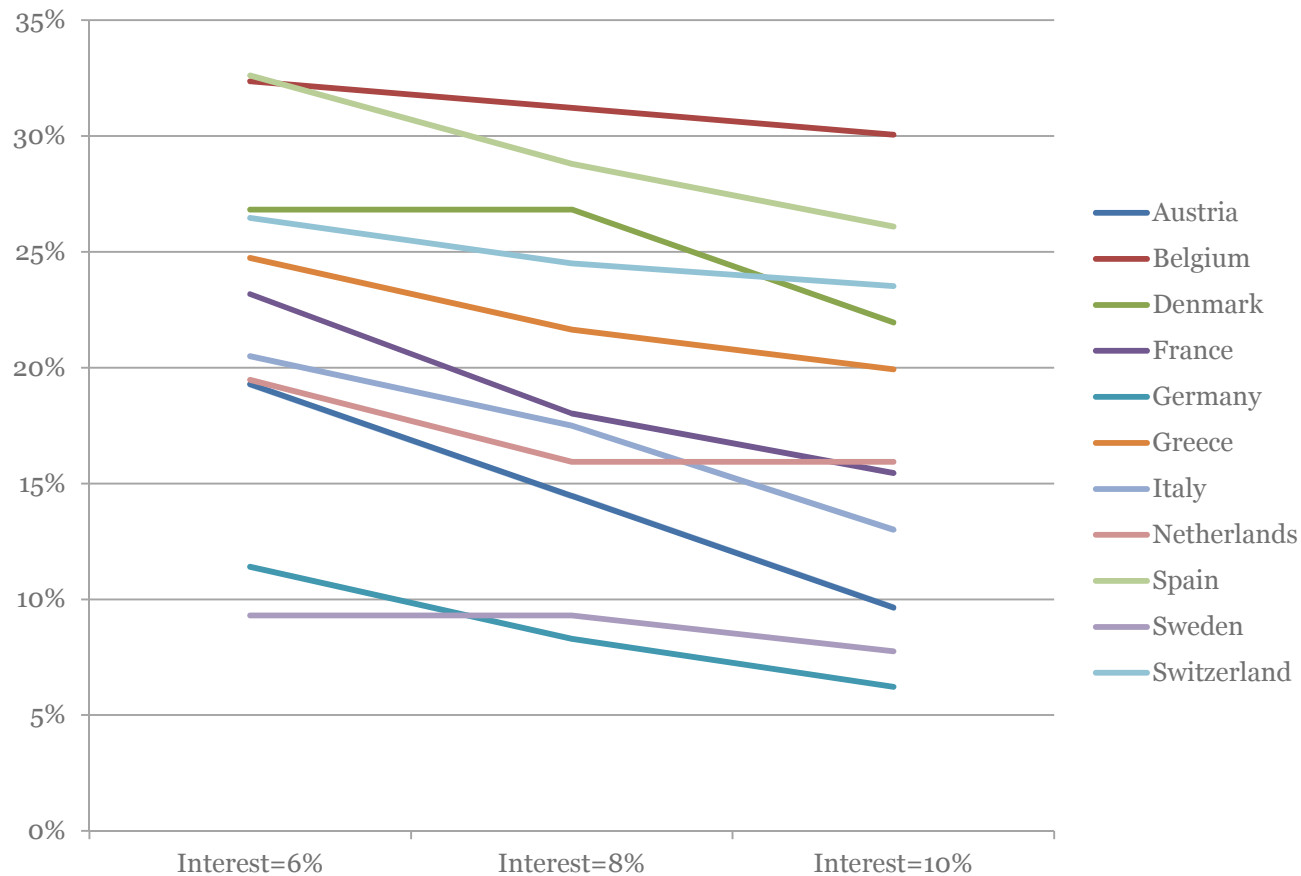
What about converting 50% of housing equity?





Data from financial institutions suggest that converting 30% of housing equity is more likely...

Percentage reduction in poverty rate of the 65 and over



Still a sizeable effect in most countries!!!



What about my grandchildren?

- Decent inheritance. Increases with higher interest rates
- Remember: non negative equity clause

Inheritance - 30% House value

Table 21. Reverse Mortgage - Inheritance (in Euro)
30% House Value

Country	House value	Interest=6%	Interest=8%	Interest=10%
Austria	201,718	163,792	166,201	168,556
Belgium	247,558	202,192	205,009	207,763
Denmark	1,941,532	1,583,580	1,605,916	1,627,747
France	334,346	271,056	275,108	279,067
Germany	254,793	206,093	209,222	212,281
Greece	97,811	79,817	80,957	82,071
Italy	240,305	193,947	196,948	199,882
Netherlands	311,178	252,439	256,169	259,817
Spain	239,118	194,187	197,049	199,845
Sweden	1,562,658	1,270,889	1,289,368	1,307,428
Switzerland	1,085,656	879,125	892,285	905,155

Source: SHARE



Conclusions

- Necessary to distinguish between decumulation and the use of such additional liquidity.
- Risk of wasting this wealth.
- But it could also be invested in productive activities (education, entrepreneurship).



Conclusions

- Reverse mortgage MAY be a powerful instrument in order to reduce poverty among the elderly
- But:
 - Complex (and still expensive)
 - Lack of interest in decumulation
 - Scarce knowledge of the products
 - Home-ownership more concentrated in high-income households
 - Could potentially increase income inequality in old-age
 - Cannot replace a retirement-income



THANK YOU

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For further information see also:

OECD Pensions at a Glance 2013 on retirement-income adequacy

<http://www.oecd.org/els/pensions/pensionsataglance.htm>



Introduction

- Fact: People do not decumulate assets as fast as predicted by LCH.
- Are people prepared to retirement? How many of them are vulnerable?
- Don't look just at pension benefits, but also assets, especially real assets