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Can home ownership contribute to the income needs of older people?

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"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" (Final Communiqué, 11th Informal Meeting of EU Housing Ministers, Kuopio, Finland, 1999; para 9)

"The Internal Market could also be helpful in extending access to additional sources of retirement income beyond pensions, such as reverse mortgages" (European Commission, Green Paper: adequate, sustainable and safe European pension systems, 2010: 11).

How much housing wealth do Europeans own?

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 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 member states is about two-thirds. 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 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 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, the figure being particularly large in the newer member states.

In most of those countries for which there are reliable figures, housing wealth appears to constitute at least two-thirds of the total personal wealth of older people.

How can older people use their housing wealth?

The wealth held in the form of home ownership can contribute to people's incomes in two ways. The first is as an income in kind in that those who own their home outright enjoy the standard of living conferred by the house without having to pay rent. So, in comparison with a tenant of a similar property and similar income they are able effectively to have a higher standard of living.

The second way is through realising some or all of the value of the house and converting it into an income, perhaps by purchasing an annuity. This may be done in a number of ways: by selling the house and buying a cheaper one, or even by becoming a renter; or, by using a financial product such as a reverse mortgage that allows the household to go on living in the house having “sold” a proportion of its value to a bank in order to obtain an income.

In general, reverse mortgages do not require an owner to have an existing loan. In essence, the owner sells the home, or some proportion of it, to a financial institution. They may continue to live in the house, while receiving a monthly payment from the institution, or a lump sum with which they may purchase an annuity. Even here there are different products with some being essentially loans to be repaid when the house is eventually sold while others constitute a sale of the house in which the original occupant is allowed to go on living. In either case, they effectively receive an income for the rest of their life, while the institution is repaid from the proceeds of selling the home.

The pattern of supply of reverse mortgage products is highly variegated across member states although it is possible to identify three broad country groupings. A first group which includes many of the accession states do not have reverse mortgage products, in many cases because they do not have a legal framework that allows them. In a second group of countries, which includes Germany and France, a legal framework exists that allows the marketing of reverse mortgage products but in practice few suppliers engage with the opportunity and few customers come forward to take them up. The third group, have both a legal framework, a range of providers and a not insubstantial body of customers. Within this third group there is considerable variation with a few - Ireland, Spain and the UK – dominating, and indeed with the latter accounting for perhaps three-quarters of the entire business. Even so, 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.

Do European households view their house as a pension?

In addition to debates among policy makers, there are important considerations concerning the thoughts and aspirations of European households. Study of a cross section of member states suggests that while retirement planning is not usually the primary motive for buying a home, most households see the financial advantages in owning a home and view home ownership as a good investment (particularly in the longer term, and compared to shares).

House price developments are in general not seen as a risk, especially where people plan to stay in the house for many years if not a lifetime. Country specific factors may significantly influence the speed at which home owners attempt to pay off their mortgage (obviously one of the main ways of accruing equity, along with house price rises). For example, in the Netherlands, significant tax incentives (alongside adequate retirement pensions/ incomes) mean that many people keep a mortgage into retirement. In contrast, the economic problems in Hungary mean that people may try and repay mortgage as quickly as possible. Fiscal policies appear to discourage the building of equity (for example, in the Netherlands, Finland, Belgium).

There is some evidence that pension planning is approached differently by the older and younger generations. Younger households often believe that it is increasingly unlikely that the state will provide in the future and individuals will themselves have to take more responsibility. Older and middle aged people in contrast often see the state as having a more central role: having paid taxes, and made contributions throughout their working lives then the state was responsible for providing them with a pension. In comparison with the younger age-groups, then, older people often appear to rely more on the public redistributive pensions and less on their own active saving strategy. Of all cohorts, those in middle groups appear to be most worried as because they may not have enough time available to adjust to new policies.

For most European home owners, first and foremost, their home gives them a good living standard and independence (when debt-free). However, housing equity is seen as important in a number of ways. Firstly, the home often represents a nest-egg that can be cashed (mainly by selling) if needed. People may need to use their housing equity for care, especially if they do not have children (or if the family is not the main provider of care in their country). Additionally, if income appears too low in retirement (and maintenance costs high) to make ends meet, some people can decide to move to a cheaper dwelling. However, this latter strategy is not available to those in the lower priced segment of the market and, apart from a few countries such as the Netherlands, a move to the rental sector is often not seen as an acceptable alternative. Secondly, most owner-occupiers appear aware of the reduced housing expenses when a mortgage is paid off, hence giving them a higher disposable income. This financial advantage is even more pronounced in countries where the rental market covers a large part of the housing stock (in particular, Germany).

There is evidence that financial products to release housing equity (or the idea of them where people did not have any knowledge of this possibility) are often encountered without great enthusiasm. Three key barriers are often evident. Firstly, a bequest motive appears especially important in some countries like Hungary, the corollary being that people without children may be more open to mortgage equity release in old age than people with children. Secondly, people sometimes have little trust in the providers of equity release products; taking out a reverse mortgage means: dealing with a complex product, losing control, running risks and becoming dependent. Financial institutions were not always fully trusted before the present financial crisis, and even less so now. Related to this, it appears that government-related financial institutions (such as the *Sparkasse* in Germany) were regarded as more reliable institutions. Thirdly, the products sometimes seem expensive appearing to offer a small income relative to the amount of the equity.

Could housing provide an adequate pension?

There can be little doubt that home ownership makes an important contribution to maintaining former living standards. People who are outright owners of their homes are able to live rent free. In contrast to those who pay rent, they receive a net income in kind the amount of which varies according to the value of the home. The average, in comparison with cash income from pension and savings, will also vary from member state to member state, but mostly adds between a quarter and a half to these other sources of income.

If all older home owners also drew directly on the housing equity, say through a reverse mortgage product, this would, very approximately contribute the same sort of addition. So, in total from housing income in kind and housing income in cash, older people might get between an extra 50 and 100 percent increase in their overall income.

While this indicates that housing wealth could significantly enhance other household income and thus increase their standard of living, there is an issue of fundamental importance in assessing the actual effects: would the income from a reverse mortgage be an *addition* or *complement* to existing sources of income, or a *substitute* for that part formerly derived from the state in the form of a pension?

As a *complement*, housing wealth offers the potential to older people to considerably boost their cash income and thereby enhance their living standards. Quite simply, by cashing in some of their assets they can consume more. As a *substitute*, however, governments may use the potential of housing wealth as a rationale for reducing the value of the state pension (or other state spending on older people). The consequences could include people being “forced” to use their housing wealth even if they would prefer to leave a bequest to their children, perhaps leading to some erosion of solidarity both across generations and across society. Furthermore, in this scenario, those who rent their homes might be doubly disadvantaged in having both a reduced state pension and no housing assets to draw upon.

But would housing wealth reduce the risk of poverty among older people? The first answer is that, by definition, housing wealth cannot help those people who do not have housing wealth – broadly, the 25% of older Europeans who rent their homes. In fact, in most member states, renters will tend to be poorer than owners and therefore most at risk of poverty anyway.

Even among those who do own their own homes those with least pension and savings income tend to own the cheapest homes and therefore benefit from the least income in kind and potential income in cash. Another way of putting this is that housing would make a large contribution to reducing the risk of poverty where people who had low incomes held a lot of housing wealth the so-called income-poor, asset –rich. Whereas such groups clearly exist in all member states, they are not generally the largest segment of those living in poverty.

Could housing provide a sustainable pension?

The pension system requires financial soundness both now and in future. In the case of home ownership, whereas in the past its investment potential may have made it an attractive option to many European citizens, and thus contributed to the growth of home ownership sectors, growth has also frequently been enhanced by state policies such as subsidies. Will the size of home ownership sectors be maintained? The future of such policies will in part be contingent on the desire of member state governments further to promote home ownership, which will be affected by their fiscal difficulties. These may be prompted by concerns about maintaining the growth and stability conditions on which inclusion in the euro zone is dependent; on the consequences of the present economic and financial crisis; and on the changing dependency ratios that are the basis of the pension crisis.

Policy Issues

So housing equity is a pension; that is a fact not a choice. The challenge for policy makers is to develop fair and sustainable policies in the fields of pensions, housing, fiscal policy and social policy that take the particular features of this asset into account.

1. There are pension-related reasons for encouraging people to become home owners:

    Encourages people to save during their working years
    Enabling them to live rent free when they retire, thus maintaining living standards

But perhaps even present levels of home ownership are only sustainable with large subsidies. Is this the best use of public funds?

2. If reverse mortgage products were more widely available this would allow more, older people to continue living in their present homes and boost their cash income. This would require:

    considerable adaptations to existing legal arrangements
    and possibly public subsidies (eg guarantees)

And even then, people seem reluctant to use their housing equity, particularly if the state pensions and social protection measures do not seem robust. Thus the use of housing equity appears conditional on, and not a general substitute for, state spending.

3. While the use of housing equity would boost the living standards of some older people, because those with the most housing income also tend to have most non-housing wealth and largest pensions anyway, its impact on reducing the incidence of poverty is limited. In any case, housing equity is irrelevant to the income needs of those older Europeans - frequently the very poorest - who rent their homes. Moreover, it is an asset that implies risk and limited interest of financial institutions to provide reverse mortgages, in particular for those living in shrinking areas and older people in less well maintained dwellings.

4. Housing equity can boost the income of older people but it may not be a fiscally cheap option.

Commencing in March 2008, DEMHOW (Demographic Change and Housing Wealth) is a 3-year research project undertaken by researchers in 10 member states with financial support from the Seventh Framework Programme of the European Union and participation of AGE Platform Europe.

For further information on DEMHOW, please visit: www.demhow.bham.ac.uk