

The great Australian dream

– “living longer and living well” through equity release



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By **Kevin Conlon**

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The Australian equity release (or reverse mortgage as they are interchangeably called) market has grown rapidly over recent years.

The popularity of the reverse mortgage reflects the flexibility of the product design and the clear preference of Australian's to select a product that does not require them to sell part of their home in order to release equity.

The “It’s on the House” SEQUAL-RFI Reverse Mortgage Study found a third of retirees (31 per cent) expected to rely on their home as a source of retirement funding. However, most thought they would be forced to sell their home and downsize to release equity and did not understand other financial options.

Although some reverse mortgage features such as not having to make regular repayments during the life of the loan and the protection offered by the no negative equity guarantee are somewhat unfamiliar, they are not generally considered to be complex transactions.

Yet according to the SEQUAL/RFI study, whilst 78 per cent of over-60s had heard of reverse mortgages as little as 40 per cent understood the basic premise of the product.

Senior Australian's who are looking to use a reverse mortgage must carefully assess both their current and future financial needs. With the growing importance of equity release as a retirement financial planning tool, financial advisers will play a critical role in ensuring that retirees are able to make fully informed decisions.

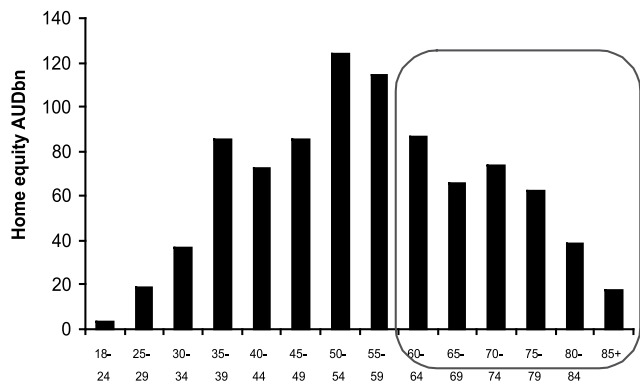
Baby Boomers were raised in households that remembered the deprivations of the Depression and operated cautiously within their means. In adult life, the Boomers constructed households that relied on both parents working in order to achieve higher levels of consumption and personal wealth. They have experienced strong economic conditions and are aligned with property ownership.

So how will the Boomers *live well* in retirement? To answer this we must first examine the effect of concentrating investment in property.

ASSET RICH BUT CASH POOR

The largest generation within the Australian population is rapidly approaching the end of their working life, poorly prepared for retirement. The good news is that the majority of Boomers have accumulated significant personal wealth through property ownership.

Figure 1.



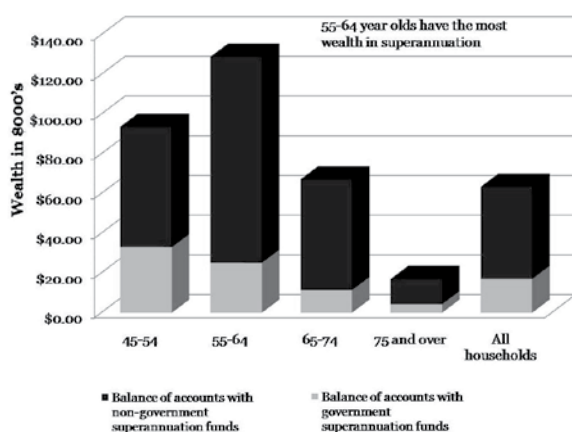
Source: Datamonitor

Total home equity (owner occupied) was \$887 billion, at the end of 2005.

The over 60s accounted for \$345 billion (39 per cent).

The bad news is that although there is emerging evidence that Australian's are now accelerating superannuation contributions towards the end of their working life, compulsory superannuation came too late for many of those now confronting the challenge of funding their retirement.

Figure 2.



Source: ABS

"The over 65s hold only half the value of accumulated superannuation as the over 55s".

The absence of significant levels of savings (superannuation) and a concentration of wealth in an indivisible and a somewhat illiquid asset (owner-occupied property) has made the Boomers asset rich but cash poor.

LIVING LONGER AND LIVING WELL

The Boomers can expect to live longer than any generation before them and they intend to live well.

More than 200,000 Australians will turn 60 every year until 2031. Projections show that by 2042 the proportion of the population aged 65 and over will double to be one in every four people.

Gender	Age	75	80	85	90	95
Female	55	89%	82%	71%	54%	35%
	60	89%	82%	70%	52%	32%
	65	90%	82%	69%	50%	30%
Male	55	82%	72%	58%	40%	24%
	60	82%	71%	56%	37%	21%
	65	84%	71%	54%	35%	19%

Source: ABS

Males aged 55 years have 58 per cent chance of living to 85 years. Females of the same age have a 54 per cent chance of living until 90 years.

Australians typically enjoy a healthy lifestyle and benefit from high standards of nutrition and medical care. Many older Australians will have the opportunity to abandon the slower pace associated with a traditional retirement and aspire to an active retirement.

Indeed, retirement is now measured in distinct phases:

- 50-65 Retirement preparation
- 60-65 Transition into retirement
- 65-75 Active retirement
- 75+ Passive retirement – aged care

CHALLENGING CONVENTION

Having realised early in life that they could influence their circumstances by confronting established conservatism, the Baby Boomers are once again challenging conventional thinking as they embrace seniors equity release in order to keep the family home "hard at work", whilst they enjoy an active retirement.

In the past, any retiree in the difficult position of being asset rich but cash poor had two choices:

- significantly reduce their living standards, or
- sell the family home – often having to then move away from an established network of family and friends.

With the emergence of the Australian equity release market, the retired and retiring Boomer generation have another option – tap into the stored wealth of their home.

According to a survey by the Australian Housing and Urban Research Institute ("AHURI"), 74.8 per cent of respondents considered that the family home was an investment that could be sold or borrowed against to fund requirements in old age.

The survey also found that the attachment of homeowners was more likely to be their neighbourhood than the home itself.

AHURI argued that "the symbolic dimension of the home as the foundation for personal identity is now somewhat blurred as the values of consumption and lifestyle begin to take precedence".¹

So are reverse mortgages the right product at the right time?

INHERITANCE EXPECTATIONS

In March 2001 Diana Beal, an Associate Professor at the University of Southern Queensland and Director of the Centre for Australian Financial Institutions published an article in the *Journal of Economic Analysis & Policy* titled “Financial Support for Adult Children in Australia”.

In that article Professor Beale found that only 5 per cent of people aged between 50 and 69 thought that ensuring they left an inheritance for their children was a major consideration.

She also found that for this age bracket:

- 33 per cent intend to use up their assets
- 50 per cent would use assets to support income

What about different attitudes for different ages:

- 35 per cent of 50 year olds expect to use their assets
- 33 per cent of 60 year olds expect to use their assets
- 18 per cent of 70 year olds expect to use their assets

REVERSE MORTGAGE CHARACTERISTICS

- A loan advanced as a lump sum or regular payment to a home-owning senior enabling them to access the equity in their own home.
- No repayments are made during the life of the loan.
- The borrower must consider interest rate and property value risk.
- The no negative equity guarantee limits exposure
- The security is provided in the form of a conventional mortgage charge

REVERSE MORTGAGES – DRAWDOWN OPTIONS

Reverse Mortgages provide for a number of drawdown options:

Lump sum

The borrower can draw down the full facility amount at settlement. The loan to valuation ratios for most reverse mortgage products are comparatively low (e.g. 29 per cent if the borrower is 74 years) and the average facility amount is currently \$60,000.

Instalment draw down

The borrower can choose to receive the proceeds of the reverse mortgage as a regular payment over time (e.g. monthly instalments over 10 years) or through a more flexible line of credit option whereby the borrower can draw down what they need, when they need it.

Combination option

The most popular form of reverse mortgage draw down is a combination of a modest lump sum and a reduced monthly instalment.

CLIENT EXAMPLE:

If the youngest borrower is 70 years, the maximum LVR = 25 per cent.

If the property value is \$500,000, the maximum loan = \$125,000

Client options

Lump sum = \$125,000

Income plan = \$1000 per month for 10 years

Combination = \$50,000 lump sum and \$625 per month for 10 years

TRANSACTION SIZE

Even a modest draw down under a reverse mortgage can provide the opportunity for senior Australians to significantly improve their standard of living in retirement.

The “It’s on the House” SEQUAL-RFI Reverse Mortgage Study referred to above, found that a modest increase to their income would significantly improve the lives of most retirees and with 50 per cent of those surveyed indicating that as little as \$300 a month would be sufficient.

The study showed that a third of retirees (31 per month) expected to rely on their home as a source of retirement funding and also revealed that baby boomers are not optimistic about their ability to fund their retirement, with a third fearing their funds would last only five to 10 years.

Note: The average loan size for a reverse mortgage is \$60,000 and the average client age is 74 years.

MISSION AND OBJECTIVES OF SEQUAL

Since its inception as the peak industry body for the Australian Equity Release market, SEQUAL has worked in the interest of the Australian community.

The SEQUAL Mission is to ensure the professionalism of those who offer or distribute equity release products for senior Australians. SEQUAL is dedicated to maintaining professional standards of practice within the Australian equity release market.

The primary objectives of SEQUAL are four-fold:

1. To provide an industry forum for the collaborative development of an ethical and successful equity release market in Australia.
2. To provide effective consumer protection through a code of conduct by which members of SEQUAL are expected to comply.
3. To represent the constituent parts of the Australian equity release market at the national level through a process of consultation with government, regulators and consumer agencies.
4. To provide a central resource of consumer information on equity release products and processes and to enable efficient access to SEQUAL members.

FUNDING RETIREMENT – EQUITY RELEASE STRATEGIES

The family home is now an intrinsic part of the planning process. There is good reason to explore the options, risks and rewards of equity release.

Over 33,700 senior Australians have a reverse mortgage:

- Total loan book size of \$2 billion.
- 34 per cent growth in 2007 compared to 2006.
- 2007 settlements – \$466 million.
- 50 per cent of sales were via the third-party channel (financial planners and brokers).

The strategies for reverse mortgages are diverse:

- For some retirees they are an effective means to supplement income or to provide access to capital.
- For others, they can be a tool to help manage market volatility.
- For frail retirees with poor health, it can provide them with choices for accessing the care they need and provides the ability to pay the aged care fees.

Equity release is not a last resort to access money when all other sources dry up.

When used effectively, reverse mortgages can help a client to access the significant wealth they have accumulated in an illiquid asset in order to more effectively live the life that they choose.

INDUSTRY ACCREDITATION

SEQUAL has established an industry accreditation protocol in order to raise professional standards above the minimum education requirements imposed by legislation and industry association membership.

To give effect to this protocol, SEQUAL has developed the educational standards required for market practitioners to achieve the designation of reverse mortgage consultant (RMC).

The RMC designation forms an important part of SEQUAL's commitment to assisting consumers to identify properly trained market practitioners.

SEQUAL works closely with industry sector associations to ensure that their members are properly trained to assist their clients to make informed decisions about equity release.

The Australian seniors equity release market represents a significant opportunity for properly trained financial planners to extend their reach beyond the working life of their clients and assist them to make fully informed decisions.

SEQUAL offers industry accreditation through its Equity Release Planner Program which is endorsed by the Financial Planning Association of Australia. The program is delivered through workshops, in-house programs and an online course and assists financial planners to better understand the various equity release strategies.

1. Which can be downloaded, in pdf format, at: http://www.sequal.com.au/images/stories/sequal_rfi_study.pdf
 2. Senate Community Affairs Committee, *A Decent Quality Of Life: Inquiry Into The Cost Of Living Pressures On Older Australians*, March 2008