Home equity release in retirement: The role of behavioural factors, aged care and bequests

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1. Introduction

In Australia, as in many countries, housing wealth is a key component of retiree household savings. This was underscored by the 2020 Retirement Income Review (Australian Treasury, 2020), which reported that for most households aged 65 and over, the family home is their largest asset. The review found that using superannuation assets more efficiently and accessing equity in the home can significantly boost retirement incomes without the need for additional superannuation contributions. Based on modelling and projections, the review concluded that using relatively small portions of home equity can substantially improve retirement incomes and that releasing home equity can boost retirement incomes with a modest impact on debt.

Australian retirees have several equity release options to access the wealth tied up in their homes without having to sell the property. The government's Home Equity Access Scheme (formerly Pension Loans Scheme) allows older Australians to supplement retirement income by accessing home equity, with repayment deferred until the home is sold. Similarly, reverse mortgages offered by different providers allow homeowners to borrow against their home equity, with the loan repaid upon selling the property, relocating, or at the borrower's death. Other options include home reversion schemes, where a portion of the home's equity is sold for either a lump sum or regular payments, and shared appreciation agreements, which provide payments in exchange for a share in the property's future sale value. While these options are increasingly recognised for their potential to improve financial flexibility in retirement, their overall uptake remains modest, suggesting a need for greater public awareness and understanding.

This paper aims to provide background information, summarise recent research in this area[1] and identify policy suggestions.

[1] There is a large and growing academic literature covering different aspects of home equity release, including optimal demand and supply side issues. In this short article we review selected papers relevant to Australian policy issues.

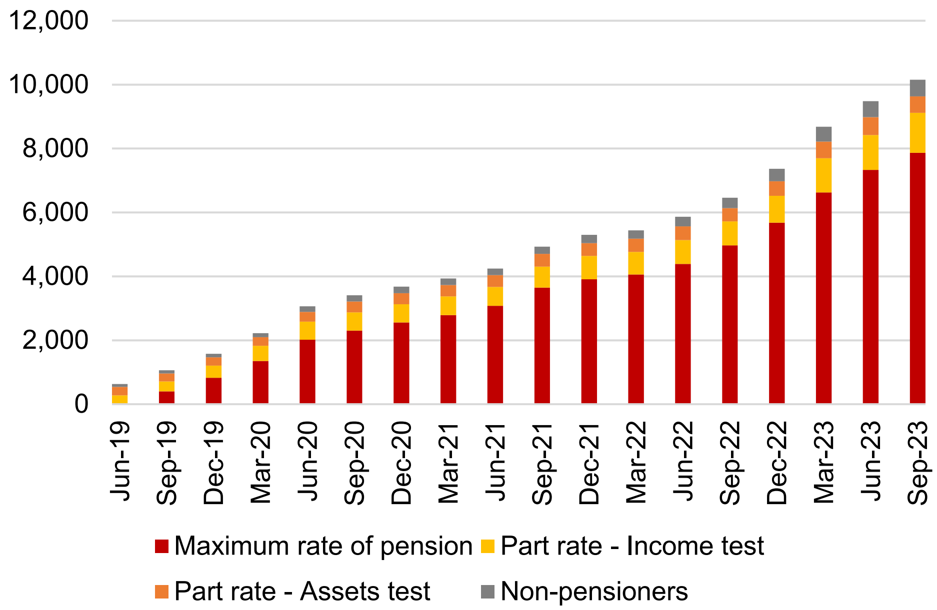
2. Background: Equity release options in Australia

This section provides more details on the Home Equity Access Scheme (HEAS) and reverse mortgages, the two most prevalent home equity release forms in Australia. We compare key features of both options in the following table.

Aspect	Home Equity Access Scheme	Commercial Reverse Mortgages
Eligibility	Australian residents who are of Age Pension age and own any real estate Australia-wide	Varies by lender; often from age 60; primary residences, holiday homes, or investment properties in capital cities or major metropolitan/regional centres
Administration	Government program administered by Services Australia and the Department of Veterans' Affairs.	Offered by banks and non-bank specialist lenders
Loan Amounts	Annual loan amount is capped at 1.5 times the maximum Age Pension rate (including any Age Pension payments), subject to a maximum loan balance determined by age and property value.	Higher loan amounts; amounts depend on property value, borrower's age and lender's policies
Payment Types	Regular fortnightly payments, lump sums, or both, within annual caps	Diverse options, including lump sums, regular income streams, and lines of credit
Repayment Terms	Repayment can be deferred until homeowner permanently moves from home (including upon death)	
Age Pension Implications	No impact on Age Pension if loan is taken as a regular income stream to spend on living expenses or non-assessable assets	
Tax Implications	Payments are not taxed	
Interest Rates	Fixed government-set rate; currently 3.95% p.a. (last changed on 1 January 2022)	Mostly variable interest rates; currently 8.4% - 9.63% p.a.
Consumer Protections	No negative equity guarantee	No negative equity guarantee; ASIC and responsible lending requirements

Recent changes to the HEAS aim to increase its attractiveness and accessibility. On 1 July 2019, the maximum amounts available under the scheme were increased from the maximum Age Pension rate to 1.5 times that rate. The eligibility criteria were also broadened to allow self-funded retirees of Age Pension age to access the scheme. On 1 January 2022, the scheme was renamed from "Pension Loans Scheme" (PLS) to "Home Equity Access Scheme" (HEAS) as part of an 'improved public messaging and branding' of the scheme. On 1 July 2022, the lump-sum payment options and a No Negative Equity Guarantee (NNEG) were introduced. In addition, there have been multiple reductions in the interest rate, from 5.25% to 4.5% on 1 January 2020 and further to 3.95% on 1 January 2022. Figure 1 shows that the number of HEAS participants has increased since 2019, primarily full-age pension recipients.

Figure 1: HEAS Participants (End of Month)



Source: Data provided by the Department of Social Services.

There is limited publicly available data on the size of the Australian reverse mortgage market, but the market appears to be growing from a small base of several tens of thousands of contracts. Active lenders include banks (Gateway Bank, G&C Mutual Bank, P&N Bank), non-bank lenders (Heartland Finance, Household Capital, ASAG), and a South Australian State Government organisation (HomeStart Finance). Heartland Finance appears to be the largest active provider of reverse mortgages in Australia, with a market share of 39.9% and has "helped more than 26,000 Australians" [with a reverse mortgage] since 2004 (Heartland, 2023, p. 78). Heartland reports strong growth in its reverse mortgage business in Australia in the financial year 2023, with receivables increasing by 20.7% to $1,54 bn (Heartland, 2023, p. 78). Household Capital reported a 50% year-on-year growth in their reverse mortgage portfolio in December 2023. Among Heartland's new customers, the primary uses for reverse mortgages were home improvements (55%), debt consolidation (51%), income (38%), vehicle upgrades (28%), travel (24%), and medical and healthcare (14%) (Heartland, 2023, p. 43). These statistics and other market information suggest that cost of living pressures and existing mortgage debt cause higher reverse mortgage demand, even with reverse mortgage rates as high as 7-9% in FY2023.

Overall, the take up of both the publicly-provided HEAS and private reverse mortgage products is very low compared to a population of over 3 million homeowners aged 65 and over.

3. The role of behavioural factors, aged care and bequests

In the following, we discuss the role of behavioural factors, aged care and bequests as factors affecting the take-up of equity release in Australia.

3.1 Behavioural factors

Several empirical studies have investigated the subdued demand for reverse mortgage products, including Ong et al. (2015) and Jefferson et al. (2017) for Australia, Davidoff et al. (2017) and Moulton et al. (2017) for the US, and Hanewald et al. (2020a) for China. Most of these studies investigated the role of economic and demographic factors such as bequest motives, non-housing wealth, age, marital status, number of children, and retirement status, as well as financial literacy, product complexity, and personality traits to explain this low demand. However, the role of behavioural factors has been little examined.

One of our ongoing projects, Bateman et al. (2024), investigates the impact of behavioural factors on demand for reverse mortgages among Australian retirees. We developed a model to assess the potential benefits of reverse mortgages for different retiree households and conducted an online experimental survey with homeowners aged 60-80 in Australia. The study participants were presented information treatments aimed at mitigating behavioural biases - specifically mental accounting, narrow bracketing, and product complexity. We also gathered data on demographics, household finances, personal preferences, financial capability, and psychological traits to explore the influence of economic and personal factors on reverse mortgage demand.

While previous research focused on socio-economic and personal characteristics, our findings indicated that behavioural barriers significantly influence reverse mortgage demand. Our findings suggest that clear, case-study-based product information significantly improves understanding of reverse mortgages, thereby addressing product complexity. Information treatments countering mental accounting and narrow bracketing were positively associated with demand, especially among participants with low income but high housing wealth. However, economic factors (experiencing financial stress), risk preferences (risk tolerance), and negative perceptions of the equity release product were also influential. The study underscores the importance of addressing behavioural barriers and negative perceptions in communication strategies to enhance the appeal of reverse mortgages.

Interestingly, the government-provided HEAS already has the potential to address behavioural barriers to reverse mortgage demand: By linking HEAS payments to Age Pension payments, the HEAS can help individuals see housing assets as part of their mental account to finance retirement. This design may also seem less complex to individuals than a separate reverse mortgage product. In a paper analysing the impact of HEAS participation on economic welfare (Sun et al., 2024), we find welfare gains for a broad selection of representative retiree households across the wealth distribution, particularly where the maximum annual HEAS payment is taken.

Aged care

Home equity release could provide additional funding for aged care. Research in this area is motivated by the fact that most individuals will need aged care at some point as they get older, and housing wealth is often the largest asset of retiree households (see Section 1).

Hanewald et al. (2020b) described several new mechanisms to fund aged care using housing wealth. The authors distinguished two components in the transaction: how housing wealth is unlocked and how it is used to finance aged care. To unlock housing wealth, individuals could sell the property (and downsize) and use the sale proceeds to cover aged care costs (including necessary home renovations) as they arise. However, there are many reasons why this may be unattractive. Selling typically involves moving away from a familiar neighbourhood and community and incurs sales taxes and moving costs. The strategy to sell to cover aged care costs is particularly challenging for couples or families with only one person needing care: the other family members still need a place to live, and they may prefer to remain in the family home. Home equity release products provide an interesting alternative as they allow individuals to access their housing wealth while still living in the home.

A simple way is to use the home as an "ATM" (or "equity bank") and withdraw cash as needed to cover aged care costs or necessary home renovations. One advantage of this strategy is that if the individual never incurs aged care costs, the value of the home is preserved and can be used for other purposes, including a bequest. A disadvantage of this strategy is that it does not provide insurance through risk pooling.

Alternatively, the additional liquid wealth obtained via home equity release can be used to purchase long-term care insurance (which exists in other markets but not in Australia). Home equity release could fund a single upfront or regular monthly or annual premium. The insurance benefits could reimburse aged care costs or provide additional income when aged care needs arise. Furthermore, home equity release can fund the deposit or bond required for an individual to enter a nursing home or retirement community. This arrangement is especially useful for couples or families living together when only one person needs care while other family members still require a home.

We have used survey methods to assess the impact of access to housing wealth on long-term care (LTC) insurance demand (Hanewald et al., 2024). We compared two new mechanisms to finance LTC insurance with housing wealth: reverse mortgage loans and home reversion (partial sale and leaseback). Using data from a randomised online survey of Chinese homeowners, we found that housing liquidity increased the stated demand for LTC insurance. On average, the survey participants spent 15% of their given total wealth to buy LTC insurance when they could use savings and a reverse mortgage, 12% when they could use savings and home reversion, and 5% when they could only use savings. Product demand was linked to economic factors, demographic variables, health, bequest motives, house price expectations, product understanding, and financial capability.

For Australia, it could be interesting to explore extensions of the Home Equity Access Scheme (HEAS) to cover aged care costs. This could include flexible withdrawal options and increased borrowing limits for aged care expenses. Moreover, providing information and advice on using HEAS for aged care funding, alongside developing partnerships between HEAS and aged care providers for direct fund usage, could help retirees. Further, integrating HEAS with existing aged care policies and funding mechanisms could ensure a more comprehensive approach to addressing the financial challenges of aged care in Australia.

3.2 Bequests

Bequest motives are often cited as an impediment to the uptake of reverse mortgages and home equity release. However, home equity release can allow families to 'bring forward' bequests and reduce the uncertainty around bequest timing. Robert Merton remarked, *"It* [a reverse mortgage] *can also be a far more efficient way of creating a bequest than holding onto a house and leaving it to heirs. After all, one does not have to be an expert to know that it is probably far from optimal bequest policy, from the point of view of the heirs' utility, to receive the value of the house as a legacy at some uncertain time in the future—perhaps next year, perhaps in 30 years*." (Merton, 2007).

Many Australian parents already assist their children in purchasing homes using financial wealth. Estimates vary, but some estimate the "Bank of Mum and Dad" as the ninth largest mortgage lender. A recent survey of mortgage brokers found that 15% of borrowers were using some form of family assistance to buy a home, with parents in New South Wales providing around AU$92,000 per adult child on average towards a deposit (Wootton, 2023).

Home equity release could provide additional funding to the "Bank of Mum and Dad" (or the Bank of Nan and Pop). Several reverse mortgage lenders provide information on how their products can be used to support family members, for example, to buy property or pay for education.[2] However, there

[2] For example, Heartland provides a "Gifting guide - Using a reverse mortgage for gifting", while Household Capital provides online information, see https://www.heartlandfinance.com.au/Uploads/Docs/Gifting_Guide.pdf and https://householdcapital.com.au/bank-mum-dad/. These guides explain that Centrelink imposes two gifting limits for Age

is limited public data available on the use of reverse mortgage payments in Australia. Heartland does *not* include gifting as one of the six primary uses among their new reverse mortgage customers in FY2023 (Heartland, 2023).

We have conducted model-based and survey-based research into the role of bequest motives for reverse mortgage demand. Our paper Wang et al. (2024) develops a new multi-period simulation model to analyse welfare gains for homeowning parents and their adult children seeking to purchase a property. Our new two-generation model accounts for house price risk, interest rate risk, uncertain long-term care costs and means-tested pensions. We apply the model to housing wealth decisions in Australia across households with different housing wealth and savings levels. The model results indicate that many families could enjoy welfare gains by using a reverse mortgage to both supplement parental retirement income and fund a child's home down payment at the start of retirement.

In a related study (Hanewald et al., 2020a), we conducted two large surveys to ascertain the potential demand for reverse mortgages in China. We developed a flexible product design addressing the shortcomings of an unsuccessful reverse mortgage product piloted in China and discovered strong interest among educated urban Chinese, both older homeowners and their adult children. Our research revealed discrepancies in expectations between these groups regarding property inheritance: some older homeowners rejected the reverse mortgage because they wanted to leave their property to children or grandchildren, while few of the adult children were expecting this. At the same time, some adult children thought their parents would not be interested, while approval rates were high in the older sample. These results suggest that equity release options should be advertised to both older homeowners and their adult children and that families should be encouraged to discuss the use of housing wealth in retirement.

Our two studies mentioned above provide new evidence to the previous research on the impact of bequest motives on reverse mortgages, which offers mixed insights: Some survey-based studies suggest that bequest motives reduce reverse mortgage demand (Davidoff et al., 2017; Hanewald et al., 2020a), while others find the opposite relationship (Choinière-Crèvecoeur & Michaud, 2023). Using survey data from the Netherlands, Dillingh et al. (2017) found that giving examples of using a reverse mortgage for the benefit of the homeowners' (grand)children significantly raises interest in reverse mortgages among people with a bequest wish and interpreted this result as evidence that people are unaware of the potential of reverse mortgages to optimise the timing of wealth transfers.

Pension recipients in Australia. Individuals or couples can gift up to $10,000 each financial year, with a total limit of $30,000 over a rolling period of five financial years. Gifts exceeding these limits are considered in the asset and deemed income tests for the Age Pension.

Overall, we conclude that this presents an opportunity for home equity release providers to increase awareness of the 'gifting function' of reverse mortgages, potentially addressing the low demand for these products.

4. Conclusion

We have conducted several studies which find potential welfare gains from the use of home equity to support retirement, finance aged care and/or assist younger family members to enter the housing market – see Sun et al. (2024) for the publicly offered HEAS, and Wang et al. (2024) and Bateman et al. (2024) for privately provided reverse mortgages – yet take-up of reverse mortgages (including the HEAS) remains low. The studies we highlight in this paper suggest that potential barriers to reverse mortgage take-up can be overcome.

- The behavioural barriers of complexity, mental accounting and narrow bracketing can be addressed via clear, case study-based product information and communication strategies to prompt retirees to include housing in the 'mental account' for retirement provision and to consider all possible expenditures throughout retirement. (See Bateman et al., 2024 and Sun et al., 2024.)
- The practice of holding on to housing assets as a precaution for possible residential aged care expenses can be addressed by specifically including aged care financing in reverse mortgage product design. This has the advantage of enabling seniors to 'age in place' while drawing on housing assets to supplement public support, as well as to retain ownership of the house when one member of a couple moves to residential care. (See Hanewald et al. 2020b and Hanewald et al., 2024.)
- A reverse mortgage can enhance the effectiveness of intergenerational wealth transfers by enabling families to control the timing of bequests to coincide with the financial needs of the younger generation. (See Wang et al., 2024.)

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