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# the prospects and potential of home equity conversion/equity release in New Zealand

## executive summary





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# the New Zealand environment

At the time of the 1996 Census, 12% of New Zealanders were aged 65 or over. This proportion is forecast to increase dramatically when the “baby boom” generation reaches retirement age, with the prospect of superannuitant numbers and the cost of income maintenance doubling in the next 30 years. In the foreseeable future, women and Pakeha people will be over-represented among the older population and a large proportion will live alone or only with a spouse.

## Homes – a considerable asset

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Home ownership is New Zealand’s most common form of significant wealth-holding. By retirement, most people live in homes that they own outright. In 1996, 261,000 New Zealanders aged 65 or over lived in mortgage-free homes. Between 1991 and 1996, home ownership rates dropped slightly for pre-retirement age people, but they still represent a large group likely to enter retirement mortgage free.

## Financial concerns a priority

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Incomes for retired people are, on average, lower than for younger age groups – nearly 75% of retired people had incomes of \$20,000 or less in 1996. This means many retired people fit the description of “housing rich, income poor” and many are worried about how adequate their incomes are. Major house repairs and replacing appliances are likely to require them to use savings or obtain funds through other capital assets.

A changing economic environment has led New Zealand governments to reconsider their stance on retirement income policy. They have questioned the sustainability of current schemes and tended to favour encouraging people to provide for their own retirement. This suggests we should explore the role of housing as a vehicle for retirement savings.

### Using housing wealth

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Housing wealth (in the form of home equity) can be preserved to provide for inheritance, saved “for a rainy day”, or used in various ways, such as trading down to a smaller and/or less expensive home. Home Equity Conversion/Equity Release (HEC/ER) allows owners to stay in their homes while releasing some of their housing wealth. The wide variety of HEC/ER schemes includes “maturity loans” and “home reversions”:

- Maturity loans are also known as reverse mortgages. People borrow money against the equity in their home, and the loan is repaid when the house is sold or they stop living there. Any money they borrow incurs interest, which is added to the balance they owe.
- With a home reversion the house is sold, but the residents keeps their right to live there for life.

Personal and family circumstances and attitudes influence which, if any, of these options are used.

# New Zealanders and HEC/ER

## HEC/ER schemes in New Zealand

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The Housing Corporation of New Zealand began a one-year pilot HEC scheme – *Helping Hand Loans* – in November 1990. This was intended to test the concept in New Zealand, to help develop appropriate procedures, and to help the private sector to participate in such schemes. It was preceded by research by Age Concern, which indicated interest in the concept but concern about consumer protection. A complementary report by McKinlay Douglas Ltd also stressed the need for consumer information and counselling and some government involvement.

*Helping Hand Loans* provided either lump sums or regular advances to older people, secured by the equity in their homes. Loans could be used only for housing-related costs, mainly house alterations and maintenance. Repayments were not required until the property was sold or the borrower stopped living there permanently. Interest and charges were added to the loan balance.

The scheme was favoured most by single or widowed elderly people on very low incomes, who received subsidised interest rates. Take-up of the pilot scheme was low, but an evaluation report concluded it had been successful by international standards and favoured implementing it

nationwide. However, changes in housing policy in 1991 meant it was never extended.

Reverse annuity mortgages (RAMs) have been marketed through the Invincible Life Assurance Company in Wellington since 1991. The company has a portfolio of interests and manages demand in relation to available funds and likely repayments. It offers several RAM products with different eligibility ages and conditions.

RAMs use a first mortgage over the property to secure an annuity. All costs can be deferred until the mortgage is repaid and the interest compounds over time. In common with the *Helping Hand Loans* scheme, the take-up of Invincible Life's products has been low.

Other HEC/ER private sector initiatives include the New Plymouth TSB's *Retired Beneficiaries Loan Facility* and *Sell and Stay* (also in Taranaki). Others in the insurance, building society and mortgage broking sectors have also expressed interest. Several recent government-sponsored reports on ageing and retirement income mention HEC/ER favourably and note a growing public interest.

Research in the early 1990s into New Zealand HEC/ER schemes showed that:

- in age structure, marital status and current living arrangements, consumers were very similar to the total population aged 60 and over
- their marital status was fairly evenly balanced between married and single (widowed, separated, divorced or never married)
- most had children and kept close contact with them
- they owned houses slightly above average values
- a high percentage came from upper socio-economic levels.

Despite this, incomes were comparatively low before consumers entered the schemes. They mainly used funds for everyday living expenses, and most expected to have some assets to bequeath. These findings do not clearly support the idea that people in HEC/ER schemes are less wedded to providing an inheritance than older people generally. However, the results tend to incline in that direction.



# what's inhibiting HEC/ER in New Zealand?

The market for HEC/ER schemes, in New Zealand and similar countries, is potentially huge owing to:

- the ageing population
- the fact that many older people are “housing rich, income poor”
- government policies that aim to reduce state support and encourage self-reliance.

Despite this, HEC/ER schemes are poorly developed in New Zealand and have not gained widespread acceptance in North America, Britain and Australia. This appears to be because the industry is waiting for signs of public acceptance, while potential customers need reassuring about the schemes' value and security.

The image of HEC/ER has been tarnished by some schemes failing and gaining unfavourable publicity, so marketing HEC/ER products demands a considerable investment in time and effort. Potential clients require a great deal of explanation and reassurance (implying a “welfare” aspect that may not be compatible with profit-driven enterprise). A broader and more balanced public debate may also help dispel many of the negatives and improve the confidence of potential providers.

## A long-term commitment for providers

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HEC/ER schemes require providers to commit capital for long periods before realising a return. This may present serious liquidity problems, especially if interest is part of the outstanding loan balance. HEC/ER organisations therefore need diversified portfolios and/or an income stream from other sources.

The capital payback from HEC/ER schemes depends on the clients' longevity, which may be hard to estimate. Re-insurance for providers can reduce the longevity risk and so far has been a feature of New Zealand schemes. However, the costs will be reflected in charges to borrowers.

Most HEC/ER schemes depend on steady property price growth and providers must make some assumptions on likely trends. If growth does not at least match the interest rate on the outstanding principal, the loan balance will exceed the property value earlier than anticipated. HEC/ER scheme designers also have to make assumptions about interest rate trends over a considerable period.

Central government policy also affects providers. Continuing uncertainty around New Zealand's retirement income policy does not provide a sure and stable "playing-field" for providers. In addition, policies on regulating financial institutions, and economic policy in general, influence the HEC/ER environment.

Some factors operate on both sides of the HEC/ER supply/demand equation. Providers' wariness is matched by suspicion in prospective clients. Older people rate security as all-important when venturing perhaps their only asset and lifetime savings. They fear lender default, losing the home or incurring debt in excess of its value. They strongly support consumer safeguards.

Consumers are also affected by the longevity risk. Annuities may be a poor return for a large slice of home equity if people do not live long to receive them. Buyers of fixed income plans can find their payments eroded by inflation.

Increased awareness of the options and a clearer understanding of how HEC/ER works should help put these apprehensions in perspective and increase take-up.

Another consumer barrier is the reluctance to take on debt after spending many years paying off a mortgage. Older people in New Zealand, Australia and similar countries come from a financially conservative and risk-averse generation, unused to "living on credit". On-coming generations, which have had easy access to credit and use it as part of everyday money management, may be more open to borrowing against their home equity.

Expectations of government support for retired people have been fostered by decades of welfare state provision. Thus many older people see it as their right as citizens to receive income and services from government, given their own contributions over a working lifetime. They are reluctant to borrow on their own housing assets.

Consumers have ambivalent attitudes towards government. On one hand they distrust politicians and suspect government will use HEC/ER to reduce its responsibility for providing services and support. On the other hand, government regulation of private sector HEC/ER schemes is seen as necessary and part of consumer protection. A range of government policies provide consumers with incentives and disincentives for HEC/ER. These include retirement income, medical services, housing and care in old age, taxation and macro-economic policies affecting interest rates.

Many older people believe they need to preserve their assets for some future emergency, despite it being illogical to amass savings and never take advantage of them. This attitude is linked with the idea that HEC/ER should be used only as a “last resort” and with views on inheritance.

Given these factors, it is important for HEC/ER providers to consider their customers’ individual needs and tailor packages to suit.

## The inheritance factor

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Attitudes about inheritance are central to the debate on whether housing wealth can or should be used to supplement income in old age. If older people set great store by bequeathing and younger people have strong expectations of inheriting, HEC/ER schemes will not be attractive (as they result in fewer assets to bequeath). However, if bequeathing is not considered important (where the next generation is well established financially), older people may consider using their housing wealth to improve their current lifestyles. Younger people might be willing to accept a trade-off between inheriting and having to support elderly parents or relatives, either financially or by providing physical and social care.

On balance, New Zealand and British research suggests that the wish to bequeath may be exaggerated as a barrier to HEC/ER. It would be a good idea to promote open discussion about inheritance and equity release at the family level and in terms of their broader implications (such as the efficient use of the housing stock and the effects on the housing market, income distribution and intergenerational equity).



# issues and conclusions

HEC/ER has considerable potential in New Zealand given the country's current and likely future social, economic and policy environment. However, despite the large group of potential clients, take-up everywhere has been low.

This is largely because of the numerous barriers and disincentives applying for both demand and supply. We need to address these obstacles if HEC/ER is to be a viable and safe option for older people.

Attitudinal factors include stoicism and risk-aversion, which are hard to change. However, they may be influenced by discussing the issue more openly and explaining new ideas and options. The next generation of older people may have different attitudes, such as lower expectations of state welfare support.

Understanding of HEC/ER as a concept, and positive attitudes towards it at the wider social level, may change take-up rates in the future, especially if action is taken to allay consumer fears and design schemes that meet consumer requirements.

Developing HEC/ER as a way of improving older home owners' financial positions depends not only on attitudes and demand factors, but on finding ways to put it into practice. The roles of potential scheme providers – commercial firms, not-for-profit agencies, central and local government – need to be explored. Until now HEC/ER schemes in New Zealand have been extremely restricted in their types and how they are

provided. A wider range of providers and schemes is desirable to provide choice and healthy competition.

Further work is needed on designing HEC/ER schemes for New Zealand's specific legal, social, economic and political environment, acknowledging the small size of the local marketplace. A well designed and successful HEC/ER scheme will:

- be flexible enough to meet a range of individual needs
- be easy to understand
- include a high level of consumer protection.

This will require collaboration between the public, private and voluntary sectors.

Finally, a detailed examination of incentives and disincentives for HEC/ER that are inherent in government policy would throw light on the prospects for the concept in New Zealand.



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