

Home Equity Release

MAIN MESSAGES

Home equity represents a key source of wealth for many New Zealanders over the age of 65 and using home equity release products to supplement retirement income may be beneficial for some. However, due to the complexity of these products and the costs involved, it is important that people have a good understanding of the costs and benefits and seek financial advice to understand if the product is right for them.

Equity release products can be beneficial for people who have low retirement income and limited options to access liquid wealth but hold substantial equity in their owner-occupied houses. This research has identified that approximately 25% of older households in New Zealand fall into this category. In general people in this “asset rich income poor” position are more likely to be older (75+), non-Māori, and no longer in paid employment. On average these households have home equity of just over \$600,000, which can potentially be released to supplement retirement income.

The two main products available in New Zealand are reverse mortgages and home reversion. These products have relatively high costs and it is important that people understand how the products can affect their financial position in the future. The loan balance on a reverse mortgage can grow to a relatively large amount within a short period of time due to the compounding effect of interest and lack of repayments. Therefore, reverse mortgages generally work best as a supplement to retirement income if regular small amounts are drawn down rather than larger lump sum withdrawals. Reverse mortgages are more suited to people who do not need to preserve the equity in their home for future uses, including bequests.

Home reversion provides an alternative to those who do not want to use debt and prefer to sell a stake in their house to receive an income flow. It provides people with certainty about the equity stake they will retain in their house providing options for meeting future costs or leaving bequests. However, it is important that people understand the cost implications, including that they will be selling a share in their house at a discounted amount to the provider.

In New Zealand the products appear to be costlier than in larger markets, however in situations where income falls short of consumption needs, home equity release products provide an alternative source of income that is less costly than other forms of consumption-based lending such as personal loans or credit cards. In the absence of suitable options to downsize, or for people whose preference is to remain in their home for the remainder of their life, home equity release products provide a means to supplement retirement income. The benefit of being able to meet current consumption needs may well offset the costs of reduced home equity in the future for specific households, providing value for money despite the financial costs involved.

BACKGROUND

Housing equity is a large part of household wealth in New Zealand and is an important asset that could potentially be used to fund retirement. However not many people make use of home equity release products in New Zealand. The low take-up of equity release products such as reverse mortgages is not unique to New Zealand. Common explanations for the low demand include high fees, limited understanding by consumers, perceptions of poor value, uncertainty about future health and expenses, and bequest motives. Lack of competition may also lead to higher costs for consumers.

In the 2022 Review of Retirement Income Policies¹ the Retirement Commission recommended that research should be undertaken to consider whether home equity release schemes provide value for money and how they might provide a suitable form of retirement income for some people. The purpose of this research project, undertaken by Motu Economic and Public Policy Research, was to respond to this recommendation.

1. 2022 Review of Retirement Income Policies | Retirement Commission Te Ara Ahunga Ora



KEY POINTS

- Home equity represents a key source of wealth for over 65s² in New Zealand
 - 65% of over 65 households own their own home outright
 - For over 65s a third of household assets are in owner-occupied homes compared to a quarter in financial assets
- The average amount of home equity for over 65s is \$370,000
 - 25% of over 65 households have at least \$600,000 in home equity
 - 10% of over 65 households have at least \$895,000 in home equity
- The target market for home equity release are households that are “asset rich and income poor”³
 - Approximately 25% of over 65s are classified in this research as “asset rich and income poor”⁴
 - More likely to be older (75+), non-Māori, and no longer in paid employment
- Reverse mortgages are more suited to people who do not need to preserve the equity in their home for future uses, including bequests. The no negative equity guarantee ensures that the homeowner, or their estate, will not be required to meet any shortfall that the lender incurs if the loan value exceeds the eventual sale price of the house
 - The key cost of a reverse mortgage is the interest cost which is higher than the cost of a normal mortgage loan due to the added risks of this product and a less competitive market in New Zealand.
 - Reverse mortgages are less costly in low interest rate environments. When house price growth is high it can partially offset the impact of interest rates on the erosion of equity.
 - Due to the impact of compounding, reverse mortgages allow home equity to be retained for longer when used for smaller drawdowns to supplement income rather than large lump sum withdrawals (see Figure 1 and 2 for comparison)
 - However, in New Zealand, the main reasons people access reverse mortgages are for home improvements and debt consolidation, rather than to supplement income so it appears that lump sum drawdowns are more common than smaller regular drawdowns⁵
 - If people are drawing down larger sums, to keep costs down they should only borrow what they need, not what they can, and avoid borrowing in advance in anticipation of future expenditures
 - The ability to access these products from age 60 can result in a long timeframe over which the interest compounds. To limit the erosion of equity, accessing these products later in life would limit this impact of compounding
- Home reversion avoids the compounding of interest and provides certainty to the homeowner that they will retain a specific percentage of equity in their home, so it might be more suitable in a high interest rate environment or for people who have a specific bequest motive
 - However, the cost involved is that homeowners will be selling 35% of their house at a discount as they only receive income equivalent to 25% of the initial valuation (taking into account annual fees reduces this to 22.7%)
 - The purchasing power of the income received decreases over time due to inflation since the income received per year is fixed
- Both products can be used to supplement retirement income either using a regular drawdown for a reverse mortgage or the regular income flow from the home reversion scheme
 - Providers of both products generally limit the period of regular drawdown or income flows to a 10 year period, at which stage, as illustrated in Figures 2 and 3, both products provide the homeowner with access to a reasonably large amount of the equity in the home⁶
 - However, if the product is retained for an additional 5 years (or longer), the impact of interest compounding results in an erosion of the equity in the reverse mortgage, which is not seen in the home reversion product
 - Homeowners need to be aware that there will be upfront costs for both these products. In addition, there are ongoing expenses that they must continue to pay to avoid default, such as insurance payments, rates, and other maintenance costs
- These products are generally not suitable for those living in multigenerational households as the home must be sold when the owner or their surviving nominated partner passes away or moves out

2. For this Policy Brief we define over 65 households as those where at least one member has reached age 65

3. For this research this is defined as retiree households whose income is below the median income and home equity is above the median home equity.

4. The average home equity of this group is \$611,582, while the average income is \$38,710.

5. Results & reports | Heartland Group

6. Assuming 3% house price growth on a \$610,000 home, with similar monthly drawdowns for 10 years.



ILLUSTRATIVE EXAMPLES

The below figures provide insights into using home equity release products under three different scenarios: a lump sum withdrawal using a reverse mortgage, a regular monthly withdrawal using a reverse mortgage, and a home reversion scheme.

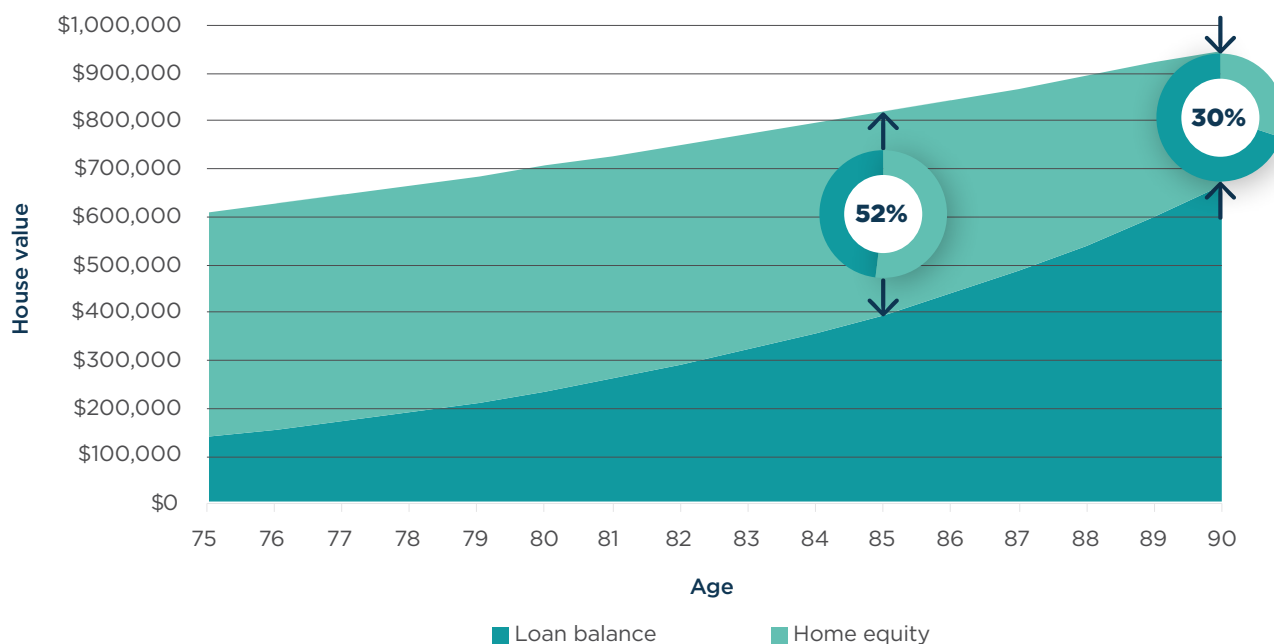
The examples are based on a person with access to home equity of \$610,000 aged 75.⁷ This restricts the amount of regular net income to \$1,154 per month for a home reversion scheme, so a similar amount is modelled as a regular drawdown from a reverse mortgage scheme.⁸ The drawdown period is limited to 10 years (in keeping with the current product restrictions). It is assumed that the house is held for an additional 5 years given longevity expectations for a 75-year-old. The lump sum scenario models the impact of taking the equivalent value of drawdown at initiation (\$138,470). A conservative assumption is used for house price growth (3% per annum).⁹ An interest rate of 10.5% reflects the current rate offered by the largest provider of reverse mortgages.¹⁰ It should be noted that there are other initiation costs and fees that are not taken into account in these examples.

As illustrated in Figure 1 compared to Figure 2, due to the impact of compounding, reverse mortgages allow home equity to be retained for longer when used for smaller drawdowns to supplement income rather than large lump sum withdrawals.

Both reverse mortgages and home reversion can be used to supplement retirement income with monthly cashflows. After the initial 10-year drawdown period, as illustrated in Figures 2 and 3, both products provide the homeowner with access to a reasonably large amount of the equity in the home. However, if the product is retained for an additional 5 years (or longer), the impact of interest compounding results in an erosion of the equity in the reverse mortgage, which is not seen in the home reversion product. The house price growth rate and interest rate assumptions impact on the outcome of the reverse mortgage in terms of how quickly equity is eroded.¹¹

Figure 1: Reverse mortgage: lump sum withdrawal

Source: Motu Reverse Mortgage Calculator



- This is the average amount of home equity available to the “asset rich, income poor” target group identified in the research, and using age 75 as this research identified the target group was likely to be 75+. The annual income is 2.5% of the house value less the 0.23% annual fee.
- It should be noted that a 75 year old with \$610,000 equity could draw down up to 35% of the home equity in terms of the criteria used by Heartland Bank (i.e. \$213,500), which could translate to a monthly draw down of \$1,780 per month for 10 years. Note these examples assume that a person does not use the Equity Protection Option for the reverse mortgage.
- The historic house price growth has been in the region of 6% per annum over the past 20 years.
- Heartland Bank current reverse mortgage rate as at 30 August 2024 is 10.5%.
- The equity remaining in a zero house price growth environment for the reverse mortgage option falls to 60% after 10 years and 33% after 15 years. However in a high growth rate environment of 6% almost 80% of home equity is still available to the homeowner after 10 years, and 70% after 15 years. If interest rates are 200 basis points higher in a zero house price growth environment 55% of the equity remains after 10 years, dropping to 17% after 15 years.

Figure 2 Reverse Mortgage: Regular monthly drawdown

Source: Motu Reverse Mortgage Calculator

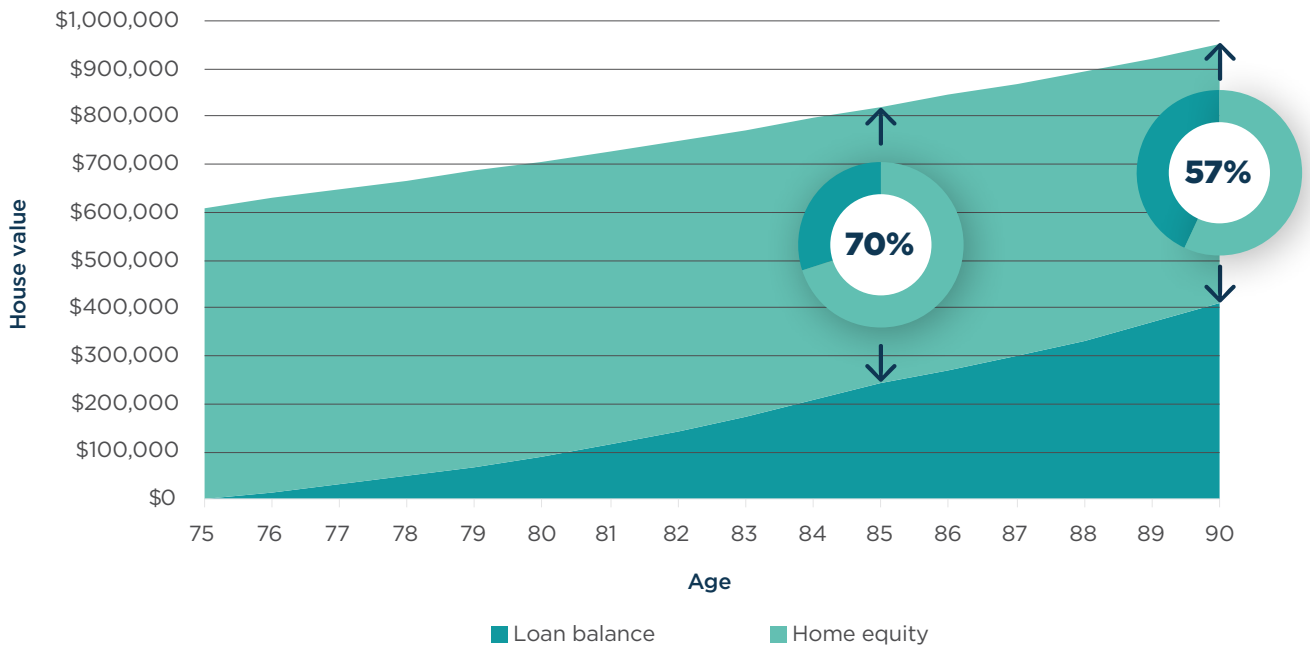
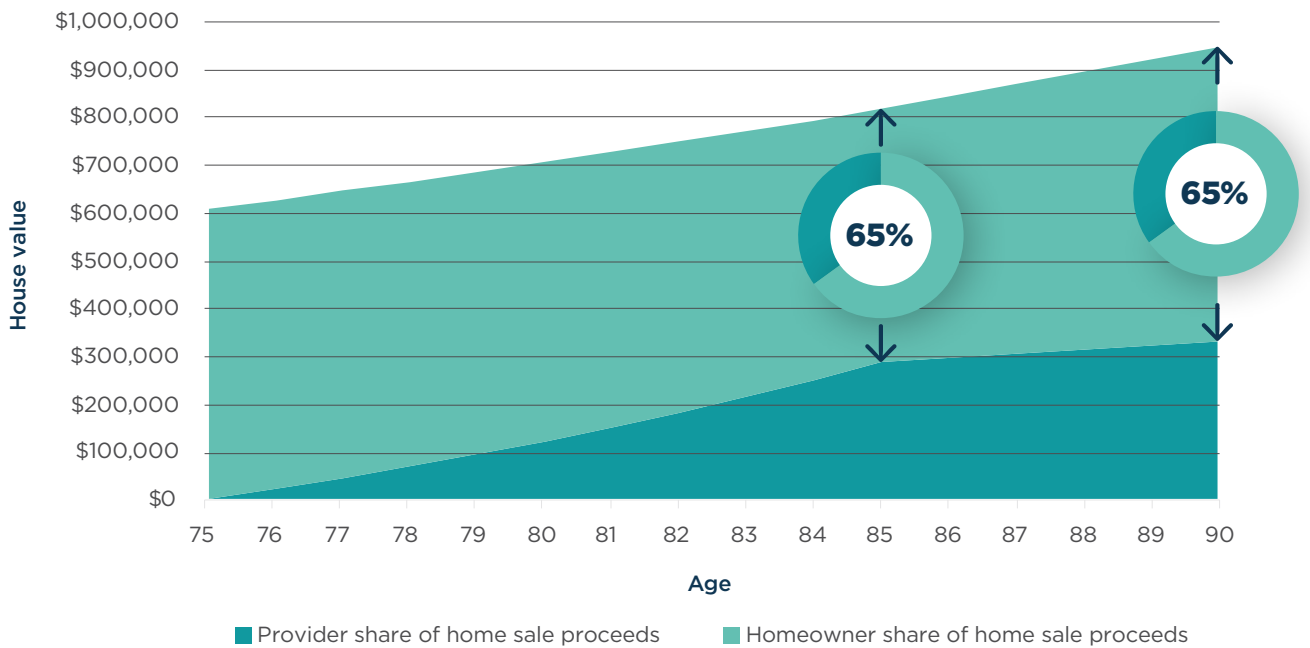


Figure 3: Home reversion

Source: Motu Home Reversion Calculator



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