AVERTING POVERTY AND GOVERNMENT BUDGETARY PRESSURE THROUGH RELEASING HOME EQUITY: A SAFE AND INFORMED SOLUTION FOR BABY BOOMER HOMEOWNERS

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ABSTRACT

Homeowner baby boomers have relatively high levels of wealth in their homes and relatively low levels of superannuation. At the same time, non-homeowner baby boomers, especially lone retirees, appear to be in increasing need of income support such as that provided by the Age Pension. Both of these groups will need income support mechanisms during their retirement. In this context, policy momentum has been building in Australia for the inclusion of home equity in the retirement income mix. To address that need, this paper outlines a generation-targeted solution for supplementing baby boomer retiree income through efficiently drawing on housing equity. The proposed new product -Home Equity Accounts - differs from existing related products by being government-backed, securitised and incorporating financial planning.

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Introduction

In a time of increased awareness of the need to self-fund as much retirement consumption as possible, the incidence of poverty among older Australians continues to increase in the context of Australia's three pillar income system of the Age Pension, superannuation and other savings. Many older Australians will face significant income shortages in retirement, particularly retired renters (ACOSS 2014). However, even if a retiree owns their home outright, the financial considerations of remaining at home in later retirement are also becoming complex with income pressure from longer life expectancies and greater individual responsibility for financing health and aged care. Consequently, this paper details the financial wellbeing of older homeowners and renters and illustrates the current and potential role of housing equity in Australian retirement portfolio composition. This study contributes to a case for novel financial product development for Australian retiree income supplementation that is suited to Australian retirees with substantial housing wealth.

The objectives of the paper are threefold. First, to illustrate that Australia needs a generationtargeted solution, in addition to the Age Pension and superannuation, to supplement retiree incomes for baby boomers, and that drawing on home equity is a necessary component of that solution. Second, this paper aims to review existing products in the home equity release market and highlight the opportunities for further product innovation. Third, this paper will provide a framework for a new solution in this practitioner and policy space that would potentially deliver social and economic benefits. In answering the first objective, this paper explores current retirement income sources particularly the unsustainable demand on the Age Pension and the lack of superannuation for emerging retirees. Also in relation to the first objective, we explore the theory and context of homeownership in Australia for baby boomer retirees (conventionally those born 1946–1965) along with Generation X (born 1966–1976) and Generation Y (or Millennials) (born 1977–1986), including recent policy directions regarding retirement income. We detail the scope and market penetration of existing home equity release products as a means of addressing the second objective, particularly by highlighting a potential gap in the home equity withdrawal market. The solution we propose in meeting the third objective draws on evidence of retiree preferences in home equity withdrawal products, retiree wealth portfolios, recent market developments, and analysis of equity withdrawal scenarios.

In building a case for new housing equity withdrawal products, we consider the high levels of homeownership prevailing among older Australians and the extent to which Australian retirees are decumulating their housing equity, including the current mechanisms for doing so. We suggest that new retiree income product offerings linked to home equity could leverage from existing and emerging products that better fit retiree needs and risk profiles, and that through integration with better financial planning, can help drive generational reform in home equity decumulation. We consider suitable parameters for potential products and pathways to home equity decumulation in retirement for baby boomers, including a policy sunset clause to emphasise the generationtargeted nature of the proposed retiree income solution. To do so, we use data from the Household, Income, and Labour Dynamics in Australia (HILDA) survey to examine the income and asset holdings of older Australians and the levels of financial stress among retirees. The important distinguishing feature of the HILDA survey is that it has interviewed substantially the same households (9,835) and individuals (25,391) every year since 2001¹, thereby allowing researchers to see how their social, economic, and financial circumstances have changed over time (Wilkins 2015). The HILDA survey is population weighted to be representative of the Australian population and includes detailed data on some three thousand retirees (aged 65 years and over). The variables we analyse include family and lifecycle dynamics, age, homeownership, household debt, wealth, savings behaviour, consumption, and economic and subjective wellbeing in retirement. The analysis in this paper examines the extent and sources of current financial strain for retirees and potential solutions based on the composition of their wealth and the age pension policy challenges.

In relation to existing retiree home equity release products, we discuss the very limited market penetration outlined in this paper in terms of the product features preferred by retirees for home equity withdrawal. This helps illustrate the lack of products meeting retiree expectations. We propose a safer supported mechanism, namely, Home Equity Accounts (HEAs), which enables retirees to relieve financial stress and meet their health and aged care needs by efficiently and safely decumulating housing equity for increased cash flow. Importantly, the proposed solution has financial planning embedded as a core component of implementing the HEA product. We conjecture that HEAs could support healthy ageing and assist baby boomers to live well, while simultaneously reducing the pressure on public pensions. Thus, we set a challenge to engage more Australians in the emerging conversation regarding age pension asset tests, and to question and reset the biases that many Australians hold about housing and retirement income.

1 Note: In 2011, there was a 'top-up' sample of 2,153 households and 5,451 persons to counter sample attrition.

The remainder of the paper is structured as follows. Section 2 outlines the breadth, depth and value of homeownership in Australia across several generations, and the context of retiree income in Australia. In Section 3 we explore the existing theoretical basis for retiree home equity withdrawal, including potential weaknesses in retiree home equity withdrawal theory. Section 4 outlines the currently available Australian retiree home equity withdrawal products, underscoring the nascent state of home equity withdrawal in Australian retirement, culminating in a proposed solution for retiree home equity withdrawal in Australia, that is, HEAs. Finally, Section 5 models several retiree home equity withdrawal/income supplementation scenarios and elaborates on the critical role of financial planning in operationalising HEAs, followed by suggested areas of further research.

Building the case for home equity withdrawal products

Context of homeownership, retiree wealth and retirement income in Australia

Numerous publications have detailed the ageing of Australia's population (ABS 2012a; Johnson et al. 2015; Ong et al. 2013). However, unlike this existing literature, we aim to link data on the ageing population and their income in retirement, with homeownership status, and the superannuation and housing wealth components of Australian retirees.

In terms of existing retirees, Australia currently has over three million people aged over 65 years (ABS 2012a) with 50 per cent receiving the full age pension and 30 per cent receiving a part pension, collectively accounting for the 80 per cent of all retirees receiving at least some age pension (Rothman 2012). In terms of the wealth of Australians overall, Table 1 shows that in 2015 housing equity remains the primary source of wealth at \$5.9 trillion (ABS 2015b), compared to just \$2 trillion in superannuation (APRA 2015).

However, these aggregates mask differences in the form of the wealth by generation. When we calculate the estimates and projections for the different generations at or approaching retirement, the significance of housing wealth for baby boomers becomes more apparent. Baby boomers hold most of their wealth in home equity and the release of home equity for income represents huge potential in helping baby boomers cross the retirement income chasm. Hence, further analysis of differences in generational asset holdings warrants analysis that is more detailed and is the subject of the following section.

There are no universal definitions of generations. However, the ABS has defined the 'baby boomer' generation as those born between 1946 and 1965, while 'Generation X' and 'Generation Y' are those born between 1966 and 1976, and 1977 and 1986, respectively. In 2006, the size of the baby boomer cohort in Australia was 5.47 million while Gen X and Y combined were another 5.49 million (ABS 2006). With the bulk of the baby boomers turning 65 between 2011 and 2029, we now examine the major asset holdings of home equity and superannuation for baby boomers compared with Gen X and Y over the same period.

Starting first with homeownership and home equity, the baby boomer generation has generally high levels of homeownership. Baby boomers in 2011 had an overall homeownership rate of approximately 78 per cent (ABS 2012b, 2013e) and as shown in Table 1, have approximate total home equity valued at \$1.39 trillion compared to only \$540 billion for existing retirees (those aged over 65 years) in 2011. Further, it is notable that the housing equity of existing retirees has continued to grow markedly with retiree home equity growing to over \$830 billion in 2014, a growth rate well above the approximate 10 per cent increase in the number of retirees, underlining the scale of growth in home equity. Looking ahead to 2031, when all baby boomers will be aged more than 65 years, the projected value of home equity is expected to be \$2.48 trillion for baby boomers alone (see Table 1).

In contrast, if we consider superannuation wealth for the various age cohorts in Australia, in 2013– 14, the median baby boomer superannuation balance was approximately \$59,000 (including zero balances), (\$93,000 for males and \$36,000 for females). In comparison, the mean balance (also including zero balances) was approximately \$164,000 (\$215,000 for males and \$114,000 for females) (Clare 2015), clearly demonstrating the positive skewness (a long thin tail extending to the right) of the distribution of superannuation account balances. In comparison, Gen X had a median superannuation balance of approximately \$35,000 (including zero balances) (\$47,500 for males and \$26,000 for females). The mean balances for Gen X, including all zero balances, was approximately \$59,000 (\$74,000 for males and \$45,000 for females) (Clare 2015).

Overall, the data in Table 1 shows that over the longer term, the value of home equity will remain more than superannuation holdings as a whole, but is more skewed for baby boomer home equity holdings than for their superannuation. In contrast, by 2033, both Gen X and Gen Y will hold more superannuation than home equity.

Table 1: Superannuation and housing value and equity*

Time period and age profile	Superannuation	Housing wealth	Size of cohort
2011 Retirees 65+	\$267 billion#	\$540 billion ¹ (equity*)	3.1 million ^a
2011 Baby boomers (ages 45-64)	\$780 billion##	\$1.39 trillion ²	5.5 million ^b
2014 Retirees 65+	\$454 billion^	\$830 billion ³ (equity*)	3.44 million ^c
2015 All ages	\$2 trillion+	\$5.9 trillion ⁴	23.5 million ^c
2029-2033 Gen X and Gen Y (will be aged between 47- 64)	\$4 trillion ^{&} (in 2029)	\$1.5 trillion ⁵	5.49 million ^b
2033 Baby boomers + migration (will all be aged over 65 by 2033)	\$836 billion ^{&}	\$2.48 trillion ⁶	6.1 million ^d
2033 All ages	\$7.6 trillion++	Est. \$10 trillion ⁷	33 million ^d

*The term 'equity' is used here to specifically refer to non-mortgaged housing value.

#Author's own calculations approximated by taking proportion of superannuation assets held by Australians over 65 in 2009-10 (20.4%) (Clare 2011) against total superannuation assets in 2011 of \$1.31 trillion (APRA 2012)

Author's own calculations approximated by taking proportion of superannuation assets held by Australians aged 45-64 in 2009-10 (59.6%) (Clare 2011) against total superannuation assets in 2011 of \$1.31 trillion (APRA 2012)

^ASFA (2015)

+ APRA (2015)

& Deloitte (2015)

++Deloitte (2015) \$7.6 trillion in future nominal dollars

1 Authors' calculations based on 3.1 million Australians aged over 65 (ABS 2012b), with 56% sharing a household with a spouse (ABS 2012b) resulting in approximately 2.2 million households, 83% of which (1.8 million) are owner occupied (ABS 2013d) by the conservative median house price of \$300,000 (HILDA 2011 Median home value of those aged 65+) = \$540 billion in retiree housing equity.



2 Authors' calculations based on 5.5 million Australians aged 45- 64 (ABS 2012b), with 49% sharing a household with a spouse (ABS 2012b) resulting in approximately 3.96 million households, 78 per cent of which (3.0888 million) are owner occupied (ABS 2012d) by the conservative 2011 'median' house price of \$450,000 (HILDA 2011 Median home value of those aged 45-64) = \$1.39 trillion in retiree housing equity.

3 Authors' calculations based on 3.44 million Australians aged over 65 in 2014 (ABS 2012b), with 56% cent sharing a household with a spouse (ABS 2012b) resulting in approximately 2.66 million households, 78% of which (2.08 million) are owner occupied (ABS 2012d) by the conservative median house price of \$400,000 (HILDA 2011 all those aged 62+ who would then be 65+ in 2014) = \$832 billion in retiree housing equity.

4 ABS 2015b

5 Conservative estimate only. Author's own calculations based on 49% of Gen X and Gen Y living with a spouse (ABS 2012b, 2013e) (49% of 5.49 million = 2.7 million) by 53% homeownership (ABS 2012b, 2013e) = approx. 1.5 million households by the median home value for ages 25-45 of \$400,000 (HILDA 2011) = \$600 billion (plus 0.5% per annum for growth each year in homeownership rate, including shared households) indexed at 2.5% for inflation, plus 2.5% pa in value growth over the time period 2015-2033 = \$1.5 trillion (ignoring intergenerational transfer).

6 Conservative estimate only. Author's own calculations of \$1.39 trillion (2011 baby boomer home equity estimate) indexed at a rate of 2.5% to account for 5% home value increase and 2.5% inflation = \$2.28 trillion plus 0.6 million new migrants with home equity \$210 billion = \$2.48 trillion.

7 Conservative estimate only. Author's own calculations (excludes new homes) as calculated by \$5.9 trillion in home value as at 2015 indexed by 2.5% per annum, compounded monthly until 2033 = \$10.2 trillion.

a ABS 2013a

b ABS 2006

c ABS 2015c

d ABS 2013c 6.1 million includes migration, 33 million approximate (Series A assumptions)

Gen X and Y (including those aged under 35 years who were heads of households) had a homeownership rate of 53 per cent in 2010 (ABS 2012b, 2013e) with an approximate aggregate home value of \$600 billion², albeit with most being owned but mortgaged. However, the projected value of superannuation in 2029 for Gen X and Y is approximately \$4 trillion compared to the baby boomer superannuation total in 2033 of \$836 billion (see Table 1). That is, in terms of potential sources of retirement income, Gen X and Y will be relatively better able to draw on their superannuation.

The relatively high rate of homeownership and lower levels of superannuation for baby boomers already suggests a way forward, but the baby boomers are not uniform and there are sizable segments that are not homeowners and in fact face the real risk of poverty. As shown in Table 2, for households with a person aged 65 years and over, approximately 11 per cent are renters, rising to 17.6 per cent of lone-person households (ABS, 2012b)

2 Conservative estimate only. Author calculations based on 49% of Gen X and Gen Y living with a spouse (ABS 2012b, 2013e) (49% of 5.49 million = 2.7 million) by 53% homeownership (ABS 2012b, 2013e) = approx. 1.5 million households by the median home value for ages 25–45 years of \$400,000 (HILDA 2011) = \$600 billion housing value.

Table 2: Living arrangements for Australians aged over 65 by household composition, 2009-10

Household composition	Estimated number of households	Homeowner %	Renter %	Other living arrangement %
Lone person	742.0	75.9	17.6	6.5
Couple only	741.6	91.4	5.8	2.8
All households	1,767.5	84.6	11.1	4.3

Source: ABS 2012b

The divide between homeowners and non-homeowners is even starker in terms of the differences in wealth as depicted in Figure 1. The mean value of the home alone for homeowners aged over 65 years is almost five times more than that of all non-homeowner assets combined.³





Source: Authors' own calculations. HILDA 2010: (N=1624 (all); 1294 (homeowners); 256 (non-homeowners)) 2014: (N= 3112 (all); 2543 (homeowners); 444 (non-homeowners))

3 2014 HILDA mean home value for +65 years homeowners is \$584,131 compared with all assets of +65 year non-homeowners of \$120,208, a wealth ratio of 4.85:1

Not only is there a disparity between homeowners and non-homeowners in terms of the components of wealth, but also in terms of the income in retirement. Table 3 shows the gross income bands of all retirees, with 44.5 per cent overall having a gross income under \$30,000, and then when disaggregated by homeownership status, with only 39.1 per cent of homeowners having an income less than \$30,000 compared to 64.3 per cent of non-homeowners.

	All households cumulative per cent	Homeowner households cumulative per cent	Non-homeowner households cumulative per cent
	n=2,477	n= 1,957	n= 442
Negative or \$0	.2	.2	.5
\$1-\$9,999	.8	.6	2.0
\$10,000-\$19,999	17.8	13.9	33.0
\$20,000- \$29,999	44.5	39.1	64.3
\$30,000-\$39,999	60.5	56.4	75.8
\$40,000-\$49,999	72.1	69.4	82.4
\$50,000-\$59,999	79.3	77.5	86.0
\$60,000-\$79,999	87.6	86.5	91.6
\$80,000-\$99,999	91.8	90.6	95.7
\$100,000 and over	100	100	100

Table 3: Gross income bands for fully retired Australians by homeowner status, 2011

Source: Authors' own calculations from HILDA wave 11.

Additionally, 54 per cent of those aged 65 years and over agreed or strongly agreed that they have had to adjust to a major decline in their income since retiring (see Table 4).

Table 4: Percentage of retirees (aged +65 years) reporting having to adjust to a major decline in income since retiring, 2011

Level of Agreement with the statement "I have had to adjust to a big drop in my income since retiring".	Per cent (n=1,089)
Strongly disagree	4.2
Disagree	27.4
Neither agree nor disagree	14.4
Agree	40.6
Strongly agree	13.4

Source: Authors' own calculations from HILDA wave 11.

We have seen that relative to Gen X and Y, homeowner baby boomers have a relatively high level of wealth held in their homes and relatively low levels of superannuation. Conversely, non-homeowner baby boomers, especially lone retirees, face increased risk of income poverty. The risk of poverty for non-homeowners indicates the urgent need for pension reform. The 65 years and over age cohort already faces a risk of poverty of at least 35 per cent (ACOSS 2014). Asset poor retirees will then need to have the age pension, as their income safety net, safeguarded. Even so, additional mechanisms for retiree income support is needed for both homeowner and non-homeowner baby boomers. The following section explores the theory and policy context regarding income in retirement and the current treatment of assets, including the primary home.

Theory and policy context of retirement income

Analysis of wealth accumulation and decumulation is traditionally grounded in the lifecycle theory of consumption, which hypothesises that households will engage in lifecycle consumption smoothing (Modigliani et al. 1954; Hurd 1990; Davies et al. 2000) and Markowitz's classic portfolio selection theory (1952, 2005), which suggests that investors select assets based on the mean and variance of portfolio returns. Traditional theories, however, may be inappropriate or need to be adapted due to the substantial structural inefficiencies present in the Australian home market, especially for older citizens and retirees. The drivers of these market disruptions are the nature of the home, the role of asset tests in determining the degree of pension eligibility, and the extent of demographic change.

The family home does not readily fit into typical strategic asset allocation given the nature of housing compared with other asset classes (Worthington 2009). The relevant characteristics include the substantial and indivisible asset size of the home, which often renders the home as a caveat or exception to analyses of strategic asset allocation, and the intangible social characteristics of the home (Easthope 2004), such as providing shelter, a sense of belonging, security and special significance for intergenerational households. Both the lifecycle theory of consumption and modern portfolio theory need to better accommodate the changing social context of retirement, longer life expectancies and housing as a major portfolio component for Australia's baby boomer generation.

Discussion

In terms of retiree income and strategic asset allocation, the analysis so far has shown that superannuation and the Age Pension alone will not provide affordable, nor adequate, retirement income for baby boomers. In addition, policy intervention has skewed portfolio selection toward housing equity, particularly because of the exemption of the primary residence from the assets and income test applied to age pension eligibility. As early as 1912, the then prime minister, Andrew Fisher, proposed that exempting the family home would help aged persons remain independent of their relatives, thereby allowing them to contribute more to national prosperity (PC 2015). At the time, only about 4 per cent of Australians were aged over 65 years, whereas by 2010, the proportion of Australia's population aged over 65 years had risen to 13.5 per cent and is expected to increase further under alternative scenarios to between 21 and 23 per cent by 2041 (ABS 2011).

Similarly, there has been other social and demographic change in Australia. For example, the overall life expectancy of Australians increased from 55–59 years in 1912 to 80–84 years in 2016, notwithstanding the substantial gap in life expectancy for Indigenous Australians of 69.1 for males and 73.7 for females in 2010–12 (ABS 2013a, 2013b, 2015a). In addition, the nature of work and ageing has changed dramatically as has the population's expectations of retirement (Karpf 2014).

The policy issues that have sought to address these forces have led to a consensus building in the academic literature and policy reports that a sustainable system of home equity withdrawal in retirement can be a potential source of retirement income. Numerous government and other reports have already proposed reforms to the principal residence exemption, including the Harmer Pension Review (Harmer 2009), the Henry Review (Henry et al. 2009), the Grattan Report (Daley et al. 2013), the Productivity Commission (2011, 2013, 2015); Rice-Warner (2015), and the National Commission of Audit (NCA) (2014a, 2014b). As an example, the NCA suggested "...a proportion of the value of the primary home should be included in the means test, such as the value over a relatively high threshold. One suggested means test would capture the value above \$500,000 for single pensioners and \$750,000 combined for coupled pensioners" (NCA 2014b, Recommendation 13).

Even with a cautious approach to intervening in the design of home equity products, a strong case has been made by the National Commission of Audit (NCA 2014a) and the Henry Review (Henry et al. 2009, 2010) to incorporate a threshold value of the primary home in the pension assets test. Importantly, the primary home would still receive concessional treatment relative to other assets, but would pave the way for some pension savings by considering housing wealth more equitably.

Although implementing such a means test could be politically troublesome, a possible way forward would be to link any such changes with a mechanism for tapping into home equity that is already widely accepted by many retirees and their advocates. The following sections note some of the characteristics of current products available and suggest some policy parameters and product characteristics that could make them more useful and successful.

This paper to now has examined the dynamics of maintaining a decent fiscal standard of living in retirement in Australia and has established that with Australia's ageing population and budgetary pressures, that there is a looming baby boomer cashflow crisis once the 5.5 million baby boomers join the current three million retirees in retirement.

The literature established that even though there is ample evidence that government budgets will be pushed to breaking point over the coming decades, that there is not sufficient research to support adequate policy reform. Consequently, to assist in closing the research gap, the following section will delve into the existing home equity withdrawal products in Australia, and in the context of recent policy work highlighted earlier, will propose a potential solution to meet the looming retiree cashflow crisis.

Current home equity withdrawal products

Australia's reverse mortgage market totalled \$3.66 billion at the end of 2014 (Deloitte 2015), up marginally from \$3.3 billion at 31 December 2011 with 42,410 reverse mortgages (SEQUAL 2016). However, this represents only a tiny fraction (0.44%) of the over \$830 billion of non-mortgaged housing equity of Australian retirees in 2014, as calculated earlier.

The lack of uptake on current products such as reverse mortgages from banks could stem from a range of issues, including uncompetitive interest rates, fees and charges, or simply from the reluctance from retirees to access their housing equity (Bridge et al. 2010). When attempting to identify the parameters that are a minimum requirement for retirees when considering home equity release, of those retirees already using a reverse mortgage, some of the key factors they considered included: access to information and advice, no negative equity guarantee (NNEG), the competitiveness of interest rates, valuation estimates (i.e. loan to value ratios, LVRs), ongoing fees and charges, their relationship with the broker/lender, and the reputation of the lender (Bridge et al. 2010). Recent product developments in this market suggest the industry is trialling a range of options.

For example, Bendigo Bank's 'Homesafe Wealth Release' is available in Victoria and NSW and allows a retiree to sell a share of the future sale value of their home in exchange for a lump-sum cash amount (Bendigo Bank 2016). In addition to the range of banks that offer reverse mortgages, home reversion schemes and reverse annuity mortgages, there have been a few new products emerging onto the Australian home equity-release market in recent years. One such product is Property Options for Pensioners and Investors (or POPI), which allows an older homeowner to grant an investor the right to purchase the home in the future at an agreed price today, in exchange for an income stream (POPI 2016). Another product is DomaCom, which provides fractionalised investment in housing, effectively a regulated managed investment scheme.

What perhaps differentiates DomaCom is that its regulated products require customers to go through a financial planner, thereby permitting its inclusion in a licensee's Approved Product Listing. DomaCom has recently applied to have a seniors-specific product for home equity release approved by the Australian Securities and Investments Commission (ASIC), which may even better meet the risk profile and needs of retirees than current reverse mortgages (DomaCom 2016).

What we do know is that the level of financial risk Australians are prepared to take on becomes increasingly less as they age (see Table 5). In evidence, the proportion of the age cohort not willing to take any financial risks increases to 52.1 per cent for those aged 65 years and over and 62.1 per cent for households [with one or more residents] aged 75 years and over. Seemingly, despite this, around 10 per cent of these same residents report that they never have any spare cash.

	All ages (n=8,335) Per cent	Baby boomers (age 47-64) (n=2,787) Per cent	65 and over (n=1,598) Per cent	75 and over (n=628) Per cent
Takes substantial risks expecting substantial returns	1.4	1.1	.6	.3
Takes above-average risks expecting above-average returns	6.1	6.2	2.4	1.1
Takes average financial risks expecting average returns	38.5	43.2	34.7	27.2
Not willing to take financial risks	41.4	37.5	52.1	62.1
Never has any spare cash	12.6	11.9	10.3	9.2
Total	100.0	100.0	100.0	100.0

Table 5: Financial risk Australian homeowners are prepared to take by age, 2011

Source: Authors' own calculations from HILDA wave 11.

The majority of older homeowners having a more conservative approach to financial risk may be a critical hurdle for the uptake of home equity-release products in Australia. In this context, there is growing evidence that older Australians are becoming more amenable to considering a debt-free home equity product if it has a government guarantee (Harper 2011). However, the parameters of any product given government backing would need to show some tight properties and would benefit from clarity of purpose, such as a focus on enabling the supplementation of retiree income to a modest level and to smooth expenses related to health shocks for retirees.

So far, this paper has examined the financial position of current retirees, to provide an overview of overall net wealth at retirement, including a comparison between homeowners and non-homeowners. In addition, the results have detailed the proportion of the retired household's portfolio that is in housing equity and other asset classes, the income of retirees and financial stress in retirement. This data has established that not only is there evidence that retirees hold substantial assets in housing, but also that both homeowners and non-homeowners could have an improvement in lifestyle if some home equity of asset-rich retirees was withdrawn to supplement their retirement income. However, this paper has also detailed evidence that retirees have not utilised current home equity withdrawal products to the extent expected, which may be due to the current product parameters not being sufficiently suited to the needs and expectations of retirees. New product offerings may better fit the needs and risk profiles of Australian retirees by being government-backed, which would help support new retirement income channels through home equity release. In addition, this paper has found that the other preferences of retirees for home equity release could be better met with products that have competitive interest rates, stronger communication and integrated support. We outline a potential product solution below.

A proposed solution – Home Equity Accounts (HEAs)

We propose a HEA as a government-subsidised, low-interest loan that retired homeowners can use to draw on their home equity for income and consumption. The proposed HEA loan would be government-backed to ensure retirees know the government supports the system, and to attract investors which would make the HEA system more viable. The government backing would need to guarantee returns for investors (albeit at low rates) as well as assure homeowners that their homes will have a no negative equity guarantee, which is inherent in the strict LVR parameters of the loan. The proposed HEA process would also ensure that retirees have been given qualified, affordable financial advice prior to undertaking a HEA loan. The loan could support healthier ageing by modestly supplementing income on a fortnightly or monthly basis, or providing lump sums for home modifications related to health needs. The homeowners would still have complete control over their home, with the loan solely drawing on a portion of the equity.

The security for the HEA loan is a portion of the retiree's home equity; however, the financing of the loan would ultimately be from investors who purchase units in the pool of retiree home equity included in the HEA system, for a modest return. In the early stages, the government may need to provide seed funding to establish the system, and subsidise the low interest rate, which would presumably be justifiable given the potential for billions of dollars in annual age pension savings (Cowan et al. 2015). Such support would also send a strong message to retirees that their home is a source of retirement income. Nevertheless, in the longer term, investors purchasing exchange-traded units or bonds formed by securitising the home equity would fund the loans.

Retirees benefit from a HEA product by being able to access low-cost, low-risk, modest income supplementation and support for health consumption. If used modestly, they would still be able to bequest the bulk of their home equity in most cases, even with changes in housing market prices, as the scenarios in the next section demonstrate. Ultimately, the retiree is able to fund healthier ageing and stay in their own home. Linking with a financial planner in a low cost way may also contribute to better financial outcomes in areas other than home equity withdrawal.

Government and taxpayers benefit from being able to safeguard the age pension as a sustainable safety net with a fairer assets test, as well as manage increasing imposts on government budgets, such as health care for a population who are living longer. Furthermore, the current urgent need for a HEA system and the government guarantee required to ensure its uptake, could have sunset clauses built-in in the order of 30 to 40 years to underscore the generation-targeted nature of the retiree income solution. For investors, the HEA units or bonds would have low risk by being government-based, albeit with a low return, and would add more choice in the fixed asset classes as well as opening up the large home equity market for investors.

The loan could alternatively link to suitable emerging products that meet criteria such as supporting a modest income in retirement, supported by trusted financial advice, being flexible, low cost, low risk, scalable and most importantly, government-backed/guaranteed. Such a product could have strict eligibility conditions for a government guarantee such as set loan to value ratio (LVR) level, fee schedule, requirements for eligibility regarding pension eligibility or aged care needs, an agreed process for valuation of properties and review, through to limits on other indebtedness (Cowan et al. 2015).

The risks inherent in the HEA product and related exchange traded products are different but also related in the proposed solution in this paper. Relatively strict parameters for a HEA loan would help safeguard the viability of HEAs as well as reduce the risk to government who are safeguarding both homeowners and investors by offering a government guarantee. Risk is also partly addressed through mechanisms such as securitisation of the home equity that is being lent back as income. By being securitised through exchange-traded bonds, a wider range of investors is able to fund the loans, albeit with modest returns.

For the most part, current comparable products such as reverse mortgages are not the best in terms of efficiency and matching to retiree risk profiles (PC 2015). Instead, the proposed HEA product could be a solution, and will depart from existing products by being government-backed, securitised, and by incorporating financial planning services. Even merely introducing the term 'Home Equity Account' could favourably challenge perceptions regarding the place of the primary home in supplementing retirement income. Rather than seeing any change to the pension assets test as a punishment or disincentive to purchase a home, rethinking of the family home as a 'Home Equity Account' in retirement that could be drawn on to supplement a modest retirement income may be a more useful framing. The following section works through and stress tests several examples of what a product might look like in order to be attractive to financially conservative retirees and to a government guarantor, with the section thereafter discussing the role of financial advice in this new paradigm.

One component of the conversation regarding the use of home equity for retirement income supplementation is to allay the fear that a retiree's home is going to rapidly decline in value by the time they die. Tables 6 and 7 detail examples of home equity withdrawal, with scenario one being for a house valued at AU\$950,000 and scenario two being for a house valued at AU\$350,000. In each of these examples, if modest income was drawn from home equity over a 25-year period, the loan to value ratio (LVR) will remain at between 10 and 45 per cent, even across a range of interest rates.

Modelling HEAs

Scenario 1: In this example, the retiree's home value is \$950,000 at the start of the loan. The retiree is borrowing a \$1,000 lump sum as well as income of \$1,115 per month. This income amount is being used to show the effect of having to replace the pension income lost if housing assets over the value of \$500,000 were deemed to be providing income at a rate of 1.75 per cent for the first \$48,600 and 3.25 per cent for the remainder (these are the Australian Department of Human Services' deeming rates for financial assets when assessing pension eligibility as at 1 July 2015). The model adjusts for 2.5 per cent per annum inflation (adjusted six-monthly). The model has home values increasing at 3.5 per cent per annum (adjusted monthly), no repayments, and ignoring fees. A term of 25 years has been shown simply to cover a longer than average life expectancy for baby boomers, which is 74.85 years for males and 78.35 years for females as at 2012 (ABS 2013a).

Table 6: Reverse mortgage calculation* for starting home value of \$950,000, various interest rates, 25-year term

Loan interest rate (Compounded monthly)	4% p.a.	5.25% p.a.	6.25% p.a.
Home value at the start of month, Year 1	\$949,000	\$949,000	\$949,000
Monthly income drawn (Yr 1 to Yr 25)	\$1,115 rising to \$2,024 by Yr 25	\$1,115 rising to \$2,024 by Yr 25	\$1,115 rising to \$2,024 by Yr 25
Home value at the end of month, Year 25	\$2,273,635	\$2,273,635	\$2,273,635
Size of loan, compounded at end of Year 25	\$746,331	\$884,934	\$1,019,781
Remaining home equity after 25 years with monthly withdrawals	\$1,527,305	\$1,388,701	\$1,253,854
Loan to Value Ratio (LVR)	33%	39%	45%

Source: Authors' own calculations

*AU\$1,000 lump sum as well as income of \$1,115 per month inflation 2.5% pa (adjusted six monthly), over 25 years, home value increasing 3.5% pa (adjusted monthly).

In both examples in Tables 6 and 7, the difference in loan value ratio (LVR) and final equity are shown across three different interest rates (4%, 5.25%, 6.25%) over a 25-year term, demonstrating that a more competitive interest rate presents a much more compelling outcome for the retiree in terms of home loan value over the longer term.

The model in Table 6, for example, shows that over a 25-year term, at 4 per cent the value of the home still exceeds \$1.5 million, even with monthly income drawings, compared to \$1.25 million at a 6.25 per cent interest rate.

Scenario 2: The second scenario models an outcome for retirees with a home value of \$350,000 who would be eligible for a full pension (even with the introduction of deeming for home values over \$500,000), but who may still require some income supplementation. Table 7 shows that a modest release of home equity to supplement retirement income of \$200 per month plus an initial \$1,000 lump sum, still leaves the homeowner with a relatively low LVR over the long term, even at the higher interest rate. However, the lower interest rate would undoubtedly make a more compelling case for the retiree to undertake home equity withdrawal.

Table 7: Reverse mortgage calculation* for starting home value of \$350,000, various interest rates

Loan interest rate (Compounded monthly)	4% p.a.	5.25% p.a.	6.25% p.a.
Home value at the start of month, Year 1	\$349,000	\$349,000	\$349,000
Monthly income drawn (Yr 1 to Yr 25)	\$200 rising to \$363 by Yr 25	\$200 rising to \$363 by Yr 25	\$200 rising to \$363 by Yr 25
Home value at the end of month, Year 25	\$836,142	\$836,142	\$836,142
Size of loan, compounded at end of Year 25	\$133,871	\$158,733	\$182,920
Remaining home equity after 25 years with monthly withdrawals	\$702,271	\$677,409	\$653,222
Loan to Value Ratio (LVR)	16%	19%	22%

Source: Authors' own calculations

*AU\$1,000 lump sum as well as income of \$200 per month inflation 2.5% pa (adjusted six monthly), over 25 years, home value increasing 3.5% pa (adjusted monthly).

In terms of the risk of a decline in home property values, if the same modelling was done as in scenario one and two, but with a negative growth in home equity, of say, -3.5 per cent per annum for a starting home value of \$950,000 at an interest rate of 4 per cent, it would take until May of the 20th year of the loan before the home equity was completely exhausted. This would be May in the 19th year at an interest rate of 5.25 per cent and August in the 18th year for an interest rate of 6.25 per cent. For a starting home value of \$350,000, (drawing only \$200 per month), negative growth in home equity of -3.5 per cent per annum would still leave home equity at the end of a 25year period of \$11,428 at an interest rate of 4 per cent. It would then take until March of the 25th year at an interest rate of 5.25 per cent and February of the 24th year at an interest rate of 6.25 per cent before the home equity was completely gone. This would be an unprecedented indeed implausible decline in long-run residential property values in Australia and is not included as a realistic risk plan, but rather to demonstrate the long-term potential of home equity withdrawal, even under this rather unlikely scenario. More realistically, short-term declines in home value may occur, but over the long term, if home equity withdrawal remained at a modest level, based on historical home value cycles in Australia, the home equity of the average Australian baby boomer could withstand a term of at least 25 years, as well as stay within reasonable LVR limits (<25% at age 65 and <45% at age 85).

In the context of financially conservative retiree homeowners and the need for appropriately knowledgeable individuals to enact the selection criteria required for a government guarantee, there is a substantial role in this system for financial planners. Similarly, the presence of financial planners will also be an assurance for retirees to ensure they make informed decisions regarding home equity withdrawal in retirement. We discuss the use of a financial planner in utilising a government guaranteed HEA in the following section.

The role of financial planning in the new retiree income paradigm

New ways of owning and investing in housing as an individual and a community, for both retirees and other generations, will require planning and support for people who have not traditionally opted for financial planning. Underscoring the critical role of financial planning is the evidence that cognitive impairment and the early onset of dementia may be affecting the financial planning decisions of older Australians (Teale 2015). To reduce the risk that financial decisions are rushed or prompted by crises when the person is most vulnerable, a new model for retiree income planning may be needed to circumvent the reluctance of older Australians to undertake planning for their possible future ill health and end of life needs (PC 2015).

A recent survey of retirees found that approximately one-third of older Australians are uncomfortable with their own financial planning for retirement (PC 2015). Data from HILDA also shows that 29.4 per cent of retirees who get financial planning agree or strongly agree that they wish they had started to plan for retirement earlier (see Table 8). These results underscore the potential positive impact of financial planning for retirees and the benefits of a nudge from government to engage in financial planning even if for a HEA process only.

Level of Agreement with the statement "I wish I had started to plan for retirement earlier".	Per cent (n=1,085)
Strongly disagree	7.2
Disagree	40.7
Neither agree nor disagree	22.7
Agree	22.3
Strongly agree	7.1

Table 8: Percentage of retirees (age +65 years) report wishing they had started to plan for retirement earlier, 2011

Source: Authors' own calculations from HILDA wave 11.

Efficiently and safely drawing on home equity for income in retirement also opens another dimension of strategy for financial planners and investment managers when planning and managing retirement income for clients. Strategy for generating retirement income in the short-term may have hitherto focussed on a narrow range of fixed-interest products, which have provided returns lower than inflation since the global financial crisis in 2008. Consequently, some financial planners may have opted for securities that have provided better returns, but in so doing, the client may be exposed to greater risk for short-term income than is ideal, particularly in a low interest rate environment. Utilising home equity for short-term income could provide a strategy alternative to moving up the equity ladder at the wrong stage in the investment cycle if fixed interest assets are not providing adequate returns. The use of housing equity to smooth income in times of stock market volatility may also help support the increased longevity of superannuation savings. Rather than seeing home equity as a final resort once all other sources of income are exhausted, home equity could then be part of a planned strategic asset allocation that is decumulated at the most appropriate time during the market cycle.

Conclusion

The retirement context in Australia displays a high risk of income poverty and financial stress for retirees, combined with increasing pressure on government budgets. This paper first established that Australia's 5.5 million baby boomers who are progressively moving into retirement need a generation-targeted solution to supplement their retirement incomes, and that housing wealth is the linchpin of that solution. Second, the paper detailed evidence that existing home equity release products have not established the market traction needed to meet the needs of retiree income supplementation. In analysing potential market failures for retiree home equity release, the preferences of retirees for home equity product parameters have been explored to assess potential solutions.

Third, we have suggested a safer, supported mechanism that enables retirees to relieve financial stress and meet their health and aged care needs by efficiently and safely decumulating their housing equity for increased cash flow. The solution proposed in this paper – Home Equity Accounts (HEAs) – differs from existing products by being potentially government-backed, securitised and in providing higher-quality planning for those retirees with lower net worth than those who typically engage a financial planner.

Overall, this paper has illustrated the current and potential role of housing equity in Australian retirement portfolio composition and contributed to a case for new financial product development for Australian retiree income supplementation. The solution is for all retirees: for homeowners, who are part-pensioners, and for those who are full-pensioners and living under financial stress. Perhaps even more critically, enabling HEAs for homeowner retirees will support the income of retiree renters, because it will shore up the ever-decreasing pool of government funding for those 11 per cent of all retiree households, and particularly the 17.6 per cent of sole person retiree households, who are renters and have very few assets at all.

The current urgent need for retiree income supplementation is not necessarily ongoing; it is a mechanism that can assist baby boomers to live well, while simultaneously reducing the pressure on pensions. Toward the end of the baby boomer cohort lifecycle, superannuation levels will begin to dramatically increase and the need for HEAs may well begin to diminish. Built-in sunset clauses for the HEA government guarantee would help underscore the generation-targeted nature of the retiree income solution.

The results of this study have important implications for social policy and financial products designed to increase the financial wellbeing of retirees. Over the next 15 to 20 years, a HEA system could potentially save hundreds of billions in age pension payments and still leave considerable home equity for baby boomer retirees to bequest from the approximate \$2.48 trillion home equity in 2033. In addition, this paper commented on the theoretical base for asset holdings and decumulation over the lifecycle and identified the theories in need of extension to reflect a new paradigm of ageing, work, and retirement, which will be an area of further research.

In terms of other related future research, we are of the opinion that recent policy reports have not gone far enough to push the market for home equity release. There is more scope to establish a targeted transition plan toward increased use of home equity for retirement income in Australia. The three million current retirees and 5.5 million baby boomers need to be drawn into a conversation on the future of retirement income planning and the emerging place of home equity withdrawal in retirement when testing portfolio scenarios for retirees.

In addition to the right product, there needs to be recognition of the will to stay in place for current retirees and a need to trust any new product offered regarding their housing equity. Ideally, any new product would be supported by trusted financial advice. With the right, well-priced product, these new scenarios could be the light at the end of the tunnel for some retirees. In the context of new financial products that draw on housing equity and match the risk profile and needs of Australian retirees, the potential positive impact of quality financial planning, could completely change the financial stability of retirees and, in turn, government finances.

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