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What determines UK housing equity withdrawal in later life?

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ABSTRACT

The UK government has encouraged the role of the home as a welfare asset especially among the elderly. Although UK pensioners express a desire to use their homes to support their retirement, few actually downsize or borrow against the value of their home using an equity release product. In this paper, we examine housing equity withdrawal behaviour by analysing the cost and benefits of housing equity withdrawal, variations in financial behaviours and attitudes to homeownership along with a consideration of regional effects. Using the UK Wealth and Assets Survey, we find that quantifying the likely amount released and transaction costs explains many of the patterns we observe in the data. Our empirical analysis helps explain the low level of housing equity withdrawal, regional variations in this activity and the choice between downsizing and equity release. We also show that releasing housing wealth would double household private pension wealth in the South of England and boost the regional economy by 30% in Wales, the South East and South West. Current demand and supply developments will likely expand this market but the trade-offs made at both household and societal level are not fully understood.

1. Introduction

The UK government has traditionally advocated homeownership as a means of providing lifetime security but the last decade has seen a paradigmatic shift to a housing-asset based welfare society (Smith, 2015). Government wishes to encourage pensioners to use their housing wealth to help pay for the cost of their social care, to release money to adapt their homes and to support their incomes (Lords, 2013). However, financial products to facilitate withdrawing housing equity are little used and government proposals to use house values to support care for the elderly have been fiercely resisted.

Almost 80% of people aged 65–74 in the UK own their own home and two-thirds of those over 65 years of age are homeowners without a mortgage (ONS, 2016). With less generous pensions, and more retirees with debt and a lack of retirement savings, many households' most valuable asset is now their home (Clarke et al., 2016). Many homeowners approaching retirement express an intention to either downsize or borrow against the value of their home using an equity release product but the reality is that only a small percentage ever do (Leach, 2012). Why more people do not use their home to supplement retirement income is not well understood (Disney et al., 2002).

In our study, we use data from the British Wealth and Assets Survey to analyse the cost and benefits of housing equity withdrawal, variations in financial behaviours and attitudes to homeownership along with a consideration of regional effects. We find that quantifying the likely amount released and transaction costs explains many of the patterns we observe in relation to housing equity withdrawal. Our empirical analysis helps explain the low level of housing equity withdrawal, regional variations in this activity and the choice between downsizing and equity release.

The paper proceeds as follows. The next section provides some background to the UK housing market and an overview of studies on why households decide to convert housing wealth to cash. In our empirical analysis, we quantify the potential costs and benefits of housing equity withdrawal and use forecasting to estimate the likely bequest. These measures along with data on household finances and financial attitudes are then used in a nested logit model with multiple imputation to explain when households decide to draw down their housing wealth. We conclude our investigation by quantifying the impact housing equity withdrawal could make on retiree wealth and on gross value added in each region if every homeowner eligible to withdraw housing equity proceeded to do so. The final section offers some conclusions and suggestions for further research.

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2. Background and literature overview

In the UK as in most Western countries, a majority of personal savings for old age takes the form of housing wealth (Ong et al., 2013). Household property wealth is greater than pension wealth in all regions of GB but the differential is greatest in London and the South of England (Belfield et al., 2015). Historically, the main channel for withdrawing equity from homes has been through downsizing. This can take different forms including a reduction in the number of rooms or the value of the dwelling or alternatively a change from ownership to rental tenure (Banks et al., 2010). There are few estimates of the number of elderly households downsizing in the UK. Banks et al. (2010) estimate that before the financial crisis 23% of homeowners aged 50 and above moved over a ten-year period though not necessarily to downsize while the English Housing Survey indicates that there was a particularly large reduction in house moving post-financial crisis (EHS, 2010).[1]

For those wishing to remain in their own homes an alternative to downsizing is to borrow against home equity through the purchase of an equity release plan. Typically, the customer receives funds in a lump sum while retaining ownership of the home. The loan amount and accumulated interest are repaid through the sale of the property which takes place after the customer dies or moves to long-term care (Alai et al., 2014). The market for equity release products in the UK has been steadily growing in size but is still regarded as being small and under-developed constituting only half a per cent of the total mortgage market (O'Mahony and Overton, 2015).

2.1. Costs and benefits of housing equity withdrawal

The home has assumed a welfare asset role providing a buffer to be drawn on to insure against shocks to income, health and family wellbeing (Painter and Lee, 2009). Housing equity withdrawal is more likely in households with difficulties in smoothing consumption due to problem debt, few liquid assets and collateral constraints (Klyuev and Mills, 2007). Housing provides collateral for borrowing and therefore many households consider withdrawing equity as risky and a last resort solution to financial problems (Benito, 2009).[2]

The decision to withdraw housing equity is conventionally treated in financial terms. From this point of view, both forms of housing equity withdrawal achieve the same economic end of converting housing equity to cash. Angelini and Laferrère (2012) find empirically that the availability of equity release plans in a country has a negative effect on the likelihood to downsize and that equity release and downsizing therefore act as substitutes. Ong et al. (2013) also conclude channels of equity withdrawal are interchangeable based on comparisons between Britain and Australia housing markets.

The income released from downsizing depends on conditions in the housing market including the level of house prices and Beach (2016) calculates that downsizing by one bedroom would release the highest amount in London (£71,262) and the lowest amount in Wales (£24,237). Similarly, the income released through an equity release scheme depends on the quality and location of the home but also on the age of the borrower with the percentage of house value released rising with age (ERC, 2017a).

Transaction costs are a deterrent to housing equity withdrawal. Sass et al. (2017) highlights transaction costs including costs of commissions, taxes, moving and fixing up a new home as a major inhibitor to downsizing for homeowners. Also, transaction costs in the form of initial set-up costs and ongoing interest rate charges have been identified as inhibiting uptake of equity release products (Nakajima and Telyukova, 2017) and the choice between alternative channels of withdrawing equity are principally guided by comparative transaction costs in some authors' opinions (Disney, 2009).

2.2. Tastes and preferences

Both forms of housing equity withdrawal are more common in London and the South-East (Beach, 2016; Key Retirement, 2017). If transaction costs are moderate then these spatial patterns may simply be due to higher house values in these areas.

But attitudinal and cultural differences within countries have been demonstrated to influence household financial decisions (Badarinza et al., 2016). Regional differences in financial confidence and knowledge (Bucher-Koenen and Lusardi, 2011) and attitudes to risk (Clark et al., 2009) have been found to shape attitudes to pension saving and retirement planning. Guiso and Sodini (2013) find that trust in formal financial institutions and systems differs across countries and regions, and low levels of trust reduce household participation in markets. Leyshon et al. (2004) argue that financial ecologies emerge over time with areas such as London and the South of England considered as 'connected' and typified by a diverse and sophisticated financial infrastructure leading to customers who are more financially knowledgeable; more confident in dealing with financial products and financial institutions; have better access to credit; and are more active in searching out financial opportunities. The divergence between connected and peripheral areas is accentuated in periods of financial crisis due to higher closure rates of financial institutions in less connected areas (Zhao and Jones-Evans, 2016; Henry et al., 2017).[3]

The bequest motive has often been cited as an important impediment to drawing down housing wealth as homeowners are reluctant to consume their children's inheritance (Toussaint and Elsinga, 2009). The desire to bequest has been identified as a factor both in reducing the incidence of downsizing (Banks et al., 2010) and in restricting the uptake of equity release plans (Sass et al., 2017). However, some studies have suggested that the desire to bequest may actually be facilitated through housing equity withdrawal. Equity release plans, for example, are used in different ways by different income groups, with those on high incomes using them to make early bequests and large one-off purchases (Overton, 2010).

Owning a home provides a range of positive feelings from independence to security and control (Saunders, 1990). Emotional attachments to the home are particularly salient among the elderly where dwellings and physical possessions are so interlinked with personal histories (Johnson and Bibbo, 2014). Releasing equity *in situ* is then more attractive than setting up a new home in a smaller dwelling but equity release also threatens a homeowner's sense of financial security and generates negative feelings around indebtedness, loss of ownership and a failure to meet normative expectations (Fox O'Mahony and Overton, 2015a; b).

3. Data and methods

3.1. Data

The data used in this study comes from waves one to four of the Wealth and Assets Survey (WAS) for Great Britain. This is a longitudinal panel study of private households and is designed to be nationally representative. Wave one commenced in July 2006 with fieldwork spread over the following two years and achieved a sample of 30,511

[1] Data for 2009–10 in Table FA2301 of the English Housing Survey indicates there were 10, 056, 000 households where the household reference person was aged 45 and over, while Table FA4141 indicates that 133,000 of these were resident for less than a year (1.3%). A subset of these households will have downsized.

[2] Entitlement to government assistance is also a disincentive to convert housing wealth into cash in the UK as housing is treated differently to other assets for certain welfare benefits such as pension credit, council tax support and social care in the home.

[3] Supply-side factors also vary across regions.