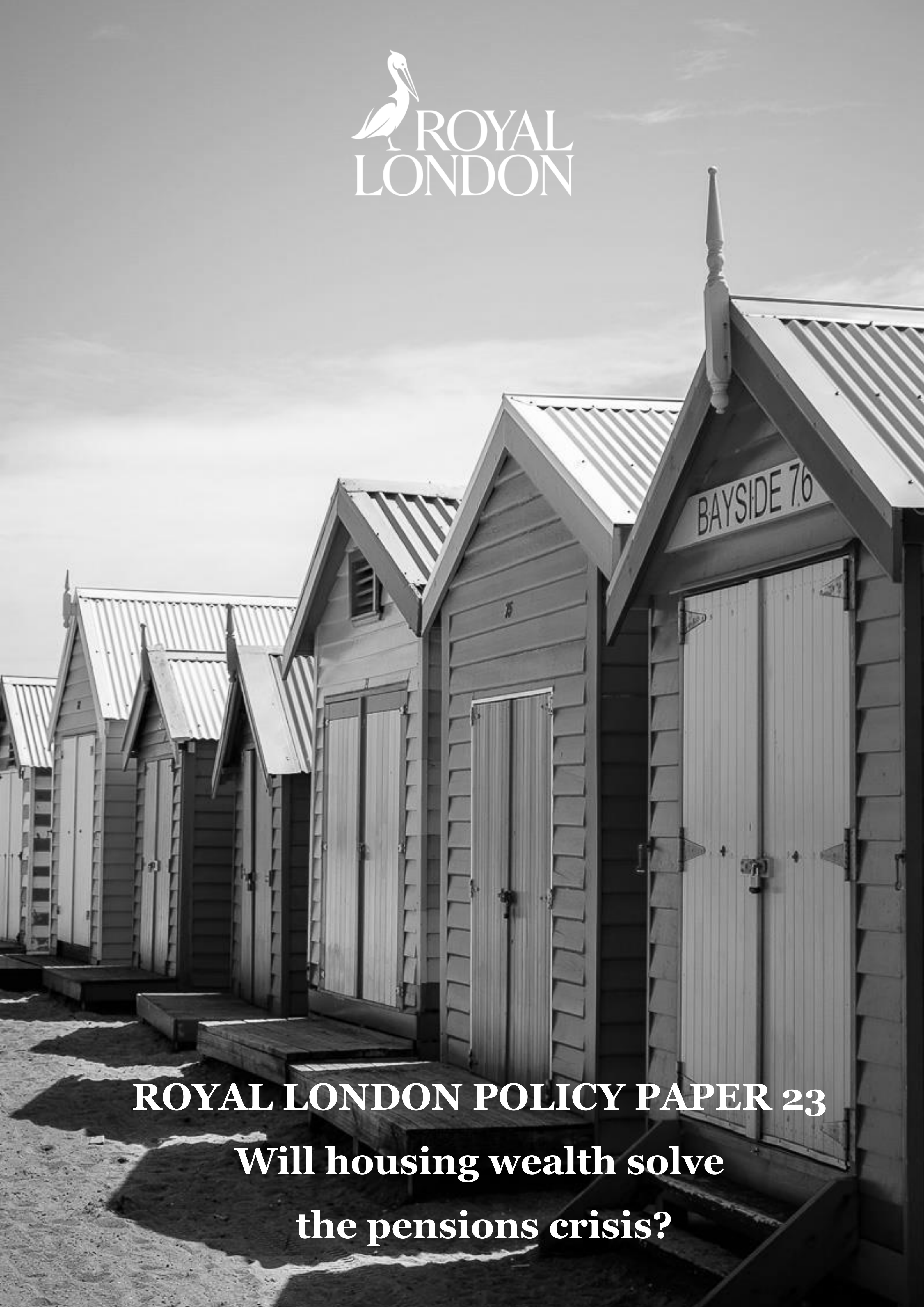
ROYAL LONDON



ROYAL LONDON POLICY PAPER 23

Will housing wealth solve the pensions crisis?

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WILL HOUSING WEALTH SOLVE THE PENSIONS CRISIS?

1. INTRODUCTION

It is widely reported that the UK faces a pensions crisis. According to estimates from the Department of Work and Pensions[1] around 12 million people of working age in the UK are 'under-saving'. These are people who are likely to see a significant fall in their standard of living when they are no longer in paid work and are dependent on pensions and other income in retirement. Whilst the successful implementation of the policy of 'automatic enrolment' has made a useful contribution (without AE, the DWP estimates that the number under-saving would be 14 million people), the decline of relatively generous final salary pensions and the relatively low level of the state pension means that far too many people are heading for a disappointing retirement.

However, what analysis of this sort rarely takes account of is the housing wealth of those coming up to pension age. Data from the Office for National Statistics suggests that amongst those aged 65-74 the home-ownership rate stands at 78%, and for those aged 75 or over at 75%. These figures compare with home-ownership rates at or below 50% for the same age groups at the start of the 1980s.

This dramatic growth in home ownership raises an important policy question. If the majority of people in retirement own a house, and if (part of) the value of that house could be turned into money to live on – either in the form of a capital sum or a regular income – then does this make up for the decline in pension provision? In short, does the growth in housing wealth 'solve' the pensions crisis? Or at least, can we make the most of current record levels of home ownership amongst retirees to 'buy us some time' to sort out under-saving, noting that home ownership rates have started to fall markedly amongst younger age groups.

This paper is structured as follows:

- We begin by looking at patterns of home ownership by age and over time, showing how owning your own home in retirement has now become the norm;

- Next, we consider how housing equity could be converted into income or capital and describe how the market for 'equity release' and related products has grown;

- We then present new analysis of the Wealth and Assets Survey (WAS) which is a unique dataset which enables us to bring together information on the incomes and assets of pensioners; in particular, it allows us to look at housing equity and how this relates to levels of pension income;

- Finally, we present policy conclusions as to how far the changing pattern of housing wealth 'solves' the pensions crisis

[1] For example, p6 of the results of the 2017 AE review, published in December 2017
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/668657/automatic-enrolment-review-2017-analytical-report.pdf

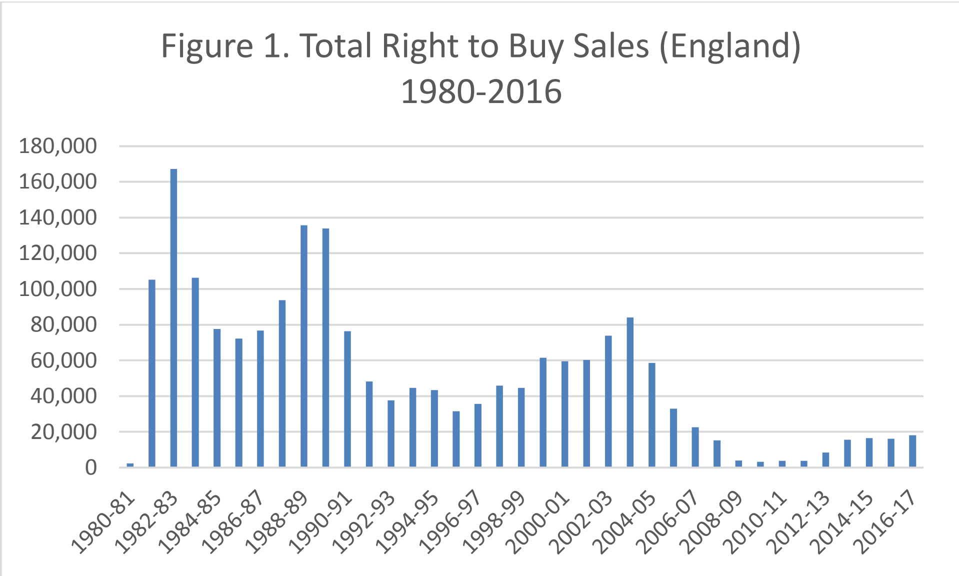
2. Changing patterns of home ownership

A number of major changes have taken place in the UK housing market in recent decades which have had a profound impact on the extent to which individuals in different age groups own their own homes. Two of the most important have been:

- Giving local authority tenants the 'right to buy' their homes, often at a substantial discount;

- The de-regulation of the mortgage market, particularly during the 1980s;

Figure 1 shows the number of 'right-to-buy' sales in England in each year since the legislation was passed at the start of the 1980s.



Source: Ministry of Housing, Communities and Local Government:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/661597/LT_671.xlsx

As the chart shows, there were a number of peaks of activity under this programme, notably in the early 1980s and late 1980s. Many of those who bought their family homes in the 1980s would now be amongst the retired homeowners of 2018. In all, just under two million social rented properties were sold under the right-to-buy scheme between 1980-81 and the end of 2016/17.

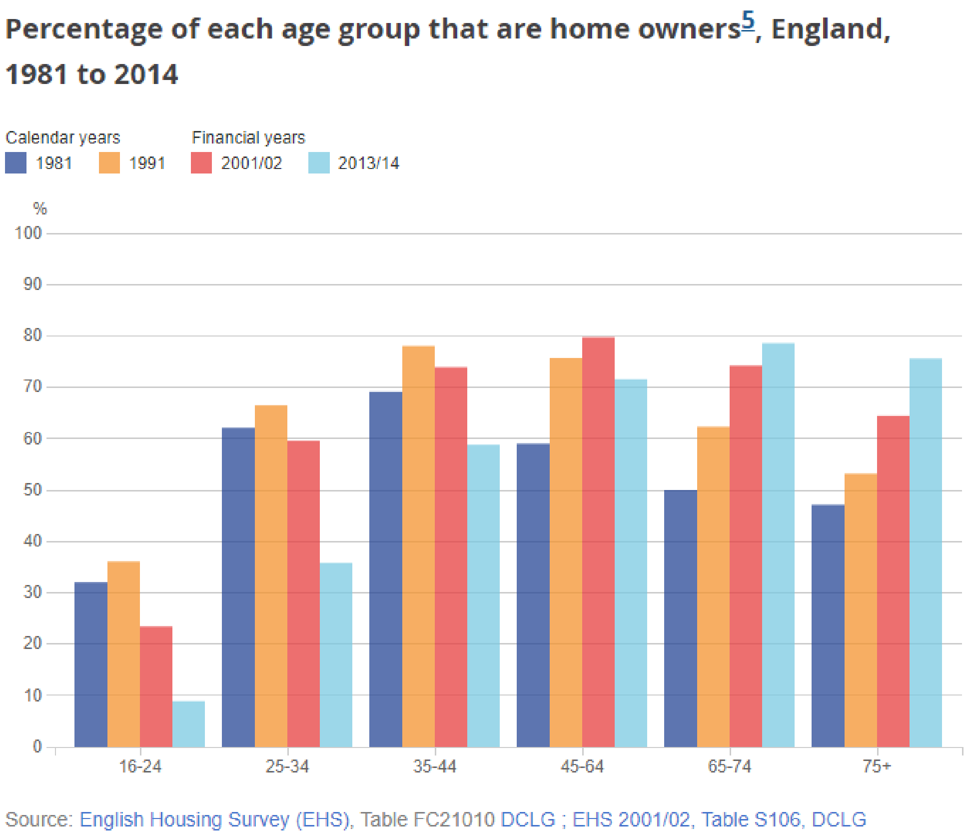
In addition to the growth in home ownership through 'right-to-buy' sales, home ownership also increased because of significantly easier access to mortgage finance. In a paper published by the LSE[2], Scanlon and Whitehead describe the key changes as follows:

> *"The big changes in the market came in the 1980s. First, the Bank of England in 1980 lifted the Supplementary Special Deposits regulations, known as the 'corset', which constrained lending to the household sector and made it relatively unprofitable for banks to lend in the mortgage market. Second, the financial framework in which building societies operated was modified in 1984 to allow them to compete more effectively with the banks" (p3)*

[2] http://eprints.lse.ac.uk/38285/1/Scanlon_Whitehead_The-UK-mortgage-market-responding-to-volatility_2011.pdf

Both of these changes have had an important part to play in the dramatic growth in home ownership amongst older households. Figure 2 shows the percentage of people in England in different age groups who were home owners, at intervals of roughly ten years since the start of the 1980s.

Figure 2. Home ownership rates by age (England) 1981 – 2013/14



Source: Office for National Statistics
(https://www.ons.gov.uk/peoplepopulationandcommunity/housing/articles/ukperspectives2016housingandhomeownershipintheuk/2016-05-25)

Figure 2 shows a number of very striking trends:

- Amongst those over state pension age, whether aged 65-74 or aged 75 plus, home ownership rates have been transformed; at the start of the period, just under half of all over 65s were home owners whereas now the figure is around three quarters;

- There is a very striking difference between older and younger groups; home ownership rates are now lower (in 2013/14) than they were at the start of the 1980s for every age group under 45; the rates for the youngest age groups are particularly striking; as recently as the early 1990s, around 1 in 3 of the under 25s were home owners (albeit in most cases no doubt with large mortgages), whereas that figure has collapsed to fewer than 1 in 10;

Although we do not yet know whether younger renters will turn into older home-owners, perhaps as they work for longer and as they inherit housing wealth, Figure 2 is a reminder that any conclusions we may draw about the role of housing equity in retirement provision need to be bear in mind that high rates of home-ownership among the retired population cannot be assumed to continue indefinitely.

But for now and for the coming years we can say with some confidence that the typical pensioner is likely to be a home owner. Whilst the charts did not provide a breakdown between those who own outright and those who are still paying a mortgage, the large majority of pensioner home-owners are wholly or largely mortgage free. To put it another way, most of them will have significant housing equity, especially given the spectacular increase in house prices in recent decades.

If housing wealth is going to 'solve' the pensions crisis, two conditions will have to be met:

a) Homeowning pensioners need to be able to access a meaningful amount of their housing equity and turn it into a more liquid form;

b) The distribution of housing wealth needs to include many of those who have low or modest pension incomes; in short, if only people with big pensions have valuable houses, then this will do little to solve the problem of those whose pension saving alone leaves them short in retirement.

We consider these two issues in the next two sections.

3. Turning housing wealth into income and capital

Living in a valuable house does not of itself put food on the table. If someone has pension income that is inadequate to secure a decent standard of living on a regular basis then the money tied up in their house is only of use to them if they can release it in some way. There are several ways in which this might be done:

a) Downsizing

If someone lives in a house which is larger than they need then they could simply sell up, move to somewhere smaller and use the capital thereby released to help sustain their standard of living in retirement. In practice however there are several barriers to this:

- Transactions costs – individuals will have to pay stamp duty on a new house purchase, pay for house moving, pay for legal fees, surveys etc. all of this eats into the proceeds of any sale;

- Availability of suitable property for 'down-sizing' – freeing up housing equity via down-sizing presumes that there is somewhere suitable available at a significantly lower cost than the sale price of the existing property; in practice this might not be the case; 'retirement' properties in particular can be very expensive and in many parts of the country the price differential between a larger family home and a smaller retirement home may not be that great, especially net of costs;[3]

- Psychological / emotional barriers – just at the point that an individual retires and perhaps loses out on the social aspects of a workplace, it is unlikely that they are going to want to sell up their home and move any distance from existing networks of family and friends; this is likely to significantly limit the number of suitable available properties that they might consider; in addition, although the family home might appear to be 'too big', many parents will want to keep one or more spare bedrooms for adult children to stay either on a short-term basis or perhaps to return home after the failure of a relationship or a job move; in short, a newly retired couple living in their long-term family home with three or four bedrooms is unlikely to want to downsize into a one-bedroom retirement flat;

- The 'bequest motive' – selling a family home and moving to somewhere smaller in order to live off the proceeds will, like other forms of equity release, mean less money for future generations to inherit; a significant group of older people place greater weight on their desire to pass on wealth to their heirs than on their own well being and may prefer simply to live more modestly than to east into their children's inheritance;

Whilst people can and do 'down-size' this often takes place later in retirement when a large home becomes unmanageable or where disability means that more suitable accommodation is required. Despite their intentions as reported to surveys, relatively few people do actually downsize at the point of retirement, for the reasons given above. This means that a different way needs to be found to access their housing wealth.

b) Equity Release

The most obvious way to 'release' some of the value of your home is to borrow against its value. This can be done in a variety of ways, and products vary according to whether repayments have to be made during the lifetime of the product, according to whether the property remains in the ownership of the home-owner or is transferred to the lender and so forth. But the basic principle is that financial products exist to help people tap in to the value of their housing wealth.

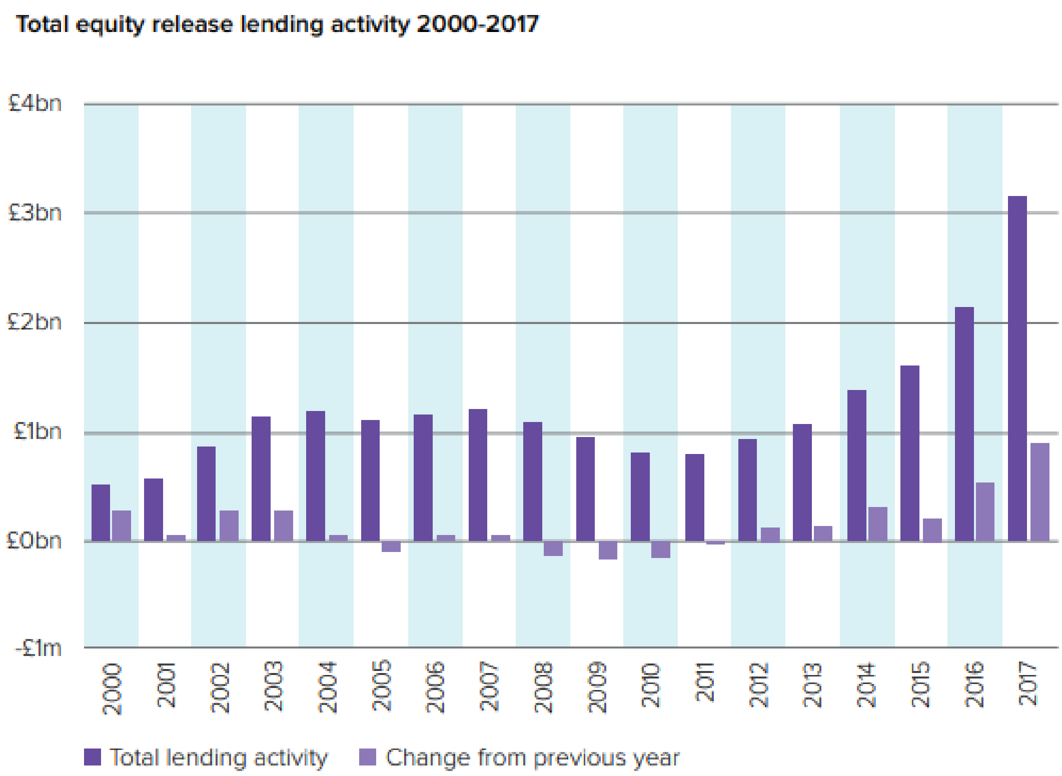
[3] We deal with this and related issues in the Royal London policy paper 'The Downsizing Delusion' which can be found at https://ww.royallondon.com/media/policy-papers

In the early days of these products, 'home income plans' developed a rather poor reputation. Many had high charges which were not well explained, and some borrowers found that the effect of compound interest meant that they ended up in 'negative equity', owing the lender more money than the value of their home.

It is widely accepted that the industry has significantly improved its practices and products since then, and the Equity Release Council exists to drive up standards across the industry. Interest rates on products are now much lower than in the past, most equity release products offer a 'no negative equity' guarantee, and more household name lenders have entered the market in recent years. All of these factors help to remove barriers to the use of housing equity in supporting retirement living. It is however worth noting that most equity release products are designed to release one or more capital sums rather than to generate a regular income, and we return to this point later.

Although the market remains relatively modest compared with traditional lending, there has been a significant growth in the use of equity release products in recent years, as shown in Figure 3. As Figure 3 shows, a little over £3 billion in housing equity was withdrawn in 2017, and separate data shows that this money was taken out by around 67,000 customers.

Figure 3. Trends in the Equity Release Market 2000-2017



Source: Equity Release Council spring market report 2018: http://www.equityreleasecouncil.com/document-library/equity-release-market-report-spring-2018/spring-market-report-2018-final.pdf

The Equity Release Council says that the average age of people taking out an equity release product on a 'drawdown' basis (where an initial capital sum is advanced and further capital sums can be taken up to a limit as required) stands at around 72.

Although the amount being withdrawn through equity release has risen rapidly, it is estimated that the total housing wealth of the retired population exceeds £1 trillion. This suggests that there is very considerable potential for this market to expand.

The ability of individuals to supplement their pension income by accessing their housing wealth will, of course, depend on how much housing wealth they have and how much they can release[4]. This in turn will depend in part on the age at which the product is taken out. In most equity release products no interest is paid during the lifetime of the product, it is simply added to the outstanding debt. As most modern products comes with a 'no negative equity guarantee', lenders will be cautious about making large advances to younger borrowers because the effect of compound interest means that the size of the debt can rise substantially over the lifetime of the product.

In practice, most lenders will be reluctant to lend more than around one third of the value of the housing equity in a property to someone at pension age. This is an important factor to bear in mind when considering how far income from housing wealth can be used to top up inadequate pension incomes.

To illustrate this point, the following table uses an online calculator offered by one equity release provider (correct as at August 2018) which shows how much equity could be released for the same £150,000 property depending on the age at which the policy was taken out.

Table 1. Equity available for equity release on £150,000 property by age of applicant

Age	Amount
60	£49,500
65	£57,000
70	£64,500
75	£72,000
80	£81,000

Source: https://www.onefamily.com/lifetime-mortgage/lifetime-mortgage-calculator/

As Table 1 shows, only a fraction of the value of a pensioner's home is likely to be available to be released via an equity release product. For the newly retired, barely one third of the property value might be available and it is only for those approaching age 80 that half of the capital value might be released. This is an important consideration when looking at those who reach retirement age with inadequate income and who might therefore wish to free up extra resources early in retirement. It should also be noted that the figures in Table 1 are gross of any product fees and other charges which would eat into the amount available to the home-owners.

In the next section we look at the key issue of how far housing equity might be the answer for those with the lowest pensions.

[4] In some circumstances, individuals in poorer health may find that they can access a greater proportion of the value of their housing equity via the health underwriting process.

4. Do people who have poor pensions live in valuable houses?

Housing wealth might be a 'solution' the pensions crisis if people who retire with modest pensions are often home owners with significant amounts of housing equity. But if the housing equity is concentrated among those who already have good pensions, then it does little to solve the problem.

In this section we look at a data set which provides information for a large and nationally-representative sample of households on both their pension income and their housing wealth. This is the Wealth and Assets Survey (WAS) which has been conducted in a series of 'waves' and started in 2006. The latest available data is for Wave 5 which was conducted over the period 2014-2016.

We conduct our analysis for the households contained in the survey who consist entirely of those over state pension age. We then look at:

a) Regular Income from state pensions, company pensions, private pensions and investments; note that we do not include earnings in this definition as we are interested in how far housing wealth can sustain people through their retirement, and we assume that at some point most people will leave paid employment;

b) Housing wealth – the capital value of the home in which the respondent lives, minus any outstanding mortgage and adding back in the value of any equity that has already been released at an earlier stage;

i) Housing equity among pensioners by region

We would expect housing equity to be strongly regionally concentrated, and Table 2 shows the average amount of housing equity for all pensioner households in our sample by region.

Table 2. Average housing equity by region, WAS Wave 5, pensioner households

Nation / English region	Average housing equity, all pensioners
North East	£136,000
North West	£178,000
Yorkshire	£165,000
East Midlands	£197,000
West Midlands	£198,000
East	£276,000
London	£399,000
South East	£334,000
South West	£259,000
Wales	£179,000
Scotland	£157,000
GB	**£234,000**

Source: Royal London calculations based on WAS Wave 5

As Table 2 shows, for the sample as a whole, the average value of housing equity is around £234,000. But there is almost a threefold variation between different parts of the country. In the North East of England, the average pensioner has around £136,000 in housing equity whilst in London the figure is a whisker short of £400,000. As we shall consider later, this points to a challenge in assuming that the use of housing equity will be a general solution to the problem of low pension incomes.

ii) Housing equity among pensioners by income

To identify the households with the highest incomes, we rank our households on the income measure above and split them into fifths or 'quintiles'. The lowest income households are in quintile 1 and the highest income households are in quintile 5.

First, we look at how far households at different income levels have any housing equity at all. Although the majority of pensioners are now home-owners, it is still the case that around a quarter are in rented accommodation of some sort. Table 3 shows what proportion of households in each quintile in the survey has any housing equity to draw on.

Table 3. Access to housing equity by income quintile (WAS Wave 5, pensioner households)

Income quintile	Percentage with any housing equity	Average value of housing equity
1 (poorest)	65%	£145,000
2	68%	£152,000
3	81%	£201,000
4	93%	£264,000
5 (richest)	97%	£407,000
ALL	**81%**	**£234,000**

Source: Royal London calculations based on WAS Wave 5

In this sample of around 6,700 pensioner households interviewed between 2014 and 2016, the overall home ownership rate was just over 80%. This is slightly higher than, but broadly in line with, the home ownership rates shown in Figure 2 for 2013/14 based on ONS estimates.

As Table 3 shows very clearly, there is a marked difference in home ownership rates between those who have modest incomes from pensions and those who have the highest incomes. Amongst the poorest two fifths (ie the bottom two quintiles) only around two in three pensioners has access to housing equity whereas amongst the richest group measured by income almost all own their own home. This shows that housing wealth is skewed towards those who also have higher pension incomes.

A similar pattern appears when we look at the average value of housing equity. The poorest fifth of pensioners could potentially access less than £150,000 in housing equity compared with over £400,000 for the richest fifth. In addition, these figures do not take account of any outstanding debts which may need to be serviced, including credit card debt etc., and rates of indebtedness are likely to be higher among lower income retired households.

One way of looking at this data would be to say that, not entirely surprisingly, those with larger incomes in retirement also tend to have (much) more housing wealth. From the point of view of solving the pensions crisis, housing wealth appears to be concentrated on the 'wrong people'.

A counter argument would be to say that it is still the case that roughly two thirds of the poorest pensioners are homeowners and that £150,000 is not a trivial sum. But if an equity release provider will only lend (say) one third of the value of a property for someone at retirement age, then in practice this group could probably typically release only around £50,000. As a capital sum this could be used to pay off debts or meet one off expenditures such as replacing a car etc.

At current annuity rates, a pot of this sort if used at retirement to generate a regular income could produce a weekly income of (very roughly) £50 per week. This is a little under one third of the rate of the new state pension which stands at £164.35 per week in 2018/19, which would be a meaningful contribution for a low income household, but does not make up for lack of access to a decent private pension income.

This also raises the interesting question of who are the people with low pension incomes who nonetheless have meaningful amounts of housing equity?

Given that we know that house prices vary far more regionally than incomes (because, for example, standard rates of state pensions are paid across the UK), it might be worth investigating how far there is a regional explanation to this puzzle, especially given the results of Table 2, which are for the pensioner population as a whole.

In order to investigate this further we look just at those who are in the lowest two income quintiles but still manage to make it into the highest two quintiles by housing equity. Table 4 shows the breakdown of this 'income poor, housing rich' group by region. The sample is relatively small (569 households) and so the pattern is likely to be no more than indicative.

Table 4. Regional breakdown of households in bottom two quintiles by income who are in top two quintiles by housing equity

Wave 5 Government Office Region code	Freq.	Percent	Cum.
North East	9	1.58	1.58
North West	29	5.10	6.68
Yorkshire & Humber	32	5.62	12.30
East Midlands	31	5.45	17.75
West Midlands	28	4.92	22.67
East of England	79	13.88	36.56
London	101	17.75	54.31
South East	128	22.50	76.80
South West	84	14.76	91.56
Wales	20	3.51	95.08
Scotland	28	4.92	100.00
Total	569	100.00	

Source: Royal London calculations based on WAS Wave 5

Out of the whole sample of pensioner age households that we have been dealing with, roughly 20% are in London or the South East. But when we look at the 'income poor, housing rich' group in Table 4, we see that twice as many – around 40% - live in London or the South East. This suggests very strongly that the small number of those for whom housing equity is likely to provide a route out of income poverty are likely to be heavily concentrated in areas of higher house prices in the South East of England. It seems likely that this could include a significant group who exercised the 'right to buy' their council house in the 1980s and beyond and have enjoyed a surge in the value of their housing equity without necessarily having built up generous pension rights.

5. Who else could be income poor and housing rich?

a) Widows / divorcees?

In general, it might be expected that those who had enough income to enable them to buy a larger house will also have had the means to build up a good pension. But there are a number of further groups who might find themselves with significant housing equity despite a poor income, and these are widows and divorcees.

In Table 5 we look at the marital status of the 'income por, housing rich' group compared with the sample as a whole.

Table 5. Marital status of a) all pensioner households and b) 'income poor /housing rich' pensioner households

Marital Status	All pensioner households	'Income poor / housing rich' pensioner households
Married	48%	33%
Cohabiting	2%	2%
Single	8%	9%
Widowed	27%	38%
Divorced	13%	15%
Separated	2%	3%
Civil Partner	0%	0%
All marital status groups	100%	100%

As Table 5 shows, whereas around 27% of the full sample were widows, 38% of the income poor / housing rich group are widows. In general, a widow will suffer a sharp drop in her income when her husband dies but this will not generally affect the amount of housing equity to which she has access. Widows account for more than a third of those who are towards the bottom of the scale when it comes to income but towards the top when it comes to housing wealth. Using housing wealthy may be a route out of income poverty for some.

Table 5, albeit based on relatively small sample sizes, also provides some indication that divorcees[5] may be another group who can find themselves on relatively low incomes but with valuable housing equity. At the time of a divorce a woman who has spent a lot of her time out of paid work raising family may receive a share in the value of a family home as part of a divorce settlement. In such a situation she may have relatively poor accrued pension rights, and may not be able to recover this in life post-divorce, but could have significant amounts of housing equity. Again, it may be the case that for some divorced people, accessing housing wealth could be part of tackling low income in retirement.

[5] Note that the table shows marital status at the time of the survey, that is, in retirement. There are likely to be some divorcees who have remarried or re-partnered and who therefore appear in other categories but who have similar characteristics to those who have remained divorced.

b) Those with inherited wealth

Another way in which individuals could find themselves with modest incomes but valuable housing equity would be if they had inherited housing wealth from their parents' generation. This would be reflected in our data if, for example, they had used inherited housing wealth to reduce the mortgage on their own home or if they had moved into a (larger) family home at the point of inheritance.

Although the sample size in our data is too small to generate reliable estimates of how far the income poor / housing rich group was characterised by inherited wealth, for the sample as a whole we find that just under 3% became owners of their current home directly by inheritance (ie they moved into their current home when they inherited it). This figure will not, of course, include the presumably much larger number who put inherited housing wealth towards meeting their own mortgage. In some cases, this inheritance will help to explain how someone can reach retirement with a relatively low income but a significant amount of housing wealth.

6. Conclusions – will housing wealth solve the pensions crisis?

On the face of it, record levels of home ownership among the retired population ought to provide a substantial measure of insulation against future declines in pensioner incomes. If people can access their housing wealth in an affordable way which allows them to top up their regular income then we might hope that this will give us more time to get pension saving levels up to more realistic levels.

However, our analysis suggests that for most households, housing wealth is unlikely to be a 'get-out-of-jail' free card. This is for a number of reasons:

a) Significant housing equity tends to be associated with larger pensions; in other words, although there is a lot of housing equity held by the retired population, a lot of it is held by those who already enjoy higher levels of pension income; we find that home ownership rates are much higher among those with higher pensions and average values of housing equity are also higher amongst better off pensioners;

b) Housing equity is significantly regionally skewed; there *are* examples of people with modest pension incomes and relatively large amounts of housing wealth, but these are much more likely to be found in London and the South East than in other parts of the country;

c) Even for those with housing equity, the amount that they can borrow at retirement age may only be a small proportion of the full value of their home; because interest can compound during the life of an equity release product, those who take out equity release early in retirement can generally borrow less than those who do so later; the ability to top up income through housing wealth at the point of retirement will therefore be significantly constrained;

d) Home-ownership amongst the retired population looks to be close to its peak and may be set to decline; we can already see that the 45-64 age group has lower rates of home ownership in the latest data than a decade earlier, this will in due course feed through into the retired population; so whilst the housing wealth of today's retirees will offer breathing space to some, we cannot regard this as a long-term solution to the problem of poor pensions;

e) The same pound of housing wealth cannot be 'spent twice'; with public funding for social care being rationed increasingly severely, more and more people are likely to have to turn to their own resources to fund their social care; if society chooses to rely on accumulated housing wealth to help solve the pensions crisis, this would make it more difficult to expect people to use housing wealth also to contribute towards care costs;

f) There may be significant psychological and emotional barriers to overcome in order to get large numbers of older people to release housing equity, whether through downsizing or financial products; physically moving out of a family home into somewhere smaller in order to downsize may present particular barriers, but the desire to avoid eating into wealth that was mentally earmarked to benefit the next generation will also be a significant barrier for some.

We do however find that there will be particular groups such as widows and divorcees who could find themselves with relatively low pensions but relatively large amounts of housing wealth. For this group, we might reasonably suppose that affordable access to equity release type products could help to ameliorate the problems they have experienced in building up pensions in their own right[6].

In sum, there are certainly particular groups – such as those who exercised their 'right to buy' and have enjoyed significant growth in housing equity – for whom housing wealth might provide a safety valve to compensate for poor pension incomes, especially for those in London and the South East. But overall we find that for most people with low pension incomes, housing is not going to ride to the rescue. Tackling the pensions crisis remains essential.

[6] It would, of course, be preferable to ensure that widows and divorcees build up decent pensions in their own right, rather than having to rely on the lottery of whether they have housing wealth or not.