

The increasing use of reverse mortgages by older households

15th Annual Pacific Rim Real Estate Society (PRRES) Conference
18th – 21st January 2009 Sydney, Australia
(refereed paper)

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KEY WORDS:

Reverse mortgages, home equity, negative equity, seniors, long-term implications.

ABSTRACT

Reverse mortgages have been increasingly accepted by older Australians which follows an international trend towards reverse mortgages. Between 2005-07 the size of the market reached \$2 billion in Australia with over 33,000 outstanding (SEQUAL 2008). At the same time the largest single asset for many older Australian households is their primary place of residence, usually in the form of a detached house or a medium to high density unit. This cohort consists primarily of retirees aged 55 years and over who have permanently left the full-time workforce with limited means of earning additional household income, but who also have a lack of prior financial planning assistance and often no access to superannuation funds. In addition there has been an increase in essential living expenses such as medical, food, transport and the introduction of a Goods and Services Tax (GST).

This paper investigates the uptake in reverse mortgages in Australia as a means of providing a viable long-term solution for older households to meet unforeseen expenses during retirement. It investigates existing reverse mortgage providers and what products they are currently offering. The emphasis is placed on the potential for reverse mortgages to be misunderstood by retirees over the long-term, as accessing home equity in this manner is an irreversible decision when there is no financial capacity to repay the loan. It examines the long-term implications for older households, especially those who are unfamiliar with banking practices, complex mortgage documents and costs associated with a reverse mortgage.

[Note: this research is funded as an Australian Research Council (ARC) Discovery Project DP0665513]

Introduction

The proportion of residents in Australia aged over 50 years is expected to rise from 29% to 46-50% by 2051 (Australian Bureau of Statistics 2005). Originally the number of years available to enjoy and active retirement were substantially less due to (a) a shorter life expectancy especially for males and (b) often a longer period of employment for many workers who used to work for many more years before seriously contemplating retirement. It is now accepted in society that older households, after ceasing full-time work, should be able to enjoy an increasingly active lifestyle after entering retirement without financial stress (Shiller 2000). This older group of retirees is predominantly without compulsory superannuation with a heavy reliance on the pension and/or a reverse mortgage. The importance of superannuation is clearly acknowledged in society today, as it is compulsory for all Australian workers to contribute to a superannuation fund for their retirement. As additional workers in the 'baby boom' generation retire and there is less tax paid to the government, it appears that there will be increasing pressure placed on the pension and there are serious doubts if the pension will exist in its current form. Those Australians who were fortunate to have a superannuation scheme should be adequately prepared for retirement. However, the remainder of the population may struggle to enjoy a fulfilling retirement and are rapidly drawn towards a reverse mortgage.

The reverse mortgage market has rapidly expanded in Australia in recent years even though the financial product was introduced in the early 1990s and was not initially widely accepted due to poor timing and a lack of understanding in the market (Reed 2004). Since reverse mortgages were reintroduced they have become commonly accepted in society as a viable solution for accessing extra funds during retirement – for example by December 2007 the market reached \$2 billion with over 33,000 reverse mortgages in Australia (Sequal 2007). Currently there are many reverse mortgage providers in the market (see appendix A) ranging from building societies (e.g. Newcastle Permanent) to major banks (e.g. Commonwealth Bank of Australia). This level of acceptance and uptake has confirmed that the initial start-up and acceptance phase of reverse mortgages has now passed and the attention is turning towards other considerations such as the ability of older Australians to understand reverse mortgages (Reed et al. 2007) and also if reverse mortgages are suitable for the majority of retirees (Dillion 2008).

There have been many factors which have contributed to the introduction and rapid uptake of reverse mortgages in Australia over the past decade, with the main reasons including an aging population and also the widespread lack of superannuation or the pension for financial support in retirement (Murdoch 2008). In a similar manner to other western civilisations, the family home is often perceived as a 'nest egg' for the future where retirees are able to access the locked up equity in the property without moving or making regular repayments. Reverse mortgages are aimed at the senior market where applications are typically over 60 years of

age. Although the concept of a standard 'forward' mortgage is well accepted as a natural and progressive step towards reaching homeownership, the market for a 'forward' mortgage normally includes much younger applicants who are possibly more familiar with mortgage documentation as well as having the ability to recover over time from a poor financial decision (Davis 2008). On the other hand a senior or retiree may not be as fluent with mortgage paperwork and certainly has limited, if any, potential for future work-related income.

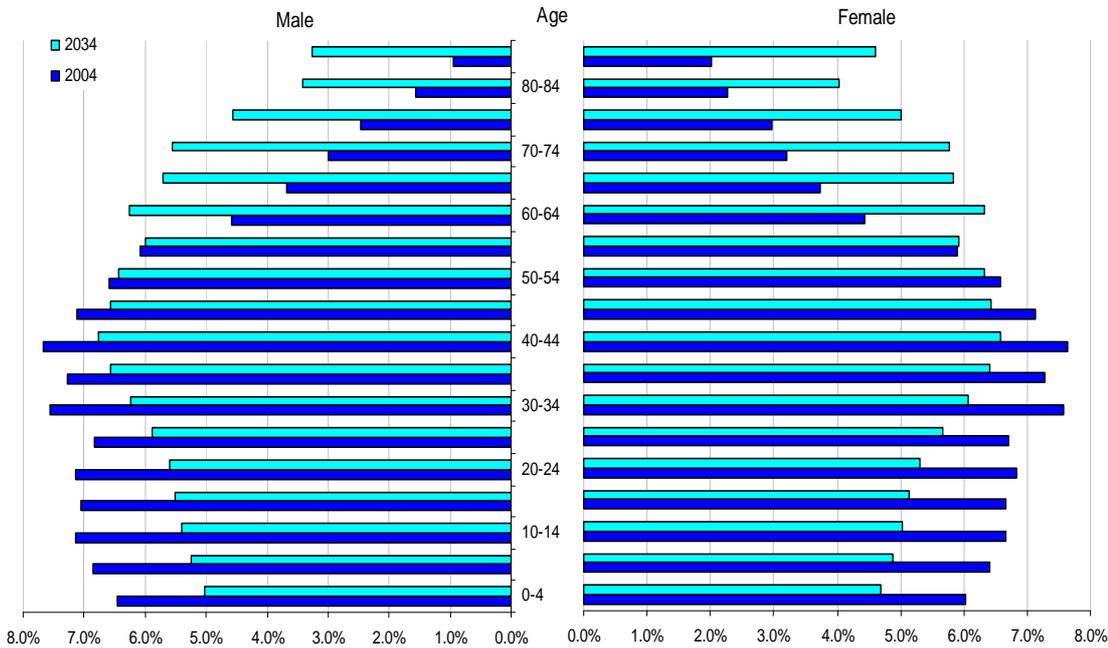
Recently in the media there have been some discussions about the potential for reverse mortgages to be misunderstood by applicants, the majority of whom are older Australians who are very conscious of media perception. For example it has been suggested that older Australians may be 'forced' to undertake a reverse mortgage in order to cover a higher cost of living (Murdoch 2008). Furthermore, seniors have been asked use caution and to be fully aware of the different options with regards to reverse mortgagees (Dillion 2008). Some concerns have been raised that reverse mortgage borrowers may be exploited, mainly because they don't understand the full implications of undertaking out a mortgage (Davis 2008).

This paper investigates the perception reverse mortgages in Australia and more specifically the potential for reverse mortgages to benefit seniors and or alternatively to be misunderstood. This paper overviews the reverse mortgage market in Australia, the existing providers and how their products differ. It also reviews two recent reports into the perception of reverse mortgages by (a) an industry body (SEQUAL) and (b) ASIC. A discussion of these findings identifies shortfalls in understanding the perception of reverse mortgages and highlights potential future research areas.

Reverse mortgages in Australia

The largest single asset for many older Australian households is their primary place of residence, usually in the form of a detached house or a medium to high density unit. This cohort consists primarily of retirees aged 55 years and over who have permanently left the full-time workforce with limited means of earning additional household income, but who also have a lack of prior financial planning assistance and often no access to superannuation funds. As shown in figure 1 there is a rapidly aging profile predicted for the Australian population between 2004 and 2034 (ABS 2004). At the same time there has been an increase in essential living expenses such as medical, food, transport and the introduction of a Goods and Services Tax (GST). These changes were generally unforeseen and have severely challenged the ability of Australians or seniors to retain a reasonable level of housing in retirement, as the combination of restricted household income and increased living costs has placed substantial pressure on the household budget (Weiner 2003).

Figure 1. Changing Age Profile in Australia 2004 – 2034



(Source: ABS, 2004)

Prior to their relatively recent introduction in Australia, many countries had already embraced the concept of reverse mortgages including New Zealand, USA, UK, Canada, Hungary and Singapore. Reverse mortgages are now being actively promoted in Australia by major banks (e.g. Suncorp) and other financiers as a means of accessing equity in a retiree’s home, even though there is no requirement to make repayments during the course of the loan (Peterson 2002). Simply explained, the borrowed principal component and other associated costs accrue interest for the term of the loan. For many households the timing of reverse mortgages is ideal, with residential property in most urban areas experiencing rapid price increases during recent years and this is a means of accessing this increased equity without relocating (Williams 2003). The equity in the home is used to repay the loan, usually on the death of the last inhabitant where the outstanding amount plus accrued interest is then fully repaid.

The overall rate of take-up has been impressive in recent years. Due to factors such as privacy laws and the competitive nature of the finance market there is limited detailed information available in the marketplace about the exact number and type of reverse mortgages. Referring to a study by the reverse mortgage industry body SEQUAL (Senior Australians Equity Release Association of Lenders) it is possible to examine aggregated information as shown in table 1.

Table 1. Uptake of Reverse Mortgages in Australia 2005-07

	December 2005	December 2006	December 2007
Outstanding Market Size	\$848,000,000	\$1,513,000,000	\$2,023,000,000
Number of Loans	16,584	27,898	33,741
Average Loan Size	\$51,148	\$54,219	\$60,000
Settlements	\$315,000,000	\$520,000,000	\$466,000,000
Faculty (settlements)	\$519,000,000	\$714,000,000	\$627,000,000
Additional Drawdowns	N/A	N/A	\$125,000,000
Discharges	N/A	N/A	(\$203,000,000)

(Source: SEQUAL 2007)

Reference to table 1 highlights growth of the market between 2005-07 where the outstanding market size more than doubled over this period, as well as the number of loans. It can also be noted that the average loan size in 2007 was \$60,000 which showed a relatively small increase between these years, although this usually represents only a very small proportion of the overall home value e.g. 10% or 20%. This is in contrast to a traditional forward mortgage where the loan will often be a large proportion e.g. 90% of the overall house value.

Previous research into reverse mortgages

There are widespread social and economic implications to be gained from conducting research into an emerging market, such as the reverse mortgage market, as well as the implications for the broader housing market. It should be noted that the provision of safe and affordable housing for citizens remaining a priority for all governments (Troy 2000). In addition, governments have had a vested interest in the housing market, and closely monitor the status of the market at any given time (Yates 2000). Nevertheless, a large proportion of the emphasis is placed on the lower end of the market at the 'first home owner' entry level - seemingly little attention is paid to existing older homeowners who are perceived to already be in the market place and have already overcome housing-related financial problems (Reed et al. 2002). However this is not correct in all circumstances with certain sectors of the older homeowner bracket in need of priority assistance. Furthermore, it is the older homeowners who, although they may have a relatively large proportion of equity in their property, struggle with important tenure issues (Reed 2006). It is unclear to what extent reverse mortgages will affect government entitlements in Australia and these complications have been highlighted in overseas markets.

For example, in the UK one of the major problems lies with the loss of state income support entitlement and other benefits that can be withheld from a UK citizen who takes out a reverse mortgage (Huan et al. 2002).

While there have been links identified between housing and health, such studies have only focussed on homeownership as a means improving the location of housing from slum areas and therefore quality of life (Easterlow et al. 2000). There are clear intangible benefits attached to independent homeownership for older citizens as most would prefer to 'age in place' in their own home (Howden-Chapman et al. 1999). Even older residents who are not 100% active are often encouraged to remain at home where possible, rather than relocate into a nursing home or a medical facility for partial care (Weinberg et al. 2001). Alternatively, it is common to have live-in nursing care at home or a limited form of care on a regular basis for meal preparation and associated duties. This is accompanied by additional expenses that were not anticipated when calculating financial needs in retirement, although a reverse mortgage can meet these expenses and is often promoted in this manner (Reed 2006).

It has been argued that in western civilisations home ownership has a direct bearing on health and life expectancy in comparison to those living in rented properties (Macintyre et al. 1998). But if growing old in the family home is the preferred option, steps must be taken to address the growing gap between income and expenses without re-entering the workforce. A reverse mortgage has the ability to provide a viable solution, such as where a reverse mortgage enabled one applicant who required money to fund a new prosthetic leg and another required a wheelchair ramp to be installed (Boreham 2003). Nevertheless, there remains the potential for the improper application of reverse mortgages with long-term consequences.

Pressures on society would be substantial if older Australians were unable to maintain a respectable quality of life and there remains a moral obligation on governments and society not to price seniors out of the marketplace. Due to changes in the level of house prices and perceptions towards lifestyle in society, the ability of older households to obtain and retain homeownership has been placed under substantial pressure. Clearly homeownership underpins the traditional Australian society, where a diminished ability to retain homeownership has the potential to directly and indirectly affect many sectors of society (Waxman 2005). For example, older Australians who don't retire at home may be forced into a nursing home earlier than anticipated, placing additional pressure on this resource. This cross-disciplinary project will ascertain the extent of the problem and the catalysts behind its development, as well as provide a direction to address this dilemma.

Significance and innovation of the research project

The larger research project, of which this paper discusses the framework, addresses a rapidly expanding area that affects a growing section of society and examines factors influencing reverse mortgages, both in supply and demand. To-date this area has been overlooked in terms of understanding the needs of older Australians, and importantly to what extent reverse mortgages adequately addresses their needs. Furthermore, it examines the potential for reverse mortgages to be misunderstood. Rather than adopting the individual perspective of (a) a bank or financier, (b) an older household or (c) the government, in part 2 of this research (the next stage) all three stakeholders will be collectively examined for their roles in the reverse mortgage process. This paper at hand overviews the growth in reverse mortgages in Australia and outlines the direction of the overall project.

The larger project will use a cross-disciplinary approach that links property, in the form of residential housing, with demography, being retirees over 55 years of age. It will be conducted in three stages and follows the three aims of this project.

Stage 1.

To investigate the role of existing reverse mortgages in the Australian market.

Stage 2.

To assess the financial needs of older Australians and their willingness to undertake a reverse mortgage or home equity loan.

Stage 3.

To examine the potential for reverse mortgages to be misused or misunderstood

Studies into reverse mortgages in Australia

Information relating to the perception of reverse mortgages in Australian is relatively scarce due to a number of factors. These include:

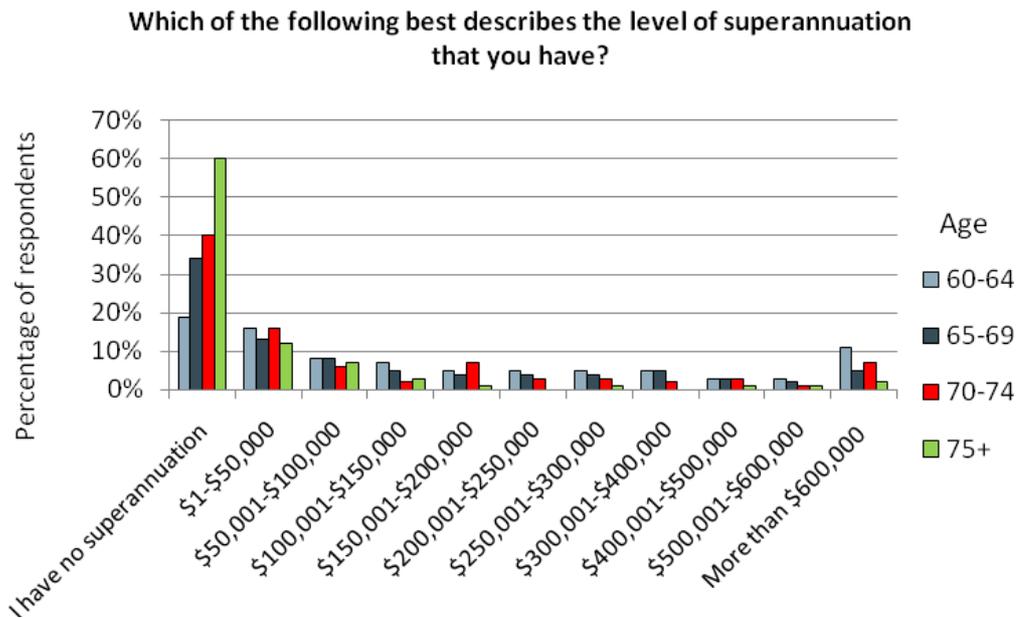
- the relative infant nature of the marketplace;
- the sensitive nature of financial information between competing financial institutions;
- the variation in individual circumstances between each reverse mortgage; and
- the different types of reverse mortgages (with varying conditions) currently available.

This section discusses recent two recent research studies into reverse mortgages in Australia and their implications for the use or misuse of reverse mortgages.

SEQUAL study (2008) – ‘Its on the House’ SEQUAL-RFI Reverse Mortgage Study

The SEQUAL (Senior Australians Equity Release Association of Lenders) study was undertaken by a private consultant (RFI), where the research targeted the over 60s age bracket. Approximately 1,000 Australians aged 60 years and over were contacted via a national telephone survey in November 2007 in order to assess their knowledge and perception of reverse mortgages. Figure 2 highlights the large proportion of seniors who have low or no superannuation reserves.

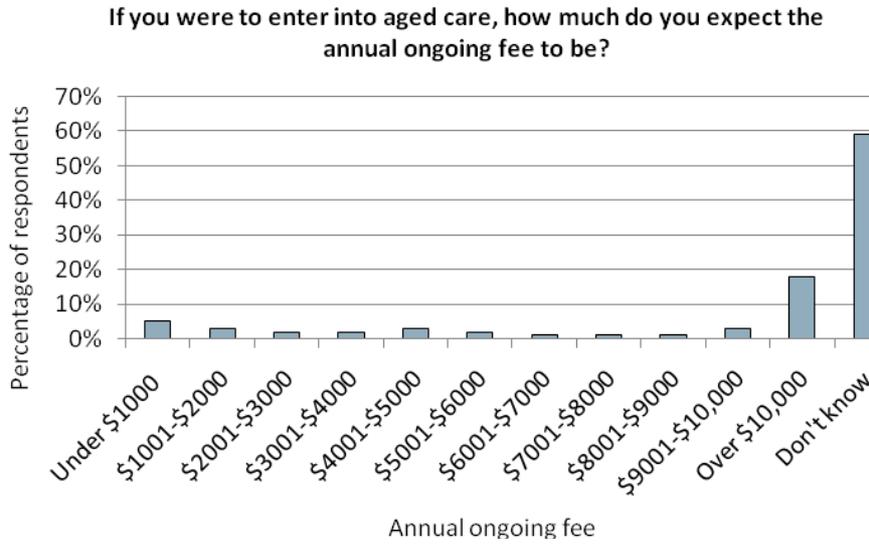
Figure 2. Superannuation Reserves – Over 60s



(Source: SEQUAL, 2008)

Figure 3 highlights the lack of knowledge that older Australians have about financial matters linked to their future. Most of the respondents in the survey of 1,000 respondents did not know how much the ongoing fees associated with aged care would be.

Figure 3. Ongoing Cost of Aged Care

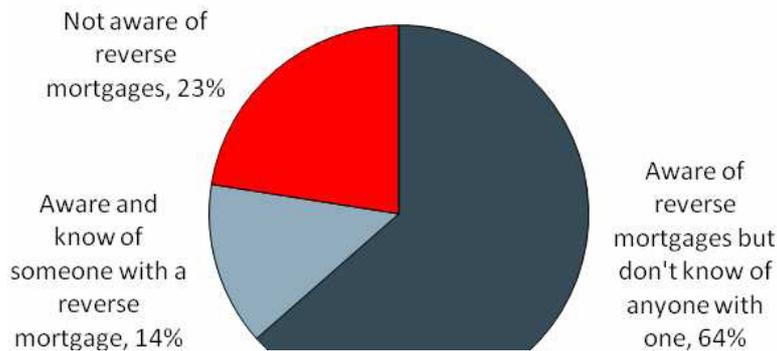


(Source: SEQUAL, 2008)

With reference to the market awareness by seniors of reverse mortgages in Australia, most respondents (77%) had heard of the term ‘reverse mortgage’ (see figure 4). This is a rapid uptake from when the author released a book titled ‘Reverse Mortgages’ in 2004 (Reed, 2004) when the term was relatively unknown in the general marketplace.

Figure 4. Awareness about Reverse Mortgages

Are you aware of loan products called reverse mortgages? If so, do you know anyone that has taken out a reverse mortgage?



(Source: SEQUAL, 2008)

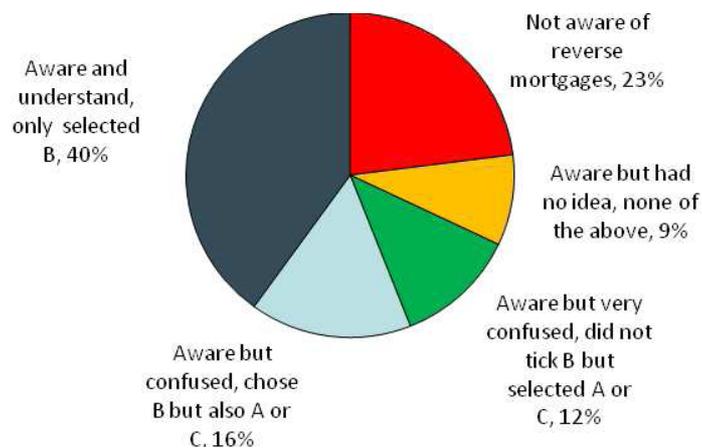
The respondents were asked the following question:

Which of the following is true of a reverse mortgage? A reverse mortgage is a product that enables a home-owner over the age of 60 to:

- (a) Sell part of their house in exchange for money*
- (b) Borrow against their home without making repayments*
- (c) Borrow against their home and repay the loan over their lifetime*
- (d) None of the above.*

Although the correct response was (b), less than half of the respondents replied with the correct answer (see figure 5). It should be noted that approximately 35% of the participants were either 'confused' or had 'no idea' of what a reverse mortgage actually is.

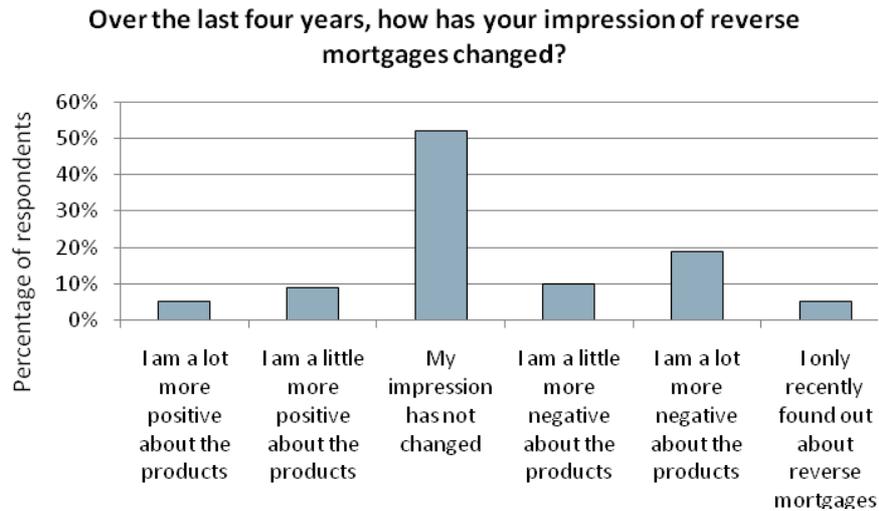
Figure 5. Understanding about Reverse Mortgage Concept



(Source: SEQUAL, 2008)

Interestingly this study also investigated how (if at all) the perception of reverse mortgages had changed over time, more specifically over the past four (4) years. Whilst the largest single reply (see figure 6) was for 'my impression has not changed', it is clear in this diagram that there were more negative responses than positive ones. This suggests there has been an attitudinal changes towards reverse mortgages, which may partly due to a lack of understanding.

Figure 6. Perception of Reverse Mortgages



(Source: SEQUAL, 2008)

ASIC study (2007) - All we have is this house – consumer experiences with reverse mortgages

In contrast to the 1,000 telephone interviews undertaken with the SEQUAL study, the ASIC research was based on 29 interviews of seniors who had already taken out a reverse mortgage. This is a different survey approach to the SEQUAL study, since the respondents were able to discuss their knowledge and experiences with a reverse mortgage. Clearly all participants had heard of and were familiar with a reverse mortgage. This section discusses some important findings from this report. With regards to understanding basic finance fundamentals, existing reverse mortgage clients appeared to be somewhat lacking. In the ASIC (2007) study the participants were asked if they actually knew how a reverse mortgage works. The breakdown of responses from the 29 participants were as follows:

- 14 participants did not know how much the loan was likely to cost over time;
- 6 participants were unaware of how compound interest works; and
- 17 participants did not know what would happen if they breached a loan condition.

Table 2 summarises of the major issues raised by reverse mortgage borrowers about their dealings with the reverse mortgage lender or intermediary (i.e. mortgage broker). It should be noted that each respondent had taken out a reverse mortgage over the past three (3) years and these questions were reflective. There is clear evidence that practically all of the borrowers were given an explanation about how the loan would work and the repayment process. However the responses were not so clear about other relevant issues, such as projections of total loan costs (over time) and also reference to remaining equity.

Table 2. Issues raised by the Lender or Intermediary

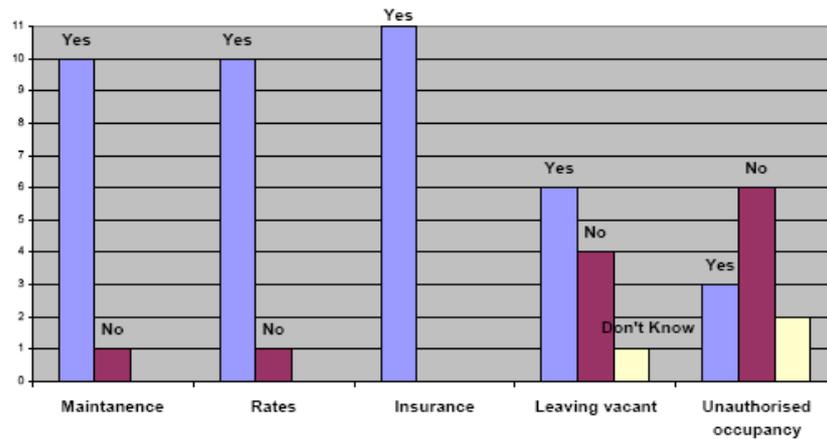
Did the representative ...	Borrower recall/agree		
	Yes	No	Not sure/not relevant
Encourage or require them to seek independent financial advice?	20	8	1
Encourage or require them to discuss the loan with their family?	22	4	3
Encourage them to seek advice from Centrelink before finalising the loan?	14	8	7
Ask questions about their financial situation and lifestyle when they applied for the reverse mortgage?	11	13	5
Clearly explain how the loan would work?	28	—	1
Explain how the loan would be repaid?	28	—	1
Explain the cost of all fees and charges?	27	1	1
Explain how varying interest rates and housing prices might affect the loan?	16	11	2
Explain the impact the loan would have on pensions?	10	15	4
Show them a projection of how much the loan might cost over time?	16	12	1
Show them a projection of how much equity might be left in the home over time?	12	13	4
Ask about their family situation and whether it is important for them to leave an inheritance to their children?	12	14	3

(Source: ASIC, 2007)

Further attention is placed on the second last question in table 2 referring to ‘*how much equity might be left in the home over time?*’ This has traditionally one of the largest concerns often raised by potential reverse mortgage users relating to the possibility for ‘negative equity’ to occur, where the amount of the loan could exceed the value of the home and the elderly homeowner/s are potentially evicted with the house being sold. A projection of the relationship between (a) the amount of the loan outstanding and (b) the total value of the property usually confirms it is extremely unlikely that negative equity would occur (note: an exception would be a severe housing downturn coupled with high interest rates and a very high loan-to-value or LVR). To alleviate this concern it is commonplace for reverse mortgage providers to have a relatively low LVR with many lenders having negative equity – refer to appendix B which highlights the differences between varying reverse mortgage products regarding negative or protected equity. For example with Suncorp the borrower will always retain 25% equity with a maximum LVR of 50%.

Figure 7 summarises the responses from 11 respondents who are all with the same lender. Whilst most borrowers were familiar that they must maintain the home and also pay rates and insurance costs, there was some confusion about whether the home could be left vacant or if there was unauthorised occupancy e.g. the property was rented to a third party.

Figure 7. Knowledge of Default Conditions



(Source: ASIC, 2007)

Further discussion

The two recent reports that formed the body of this paper were both seeking to assess the perception of reverse mortgages, although the findings from each study were based on different research methodology. The only common link was that both studies were restricted to senior Australian who would be potential reverse mortgage borrowers i.e. senior Australians. The SEQUAL (2008) study involved a large scale of participants (1,000) in the broader marketplace, where respondents had no obvious association with reverse mortgages. The ASIC (2007) study was based on interviews with 29 reverse mortgage borrowers, with the loans taken out during the past three years. Nevertheless some conclusions can be drawn from both reports.

The age pyramid in figure 1 clearly supports the reasons for the increased levels of demand for reverse mortgages, which is supported by figure 2 where many seniors have little or no superannuation. Surprisingly few Australians are aware of the costs of aged care (figure 3), which also complicates their understanding of their financial requirements. This poses a question: *how much certainty can there be about a reverse mortgage if there is a gap in knowledge about a borrower's future needs?*

Both studies suggest that the relatively new concept of a 'reverse mortgage' is not yet fully understood by everyone, being either existing clients or the market in general. Reverse mortgages have not yet fully saturated the marketplace and they don't have a high profile in the broader society (figures 4 and 5), although their profile has increased substantially in recent times (figure 6). Therefore it is important that the profile of reverse mortgages is raised so that it is better understood by seniors, either with existing or potential reverse mortgage borrowers.

Table 2 and figure 7 from the ASIC highlight an alarming gap in knowledge about reverse mortgages by reverse mortgage borrowers. However there must be some doubt dispersed over the validity of these responses. For example with regards to a conventional forward mortgage, *how many forward mortgage respondents would be able to confidently answer the same questions?* In other words, are such borrowers given an explanation of total loan costs including future projections, or *is the focus placed on current interest costs and the total loan amount?*

Further research

This paper discussed findings from two recent reports into the perception of reverse mortgages in Australia. There is evidence that the perception of reverse mortgages has changed rapidly and although concerns have been raised about a borrower's understanding of a reverse mortgage, there is little consideration given to other influencing factors. For example, *is any borrower able to accurately recall the terms and conditions of the loan at any point in the future?*

The next stage of this research is to interview current and prospective reverse mortgage borrowers about their perception about this product. This in turn should identify any problems with the product and provide invaluable feedback to reverse mortgage providers, industry bodies and the relevant government authorities. The data for the analysis will be taken from two main areas:

- (a) primary data collected from focus groups conducted in Brisbane, Melbourne and Sydney;
- (b) secondary data sourced from organisations e.g. Australian Bureau of Statistics (ABS), The Real Estate Institute of Australia (REIA) and government records on a time series basis.

The data will then be assembled and analysed to address the research aims. Preliminary results from this data analysis will highlight difficulties associated with reverse mortgages, prior to conducting the focus groups in the three capital cities. Furthermore, the preliminary results will ensure that the focus groups questionnaires are robust and address areas of concern for older households in respect of reverse mortgages.

Reverse mortgages continue to rise in popularity in Australia, in a similar manner to other western societies. At the same time the target market for reverse mortgages are seniors, who typically are unfamiliar with complex mortgage documents and may be vulnerable. It is critical that older Australians are kept abreast of changes in the reverse mortgage market and the conditions that affect their loan, both at the date of commencement and during the term of the loan. Whilst conducting research for this paper it was acknowledged there was relatively little information about reverse mortgages which was available to the public. It is envisaged that raising the

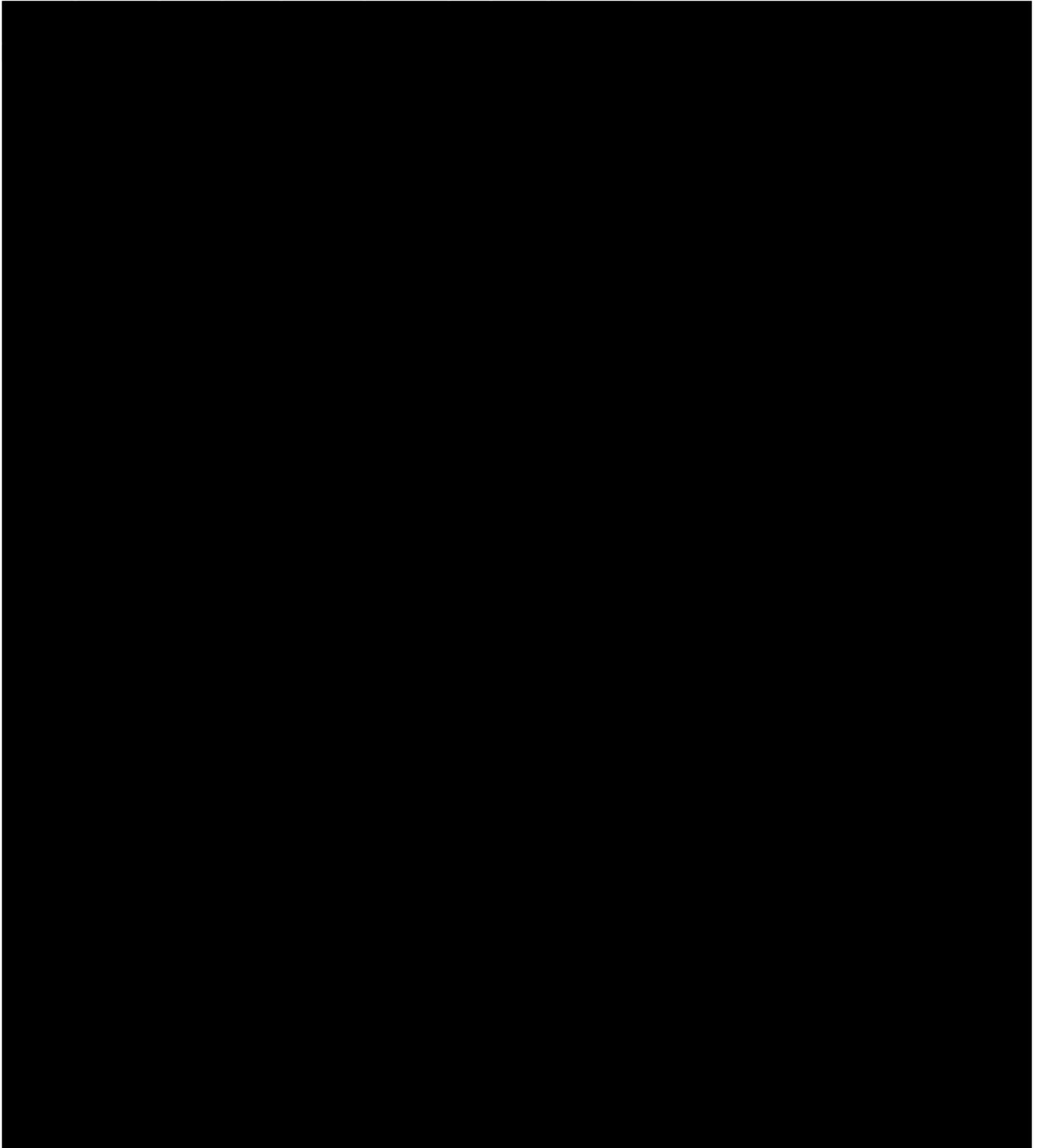
awareness about reverse mortgages will assist to educate current and prospective older households about the use and misuse of reverse mortgages.

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Appendix A – Existing Reverse Mortgage Providers in Australia (as at 30th August 2008)



(Source: *Cannex 2008*)

Appendix B – No Negative Guarantee and Protected Equity Analysis (as at 30th August 2008)

Company	No Negative Equity Guarantee (NNEG)	Conditions of NNEG	Protected Equity	LVRs (Max Loan to Value Ratio)
Suncorp	Yes	Compliance with the terms of the loan	25%	50%
Vision Equity Living	Yes	Your home must be in reasonable condition and be properly maintained – as this affects its market value; You must ensure that all rates and taxes are paid; You must maintain your household insurance.	Up to 25%	50%
ABN AMRO	Yes	Compliance with the standard loan terms	25%	50%
Australian Snrs Finance	Yes	Observe the terms and conditions of the Lifetime Loan	10%, 20% or 50%	50%
BankSA	No Obvious Statement		N/A	25%
BankWest	Yes	Not Specified	N/A	25%
Commonwealth Bank	Yes	borrower's liability is limited to the value of their interest in the property provided they have not breached any terms of, nor any warranty or representation in connection with, the loan contract	N/A	45%
Lifepan Funds Managemnt	No Obvious Statement		N/A	40%
Mariner Retirement Sols	Yes		25%	50%
Maroondah Credit Union	No Obvious Statement		N/A	5,200
Newcastle Permanent	Yes	Compliance with the standard loan terms	25%	50%
Nurses First	No Obvious Statement		N/A	35%
Police & Nurses Credit	Yes	Provided the terms and conditions of the loan have been met	N/A	35%
St George Bank	No Obvious Statement		N/A	25%
Bluestone	Yes	Applications subject to Bluestone Equity release lending criteria	20%	45%
SGE Credit Union	No Obvious Statement		N/A	30%

(Source: *Cannex 2008*) (Note: N/A = Not Available)