

1. Publishable Summary

Demographic change and housing wealth

1.1 PROJECT OBJECTIVES

The starting point of DEMHOW is the observation that macro processes of demographic change that are leading to an EU-wide shrinking and ageing of populations are accompanied by another macro process: the EU-wide changes to housing systems. The co-incidence of these two macro processes suggests the intriguing question of the extent to which home ownership provides a potential cure for some of the consequences of ageing populations, as well as contributes to the causes. The overall aim of DEMHOW is, then, to investigate the ways in which, across member states, demographic change and housing wealth are linked, and to use those investigations in order to contribute to policy making.

1.2 WORK PERFORMED DURING THE PROJECT

In the first period of the project, two main areas of research have been undertaken and completed:

Econometric Analysis. Using macro and micro data, econometric studies have been carried out in order to investigate how the composition of wealth has changed over countries, with respect, in particular, to changes in population, housing systems, state pension arrangements, and financial institutions.

Policy Analysis. Using scientific literature and policy documents and drawing on international evidence within and without the EU, the strengths and weaknesses of housing equity based approaches to the provision of pensions and other welfare needs in old age have been assessed.

There has been progress in two further areas. Firstly, a household interview schedule has been designed and piloted and the full interviews carried out by partners in eight member states. Secondly, dialogue and dissemination activities - ranging from the establishment of a website, the presentation of papers at conferences and the holding of advisory group meetings - have been undertaken.

1.3 MAIN RESULTS

The econometric methodologies applied in the first stage of the project have enhanced European added value by using the similarities in and differences between member states to inform analysis. The findings provide important insights into the understanding of housing assets and their use. Even so, the conclusions are limited and provisional for a number of reasons. These include the wide diversity across the member states in all dimensions being studied, the lack of completeness of the data sources available, and the fact that the substantive findings can be considered as preliminary, to be added to by studies scheduled to be undertaken later in the project.

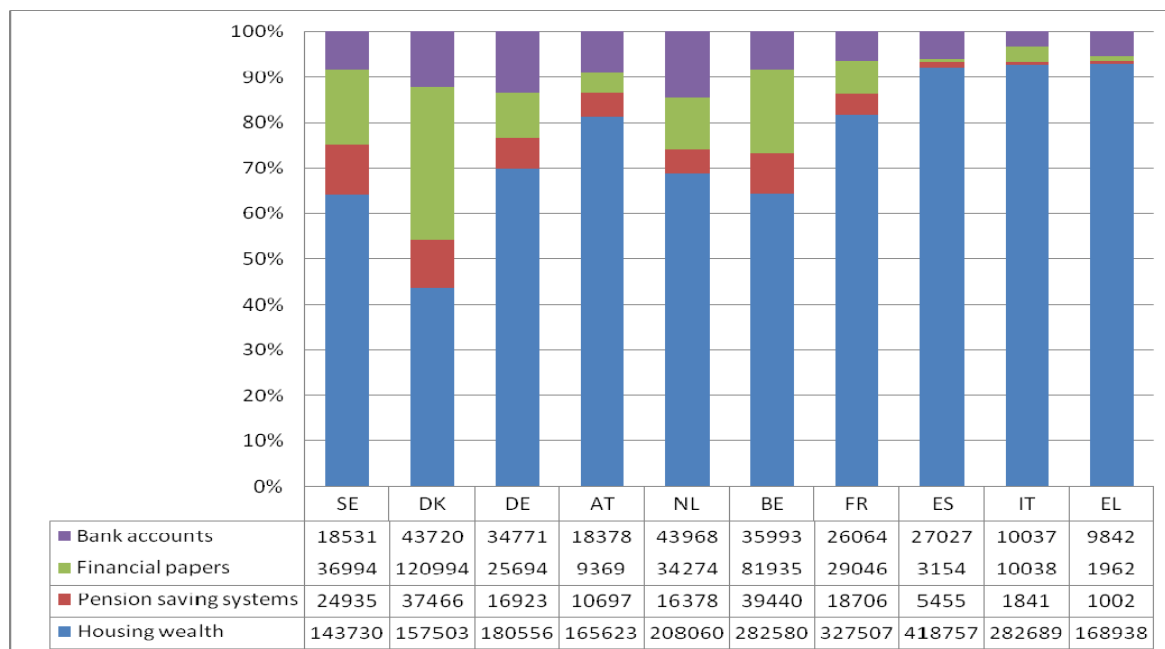
Housing as a financial asset

In econometric studies, savings and consumption are generally examined through the life cycle model, which, in simplified form, assumes that during their working lives individuals save money out of their income in order to be in a position to consume during their retirement years, a process referred to as consumption smoothing. The DEMHOW study adds to this a recognition that housing is both consumption – of the flow of services provided by the physical structure – and investment – as a capital and tradable asset. Since house purchasers frequently make use of a housing loan, housing thus enters directly and in an interconnected way into consumption strategies.

Albeit with differences between countries, the general pattern is that European households tend to behave as if housing, whatever else it might mean to them, is a financial asset which is used like other financial assets: broadly, households save in the years during which they work, and use savings in retirement to supplement income from pensions. So, over their life course up to the age of retirement and maybe beyond, households increase the amount of their housing wealth,

as well as the amount of cash they have in bank accounts, the value of shares they hold and so on. Figure 1 shows that among older Europeans, on average, housing is their largest single financial asset, this being particularly so in Italy, Spain and Portugal, much less so in Sweden and Denmark

Figure 1 The composition of wealth held by older households (over 55 years)



Source: Calculated mean values from the SHARE 2003-2004 database.

The variation in the composition of savings across member states is more than a direct reflection of the relative size of their home ownership sectors. Broadly, the proportion of wealth held by households in the form of housing is higher in countries where:

- house prices have been rising faster than other assets
- share prices have been rising more slowly than house prices
- the state pension system does not provide retired people with an income in old age that largely allows them to maintain the same standard of living they had when working
- the social security system does not provide strong protection against special needs for financial support, such as for long term social care

The last two factors in this list suggest that households view housing as a means through which they can provide themselves with a sort of personal safety net that can offset any inadequacies in the state system for protecting the wellbeing of its citizens. In that sense, housing appears to be viewed as a substitute for state provision.

The corollary of the notion that households build up housing and other forms of wealth during their working years in part as a substitute for the anticipated limitations of state protection during their old age, is that households will indeed spend some of their wealth during retirement. Our analyses indicate that that is precisely what happens: on average the amount of personal wealth held continues to increase until the late 60s, from which point on the amount held declines at an increasing rate. Interestingly, the evidence also shows that there is a tendency in all countries, though more marked in, for example, the Mediterranean member states, to spend non housing assets more quickly than housing assets.

Housing as a pension

The potential contribution that housing might make to the income needs of older Europeans depends on how individuals exploit its two forms of income. Those households who own their homes outright will benefit from the fact that they can occupy it without having to pay rent, and in that sense their income, including any pensions, received as cash is

enhanced by an income in kind from their home. Home owners also have a financial asset that they may be able to convert into cash. This may be done in a number of ways: by selling the house and buying a cheaper one or even by becoming a renter; or, by using a financial product, such as a reverse mortgage, that allows the household to go on living in the house having “sold” a proportion of its value to a bank and thereby obtaining an income. The two sorts of housing income are correlated - those with most income in kind own the most highly priced houses – so an assessment can be made by looking either at them individually, or at both together.

An important criterion against which pension systems are usually evaluated is the “adequacy” test. This asks two questions: how far does it reduce the risk of a household being below the poverty line; and, how far does it help households to maintain the same standard of living they had before they retired?

Reducing the Risk of Poverty

Broadly, those member states with the highest levels of poverty among older people - of the older member states, Ireland and many of the Mediterranean countries - also have the largest home ownership sectors. This suggests that it is in these countries that there is also the greatest potential for housing wealth to reduce poverty. But, more detailed examination of the available data suggests this may not be so:

The risk of poverty is not everywhere highest among older people. In fact in about a third of member states – particularly in the newer member states - it is higher among younger people. In these countries the use of housing wealth to enhance the consumption of older people, rather than pass housing wealth to the younger generation in the form of a bequest, might increase rather than decrease inequality.

There are many examples, particularly but not solely in the newer member states, of older people who have considerable housing wealth but low incomes, the so-called “asset rich, cash poor”. For them, releasing housing equity would lift them above the poverty level. However, the more general picture across Europe is that those older people with the highest incomes, both before and after retirement, and the most non-housing wealth, also have the most housing wealth. In short, they are “asset rich, cash rich”. For them, since they are not below the poverty level to start with, releasing housing equity would have the effect of even further increasing their consumption possibilities.

There are also, in all member states, many older people who can be described as “asset poor, cash poor”. These are frequently renters, for whom releasing housing equity is not an option.

In general, therefore, housing wealth could have an effect of lifting some older households out of poverty and its greater use could provide positive benefits. But, a significant effect of the widespread release of housing equity to enhance the incomes of older people, might also be to increase inequality by having little impact on the lower end of national income distributions, while enhancing incomes at the top end.

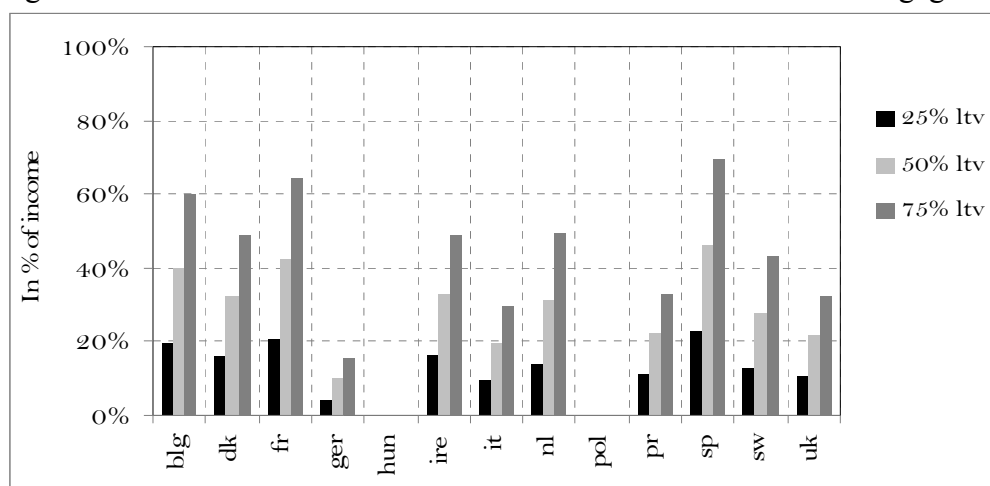
Maintaining former living standards

Estimates of the amount of the income that older Europeans might derive from their housing must be based on a number of assumptions. In part, this is because accurate data about the distribution of house prices in each member state is not available. It is also because, in order to estimate the amount they might receive from a financial product such as a reverse mortgage, it is necessary to make assumptions about how house prices and interest rates might increase (or decrease) in the future as well as the proportion of the total value of the house that the householder (and the bank) would be willing to “sell” (buy).

Based on such assumptions, Figure 2 shows that in seven of the eleven member states, for which relevant data are available, the contribution, for those taking a reverse mortgage on 75% of the value of their home, would be over 40% of their income. In three member states it would be at least 60%.

While this indicates that housing wealth could significantly enhance other household income and thus increase their standard of living, there is an issue of fundamental importance in assessing the actual effects: would the income from a reverse mortgage be an *addition* or *complement* to existing sources of income, or a *substitute* for that part formerly derived from the state in the form of a pension?

Figure 2 % increase in income of retirees derived from a reverse mortgage



1.4 EXPECTED FINAL RESULTS

Overall, DEMHOW involves a series of linked studies that investigate: the development in wealth portfolios over time and with respect to demographic changes; changing behaviour and attitudes (of both households and governments) toward the use of housing wealth to support the costs of ageing populations; the availability now and in the future of financial products that will facilitate the use of housing wealth; and the characteristics of housing wealth as a form of pension. In all these areas DEMHOW will provide scientific results.

1.5 POTENTIAL IMPACT AND USE

It is expected that potential impact of the DEMHOW project will take a number of forms.

* Advancing the state of the art. There are a number of literatures - located in the different social science disciplines - that inform DEMHOW's linked studies. For a number of reasons, however, our understanding is incomplete. DEMHOW will extend beyond the state of the art by undertaking similar studies with respect to a sample of member states that are in important respects representative of the entire EU. It will also undertake studies from different disciplinary perspectives and contribute to the state of the art both within each of these disciplines, but also through their combination.

* Cooperation. In its structure, objectives and methodology, DEMHOW will enhance co-operation between researchers undertaking investigations in different policy areas, in different disciplines and in different countries.

*Informing Policy. The scope of DEMHOW should ensure that its findings are policy-related and as such contribute towards potential formulation, development and implementation of policies in a number of fields, including pension, financial markets and housing

1.6 CONTACT AND FURTHER DETAILS

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