Lengthening the ladder

The future of mortgage borrowing in older age

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A research report by the ILC-UK, supported by the BSA in conjunction with the CML

Building Societies Association

ILC

About the BSA

We fulfil two key roles. We provide our members, all 44 building societies and four credit unions, with information to help them run their businesses. We also represent their interests to audiences including regulators, the Government and Parliament, the Bank of England, the media and the general public.

Building societies have total assets of over £366 billion and, together with their subsidiaries, hold residential mortgages of over £284 billion, 22% of the total outstanding in the UK. They hold over £262 billion of retail deposits, accounting for 18% of all such deposits in the UK. Building societies account for 33% of all cash ISA balances. They employ approximately 40,000 full and part-time staff and operate through approximately 1,550 branches.

About the ILC-UK

The International Longevity Centre – UK (ILC-UK) is a futures organisation focussed on some of the biggest challenges facing Government and society in the context of demographic change. Much of our work is directed at the highest levels of Government and the Civil Service, both in London and Brussels. We have a reputation as a respected think tank which works, often with key partners, to inform important decision-making processes.

Our policy remit is broad, and covers everything from pensions and financial planning, to health and social care, housing design, and age discrimination. We work primarily with central government, but also actively build relationships with local government, the private sector and relevant professional and academic associations.

Foreword

Paul Broadhead
Head of Mortgage Policy at the BSA

When the BSA published its first report on lending into retirement in 2015, we all knew that older borrowers were becoming a bigger part of the market. Back then, we identified various challenges that lenders, policymakers and regulators needed to address. Last year we followed this up by publishing a leaflet for consumers, 'Can I get a mortgage at my age?' to address concerns people may have about borrowing in older age.

The fascinating findings in this report from the International Longevity Centre (ILC) demonstrate that the demographic and economic shifts are set to interact so that borrowing in retirement is expected to double by 2030. Today's niche market is to be tomorrow's mainstream. And it is not just older borrowers who will be affected – this will have a knock-on effect on home-ownership across younger age groups as people wait longer before getting their first mortgage.

Addressing the challenges around lending to older borrowers is therefore vital. We need a market that can accommodate complexity and adapt to change, whether that is a change to the individual borrower's circumstances, or shifts in the financial position of future generations of borrowers entering retirement. We look forward to continuing to work with regulators, policymakers, and other parts of the industry to develop the flexible marketplace that we will need over the coming decades.

There are so many factors at play that understanding the customer is key. One thing that I drew from this report is the importance of maintaining a discussion with the borrower about their changing needs through the term of the mortgage, not just when the loan is granted. In older age life can change significantly if illness affects a person's capacity, or should a partner die. This amplifies the importance of lenders understanding their customers, to pick up on early warning signs of vulnerability, and to have policies to help deal with adjustments to circumstances.

Technological developments such as Big Data can no doubt help here, but to me it really comes down to the importance of relationships. And this indicates why mutual building societies have often been at the forefront of changes in this market, whether that be innovative mortgage products or reviewing – and in some cases removing – age limits on lending.

It has been said that the special value of mutuality rests in its capacity to build long-term relationships. Built on trust between the parties, such relationships help to promote a more free-flowing passage of information between borrower and lender, enabling a flexibility of response toward each parties' long-term best interests: helping people to make the most of their home for the whole of their retirement.

Introduction

Based on current trends for home ownership, mortgage debt, housing equity and population change, we estimate that there will be a significant shift in the customer base of the mortgage market over the next 13 years.

Currently, the over 65s own around £1.5 trillion in housing wealth – accounting for 39% of self-reported housing wealth in the country. **By 2030, we project that this will have more than doubled to £3.3 trillion – 58% of all housing wealth.**

Meanwhile this older age group is also likely to account for a rising quantity and share of total mortgage debt. The over 65s currently hold around £20.1 billion of mortgage debt which accounts for roughly 2% of total self-reported mortgage debt. **By 2030, we project that this will have doubled to £39.9 billion – approximately 4% of mortgage debt[1].**

Many people are stepping onto the housing ladder later in life and taking mortgages with terms that extend into retirement. This trend is likely to increase.

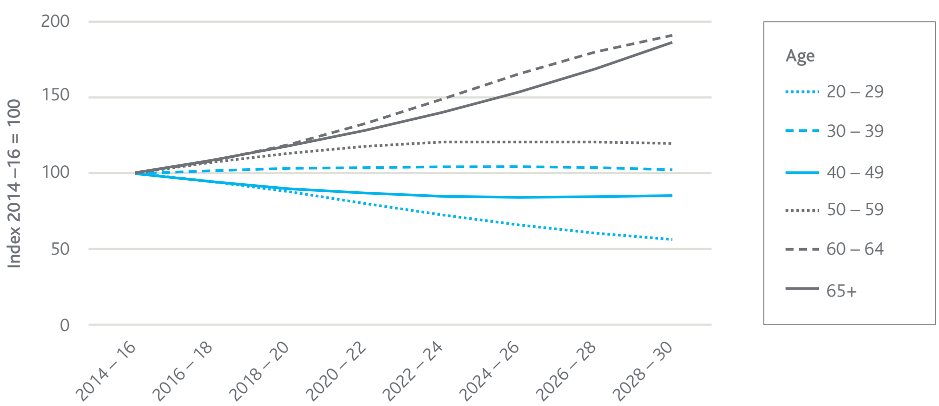
The traditional home buying market could be turned on its head:

- Buy in your 20s
- Trade up in your 30s and 40s
- Pay off debt in your 50s and 60s
- Enter retirement with no mortgage debt

What might be the new normal?

- Buy in your late 30s or 40s
- Longer mortgage terms from the outset
- Trade up later in life
- Repay part of the mortgage from retirement income, or draw more to fund needs in later life

Mortgage debt index by age group



1 For further details on our calculations please see Appendix A of the full report at https://www.bsa.org.uk/LendingLater. Debt and housing equity levels rise at older ages because both the population of older people rises as does the level of debt and equity per older homeowner. Meanwhile debt and housing equity values fall for the under 50s as per the real term trend since 2006. This means older households account for an increasingly large share of both net property wealth and mortgage debt.

The characteristics of older borrowers

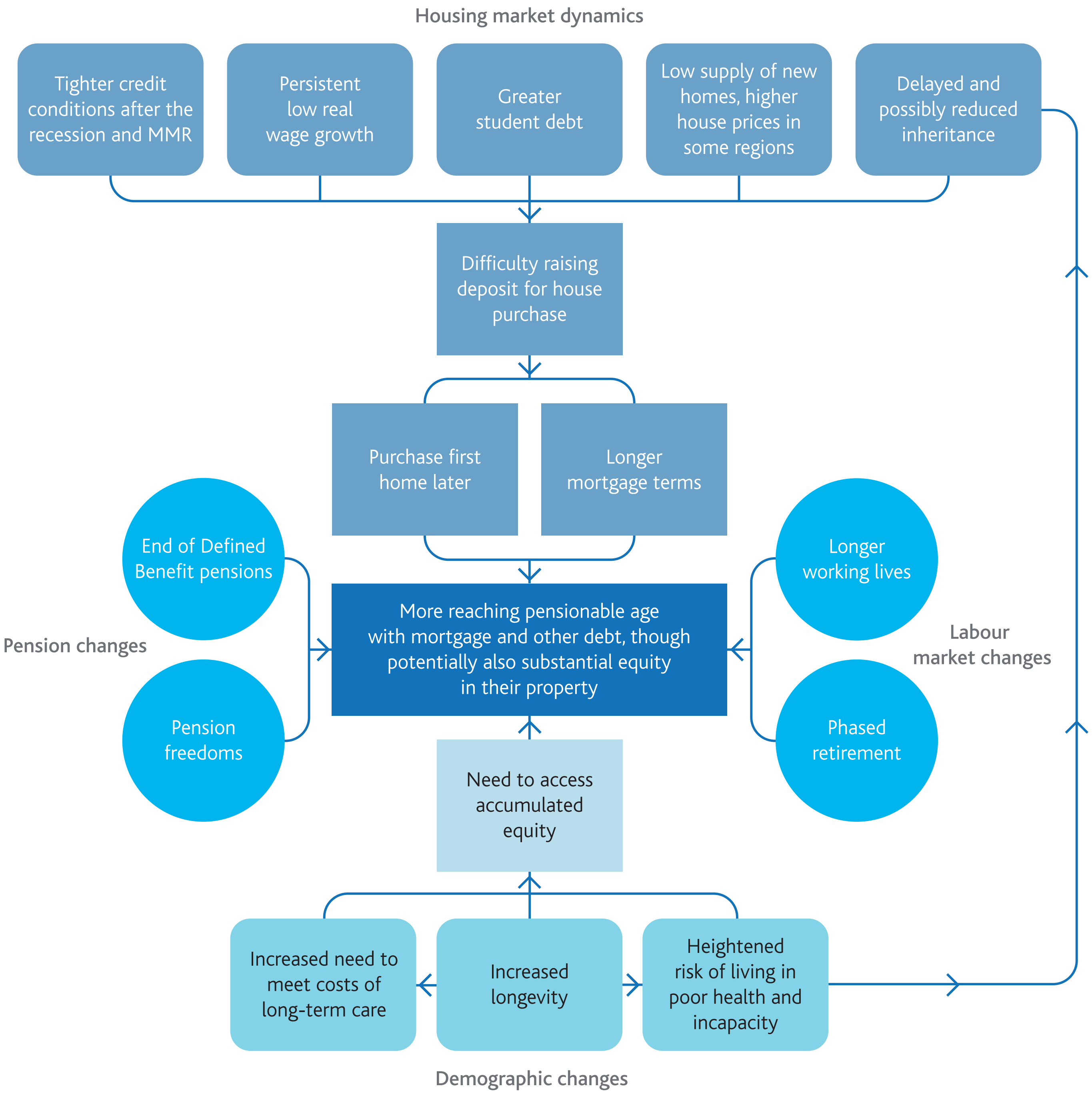
We may be at the beginning of a journey, but clues are already emerging about the circumstances facing older borrowers. This report is dedicated to examining these clues through detailed analysis of the largest nationally representative dataset on the wealth and assets of the population – The Wealth and Assets Survey from the Office of National Statistics.

This analysis allows us to unravel the sociodemographic and financial characteristics of those who are currently borrowing in retirement, as well as the characteristics of those who are likely to be borrowing into retirement in the future.

Our findings show that there are important differences between the two groups. While the generation currently borrowing in retirement has higher incomes and greater pension wealth, this will not necessarily be the case for future generations.

Wage growth is sluggish and house price inflation is stretching affordability. There is also a question of whether we are reaching a peak of pensioner wealth, with Defined Benefit pension schemes becoming less common and stagnant wage growth making saving for the future harder.

Why might people borrow into retirement?



What are the opportunities and risks?

The socio-economic trends are clear, the detailed analysis that sits behind this report[1] enables us to determine opportunities, risks and issues and make recommendations on action for a range of stakeholders.

A key question, primarily for national policy-makers including the government, is whether we should take action to try to maintain the market status quo, or whether these socio-economic changes are unstoppable. If the latter then we need to take the necessary actions to adapt to a changing market.

David and Gill

Are both retired and in their 70s. They didn't wish to move home, and after reading in the press that a number of building societies lend to older borrowers, they secured a £150,000 interest-only mortgage with the Cambridge Building Society. David said: 'We need it for home improvements, a new car and to support our lifestyle for things like holidays. I am glad lenders have reviewed their age limits as there are a lot of people in the UK who are sitting on good equities and are asset rich but cash poor.'

1 https://www.bsa.org.uk/LendingLater

Current borrowers in retirement

We define current borrowers in retirement as individuals over the age of 65 who still have mortgage debt.

To explore the characteristics of this group we have compared them to individuals over 65 who own their home outright.

Our research suggests that approximately 470,000 people are current borrowers in retirement. The proportion is higher among the 65-69 age group (9.3%, equivalent to approximately 300,000 people) and progressively lower across the older age groups, with 2.2% of the people aged 75 and over still paying off a mortgage.

Overall, our findings suggest that most of these consumers are unlikely to struggle to pay back their loans.

They have higher incomes (+£6,295) and pension wealth (+£29,845) than homeowners who do not have a mortgage.

Encouragingly the average size of the outstanding loan to household income is relatively low at 2.69 times.

Most borrowers are concentrated at the lower end of the debt scale with small outstanding mortgages.

Current borrowers in retirement typically have higher incomes and greater equity in their property. They also have higher pension wealth than non-borrowers, but lower financial wealth. Overall this suggests they are relatively affluent people who are more disposed to spending than saving over their lifetime. Borrowing generally appears affordable for these borrowers.

Mr and Mrs F

Both retired (75 and 73), met when they were both living in Spain. They then moved back to the UK and struggled to find a lender who would give them a mortgage so rented for many years before getting a £52,000 mortgage with the Family Building Society. They have since got married and have settled into their own home in Kent.

Future mortgage borrowers in retirement

We define future mortgage borrowers in retirement as individuals who are yet to retire but may, given their current mortgage term, be borrowing into retirement. This allows us to see if there are likely to be differences in the challenges facing tomorrow's borrowers in retirement versus today's.

230,000 people aged 35 to 49 (5.4%) will not have paid off their mortgage before retirement given the current term of their loan.

The proportion is higher among 55-59 year olds with 400,000 or 11.4% of people set to be borrowers in retirement.

Future mortgage borrowers have also accumulated lower pension wealth (-£14,537) and have fewer financial assets (-£26,277) than those who will not be borrowers.

However, they have a higher degree of housing equity (+£26,300).

By comparison to our results for current borrowers, there is a slightly higher proportion of households with high debt to income ratios. However, this may be as we are looking at younger borrowers who are in the earlier stages of paying down the debt.

The values of outstanding mortgage debt are still concentrated at the lower end suggesting that on current incomes most of these loans are affordable.

Future borrowers in retirement generally have similar incomes to those who are unlikely to be future borrowers, but they do have lower levels of pension and liquid financial wealth. On average, borrowing is relatively affordable, but some borrowers have higher debt to income ratios likely due to taking on more debt earlier in life.

Jan H

Now retired and still a mortgage customer with Teachers, Jan needed a sizeable mortgage at 50+. She said: 'Faced with divorce, university fees for two bright sons and a property move, I needed help. Enter Teachers Building Society!'

Factors that determine borrowing into retirement

The research also looks at the probability of being a borrower in retirement across different attributes. This suggests that individuals with the following features are more likely, compared to non-borrowers, to borrow in retirement:

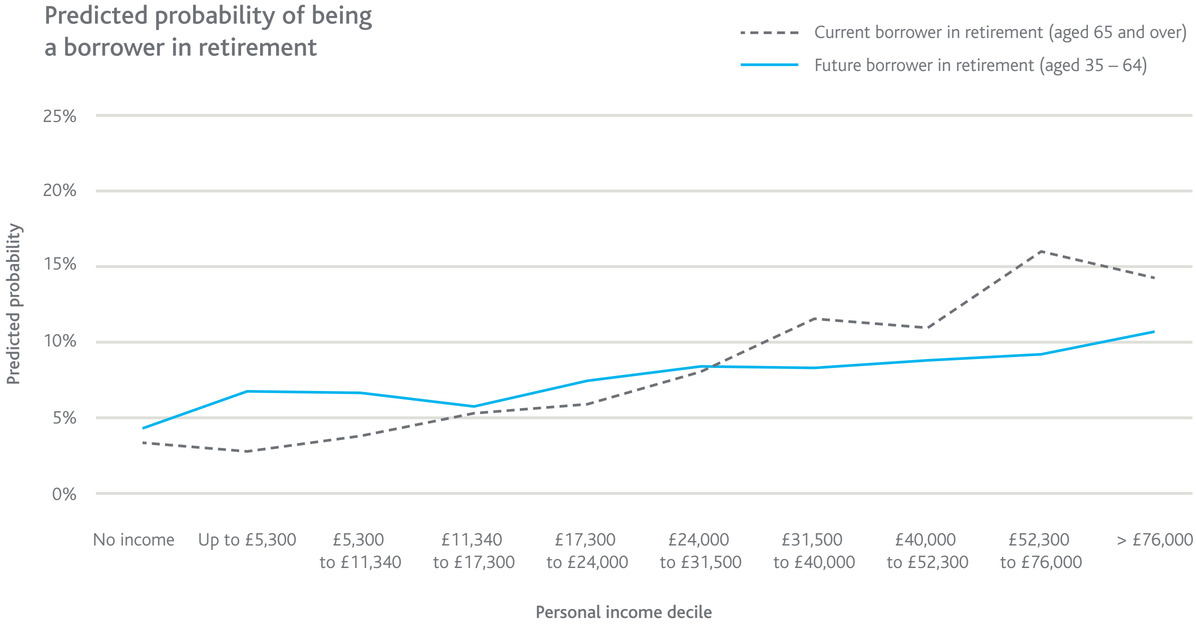
	Current borrowers in retirement	Future borrowers in retirement
Marital status	Divorced/separated	Divorced/separated
Gender	No difference	Male
Household size	Larger household	Smaller household
Qualifications	Have some level of qualification	Have degree level qualification
Household income	Higher household income	Higher household income
Property value	Higher property value	Higher property value
Financial wealth	Less financial wealth	Less financial wealth

The relationship between borrowing into retirement and incomes

The impact of household income on the probability of current and future borrowing differs for the two groups. While the probability of currently borrowing in retirement rises significantly with income for people aged 65 and over, it is substantially flatter for the potential future borrowers.

Clearly higher incomes help to support affordability, so it is good to know that higher incomes are associated with current mortgage borrowers. But the story is not so clear with regards to future mortgage borrowers, where the relationship is not as strong.

Predicted probability of being a borrower in retirement



Conclusion and recommendations

We already know intuitively that people are buying homes later in life in response to economic trends. House price inflation, tighter credit conditions and low real wage growth all have an effect. The combination of these factors may drive even greater levels of mortgage borrowing into retirement.

Our findings suggest that, overall, current borrowers who are in retirement will be able to afford their mortgage. Future borrowers in retirement may not all be as financially comfortable. However, there is clearly a significant degree of uncertainty here given that many households still have many years left before they reach pension age and may remortgage before then.

Crucially, our research suggests the possibility of a significant shift 'up the age scale' in the housing and mortgage market. We therefore need a market that is able to adapt and deal with change, on two levels:

- At the level of the individual borrower to help older consumers to respond to life events and subsequent changes in needs and circumstances.
- At the market level to accommodate demographic and economic shifts such as people working for longer, entering retirement in stages and changes to the pension landscape.

What does the mortgage market need to look like to deal with the growth, and the changing needs, of borrowers over the coming years? We discussed these recommendations at a policy roundtable with mortgage experts from across the industry, with the aim of describing a more adaptable market in the future.

Recommendations for the mortgage industry and regulators

1. Know your customer – throughout the life of the mortgage

The growth in the number of borrowers in retirement doesn't mean they are all in the same situation. Understanding the different market segments is vital, as is understanding how these might evolve and people may move between them as circumstances change.

Given the multitude of events that can happen to anyone – needing to stop work, to seek social care or the death of a partner – it is vital to move towards a better understanding of an individual customer's evolving needs. Mortgage products and arrears processes need the flexibility to adapt to 'trigger points', supplemented by regular communications, and perhaps routine, regular advice sessions through the mortgage term.

Staff also need to be trained to recognise vulnerability, including the ability to recognise the signs of dementia and other cognitive vulnerabilities. During the policy roundtable we were delighted to hear that some firms are actively seeking to become 'dementia friendly'.

2. Recognise that age is only one factor

Borrowers cannot be rejected solely on the basis of their age. In the light of our findings mortgage lenders will need to keep their age policies under review to adapt to developing trends.

The extent to which borrowers can afford to repay the mortgage over their retirement or on death is the important judgement in lending. Currently Mortgage Conduct of Business rules concentrate on income for determining affordability. The regulator may need to revisit this to look at models which better reflect the financial circumstances of many older borrowers.

To improve lending decisions for older borrowers the industry and regulators should look to learn from other spheres. These could include:

- Incorporating the expertise of the actuarial profession on longevity risk;
- Exploring with the High Net Worth sector how other accumulated assets – such as property, savings and stocks and shares – can provide reliable alternative forms of repayment and;
- Learning from behavioural sciences how to incentivise older borrowers to make sound financial choices in good time.

3. Encourage more partnerships and integration

No single organisation can provide a comprehensive financial planning or product solution for each individual, so will have to form partnerships and links with others. These arrangements should be open and flexible, and carefully designed so that they do not have gaps or barriers that prevent an older borrower's interests being served. Currently the delivery of expert financial advice is highly compartmentalised. Mortgage advisers, financial advisers and later life advisers look at different aspects of the financial planning process.

Given the potential range and complexity of older borrowers' circumstances, there may be a need for the relevant industry and professional bodies to seek further integration of advice across the marketplace. The Financial Conduct Authority should explore through its Ageing Population Strategy how regulation and permissions may need to change to enable this goal.

We also look forward to a forthcoming report from the Council of Mortgage Lenders which is looking at the advice framework in the round.

Recommendations for Government

4. Drive new housing supply across a range of tenures and price points

Our analysis has shown a significant shift in the housing and mortgage market. This has in part been driven by the lack of supply of new homes reducing affordability for many working age households. While there is agreement that more homes are needed, most of the focus has been on first-time buyers.

In response to the government's Housing White Paper, we would also urge more initiatives for last-time buyers, who have typically accumulated more housing wealth. This could unlock homes further down the chain for younger people. A range of homes designed with older people in mind, with flexible spaces which can adapt as peoples' needs change, could be an attractive option for last-time buyers.

However, our findings also show that a shrinking proportion of younger people are able to access mortgage finance. Reversing this trend will be difficult but the government may need to explore further expansion of shared ownership and shared equity models, as well as the increased supply of new homes which is needed. For those who may still find it difficult to get onto the housing ladder, a high-quality rental market with more certainty for tenants will be vital.

5. Planning for freedom and choice

The end of compulsory annuitisation and the introduction of more freedom and choice in the pension world is still a relatively new development. However, greater choice also has the potential to introduce greater uncertainty and complexity.

Lenders may be concerned about what this means for consumers who borrow on the basis that they will repay all or part of a mortgage out of pension income. It will be for the mortgage industry, as well as the regulators and government to keep track of how consumers are behaving.

6. The importance of financial education

Pensions are complex and to deal with greater freedom consumers need to be equipped with the understanding to make sound decisions. The merger of the Money Advice Service with the Pensions Advisory Service and PensionWise provides an opportunity to rethink how we engage consumers in their retirement planning. Sustained effort and long run political support are required to deliver positive outcomes for consumers.

For the full research report please visit: bsa.org.uk/LendingLater

Acknowledgements

This report was kindly made possible by the Building Societies Association with support from the Council of Mortgage Lenders. The authors would also like to give special thanks to all those who came along to debate the report's findings and recommendations at a policy workshop in March. The advice provided was invaluable. Nevertheless, the approach, contents and findings of the final report are solely the responsibility of the report's authors.

The policy workshop consisted of:

- Dudley Building Society
- Nationwide Building Society
- Santander UK plc
- Skipton Building Society
- The Family Building Society
- Coreco Group
- The Council of Mortgage Lenders
- The Equity Release Council
- The Building Societies Association

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