98 Spofforth Street, Cremorne, NSW
Developer: Helm Properties

Demography is destiny

- The impact of an aging population is the most recent example of how demography matters.
- Aging, balance sheets, and housing are interacting in a way with far reaching consequences.
- Older households are asset rich but cash poor, and they live in increasingly inappropriate housing.
- The attraction of, and pressures for, "downsizing" are increasing.
- Innovative financing techniques to encourage downsizing are part of the solution.

The demographic challenge

Demography, or population trends, affects pretty much everything that is important to us.

The size of a country's *population* determines the demand for goods and services. The *participation* of that population in the labour force is a key driver of what an economy can supply. And the *productivity* of that population largely determines income.

Economists call this trilogy the 3-P's: population, participation and productivity (Chart 1).

Trends in the 3-P's ultimately drive economic activity, jobs and incomes. They create the wealth needed to fund a country's longer-run objectives and deal with the longer-run challenges such as climate change. They also provide a framework for policy makers.

The focus of the demographic debate has shifted over time. The aging population and the baby boom cohort driving that aging is now front and centre. It is generating forces that are impacting on income and spending patterns. It is influencing government taxing and spending policies. It is focusing attention on retirement income systems.

Australia's retirement income system ranks highly overall and on a global comparison (Chart 2). But the decline in "adequacy" (covering benefits, home ownership, government support, growth assets) at a time of rapid population aging is a concern.

We have (successfully) dealt with these sorts of challenges before. But we need to be on the front foot. Innovative techniques to adjust to the aging population structure are required.

Housing is a case in point. Australia's aging population is increasingly finding itself asset rich but cash poor. This older population lives in a housing stock that is increasingly unfit for purpose. And a variety of government, institutional, and social factors are increasingly constraining the needed adjustments.

Downsizing is part of the solution for boosting retirement incomes and repurposing the housing stock. The need for downsizing buyers to find the necessary deposit and for developers to obtain the necessary construction finance are constraints. The products and services provided by Downsizer (downsizer.com), for whom this report has been prepared, are an innovative way to ease these constraints.

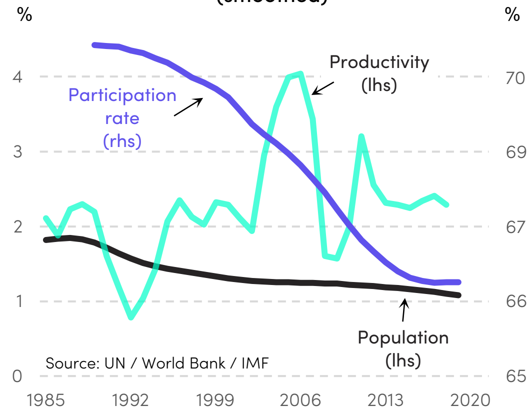
Downsizer.com allows homeowners with sufficient equity in their current property to buy new dwellings "off-the-plan" without the need for a cash deposit.

The analysis shows that the appetite for downsizing is increasing. The potential pool of downsizers over the next five years stands at nearly 1.7 million households. The main aim is to release capital to fund retirement. The potential net equity released could be over $300 billion. The potential addition to retirement savings and incomes is significant.

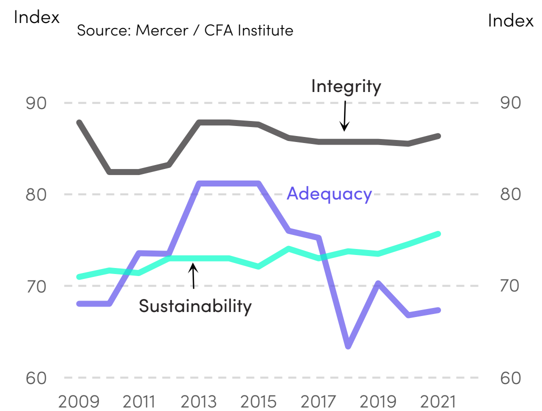
Australia and the baby boom

There was a "baby boom" in post-WW2 Australia. The number of births grew by 2½%pa, on average, during the period. This growth was well above the

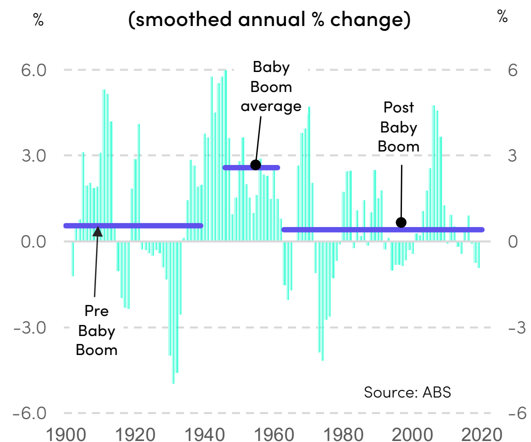
01. The Global 3-P's (smoothed)



02. Australia: Pension Index Ranking



03. Births (smoothed annual % change)



½%pa rate that prevailed either side of the boom (Chart 3).

The shift in direction began earlier in the 1940s when the birth rate rebounded from the slump associated with the Great Depression. That earlier jump had little impact on Australia's broader demographics because it coincided with a period of low immigration. The impact on overall population size was limited.

This observation highlights the importance of other demographic drivers. Like immigration. The baby boom coincided with a dramatic (and permanent) lift in migration (Chart 4). Some 47% of all population growth in the post-war period reflects immigration.

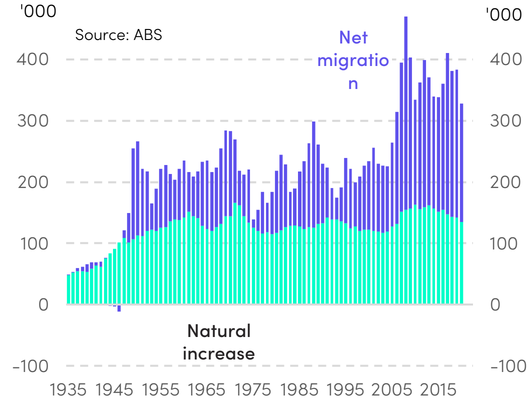
Migration is often seen as an antidote for an aging population. And that is true given that most migrants are at the lower end of the age range when they arrive in Australia. But migrants age at the same rate as everyone else. As the population share of migrants rises, we need more and more new migrants to offset the aging impact of those already here.

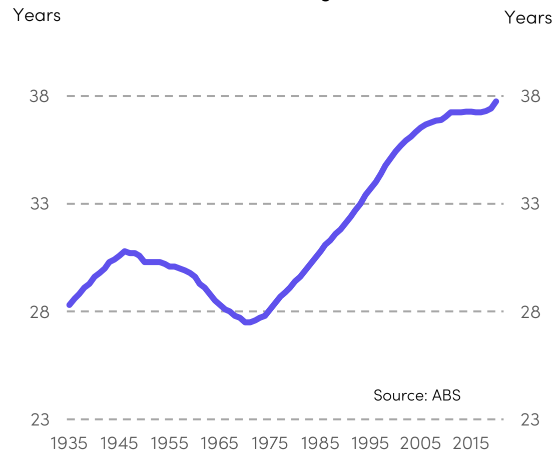
There are limits. And Australia appears to have hit those limits in the mid 1970s. The median age – that divides the younger half of the population from the older half – was 28 years in 1975. That median had increased to nearly 38 years by 2020 (Chart 5).

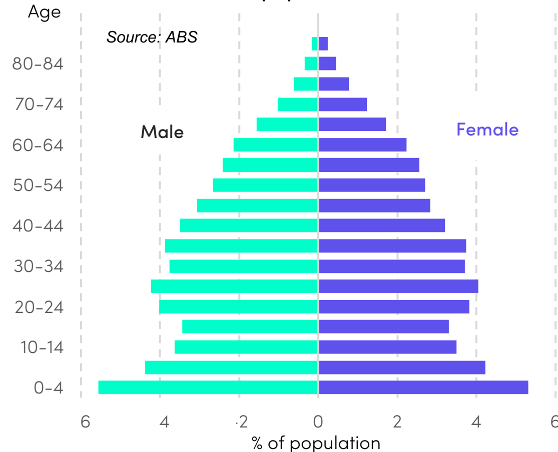
One way to visualise the changing age structure is through population pyramids. These pyramids show the share of population at a point in time by age bracket. The aging story has changed Australia's pyramid from a "Christmas tree" in 1950 (Chart 6) to a "coffin" in 2021 (Chart 7).

The language sounds a little alarming. But there is no agreement on what an optimal pyramid looks like.

What we can say is that the present under the Christmas Tree is a demographic dividend. A larger share of younger age groups means a boost from a larger and more productive workforce. Back to the 3-P's! The coffin means the dividend is over and the more even age distribution is an indicator that population growth will slow. And a population peak is approaching. A stable population should also mean a stabilisation in demand for resources







The population pyramid: from *Christmas tree...*

and could be seen as a more environmentally friendly outcome.

An aging population: are we there yet?

The Second World War ended 76 years ago. The last of the boomers were born about 60 years ago. Those in the post-war surge in migration are now comfortably into their seventies. The process of aging is well advanced in Australia. The share of population aged 65 and over is now over 16%.

At one level, the period of rapid acceleration in aging is nearing its peak (Chart 8). But the process has much further to run.

The government produces an Intergenerational Report (IGR) at roughly five-year intervals. The objective is to assess the sustainability of current policies, and how demographic, technological, and other structural changes may affect the economy.

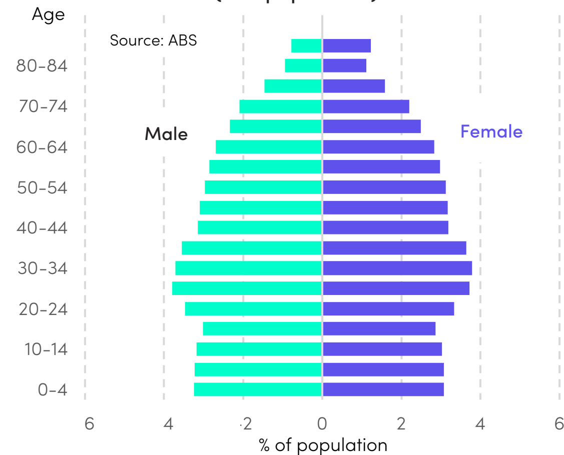
The latest IGR was released in 2021. The report contains the most recent population projections. These projections show a steady rise in the number of people aged over 65 – to around 9 million people by 2061 (Chart 9). The older age group will account for nearly 23% of the population at that point.

There is a certain mathematical inevitably behind demographic projections. But the real world rarely moves in the straight lines favoured by demographers.

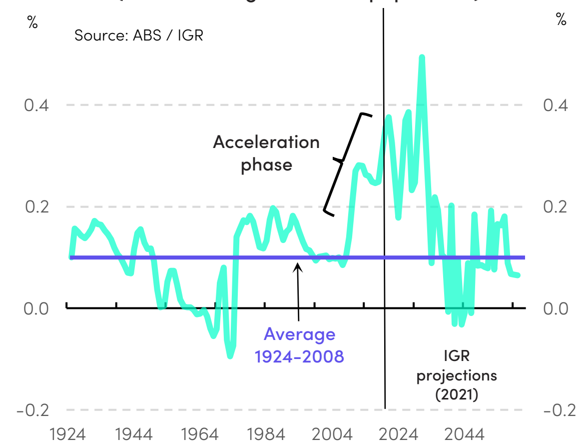
The impact of COVID-19 is a case in point. Migration collapsed with the pandemic-driven closure of Australia's international borders. The usual large net *inflow* became an *outflow* in 2020/21 for the first time since 1945/46. The usual experience is that economic "shocks" also lower the birth rate, at least for a period.

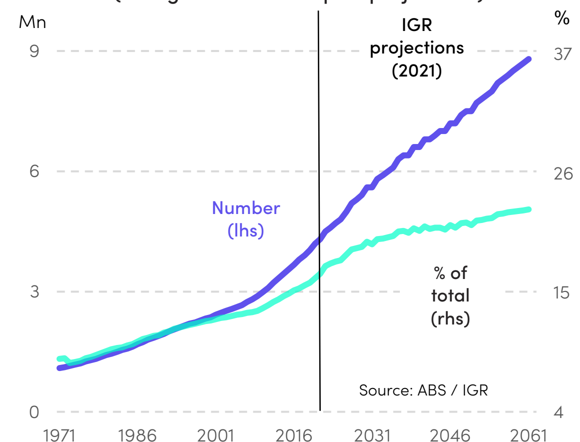
Calculations by the government's *Centre for Population* make the point. The main pandemic impact is on near-term population growth rates (Chart 10). While those growth rates eventually recover to something like pre-COVID norms, the cumulative impact is a smaller population. The centre's estimates imply 1.1 million fewer people by 2031 than would otherwise have been the case.

The centre's estimates also mean the population ages at a faster rate than in the absence of COVID-19. The birth rate is lower and the flow of



...to *coffin*





(younger) migrants is smaller. The median age in 2031 would be 40 years, older than the pre-COVID estimate of 39 years.

Boomers, aging and housing

Demographics and the aging population story cut across all parts of the economy. But they are particularly important for housing. Something of an industry has developed to produce charts showing just how important that baby boom bulge is as it works through the age distribution. And so the "OK Boomer" meme was born!

One example is how trends in the home-ownership rate have tended to vary with the relative size of the boomer cohort (Chart 11). Home-ownership rates took off initially as the parents of the boomer generation needed somewhere to raise their children. Boomers were schooled in their early life of the need to own a house. Government policy, such as first home buyer schemes, reinforced the lesson. Affordability was high. And so Australia's love affair with housing began.

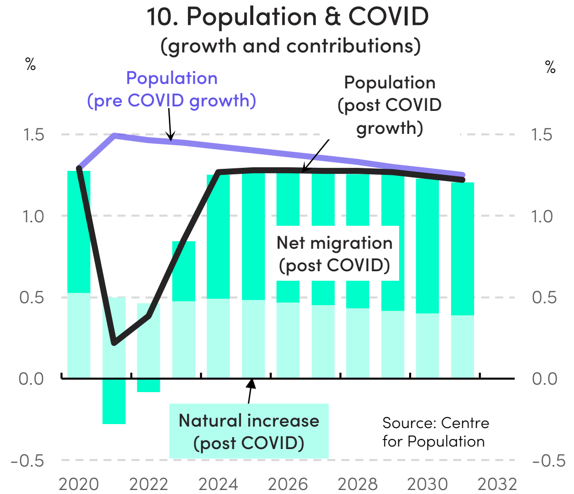
This love affair does have some distinct boomer characteristics.

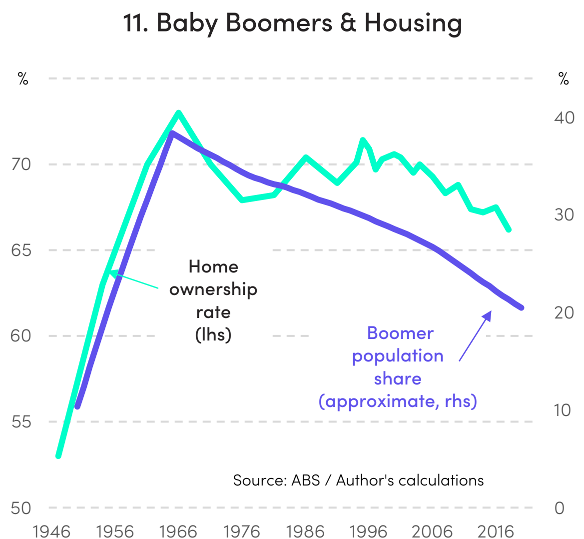
The most interesting aspect is how boomers have managed their housing *liabilities*. The pre-boomer view was that you got your home loan and paid it off as fast as you could. Boomers, in contrast, looked at the house as a line of credit. So you may pay off some of the home loan. But then redraw to fund renovations. And a new car. And maybe that overseas holiday.

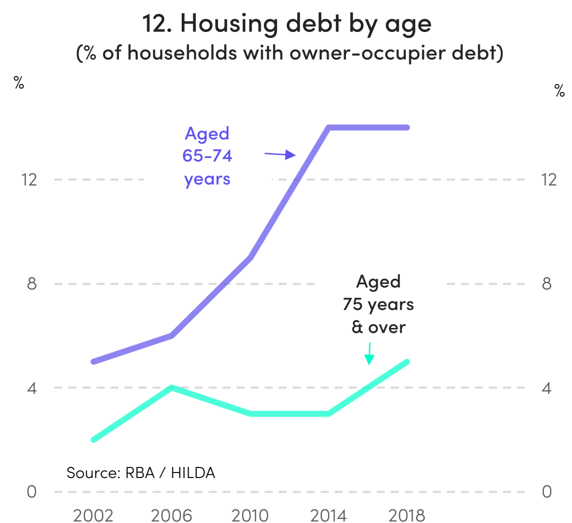
Put that line of credit idea together with an aging population and a significant number of households are reaching retirement age with a mortgage still in place.

The well-respected HILDA survey makes the point:

- The survey shows that the proportion of households aged 65-74 with owner-occupier housing debt rose from 5% in 2002 to 14% in 2018 (Chart 12).
- And some 5% of those aged over 75 still have a home loan.







- In addition, up to 13% of older households are also carrying credit card debt.

Older households have, by definition, been in the housing market for longer than younger age brackets. Some 50% of households where the reference person is 65 or older have been in their current dwelling for more than 20 years (Chart 13). More than 80% of those aged 65-74 live in separate dwellings rather than flats/apartments.

So older households have enjoyed a significant period of house price appreciation on their larger homes. The asset side of their balance sheet looks pretty good. So boomers also came to see housing as a form of "savings" as well as a line of credit. And it was going to fund retirement.

This "buy and hold" approach has been an effective way to generate wealth. But it has produced some distortions in the housing market.

In particular, the type of housing held is increasingly inappropriate for its aging residents. The main point is that dwellings are now too large. The recent Aged Care Royal Commission noted that of the population aged 65-74:

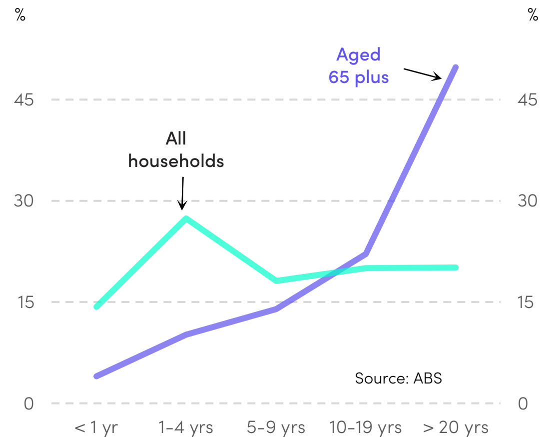
- 88% of them lived in dwellings with only 1-2 residents (Chart 14); but
- 76% of those dwellings had 3 or more bedrooms.

It's no wonder that demographers frequently trot out the line that Australia doesn't have a shortage of housing. Rather, it has a glut of bedrooms!

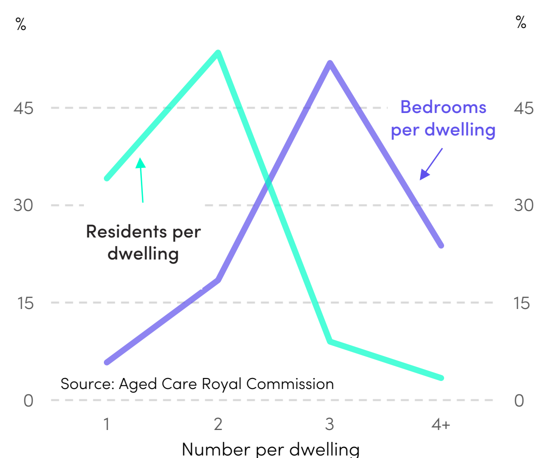
Of course time hasn't always been favourable to the boomers. They have benefited less from the spread of superannuation than younger age groups. Australia's compulsory super scheme dates from 1992. And most of today's older population were a fair way through their careers at that point. They have had less time to take advantage of the magic of compounding. Initial contribution rates were also low (3-4% of earnings rather than today's 10%).

ABS data shows that only 45% of those aged 65 and over have superannuation (Chart 15). This share is well below the overall coverage rate of 72%.

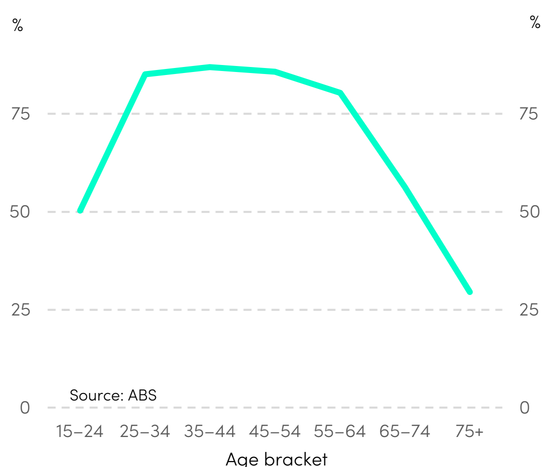
13.Time in Dwelling by Age
(% of total)



14. Residents & Bedrooms



15. Super Coverage by Age



The superannuation story is one component of a bigger issue: older populations tend to hit peak wealth around the time that their incomes plunge.

In 2017/18, for example (latest survey) the housing wealth of older owner-occupiers was around $600k, well above younger age groups. But their disposable incomes were 20-40% lower than those younger age groups (Chart 16).

In that well known phrase, older households are "asset rich but cash poor".

Balance sheets, aging and a pandemic

Some standard assumptions underlies the "life cycle" of a household's balance sheet (Chart 17):

- Initially, financial assets are accumulated as the first step into the housing market;
- once in the housing market, non-financial assets come to dominate;
- over time, the share of non-financial assets increases courtesy of house price appreciation and as financial assets are run down to fund retirement.

More variation is, however, evident in the composition of financial assets (Chart 18).

Older households are "overweight" property, bank deposits and equities relative to younger households. And they are "underweight" superannuation and other financial assets (mainly businesses).

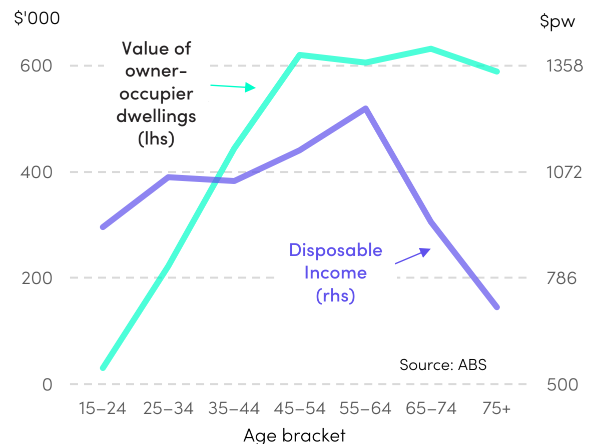
So older households have a skewed, dumbbell shaped, asset distribution. Their assets are concentrated at the "safe" and "risky" ends of the spectrum (Chart 19).

In normal times this distribution would be perfectly appropriate. Older households need to be a little more conservative in their investment approach. The ability to rebuild assets after a negative event is limited. But equally some exposure to growth assets is needed given rising life expectancy.

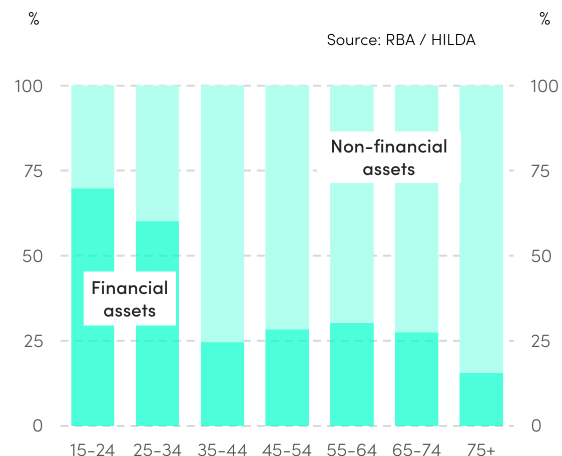
But these are not normal times. The pandemic and the economic fallout are impacting on returns. And are potentially distorting asset allocations as well.

The main issue is that central banks everywhere have pushed interest rates as low as they can.

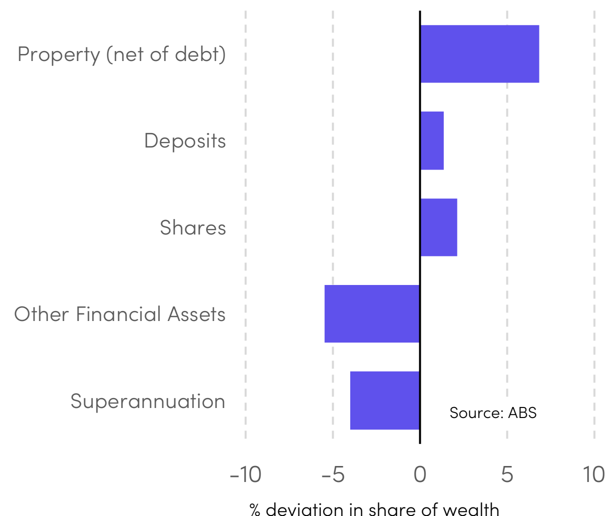
16. Wealth & Income by Age



17. Assets by Age



18. Balance Sheet Composition
(Aged 65+ vs 25-64yrs)



Some countries even had negative interest rates. In Australia, the RBA's policy rate sits at 0.1% and they have pursued quantitative easing (QE) through government bond purchases. The aim is to keep interest rates low.

RBA Governor Lowe has also made it very clear that the Bank will remain "patient" and any rise in interest rates is unlikely for "some time". The hint is no change before 2023.

The unsurprising outcome is that earnings on interest-bearing deposits have collapsed. Rental yields and dividend yields now far exceed bank deposit rates (Chart 20). This divergence has gone on for long enough that investors are responding to the incentives on offer. So the other unsurprising outcome is that a pursuit of yield pickup and capital gains is now a central investment theme.

Asset prices have increased. Housing and equities are notable examples. The issue for older households is that while rising house prices make them wealthier, it does little for incomes. Nor are the older age brackets likely to try and supplement their income by purchasing more property and chasing rents. The bigger risk lies with an increased appetite for (riskier) equities.

There is some survey evidence for this increased equity appetite. Information from Investment Trends, for example, shows a sharp rise in retail online equity trading (Chart 21).

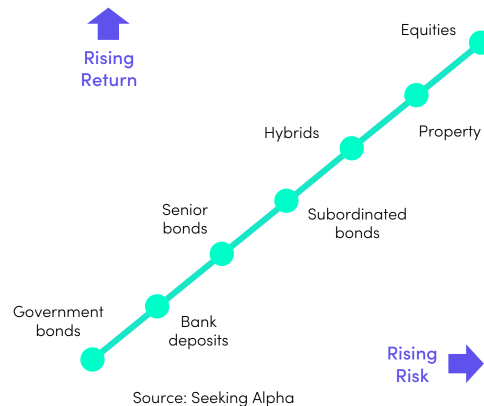
Interest rates will rise one day. Higher interest rates may ease some of the income squeeze. But it should be remembered that low interest rates are the historical norm.

A few years ago, the Chief Economist at the Bank of England - Andy Haldane - commented that interest rates had never been as low as they were then. When challenged on that call he assembled a group of experts who produced a time series for interest rates going back 5,000 years! (Chart 22).

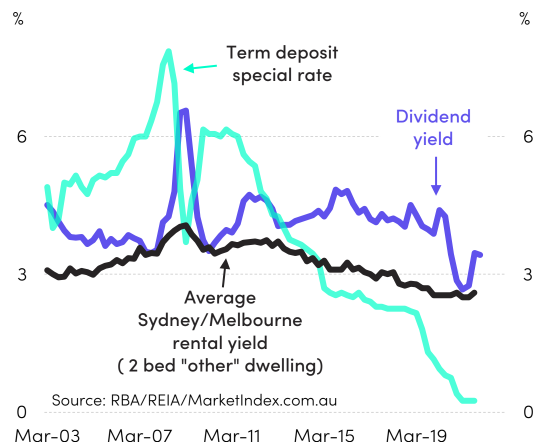
The chart shows that Haldane was right in his call about record low interest rates. But his research also revealed that interest rates are normally "low".

Apart from a brief period at the height of the Babylonian Empire, the real aberration in interest rates was the 1975-2005 period. Interest rates

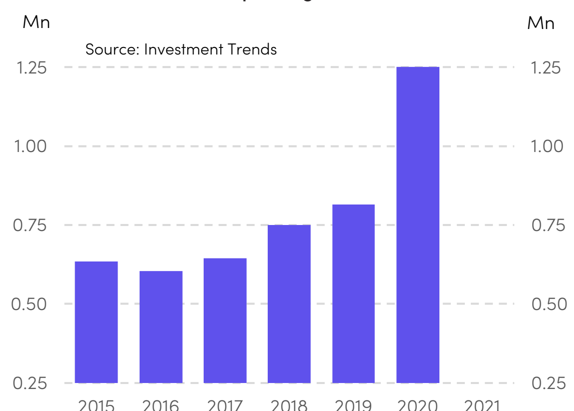
19. Risk vs Return



20. Australia: Selected Yields



21. Retail Online Equity Trading
(no. of investors placing at least one trade)



were high during that period as a reflection of the high inflation rates at the time. What the economic historians like to call the Great Moderation from the mid 1980s, however, tamed inflation and interest rates returned to their normal (low) levels.

So its "back to the future" from here. Interest rates will remain low relative to expectations. Interest income is set to remain contained. And dwelling prices probably have further to run.

The consensus among economists at the major banks is that Australian house prices will rise by 6% in 2022, building on the 22% rise in 2021 (Table 1).

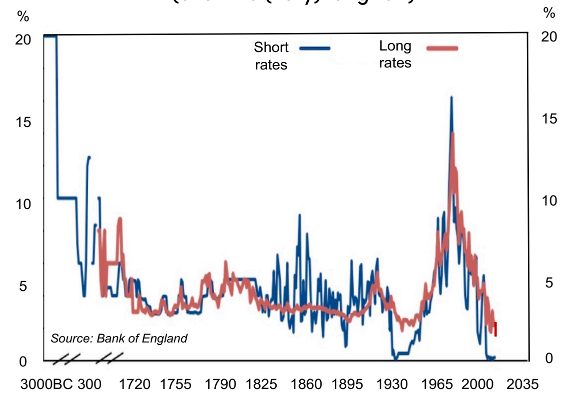
Table 1: Dwelling Price Forecasts (%pa)

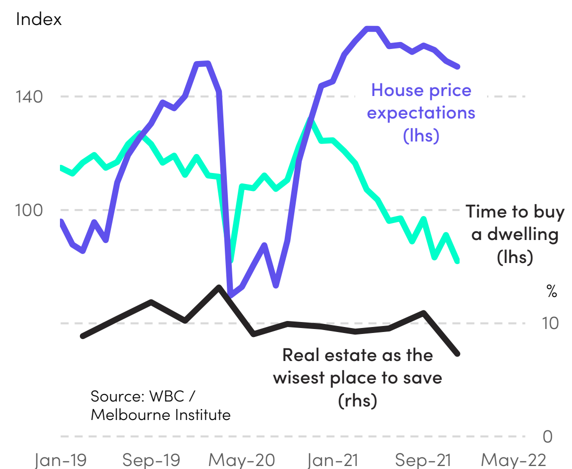
	2020 (a)	2021 (f)	2022 (f)
Sydney	3	25	6
Melbourne	-1	15	7
Brisbane	4	27	8
Adelaide	6	23	5
Perth	2	13	5
Hobart	6	28	6
Darwin	9	15	5
Canberra	8	25	7
Australia	**2**	**22**	**6**

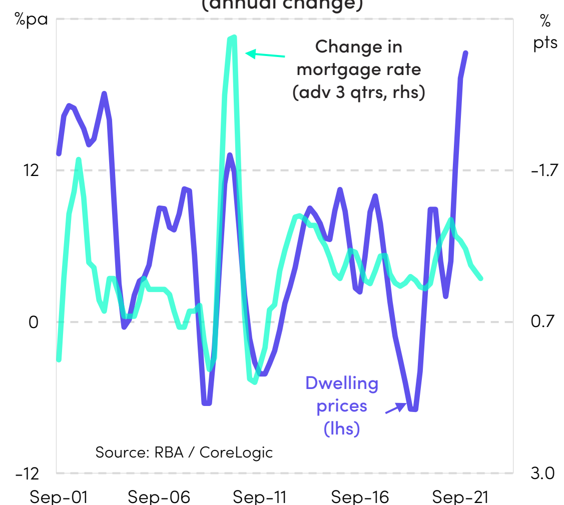
Source: CBA / NAB / WBC / ANZ / CoreLogic

The usual array of forces will be at work on dwelling prices over the next few years:

- Rising prices are denting affordability and buyer sentiment. Views on whether now is a "good time" to buy a dwelling have fallen as prices have risen (Chart 23).
- But sustained low interest rates keep servicing costs manageable (Chart 24).
- Macroprudential policies are in play to cool the market. But expected house price momentum means that attempts so far have had little impact (Chart 23).







- Overhanging all this is the likely return of migrant and student housing demand as Australia's international borders reopen.

Against this backdrop, the asset rich, cash poor status of older households will persist. Some have debts they need to service. The pressure to restructure balance sheets in a higher-return / higher-risk fashion will continue.

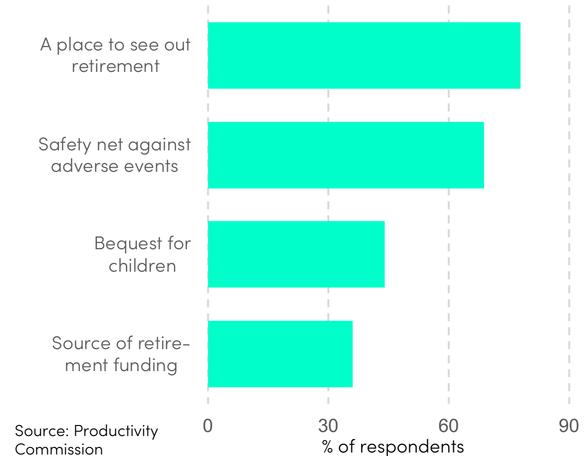
Household balance sheets can be restructured in other ways as well. There is an arbitrary line that households draw between non-financial assets and financial assets. There is a great reluctance to touch non-financial assets like the family home. The idea that the family home was "savings" to fund retirement disappeared when push came to shove. The reluctance to downsize also sits at odds with the standard life-cycle theory of household balance sheets.

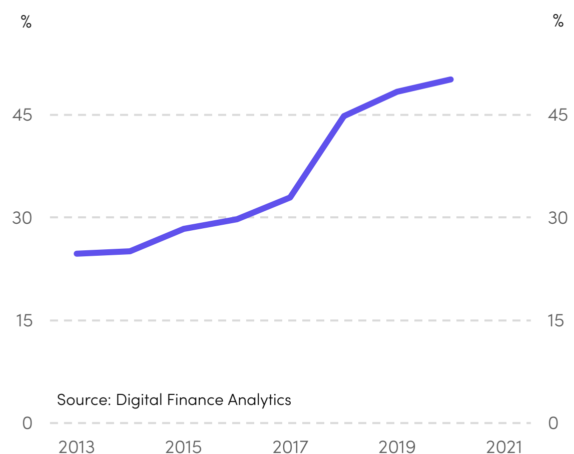
But releasing equity from the family home is one way that the stock of financial assets can be increased. And income/cashflow improved.

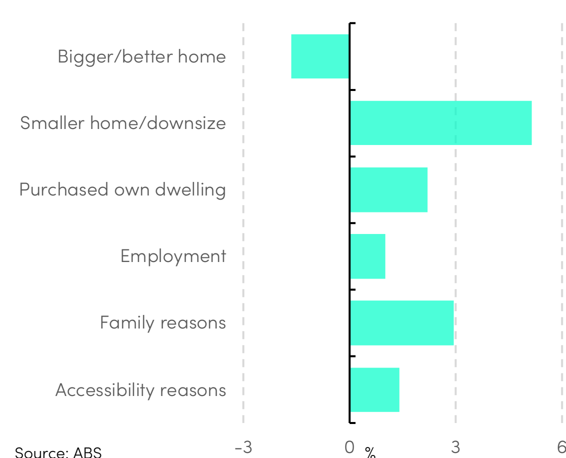
A study by the Productivity Commission in 2015 highlights the magnitude of the task in shifting perceptions. Some 78% of those aged 60 and over, on average, want to age-in-place. That is, they want to spend their retirement in their current home (Chart 25). From a financial perspective, a much larger proportion see the family home as a "safety net" against adverse events (69%) rather than a source of retirement funding (36%).

Nevertheless, perceptions are changing. A regular study of Australian households by Digital Finance Analytics (DFA) shows a steady increase in downsizers who indicate they are aiming to release capital to fund retirement since the Productivity Commission study in 2015 (Chart 26). It is now the most common reason for downsizing.

A separate study by Westpac shows similar trends in downsizing appetite. And an ABS survey on the reasons people move shows a big increase in those age 65 and over nominating a desire for a smaller home/downsizing (Chart 27).







COVID-19 has had some impact on the moving plans of older age groups. But these impacts are quite small. The most common impact cited in an ABS survey was a delay in the moving process. And the most common reason for delay was housing market disruption related to the pandemic. These disruptions reflected lockdowns, travel restrictions and fewer dwellings for sale.

The emphasis is on delaying downsizing rather than abandoning the idea altogether. A study commissioned by Downsizer and conducted by DFA shows the most common timeframe for downsizing is in the next 1-2 years. Around 46% of respondents have this period in mind. And a further 26% nominate the next 2-3 years (Chart 28).

Some other financial trends are nudging older households towards downsizing and capital release. These trends include:

i. The growing demands on older-household finances

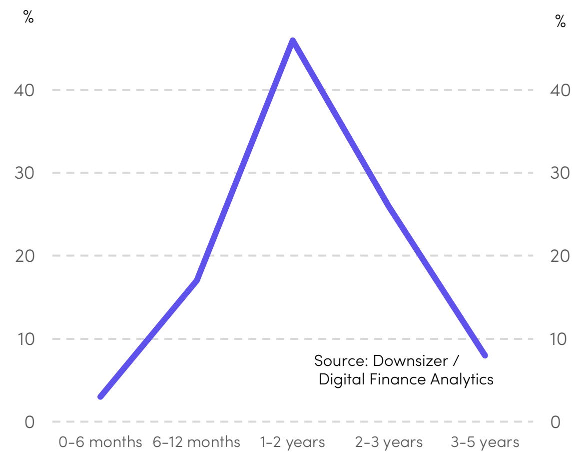
Children are staying at home longer. The HILDA survey reports that in 2017 56% of men aged 18-29 were living at home. Affordability issues mean this proportion has probably risen further. And it is certainly well above the 47% figure recorded in 2001.

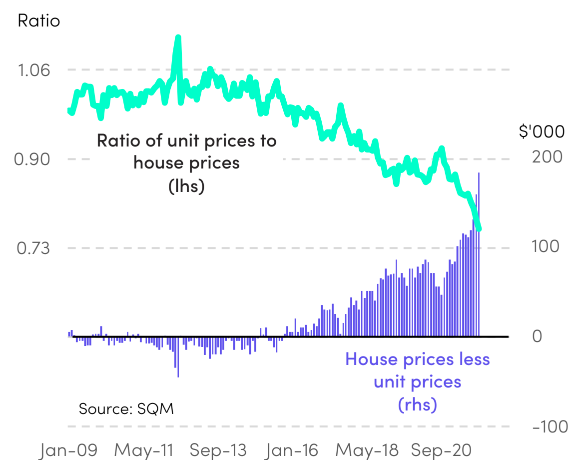
The practical upshot is that the idea of maintaining the family home as a bequest for the children is waning. And so the Bank of Mum & Dad was born. Estimates by DFA put lending by this “bank” at $35 billion. This ballpark number implies the Bank of Mum & Dad is now the ninth largest mortgage provider in the country!

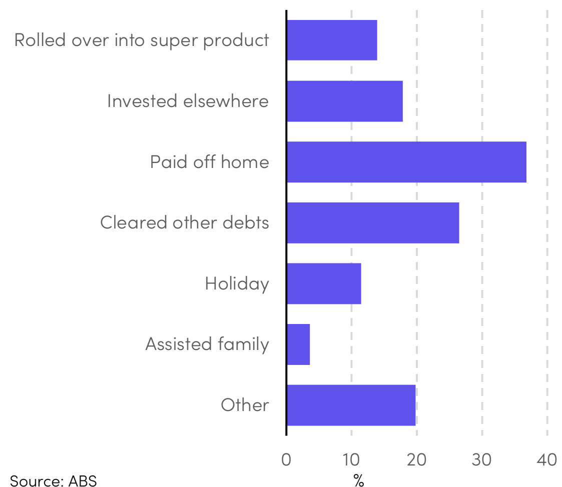
ii. Growing amount of equity that can be released

A common view is that downsizing doesn’t necessarily add much to the bank account. The smaller, newer, properties favoured by downsizers aren’t necessarily that much cheaper. And moving costs eat into what’s left. But the dynamics are shifting.

The typical downsizing operation involves moving from a “house” to a “unit”. The ratio of unit prices to house prices was relatively constant up until 2017.

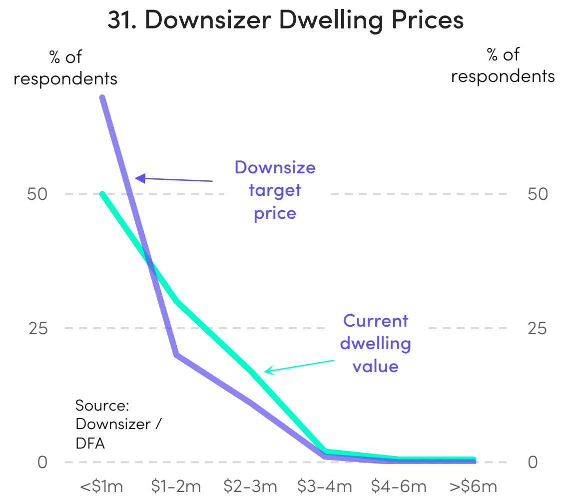






But the ratio has fallen steadily since (Chart 29). The downtrend reflects the shift from building houses to building units. The supply of units has increased as a result. These units also tend to be smaller (so cheaper) than they once were.

As a result, the price gap between houses and units is as large as it has ever been (Chart 29). This larger gap is a powerful financial incentive to downsize.



iii. Government incentives

Governments facing their own cashflow issues are keen for older age groups to self-fund their retirement. They have acted to make downsizing more attractive.

The Commonwealth Government has a scheme whereby downsizers can deposit $300,000 of any downsizing sale proceeds ($600,000 for couple households) into their super funds.

This package is smart policy. The boost to superannuation targets an asset class that older age groups are "underweight" (Chart 18). The lift in older household financial assets should improve their income. Other by-products of the package should be a better match between the type of housing older age groups live in and what they need. And an increase in effective supply of housing should help improve affordability for other demographic groups like first-home buyers.

State governments are also helping at the margin. Victoria, Tasmania, the ACT and the NT all provide stamp duty concessions for downsizers.

There is potentially some "leakage". ABS surveys show a significant proportion of any superannuation "lump sum" ends up in paying off debt (Chart 30). But the end result is the same. The reduction in debt interest payments boosts disposable income.

The potential size of the downsizing market is large.

The Downsizer/DFA survey provides some useful benchmarks. The survey shows the potential pool of downsizers over the next five years stands at around 1.68 million households. Around 50% of that group live in a dwelling worth more than $1 million. And 68% are looking at downsizing to a property in the sub $1 million price range (Chart 31).

The survey essentially implies property sales of around $1.7 trillion over the next five years. The net equity released, on DFA estimates, would be over $300 billion. Or about $310,000 per household. Interestingly, this release is very close to the $300,000 cap of the government's superannuation incentive.

Downsizing and retirement incomes

According to APRA, the financial regulator, the average return delivered by super funds over the past decade was 6.9%. So that extra $310,000 of financial assets released by downsizing could potentially boost retirement income by $21,000 per annum. Any remaining equity release is available for investment elsewhere, further adding to income streams.

There is a wide range of outcomes within this "average". Differences mainly reflect location. Calculations on potential (pre-tax) income boosts based on locations identified by Downsizer as key downsizer areas are shown in Table 2.

Outcomes in Table 2 reflect a range of assumptions. They reflect historical averages. And, in that famous phrase, "past performance is no guarantee of future results".

Table 2: Downsizing and potential retirement income boost

	North Sydney & Hornsby	Sydney Eastern Suburbs	Brisbane City	Melb Inner South	Melb Inner East	Canberra
Balance sheet impact ($)						
Equity release	$1.52m	$1.67m	$410k	$750k	$680k	$310k
Addition to super	$300k	$300k	$300k	$300k	$300k	$300k
Addition to deposits	$610k	$685k	$55k	$225k	$190k	$5k
Addition to equities	$610k	$685k	$55k	$225k	$190k	$5k
Boost to income ($pa)						
Super	$20,700	$20,700	$20,700	$20,700	$20,700	$20,700
Interest	$15,860	$17,810	$1,430	$5,850	$4,940	$130
Dividends	$25,010	$28,085	$2,255	$9,225	$7,790	$205
Total ($pa)	**$61,570**	**$66,595**	**$24,385**	**$35,775**	**$33,430**	**$21,035**

Source: Authors calculations / Downsizer / DHA / APRA / RBA / marketindex.com.au

The key assumptions are:

- Individual households that take full advantage of the super concessions for downsizers ($300k).
- Remaining equity released is invested in line with historical averages (50% deposits / 50% equities).
- Super fund earnings based on APRA data for past 10 years (6.9%).
- Deposits earn the "neutral" cash rate ("at least" 2.5% as nominated by RBA Governor Lowe in Nov-21) plus a term premium (0.1%).

Equities return the 10-year average dividend yield (4.1%).

Before COVID appeared on the scene and changed everything, one persistent worry held by economists revolved around the weakness in household income growth. The weakness contributed to a softness in consumer spending, and was a key factor in the underperformance of the Australian economy. GDP growth averaged 2½%pa from 2013 to 2019, well short of Australia's potential growth rate of 3¼%pa. Sluggish growth in wages was the main culprit. And weak wage growth was identified as a major economic problem by Australian policy makers. RBA Governor Lowe even made the extraordinary suggestion that everyone should go and knock on the boss's

door and ask for a pay rise! For older age groups, where wages are less important, the weakness was concentrated in investment income as interest rates fell.

As we move into 2022, the expectation (again) is that wage growth will pick up. And a debate about the likelihood of higher interest rates is underway. But any addition to consumer spending power from these sources will probably struggle against higher prices as inflation rates lift. The pressure on households to find new sources of income will persist. As discussed earlier in this paper, releasing equity from the family home is one way to lift the stock of financial assets, and improve incomes/cashflow.

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