

Equity release and older people

A briefing note for the Social Justice and Regeneration Committee of the National Assembly for Wales

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Introduction

The development of products and services that will allow those older people to draw on the free equity tied up in their home has been a chequered one. Current interest from government and others in encouraging older people to deploy these resources to finance the repair, maintenance and improvement of their homes and, possibly, the funding of their personal care needs, is stimulating debate but the growth of the market has progressed relatively slowly. Whilst many of the mechanisms are in place the actual completion of loans has been slow with high levels of "drop out" between initial enquiry and completion. The possible reasons for this phenomenon are among the summary points set out in this briefing.

An absence of "fit" between the offer and the requirements of potential customers

The most fundamental deficiency is a lack of fit between products and potential market. The minimum value of property threshold is too high, draw-down levels are too inflexible, and administrative expenses are too costly. Many older people are looking for a simple line of borrowing that they can draw on by borrowing relatively modest amounts to finance lifestyle items such as a holiday, a new car, a new kitchen, a conservatory or replacement doors or windows. Even those who wish to finance more fundamental works of repair or improvement to their homes need access to sums of a few thousand pounds at a time. Some may wish to fund an operation or other episode of care, even here the need is for smaller sums than those generally offered as the minimum advance. For smaller sums especially the administrative costs associated with these loans seem costly. Very many older people live in lower value properties, often they will be among those who might see the greatest benefit in access to this type of product but the value of their property is too low to qualify.

The memory of past difficulties

The folk memory of bad outcomes from the late 1980s is still strong and organisations such as Consumers' Association will keep it fresh. The knowledge that products to release equity led people into negative equity, re-possession and financial disaster creates apprehension for many older people. Some

of these cases are still not resolved and from time to time receive notice in the press. Organisations, such as the Consumers' Association, are committed to keeping the issue alive. To lay this ghost a gesture is needed from the lenders to settle outstanding cases, perhaps by forgoing all claims beyond the current value of the property, or the value at the point the borrower died. If the introduction of regulation is to act as a springboard for the re-building of public confidence then the gesture to settle all outstanding contentious cases should come before regulation arrives.

Ambivalent attitudes in the media

There is sporadic evidence of increased promotion through the media. For example in the course of the summer the Daily Express carried a promotion with Key Retirement Solutions that included extensive coverage in the paper and the offer of free explanatory booklets. Media attention is rarely consistently in one direction and it is worth noting that a few weeks later the same newspaper gave prominence to negative elements of the reports on equity release contained in the August 2003 edition of Which magazine.

The introduction of regulation

There is a widespread expectation that both providers and consumers will draw comfort from the introduction in Autumn 2004 of regulation by the Financial Services Agency. Whilst SHIP (Safe Home Income Plans) provides a degree of re-assurance through the self-regulation of members of the scheme, government has recognised the need for formal regulation by the FSA. For providers it will allow them to market equity release products as "safe" and respectable. For consumers it will indicate that these are mainstream financial products in which they may have the same confidence as in more familiar forms of mortgage. There are widespread concerns about the position of reversions and a desire that the consultation that Government has proposed should result in comparable standard of regulation to that for mortgage based products.

Funding repairs and renovations through equity

Local authorities are required to respond to the flexibilities offered them in the Regulatory Reform Order 2002 by producing a strategy statement setting out how they will use a mixture of grants and equity based loans to encourage repair and improvement in housing stock within their area. The promotion of borrowing as an alternative to grants for older home-owners will only start to bite in most areas in 2004/5 and thereafter as local authorities work through the detail of the schemes through which they will offer appropriate forms of loan. In many cases it is the Home Improvement Trust that has been cited in

strategies and success will depend on their ability to gear up to a potentially high level of enquiry in the months following the simultaneous implementation of strategies in many local authorities.

The role of Care & Repair Cymru

In rolling out an equity loan based strategy to finance repairs in the homes of older people Care & Repair agencies are expected to play a key role. Care and Repair Cymru, has had the benefit of working with a variety of pilot equity release arrangements through Care & Repair agencies in Wales. The administrative costs of advancing small sums are prohibitive for the lending organisations and the evidence of the pilot projects, and of various initiatives in England, is that there is a strong case for an intermediary body to be subsidised to carry out that work. Care & Repair Cymru and its network of locally based agencies offer a means of delivering such support and lending.

Equity to fund care

Whilst Government may hope that equity based products will help people make provision for their long-term care in old age there must be some doubts as to whether this is a realistic prospect in the current climate. The provision of free nursing care for old people in England, more generous arrangements in Scotland and continuing debate in Wales encourages an individual to assume that they do not need to commit themselves to making such arrangements as somehow the difficulties will be resolved. Natural reluctance to enter such arrangements is stiffened into resistance by the opposition of such organisations as the Consumers' Association to the very notion that anyone but the state should shoulder the burden of financing care in old age.

The balance of risk and advantage

In many quarters there is a perception that the balance of risk in the operation of equity release products still favours providers. Whilst consumers may be protected against negative equity if the market declines with some products they may suffer disadvantage where the property appreciates steeply. In these circumstances they may find themselves surrendering a proportion of the improved value that represents an astronomic effective rate of interest. In these circumstances there may be an argument for limiting such windfall returns in a sharply rising market?

The role of national organisation representing older people

The direct involvement of one or other of the main national organisations representing the interests of older people would doubtless do much for confidence among potential consumers. Help the Aged do not see themselves as providers of these products but do retain a close interest in the field and a concern that the interests of older consumers should be protected. The commercial and insurance arm of Age Concern England is an obvious prospect for entry into this market but they would need to be able to offer appropriate products that address the fundamental difficulties identified in point one above. Were Age Concern England's commercial arm to develop and launch such products it may be expected that Age Concern Cymru would make them available to older people in Wales. If such an initiative were to come from ACE it would have a significant impact upon consumer confidence and the prospect of higher business volumes.

Limits to our knowledge

There is still little known about what motivates consumers to enter a contract for an equity release product. The ratio of enquiries to contracts completed is high. Greater attention might be given to the circumstances that trigger an application. Anecdotally it seems, for example, that a significant number of applicants are widows whose circumstances have deteriorated significantly on the death of their spouse. A better understanding of this and other scenarios would allow products to be refined to better match the needs and priorities of potential consumers.

These summary points draw upon the Report: "Ready, Steady, but not quite Go – older home owners and equity release" by Nigel Appleton, published on the Joseph Rowntree Foundation website in September 2003.

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Appended Note on products

To those who do wish to draw on the equity in their property there are a range of products that will allow them to do so. All have conditions attached and the choice of the appropriate product may as often be a matter of "comfort" for the borrower as fitness for purpose judged by financial criteria alone. Some may be more comfortable with the security of knowing how much they will owe at the conclusion of the loan, others will prefer the comfort of knowing they are minimising the cost of borrowing.

Equity Release Mechanisms (ERMs) are financial schemes, normally mortgage or reversion based which enable a householder to draw down some of the equity in the house. The amount drawn down is repaid when the houseowner dies or moves out of the house. Repayment can be deferred until the death

of the plan holder or a surviving spouse, or the point at which they dispose of the property. In some schemes interest is paid each year, but in others interest (or equivalent capital appreciation) is rolled up and paid when the capital is repaid. With most ERMs the scheme can be transferred to another house if the owner moves.

Re-mortgaging with regular repayment of capital and interest.

This is the product with which most home-owners will be familiar as many will have originally acquired their property with such a mortgage. Standard mortgage conditions apply, the term will commonly be between five and twenty years with interest at a variable rate. For those who have a reasonable level of income but want to release a lump sum to finance repairs or improvements, or a major purchase this may be an appropriate method. Advances will generally be up to 30% of the value of the property. The advantages are that it is familiar and "main-stream" which will commend it to some borrowers.

Interest Only Loans

This is the simplest method for those whose income may be too limited to service a repayment mortgage. No repayments of capital are made by the borrower until their death, when the capital sum is settled through the estate, or unless they sell the house against which the loan is secured. Interest-only mortgages are more affordable for older people than a normal repayment loan but they may still be too expensive for many on low incomes. Those in receipt of benefits in addition to their state pension may be able to secure assistance with interest payments for loans taken out for qualifying purposes, such as to fund repairs.

Home Income Plans

The most common form of home income plan involves a secured loan that is used to purchase a lifetime annuity that provides a fixed payment at regular intervals until death. The amount of the payments will depend upon life expectancy when the plan is taken out and the rates of return available on annuities at the time of purchase. The income from the annuity is intended to make the payments of interest and provide a surplus that is available for any purpose the plan holder chooses. Home Income Plans are restricted to people over 70 as only in these cases do the actuarial calculations provide a sufficient return to meet the interest payments and provide a surplus. Poor rates of return have made it difficult for new entrants to secure a return that does more than service the interest payments.

The plans came into disrepute in the late 1980s when some used alternative mechanisms to invest the funds raised via the loan in order to secure a higher return than an annuity purchase could provide. As is generally the case higher returns carried higher risks and in adverse conditions some schemes were unable to generate sufficient income to meet interest payments, still less to provide a surplus. Some Plan Holders were left with unsupportable and mounting debts leading them into negative equity and, in some extreme cases, re-possession of their property.

Reverse Mortgages or Interest Roll-Up

These are mortgages on which neither capital or interest is repaid during the life of the loan but interest is added to the capital sum outstanding. The major draw-back to this product is that the amount owed can rise very quickly with the total outstanding doubling in around eight years. This product is generally considered only to be appropriate for those over 75 years of age. In the late 1980s a fall in house values and rise in interest rates led to some borrowers finding themselves in negative equity. For some this resulted in re-possession of their property. Most lenders currently offering this type of product offer a "no negative equity" guarantee so that even if the balance of capital and rolled-up interest exceeds the value of the house it will not be re-possessed. The amount to be repaid from the borrower's estate or on their sale of the property will not exceed its current market value. If the value of the property exceeds the amount of capital and interest to be repaid the balance belongs to the borrower or their estate.

Shared Equity and Shared Appreciation Mortgages

These products provide for loans at nil interest or interest below the market rate. The margin of interest that the lender foregoes is met by the assignment of a share of future equity appreciation. Rather than a share in the whole property the investor receives a share, if any, of the increase in property value during the life of the loan, plus the sum originally advanced. Whilst the product, when first offered, was popular with borrowers it is less attractive to the money markets as the lending cannot be readily securitised and for this reason is not currently being offered. Some advisors would warn borrowers against this product as in a time of high increase in property values the return achieved by the lender will exceed what might otherwise be regarded as a reasonable rate of interest.

Home Reversion

This is not a mortgage but a sale with conditions. The older home owner sells all or part of their property to an investor but retains the right to continue living in the property for their lifetime. The price at which the purchase is made represents a discount on the full market value to reflect that continuing right of occupancy. The level of the discount will depend upon the age and life expectancy of the home owner. There is a degree of "wager" involved for the home owner. If they die soon after entering the arrangement they may in effect have sold their house at a substantial discount for a limited benefit.