

# Equity Release Issues

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## Introduction

As the economic crisis rumbles on and the Bank of England keeps the base rate at 0.5%, many older clients are looking for ways of raising cash or increasing their income due to the poor return on their savings. In addition it is quite common for many people to enter into retirement with an existing mortgage, loan or credit card debts. One option to correct this imbalance is to access some of the equity locked into the value of their home and use the cash released to pay down their debts, thereby increasing their available income.

## Uses of Equity Release

Equity Release schemes have helped thousands of pensioners all over the UK improve their quality of life by making home improvements, modifications to the property for care needs or for the payment of care fees. Many have used the payout to treat their family to a holiday, or help their grandchildren through university or onto the property ladder. Inheritance Tax (IHT) planning via Equity Release can also be very effective.

## An Example of IHT Planning

Doris, a widow aged 78 in good health with a property valued at £800,000, releases £300,000 via a Lifetime Mortgage at an interest rate of 6.59% p.a. thus creating a debt against the estate. The proceeds are then invested into a low risk Business Property Release Scheme (BPR). Doris still has access to the capital if required. After 2 years the BPR investment is outside the estate thereby saving a potential £120,000 of IHT.

## Current Situation

Demand for Equity Release has remained strong despite current house price uncertainty, according to a recent report by Key Retirement. Retired homeowners aged 65-plus gained a collective £7.94 billion in house price value during the past 3 months despite the continuing fragility of the wider housing market. The report reveals that this age group owns property worth £775 billion. Surprisingly the biggest winners were homeowners aged over 65 in Scotland who gained on average £12,353 of house price growth, while pensioners in the South West were £3,713 better off. However pensioners in the North East lost an average £5,484 and those in the North West suffered a £1,643 drop.

In general the housing market is fragile with the ongoing squeeze on mortgage lending affecting the possibility of growth.

However, homeowners over the age of 65 generally own their homes outright and have not been as affected as the rest of the market. Pensioners may have seen house prices fall but are still sitting in properties that in many cases are their greatest asset. The over-65s own considerable property wealth yet many pensioners are on fixed incomes and are suffering financially because they have been relatively hard hit by rising inflation. The

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consumer prices index shows inflation at 3.1 % p.a., but for most pensioners it is generally thought to be running at about 7% p.a.. The things they spend money on such as food, transport, utility bills and council tax have been rising

much faster than the items used to create the inflation index.

Equity Release allows pensioners to raise extra money whilst continuing to live in their own property. They can carry on living

there for the rest of their lives or can sell up and move to another property if they want to. Equally if they come into an inheritance they can repay the loan early although they may have to pay redemption penalties.

### Types of Plan *There are 2 different schemes available:*

**Lifetime Mortgage** – This is the most popular type of scheme. The interest on the loan rolls up year after year until it is finally cleared, along with the capital, when the property is sold after the death of the homeowner or entry into long term care. Any surplus funds from the sale form part of the estate. All plans also offer a ‘no negative equity guarantee’ which means that the client can never owe more than the property is worth, no matter what happens to house prices in the future.

**Reversion Plans** – Under this scheme a proportion of the property is sold. The client receives a lifetime lease in addition to the capital sum. On death or entry into long term care the property is sold and the estate receives the applicable proportion of the sale price received. i.e. If 60% of the property was sold then the estate would receive 40% of the sale price.

In other words under a Reversion Scheme the percentage of the remaining surplus funds after sale are known at the onset of the plan whereas with a Lifetime Mortgage the remaining funds are unknown. The market in the schemes is basically split in the order of 95% Lifetime Mortgages and 5% Reversion Plans.

### Rates of Interest

The average Lifetime Mortgage charges a fixed rate of about 6.74% for the life of the loan compared with a fixed rate of just 5.72% for a standard 10 year fixed rate mortgage.

However it is unfair to compare Equity Release mortgages with standard mortgages because they are very different. With a standard mortgage the client makes regular payments every month or their property will be repossessed. With Equity Release, the client does not have to make any repayments during their lifetime. In addition the interest rate is fixed for life not

for just a specified term as with a standard mortgage. This obviously makes Equity Release plans more expensive. The ‘no negative equity guarantee’ is also an essential safeguard because it ensures that no debt can be passed to the next generation, however this also increases the cost of the plans.

In general Equity Release rates also rose after a number of providers (such as Prudential) left the market during the last eighteen months due to the high costs of setting up plans and the difficulty of raising capital in these challenging economic conditions. However there is still a good range of lenders available

in a very competitive marketplace.

The majority of older people will have lived in their property for many years and will typically have seen its value at least double. The average house price fifteen years ago was £65,000 - today, even allowing for the recent falls over the last couple of years, it is still about £170,000.

### Conclusion

It is always suggested that where possible the family should be involved in the decision to use an Equity Release scheme to avoid the issue of disappointed beneficiaries in the future. Finally we would always recommend that independent financial advice from a suitably qualified IFA should be sought before any client enters into a Lifetime Mortgage arrangement. Buying plans ‘off the page’ will often be a more expensive exercise due to lack of advice and the client not fully understanding the terms and conditions.

**For technical assistance and advice call:-**

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