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guide to equity release

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which is right for me?

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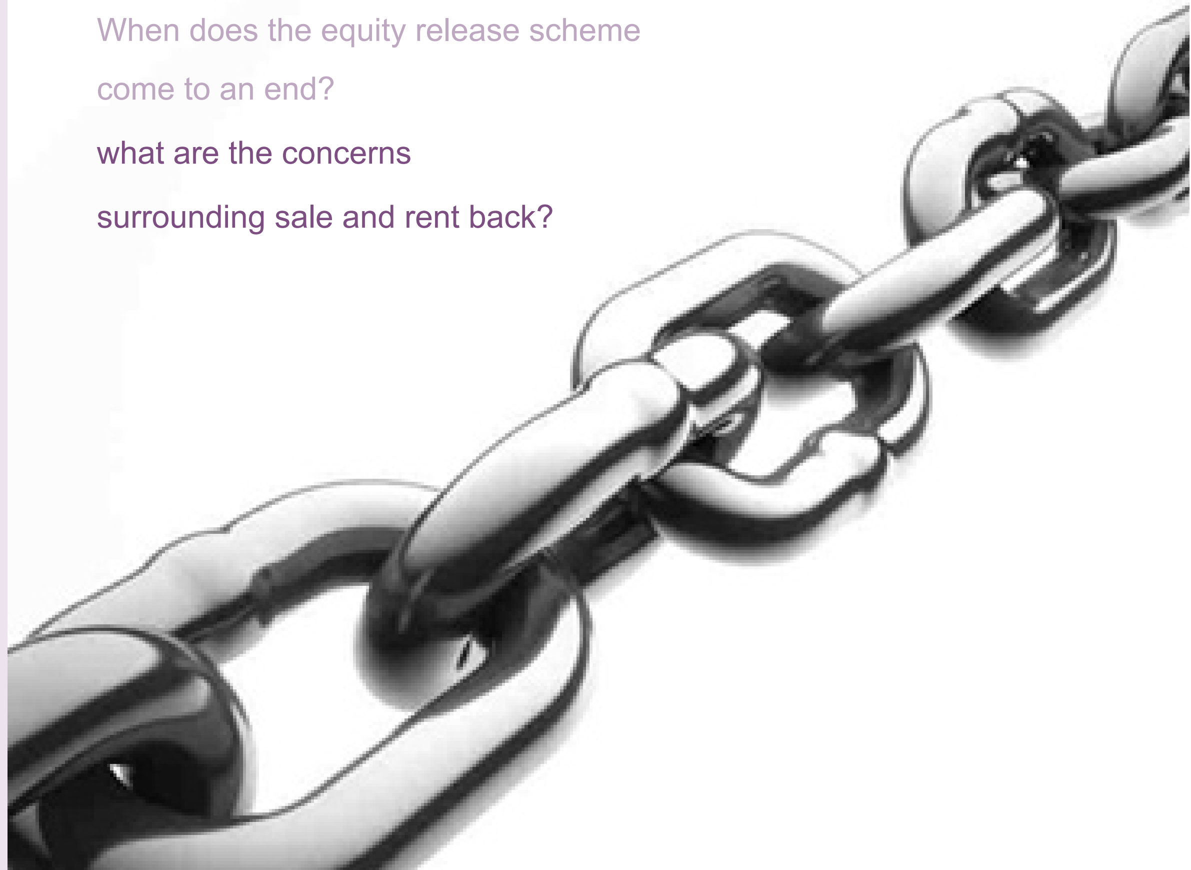

Equity Release Solicitors' Alliance

what are the different types of equity release schemes?

Which is Right for me?

There are two main types of equity release schemes that will enable you to release equity from your home, by releasing a lump sum, an income, or both: home reversion and lifetime mortgages. There are many variants of the schemes and not all may be available at any time. When choosing the most suitable scheme to meet your needs it is recommended that you look for a financial adviser with specialist qualifications in dealing with equity release.

Home reversion schemes

With these schemes you would sell all or part of your home to a provider, subject to a lease at a nominal rent (typically around £12 per year), giving you the right to continue in occupation until the occurrence of a 'determinable event' usually when your home is sold or you go into a care home (see Part 5 of the guide – 'Jargon Buster'). When your home is sold, the provider will receive the proceeds of the sale relating to the share it has purchased from you. With a home reversion scheme, the provider will share in the increase in the value of your home proportionate to the share it owns. You, or your beneficiaries, will then benefit from the value of the share you retained.

Home reversion schemes are not to be confused with the new 'sale and rent back schemes' which have emerged during the past few years.
(see page 11).

Example

In 2003, Stuart, aged 73, owned a property with a market value of £200,000. He entered into a home reversion scheme by selling 75% of the property to a home reversion company. The company offered him a lump sum of £79,500 (53%) representing the figure the company was prepared to pay for his 75% interest. Stuart uses £19,500 to buy a new car and carry out essential repairs to the property. He gifts £10,000 to each of his three children and invests the remaining £30,000 in a purchased life annuity which gives him an income of £2,450 a year before tax. Assuming Stuart dies in 2012 when the value of his home has risen to £280,000, the home reversion company will take £210,000 (75%) and the remaining £70,000 will pass into Stuart's estate.

Advantages of Home Reversions

With schemes that pay a lump sum, the benefits and costs are known at the outset

You will receive a tax free cash sum to spend or invest as you wish

Income benefits can be greater with a home reversion scheme than with a lifetime mortgage

There will be no ongoing repayments to the provider, other than nominal rent

You can preserve a known share of your home as inheritance

Where only part of your home is sold, you can share in the rise in value

There is the possibility of you taking an extra lump sum from your home in the future

The share of your home you have sold can reduce the size of your estate and may reduce or eliminate liability to Inheritance Tax

Disadvantages of Home Reversions

The provider will own a share (or all) of your home, thereby restricting its use

If you have sold all your interest in your home, you will not share the gain from any increase in its value

The scheme will reduce the value of your estate and thereby reduce any inheritance you plan on leaving

If you die soon after entering into the scheme, your home could be effectively sold, or a share of it, cheaply

Some schemes can take a long time to arrange

Providers may be selective about the properties they will consider as security

You may lose entitlement to some means-tested benefits and services

Lifetime mortgages

With a lifetime mortgage you take out a loan (mortgage) secured on the property and retain ownership of your home. The loan and interest, if any, is typically paid on the happening of a 'determinable event'. There are a number of types of lifetime mortgages and the most popular currently available are:

Roll-up lifetime mortgage

This is the most popular equity release scheme, where you take out a loan secured against your home, in return for a cash lump sum, a drawdown income or both. The interest, which is usually at a fixed rate, is 'rolled-up' and repaid on the happening of a determinable event, including death or a move into permanent care.

Example

Diane owns her home which is valued at £260,000 and takes out a roll-up lifetime mortgage by borrowing £50,000 at a fixed rate of interest of 7%. Ten years later, Diane suffers a stroke and is admitted permanently into care and her home is sold. At the time, the property was valued at £310,000 and the interest on the lifetime mortgage amounted to £48,358. The equity release provider will take £98,358 (£50,000 originally borrowed + £48,358 interest) together with any administration charges in bringing the scheme to an end. The remaining money following the sale, £211,642 (£310,000 less £98,358) will pass to Diane to fund the cost of her care directly, or through a long-term care insurance scheme which will enable her to gift part of her estate to her children during her lifetime.

Because cumulative interest is charged on the loan, the amount you owe can grow quickly, particularly if you have taken a lump sum at the beginning rather than by stage payments under a drawdown facility (where interest is only incurred on the amount of payments drawndown from the initially agreed loan amount).

Years since Plan taken out	If you had taken an initial lump sum of £50,000, the amount you will owe at a fixed interest rate is:				
	3% p.a.	5% p.a.	7% p. a.	9% p. a.	11% p.a.
Initial loan	£50,000	£50,000	£50,000	£50,000	£50,000
1	£51,500	£52,500	£53,500	£54,500	£55,500
5	£57,964	£63,814	£70,128	£76,931	£84,253
10	£67,196	£81,445	£98,358	£118,368	£141,971
15	£77,898	£103,946	£137,952	£182,124	£239,229
20	£90,306	£132,665	£193,484	£280,221	£403,116
25	£104,689	£169,318	£271,372	£431,154	£679,273

Advantages of Lifetime Mortgages

A lump sum can be released to spend or invest as you wish, without payment of interest

The cost to you is limited to the amount and period of the loan: 'pay as you use'

You retain full ownership of your home and benefit from any increase in its value

As with most equity release schemes, it may be possible to transfer the plan to another property if you wish to move in the future

Depending upon your age and the value of your home, it may be possible to obtain further loans in the future

The loan repaid will reduce the size of your estate and can reduce or eliminate liability to Inheritance Tax

Disadvantages of Lifetime Mortgages

Interest is compounded (interest added on interest) and the debt can accumulate rapidly. For example, the debt could double within 10 years when interest rates are 7%. The younger you are at the time of taking out the loan, the greater the potential debt due to longer life expectation

The value of your estate is unquantifiable which means that you cannot plan on leaving a guaranteed inheritance

The loan repayable may consume all of the equity in a prolonged period of low house price inflation. You may end up owing more than the property is worth, however most schemes have a ‘no negative equity’ guarantee as a safeguard (see Part 5 of the guide – ‘Jargon Buster’)

Interest rates can be high due to the rate being fixed for the life of the loan, which can last for a number of years. It may be possible to re-mortgage at a lower rate in the future, however there will be penalties and costs to consider.

You may be unable to obtain further advances if there is little value left in your home.

If you repay the loan early, early repayment charges may be payable

You may lose entitlement to some means tested benefits and services

Interest only lifetime mortgages

These schemes are relatively new and are similar to a standard mortgage where the provider will require interest to be paid on the loan. Your financial status will be assessed and the amount you can borrow will depend upon your age, the value of your home and your ability to meet the monthly interest payments. This scheme will only be suitable if you have a regular income such as a salary, state retirement pension, occupational pension, or other guaranteed income.

The interest rate is fixed at the start and is usually lower than the interest rate on a roll-up lifetime mortgage. Unlike a traditional interest-only mortgage, there is no mortgage term and the loan is repaid on the happening of a 'determinable event', including death or moving into permanent long-term care.

Example

Peter is single and aged 66. He owns a property with a market value of £250,000. Although he is in receipt of state retirement pension and a reasonable occupational pension, he has nominal savings with which to pursue his passion to travel. Peter takes out an interest-only lifetime mortgage of £30,000 with a fixed interest rate of 5.99% (6.4% APR). He will pay to the provider monthly interest payments of £149.75.

Peter dies 12 years later during which time he would have paid £21,564 in interest. The initial loan of £30,000 will be repaid from the sale of his property, which will undoubtedly have increased in value over the years, leaving a reasonable inheritance for his children.

With some interest-only lifetime mortgages it is possible for you to convert to a roll-up lifetime mortgage on a pre-agreed date, or automatically if there are financial difficulties; for example, your partner may die - thus substantially reducing your retirement income.

Advantages of Interest-Only Lifetime Mortgages

A lump sum can be released to spend or invest as you wish

You retain full ownership of your home and benefit from any increase in its value

As with most equity release schemes, it may be possible to transfer the plan to another property if you wish to move in the future

It may be possible to obtain further loans in the future depending upon your age, the value of your home and your financial ability to meet increased interest payments

When the scheme comes to an end, only the capital has to be repaid

The loan repaid will reduce the size of your estate and can reduce or eliminate liability to Inheritance Tax

Disadvantages of Interest-Only Lifetime Mortgages

The amount that can be borrowed may be a comparatively small percentage of the value of your home

You must have sufficient income to meet the interest payments for the duration of the loan

Interest rates can be high due to the rate being fixed for the life of the loan which can last for a number of years

If you repay the loan early you may have to pay early repayment charges

You may lose entitlement to some means-tested benefits and services

Home income plan

With a home income plan you take out a loan secured against your home and use the sum released to buy an annuity. Part of the income pays the interest on the loan, usually at a fixed rate, and the remainder provides you with an income for life. The loan is repaid on the happening of a 'determinable event', including death or moving into permanent long-term care.

The income received from the home income plan is fairly low if it is taken at an early age, for example, soon after retirement. These schemes will only benefit you if you are advancing in years. The older you are when the annuity is bought, the higher the income you will receive due to your limited life expectancy. Although these schemes

were very popular in the past, the removal of MIRAS tax relief in March 1999 has made them less favourable for homeowners under the age of 80.

Example

Sue is a widower aged 80 and lives in her own home worth £190,000. The mortgage was paid off a number of years ago. She receives state retirement pension and a small pension from her former employer. She is a basic rate tax payer. In 2002 she takes out a home income plan of £30,000 which is used to buy an annuity of £4,044 a year for life. Interest on her loan is £2,475 which is deducted from Sue's annuity leaving her with an annuity income of £1,569. However, the interest element of the annuity (£994) will be subject to income tax at 20% (i.e.) £199. The tax will be deducted by the provider at source. Sue will receive a net annuity income of £1,370 for life by monthly instalments of £114. Sue dies ten years later. Her home is then worth £260,000. The provider takes £30,000 as the original loan repayment and the remaining £230,000 passes into Sue's estate for her children to inherit.

Advantages of Home Income Plans

Provided a scheme is chosen with a fixed rate of mortgage interest, the income will remain unchanged during your lifetime; subject only to a change in the rate of tax

You keep ownership of your home and will be in a position to gain (or lose) from any future increase (or decrease) in its value. A rise in the value of your home will enable you to increase the loan and provide additional income, giving some protection against inflation

The loan is to be repaid at death and will reduce the value of your estate when calculating liability to Inheritance Tax

Disadvantages of Home Income Plans

This scheme is not suitable if you are looking for a substantial cash lump sum

The monthly annuity income paid from most schemes is not index-linked and will not keep pace with inflation

If a capital protection plan is not incorporated into the plan, your estate will be significantly reduced

The plans are more suitable for older people who qualify for higher annuity rates. The minimum age requirement is generally higher than for home reversion and roll-up lifetime mortgage schemes

The income derived from a home income plan is much reduced following the withdrawal of MIRAS tax relief in March 1999

The additional income received from the home income plan, added to your existing income, may put you into a higher tax band which may result in you having to pay tax (or pay more tax) than you did before taking out the plan

The income could affect your eligibility for means-tested welfare benefits and services

When does the equity release scheme come to an end?

Provided you are not in breach of any of the providers terms and conditions, the determinable event with both home reversion and lifetime mortgage schemes will usually be when you (or a related person such as a surviving spouse or partner) dies, moves permanently into long-term care or you vacate your home and do not move to another property where the scheme can be transferred.

what are the concerns surrounding sale and rent back schemes?

A Sale and Rent Back Scheme (SARB) is where you sell your home to a company at a discount, releasing cash to enable secured and other debts to be cleared. Your home will be rented back to you, usually under a short term tenancy at a market rent.

There has been concern as to how these schemes have been marketed and sold. They were traditionally aimed at people in a desperate position who were facing repossession or who needed money quickly. The marketing of these schemes has raised queries, particularly where they are being described as a traditional equity release scheme.

There are a number of concerns regarding these schemes and it is recommended that you seek both legal and financial advice before committing yourself.

- The schemes are not currently regulated by the Financial Services Authority and you will have little protection if things go wrong; however full regulation will come into practice in 2010.
- You may be confused where the schemes are being marketed as ‘equity release’, whereas in reality the schemes differ considerably from the regulated lifetime mortgage and home reversion schemes traditionally associated with equity release
- They are often marketed as a quick and speedy sale with little opportunity given to you to reflect on the implications
- A number of the schemes do not offer you the security of a long term tenancy at a low fixed rent

contact us

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