Setting the standard in equity release

EQUITY RELEASE COUNCIL
Incorporating SHIP Standards

Equity Release Market Report

Autumn 2015

www.equityreleasecouncil.com

Introduction

The latest Equity Release Market Report shows that the over-55s' appetite for unlocking their housing wealth continues to grow across the UK. The retirement landscape has changed considerably in the last six months alone after the arrival of the pension freedoms on 6th April and the introduction of the first part of the Care Bill. This is giving people new options to consider for funding later life, but at the same time, it remains a challenge to amass the savings needed to support a comfortable retirement.

Equity release can play an important role for many in helping to achieve this. It therefore makes sense for any conversation about financial planning for retirement to consider the role that housing wealth can play.

In addition, the sector has seen Legal & General arrive on the scene this year. The prospect of more new providers and products entering the market - as well as different funding options helping providers to develop their product portfolios - will introduce further innovation. One example is the option to make interest payments in the early years of a loan, which will ensure the market can satisfy wider demand.

As more people are attracted by the possibilities offered by equity release, it is vital that efforts are made to maintain the standards of financial and legal advice across the sector, underpinned by appropriate regulation and The Council's own Statement of Principles and associated Rules and Guidance. These standards are crucial to maintaining the positive outcomes enjoyed by the vast majority of customers, based on an understanding of how equity release works and the situations in which it can be of benefit.

Nigel Waterson, Chairman, Equity Release Council

What protections exist in today's market?

- **Regulated financial advice:** equity release products can only be arranged by qualified and regulated advisers. All new plans taken out via members of The Council now involve independent advisers. In addition to their regulatory obligations, Council members commit to taking customers through a detailed advice process set out by its Standards Board (see page 10).

- **Independent legal guidance:** all equity release sales are reviewed by a solicitor of the customer's choice, who signs a certificate to confirm the rights and obligations of both parties (the customer and the product provider) have been explained and that the customer wishes to go ahead. The certificate also confirms that the solicitor is acting independently of the product provider and the financial adviser. The client is required to sign the certificate, along with the solicitor to confirm their understanding and agreement.

- **Product safeguards:** provider members of The Council offer a range of safeguards including protection against negative equity and the guaranteed right to tenure (see page 11).

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Key findings

More than 10,000 new equity release plans have been agreed in each of the last 4 half-year periods (i.e. since H2 2013).

Comparing H1 2015 with H1 2007 (the busiest 1st half on record), drawdown lifetime mortgages are established as the preferred option, with 65% of new plans compared with 44%, while lump sum products now account for 35% of plans, down from 51%.

The 65-74 age group has seen the biggest growth of customer numbers over the last year, while the percentage of customers aged 55-64 has dropped from H2 2014 to H1 2015.

There are a number of characteristics distinguishing between customers based on product preference. Specifically, drawdown customers are typically older and are opting for smaller withdrawals of housing wealth initially. Those seeking a lump sum are closer to the traditional retirement age of 65 and seek a larger amount.

Average rates for equity release products fell below 6% during April 2015 and have fallen by more than half a percentage point since December 2014.

Market trends

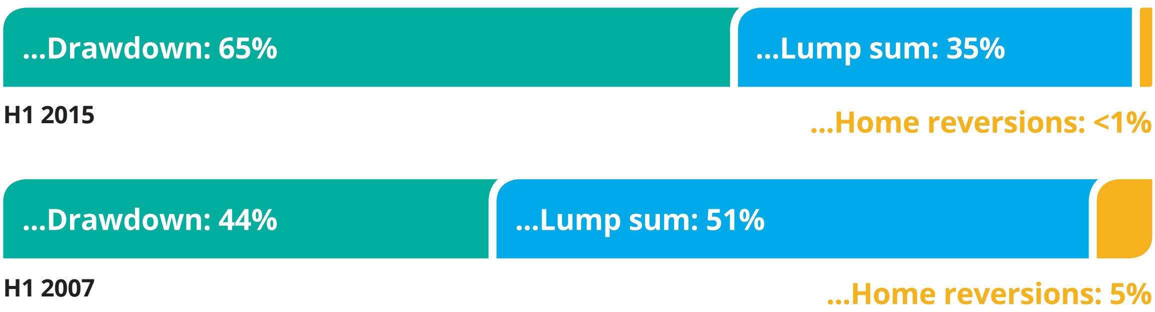
Product preferences re-shaped since 2007

More than 10,000 new equity release plans have now been agreed in each of the last four half-year periods from H2 2013. Equity release lending of £710m in H1 2015 was the highest amount seen in the first six months of any year since The Council began tracking half-yearly returns in 2002.

This was up 11% year-on-year, although 4% lower than the half-year record of £741m set in H2 2014. This brought an end to a sequence of growth for three consecutive half-year periods. The number of new plans agreed also dipped by 9% in H1 2015 compared with H2 2014, although this was still up 2% year-on-year.

The busiest first-half for new plans agreed (over 14,000) remains H1 2007, but the shape of the market has changed considerably since then. Almost two thirds of customers (65%) chose drawdown lifetime mortgages in H1 2015 while 35% opted for lump sum lifetime mortgages and less than 1% took out a home reversion plan. In contrast, during H1 2007 51% chose lump sums, 44% drawdown and 5% home reversion plans.

Customers choosing...



As the subsequent sections of this report show, there are a number of characteristics that distinguish between today's customers based on their preference for drawdown or lump sum products.

Drawdown allows people to access their housing wealth in instalments, and can provide an additional source of regular income as well as with meeting one-off costs. Lump sum plans typically involve a larger withdrawal up front, which might be used for bigger items of expenditure such as clearing an existing mortgage or other borrowing.

	Drawdown	Lump sum
HOUSE PRICE	£304,340	£242,476
INITIAL WITHDRAWAL	£46,958 (15.4%)	£77,494
DRAWDOWN RESERVES	£32,348 (10.6%)	NA
LOAN-TO-VALUE (LTV)	26.1%	32.0%
AVERAGE AGE AT PURCHASE	71.5	67.7

65-74 age group sees the biggest year-on-year growth

The average age of customers dipped slightly to 70.1 in H1 2015, down from 70.3 in H2 2014 and 70.8 in H1 2014. This was a result of lump sum borrowers being just over a year younger on average than they were this time last year (67.7 vs. 68.8). In contrast, the average drawdown customer has remained roughly halfway in between their 71st and 72nd birthdays.

Average age of new customers

	All customers	Lump sum customers	Drawdown customers
H1 2015	70.1	67.7	71.5
H2 2014	70.3	67.6	71.6
H1 2014	70.8	68.8	71.6

Tighter lending criteria following the Mortgage Market Review (MMR) are likely to have played a role in the falling age of lump-sum customers – as has the growing number of maturing interest-only mortgages needing repayment. However, one possible impact of the pension freedoms introduced on 6th April 2015 is that this trend may be reversed in future. If more people use a proportion of their pension pot for immediate costs when they enter retirement, they may opt to reserve their housing wealth to call upon later in life.

In terms of annual growth, the 65-74 age group saw the biggest percentage increase in customer numbers (5%) from H1 2014 to H1 2015, compared to 4% among those aged 55-64. In contrast, the number of customers aged 75-84 dropped by 3% while those aged 85+ fell 13%.

Looking at how this affects the overall percentage breakdown, a growing share of plans are now agreed between the ages of 65 and 74: 58% in H1 2015, up from 56% last year and the highest since tracking began in 2011. The two older age groups still accounted for one in four (25%) new plans taken out in H1 2015. This is noticeably more than the youngest age group (55-64s), where 18% of new plans were taken out: down from 20% in the previous six months.

Age breakdown of new customers

	55-64	65-74	75-84	85+
H1 2015	18%	58%	22%	3%
H2 2014	20%	56%	21%	3%
H1 2014	17%	56%	23%	3%

The number of divorced, separated, single or widowed customers grew by 17% year-on-year in H1 2015, while the number of married or cohabitating customers fell by 4%. Individual customers took out 39% of plans in H1 2015, compared with 34% in H1 2014. Married or cohabitating customers dropped to 61% in H1 2015, from 66% in H1 2014.

Housing wealth

Drawdown trends

Among drawdown customers, the average first withdrawal was £46,958 (H1 2015) which is 2% lower (-£872) compared with H2 2014. This is despite their homes being worth £4,082 or 4% more on average.

Despite having greater housing wealth at their disposal, the trend shows drawdown customers are limiting their initial borrowing and reserving more equity to draw on at a later date. They took an initial 15.4% advance in H1 2015 compared with 15.9% in H2 2014. By holding back on withdrawing money until it is needed, they can limit the build-up of interest over the lifetime of their loan.

The typical amount reserved for future use rose by £5,529 or 21% from H2 2014 in H1 2015. Extracting the full reserve amount plus the initial sum would leave the average customer having drawn on a little over a quarter (26.1%) of their total housing wealth.

Drawdown customers

	H2 2014	H1 2015
HOUSE PRICE	£300,258	£304,340
INITIAL WITHDRAWAL	£47,831 (15.9%)	£46,958 (15.4%)
DRAWDOWN RESERVES	£26,820 (8.9%)	£32,348 (10.6%)
LOAN-TO-VALUE (LTV)	24.9%	26.1%

Lump sum trends

The average value of new lump sum lifetime mortgages grew by £3,285 or 4% between H2 2014 and H1 2015 from £74,209 to £77,494. Customers taking out these products in the first six months of this year had homes worth slightly less than in the previous six months (£242,476 vs. £243,535).

As a result, their average LTV was higher at 32.0% compared with 30.5%, although this is still significantly below the maximum available on the market, which exceeds 50%.

Lump sum customers

	H2 2014	H1 2015
HOUSE PRICE	£243,535	£242,476
INITIAL WITHDRAWAL	£74,209	£77,494
LOAN-TO-VALUE (LTV)	30.5%	32.0%

Personal borrowing rates tracker

Average equity rates fall below 6% for the first time

The average rate for equity release products that are aligned to The Council's rules and guidance – and therefore include consumer protections such as the 'no negative equity guarantee' – fell below 6% for the first time in April 2015 and have remained below this marker since then.

The average rate of 5.97% in July was more than half a percentage point (0.55%) lower than at the end of 2014 (6.52%). This is a bigger fall than has been seen across all other mainstream forms of borrowing with the exception of personal loans.

	Dec 2014	Jul 2015	Difference
Overdrafts	19.66%	19.67%	+0.01
Credit cards	17.75%	17.84%	+0.09
Personal loans (£5k)	8.78%	7.87%	-0.91
Equity release (average)	6.52%	5.97%	-0.55
SVR mortgages	4.48%	4.49%	+0.01
Personal loans (£10k)	4.93%	4.25%	-0.68
Five / ten year fixed rate mortgages (75% LTV)	3.61%	3.09%	-0.52
Lifetime tracker mortgages	2.89%	2.59%	-0.30
Two / three year fixed rate mortgages (75% LTV)	2.49%	2.21%	-0.28
Variable rate mortgages	1.60%	1.59%	-0.01

Source: *Moneyfacts/Bank of England. Rate changes measured in basis points (bps). Average equity release rates exclude products which do not offer protections such as the guaranteed right to tenure and no negative equity guarantee.*

Why do rates differ between lifetime and residential mortgages?

Lifetime mortgages differ from 'standard' residential mortgages in a number of ways, including: offering a fixed rate of interest for an indefinite term; guaranteeing the right to tenure; and protecting the customer against negative equity, with the provider absorbing the risk. Because of this, lifetime mortgage providers use different funding sources (typically annuity funds, backed by the purchase of secure long-term gilts) and have to set their rates to account for factors such as longevity and potential changes in the housing market.

Analysis: Compounding of interest

Where interest is compounded or rolled up on lifetime mortgages this is done in lieu of customers making repayments – just as compound interest is paid on savings where customers do not make withdrawals. Compound interest increases the overall cost of lifetime mortgages, and can double the total amount to be repaid within 12 years based on the latest average rate (5.97%). The same would occur after 17 years if 'simple' interest is used.

Recent innovations mean some newer products allow equity release customers to make interest repayments to begin with. Simple interest* is used throughout the period where repayments are made, before switching to roll-up when the customer chooses: for instance, when their income reduces in later life.

Based on the latest averages, the annual 'simple' interest payment on a £77,494 lump sum lifetime mortgage at 5.97% would be £4,626. Over ten years, this amounts to £46,264 compared to £60,894, where interest is compounded or rolled up. The difference is £14,630 over ten years, meaning the customer pays the equivalent of an extra £1,463 or 1.9% of the original loan for each year where they do not have to make repayments and can maximise their available income during retirement.

The difference will be greater over a longer period of time or lesser over a shorter period (see below) but it shows the 'extra' cost of compounding can be less severe than is often portrayed. Importantly, the most popular products on today's market – drawdown, chosen by 65% of customers – are less affected by compound interest as the first average withdrawal (£46,958) is smaller and interest is not charged on subsequent withdrawals until these are made.

Original loan **£77,494**

Rate **5.97%**

	After 5 years	After 10 years	After 15 years
Interest accrued (compound)	£26,064	£60,894	£107,438
Interest accrued (simple)	£23,310	£46,264	£69,396
Difference - annualised	£586 (0.8%)	£1,463 (1.9%)	£2,536 (3.3%)

** Simple interest is when the agreed rate of interest is regularly paid on the balance outstanding rather than being added to the loan.*

Analysis: Compounding of house prices

Compounding also affects house price growth and can help to preserve customers' remaining equity in a rising housing market. The following illustrations are based on the average lump sum lifetime mortgage of £77,494 and the average house price among lump sum customers of £242,476, leaving £164,982 of equity remaining at the outset (excluding fees).

Data from the Office for National Statistics (ONS) shows house price growth has averaged 5.3% a year since 2003 (when ONS expanded its sample data) with the worst-performing region (the North East) averaging 4.2% annual growth.

The example below shows, while compound interest increases the total amount owed over 5, 10 and 15 years, this level of house price growth means their remaining equity also grows to a larger amount than they had left to begin with – even when adjusted for inflation.

Example: 4.2% annual house price growth

	Loan	House price	Equity left
At start	Loan at start **£77,494**	House price at start **£242,476**	Equity left at start **£164,982**
	Loan at end	House price at end	Equity left at end / **Equity left at end (inflation adjusted)***
After 5 years	£103,558	£297,857	£194,299 / **£175,983**
After 10 years	£138,388	£365,886	£227,498 / **£186,628**
After 15 years	£184,932	£449,453	£264,521 / **£196,543**

**Based on the Bank of England's 2% annual inflation target, to show how remaining equity looks in today's terms*

Based on a more modest projection – 2.1% annual house price growth, half the average of the worst performing UK region since 2003 – then after 15 years, the customer is still left with over £100,000 of equity remaining in their home in today's terms.

Example: 2.1% annual house price growth

	Loan	House price	Equity left
At start	Loan at start £77,494	House price at start £242,476	Equity left at start £164,982
	Loan at end	House price at end	Equity left at end / **Equity left at end (inflation adjusted)***
After 5 years	£103,558	£269,028	£165,470 / **£149,871**
After 10 years	£138,388	£298,488	£160,100 / **£131,338**
After 15 years	£184,932	£331,173	£146,241 / **£108,659**

In the event that house prices remained flat (0% annual growth) over the lifetime of the plan, this customer would be left with more than half their initial equity after 10 years once inflation is taken into account, and over £40,000 after 15 years. The no negative equity guarantee means even if house prices fell, customers are protected from ever owing more than the value of their home or leaving any debt to their estate, since any losses arising from negative equity are borne by the provider.

Example: 0% annual house price growth

	Loan	House price	Equity left
At start	Loan at start £77,494	House price at start £242,476	Equity left at start £164,982
	Loan at end	House price at end	Equity left at end / **Equity left at end (inflation adjusted)***
After 5 years	£103,558	£242,476	£138,918 / **£125,823**
After 10 years	£138,388	£242,476	£104,088 / **£85,389**
After 15 years	£184,932	£242,476	£57,544 / **£42,756**

Equity release and advice

All equity release plans agreed via members of The Council now involve independent advice. In addition to their regulatory responsibilities, adviser members of The Council are required to undertake the following with customers as part of the advice process:

- Fully discuss **alternatives to equity release** including trading down, grants, use of savings and pension income, financial assistance from any family member – both for the current point in time and how any of these alternatives may be relevant in the future
- Establish or refer for investigation the customer's **eligibility for state benefits** and the effect equity release benefits may have on them
- Consider the customer's **tax position** in making a recommendation
- Advise the customer to **speak to their family** and **any other material beneficiaries** of their Will, and to consult an **independent legal adviser**
- Discuss the customer's **health and life expectancy** and take into account the effect of **positive and negative changes in house values**
- Explain the **impact on their Will and estate planning** and how any released funds may impact on their ability to fund later life financial requirements such as **long-term care funding**
- Prior to any recommendations, provide the customer with a **fair and balanced overview of the pros and cons** of both lifetime mortgages and reversion plans, **taking into account the customer's current and future financial status**
- **Be sure the contract recommended is the most suitable** lifetime mortgage or reversion plan and advise that any other outstanding mortgage will need to be redeemed before the lifetime mortgage contract can be entered into
- Explain clearly that it is **inadvisable that the funds released are reinvested** into any medium or long term investments
- Fully explain **all fees and risks associated with the product recommended**, for example: the impact of any **compound interest**; any **early repayment charges**; the **opportunity to move** the mortgage in the future will be restricted to properties acceptable to the lender. This may rule out moving to age-restricted or sheltered accommodation, depending on the lender's policy at the time.
- Review the customer's **needs and objectives, future plans** and **ongoing commitments** including moving home. This includes income requirements as well as property maintenance and insurance.
- Ensure that the amount released **does not exceed the customer's current requirements** and is **appropriate to their attitude to risk**. This includes debt consolidation, if applicable.
- Check if the customer has put together a **realistic expenditure budget** plan for the funds released. This includes making use of drawdown facilities, if applicable.
- Give the customer a copy of the Suitability Report, outlining all of the information in 1-12 above, and confirm their receipt and acceptance of it.

Case studies: improving lives

The following are examples of situations where equity release has had a positive effect on people's finances during retirement. They are taken from 'The Future of the UK Equity Release Market: Consumer Insights and Stakeholder Perspectives', by Louise Overton of the University of Birmingham and Lorna Fox O'Mahony of the University of Essex, published in June 2015 and included here with permission from the authors.

Bernard was 99 years old when we interviewed him. He had taken out a lifetime mortgage with his wife approximately ten years previously in order to prevent what he feared would be repossession of the property that they had lived in for 50 years.

Reflecting on how he felt about the situation now, Bernard said:

> **"In the long run it was definitely worth doing because it got rid of any troubles or worries, it gave us an income and gave us a place that they couldn't take away from us."**

Victor was 75 years old when we interviewed him. He had taken out a home reversion in 2007 which provided him with a lump sum of £83,000 to help pay off his mortgage. Having retired, Victor was still paying almost £500 per month towards his mortgage, and wanted more financial freedom so he no longer had to be 'very, very careful' with money. Victor feels very satisfied with the outcome.

> **"I'd looked into it very carefully and knew the risks, knew the constraints … and would I do it again? Yes, I would … because, as I said, it's given me more flexibility. Even though I have a good pension, I've got rid of the mortgage and that was a loop around my neck … and so, yes, it worked for me. But I'm single, no family and that's a big thing. If one had a family or you had someone who would benefit and looked forward to receiving some of your inheritance, then that's another matter. But I didn't have those constraints or worries. So it made it easier for me."**

Roy was 75 years old when we interviewed him. He had taken out a (partial) home reversion on his three bedroom bungalow in 2007 to allow him to remain in the property while providing a lump sum of £50,000 to his ex-partner following their separation. The £20,000 that Roy received enabled him to have ‘a nice lifestyle’. He said it wasn’t a difficult decision to make and can’t understand why more people don’t make the most of the money tied up in their properties.

“It was absolutely the right decision. I mean, why would I be sitting, you know, I’d be sitting here on £180,000 for what? I can’t downsize any more than a three-bedroom bungalow…I can’t understand why people want to sit on houses that are going down in value, you know, for the sake of, well, generally, it’s for the sake of kids, isn’t it?”

Bill was 82 years old when we interviewed him. Bill had always lived alone, and when he was made redundant at age 57 during a period of high unemployment he was unable to get another job. Several years later, Bill found that his pensions were not keeping up with the cost of living and he was finding it hard to meet all of his housing costs. A survey on the roof of the block of flats he lived in revealed that major repairs were necessary at a cost of £25,000 per owner.

Bill had very little savings and a fairly modest annual income, so could not afford to pay his contribution to the repairs. Having been refused a traditional loan on the basis that he was too old and his income was too low, he turned to equity release to solve the problem. With a lump sum of £69,000, Bill was able to pay for the repairs and have a sufficient amount left over to live a more comfortable and enjoyable lifestyle, giving him a ‘new lease of life’.

Reflecting on how he felt about the situation now, Bernard said:

“I had to make a decision, that was it, and I have no regrets, it was the right decision, time has proved me right.”

About the Equity Release Council

The Equity Release Council (The Council) was formed in May 2012 to create a united voice for the industry and build on the legacy of Safe Home Income Plans (SHIP), founded in 1991 as the trade body for equity release product providers. The robust standards of consumer protection upon which SHIP was founded have underpinned the development of a flourishing sector which has served over 340,000 consumers, lent over £16bn and enjoys high levels of customer satisfaction.

The Council's membership now exceeds 400 and includes advisers, solicitors, surveyors, providers, intermediaries and other industry professionals – each committed to support the equity release Statement of Principles and related standards. The Council and its members work to ensure customers can safely use this form of borrowing to support their retirement income and to boost public and political awareness of equity release as a solution to many of the financial challenges facing the UK's over-55s.

Statement of Principles

Equity release customers enjoy three levels of protection, encompassing a structured financial advice process, face-to-face legal advice and product safeguards set out in the standards. The Council's Standards Board oversees the Statement of Principles and standards which members sign up to, instilling confidence in their products and advice. This ensures customers:

- retain **the right to remain in their property for life**, provided the property remains their main place of residence.
- receive a 'no negative equity' guarantee so they will **never owe more than the value of their homes or leave any debt behind** – regardless of changing property prices.
- receive **fair, simple and complete presentations** of the plans they are considering taking out – including any benefits and limitations of the product, and obligations they must adhere to. This includes **an outline of all potential and associated costs.**
- have the right to choose an independent **solicitor of their choice** to carry out associated legal work.
- have the right to **move their plan to another property** deemed suitable by the lender without being subject to any financial penalty.
- receive a certificate recognised by The Council and signed by their solicitor, which **clearly states the main cost to the householder's assets and estate** – for example, how the loan amount will change or whether part or all of the property is being sold.

Methodology

The Equity Release Market Report is designed and produced by Instinctif Partners on behalf of the Equity Release Council. It uses aggregated data supplied by members of The Council to create the most comprehensive view of consumer trends and product uptake across the equity release industry.

The latest edition was produced in August 2015 using data from over 90% of new equity release plans taken out in the first half of 2015, alongside historic data from over 45,000 new plans taken out since 2011. All figures quoted are aggregated for the whole market and do not represent the business of individual members. For a comprehensive list of members, please visit The Council's online member directory.

Contact

Find out more about the Equity Release Council, its members and the products and services they provide by visiting **www.equityreleasecouncil.com**

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