SENIOR ISSUES

Equity Release Guide

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The Caesar & Howie Group
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EQUITY RELEASE GUIDE

As the demographics of our society changes so do our needs. Due to an ageing population there has been an increased demand for Equity Release Schemes.

People are living longer and accordingly many retired people are concerned that their savings will be insufficient to allow them to have the standard of living they had hoped for during their working careers. Furthermore people are finding their level of pension less than they had anticipated. Equity Release Schemes may be the financial answer for many.

As property prices have soared over the last 20 years many retired people may find they own a large capital asset in their homes but are struggling to live on their income or don't have the extras for the luxuries in life. Equity Release Schemes can be an excellent method of unlocking your equity in your home.

Equity means the difference between the value of your house less any mortgages you have over it.

WHY MIGHT YOU USE EQUITY RELEASE?

- You may wish to remain living in your existing home but want to supplement your income. Equity Release allows you to do this. Many people do not want to go down the road of down-sizing and wish to retain the family home.
- You require to top up your income. With living costs rising at an alarming rate many retired people are finding that their income is now not covering their financial needs.
- A capital sum is required for repairs and maintenance to your home.
- You may wish to go on that holiday of a lifetime which you always promised yourself.
- You may need some capital to buy a new car.
- Capital may be required to make gifts to perhaps your children or grandchildren.
- You may even use Equity Release for Inheritance Tax planning. If you spend or gift the money received from an Equity Release Scheme your assets for IHT purposes will be reduced by the debt due to the Equity Release Company on death.
- As a device to avoid Nursing Home Costs.

As you can see there are many varied reasons to take out Equity Release.

Equity Release Schemes are, however, not suitable for everyone and the alternatives must always be considered.

Before making any decisions you need to consider your own financial circumstances and consider whether Equity Release is the right option for you.

It is prudent to use up your own saving before encountering upon an Equity Release Scheme as this is far more cost efficient. Essentially the rate of interest paid on an Equity Release loan will be higher than the rate of interest which is paid on your savings.

In addition the interest rate payable on an Equity Release Scheme is generally higher than the rate charged on a standard mortgage.

Also if you do use up all your savings you may become eligible to a number of means-tested benefits thus relinquishing the need for an Equity Release loan.

It may also be the case, that depending on the valuation of your property, Equity Release Schemes will not provide a large enough cash sum for your needs. Alternatively the amount required may be less than the minimum amount the Equity Release provider is prepared to lend.

Moreover as an Equity Release loan will have a direct effect on your available inheritance you should always consult with your family and explain the implications of the scheme for them. It may well be that your family may come up with an alternative.

ALTERNATIVES TO EQUITY RELEASE

You should always consider the alternatives to Equity Release

In many circumstances moving to a smaller house may be the best and correct option. Down-sizing could reduce your monthly outgoings to a manageable level.

If you want to leave an inheritance to your family then Equity Release may not be the correct way forward. If you embark upon an Equity Release Scheme the value of your property which you can pass onto your relatives will obviously be reduced.

It is crucial to check out any entitlements to means-tested benefits. You may be entitled to benefits which negates the requirement for Equity Release. Furthermore an Equity Release loan might affect any means-tested benefits that you already receive.

If you are obtaining the loan to carry our repairs and maintenance you should always investigate whether you may be eligible for any repair grants provided by your Local Authority.

Before embarking upon an Equity Release Scheme your financial adviser will ensure that all your personal circumstances are taken into account and all the alternatives are explored.

WHO IS ELIGIBLE?

You need to be 55 or over. Some lenders will insist on you being 60. If it is a joint application the age requirement will have to be met by both applicants.

You need to be a homeowner.

In addition your house will have to meet certain requirements. For example it will have to be in a reasonable state of repair and suitable for loan purposes. You will need to obtain a surveyor’s report to confirm this. It will also ascertain the valuation of your property.

You will also have to show that you have adequate building’s insurance.

Unlike a standard mortgage there will be no credit cheque or investigations into your income.

HOW MUCH WILL I BE ENTITLED TO?

The amount of equity you will be entitled to is determined by a number of factors. The equity release company will take into account the value of your property, your age, your health and your life expectancy before deciding the amount they will offer you.

There are no hard and fast rules and what is on offer will vary between lenders and the type of product you choose.

HOW DOES IT WORK?

If accepted for an equity release loan you will receive either a capital lump sum or income both of which will be tax free. There are 2 types of scheme on offer. There is either the option of a Lifetime Mortgage or a Home Reversion Scheme.

LIFETIME MORTGAGES

You are taking out a loan on a percentage of your house's valuation. It differs from a standard mortgage as the loan will not be repaid until the death of the borrower or when the house is sold, whichever is earlier. If it is a joint Lifetime Mortgage the loan will not be repaid until the death of the survivor.

EXAMPLE

Mr and Mrs Wilson took out a lifetime mortgage and received a lump sum which amounted to 20% of the market value of their house in 2006. Mr Wilson dies in 2011. Mrs Wilson's dies 2 years later in 2013. The lifetime mortgage will not need to be repaid until the death of Mrs Wilson in 2013.

The amount of loan to be repaid on death or on the sale of the property will be the capital sum plus the interest accrued over the length of the loan. The longer the loan has been in existence the more interest will have accrued.

There are many variations to the type of lifetime mortgage. They will be discussed later on in this guide.

HOME REVERSION SCHEME

With this type of scheme in return for the equity the homeowner enters into a joint ownership with the Equity Release Company. The proportion of the share of the property depends on the amount of equity required and the market value of the house. What essentially is happening is that the homeowner is selling a share of his house to the Equity Release Company. The company will pay the homeowner for that share a price less than the current valuation – that is the sum released to the homeowner. The company will then recover the full value of its share when the property is eventually sold after the homeowner dies or goes into care. Again if it is a joint scheme then the equity will not be required to be repaid until the death of the second homeowner or the occasion of the second homeowner going into care. The homeowner will be given the right to remain living in the property until after death or if the property is sold. Home Reversion Schemes can be differentiated from Lifetime Mortgages as with the latter the applicant remains sole owner of the property.

When the house is sold the equity release company will be entitled to receive the proportion of the sale proceeds relating to the percentage owned under the scheme.

EXAMPLE

Mr Fraser entered into a Home Reversion Scheme in 2006 when he received a cash lump sum in exchange for 20% ownership of his house. The house was valued at £200,000. Mr Fraser unfortunately due to failing health had to go in to a Nursing Home 3 years later in 2009, and the house had to be sold. The house is sold at a sale price of £280,000. Mr Fraser will receive £224,000 of the sale proceeds (80% of £280,000) and the Equity Release Company will receive £56,000 (20% of £280,000.)

Home Reversion Schemes will be looked at in more detail later in this guide.

HOW CAN I BE SURE THAT I AM RECEIVING GOOD FINANCIAL ADVICE?

All equity release plans are regulated by the Financial Services Authority (FSA). This body regulates all providers of financial services in the UK. One of the main purposes of the FSA is to ensure that consumers receive a fair deal. If any providers of financial services do not meet the required standards set by the FSA action will be taken against them.

More confidence can be created in these products as the vast majority of companies providing equity release are also member of Safe Home Income Plans (SHIP). SHIP is dedicated to ensuring that the consumers receive a fair deal in Equity Release Schemes. Companies that are a member of the SHIP organisation sign up to a voluntary Code of Conduct.

The Code of Conduct insists that the Equity Release Company comply with the following rules:-

- Provide a fair, simple and complete presentation of the plan. This means they must point out all the pitfalls as well as the advantages of the plan.
- Clearly state the full costs of the plan including the full effect it will have on their assets and estate. This should also include the position on moving house, tax implications and the effects of changing house prices.
- Ensure that the customer’s legal work can be carried out by a solicitor of his/her choice.
- Provide a no negative equity guarantee. This ensures that the final debt will not exceed the value of the property sold. Although in recent years we have enjoyed a period where house prices have rocketed we are now experiencing the “credit crunch” and some uncertainty lies around property values. Therefore it is very reassuring to note that if property prices become static or decrease your estate will not be in debt.

LIFETIME MORTGAGES CONSIDERED FURTHER

As explained earlier with a Lifetime Mortgage you are taking out a loan on a percentage of your house's valuation which will be repaid on the death of the borrower or when the house is sold, whichever is the earlier. There are many variations to the type of Lifetime Mortgage you can take out.

1. Lump Sum

The borrower receives a tax fee lump sum which is determined by the borrower's age and the valuation of the property. Interest will accrue on the loan each year. The loan, being the capital and the interest accrued, is not repaid until the death of the borrower (or death of the second borrower if it is a joint application) or when the house is sold. The outstanding loan will be deducted from the sale proceeds of the house. The remaining proceeds will fall to your estate.

2. Income

Instead of receiving one large cash sum at the beginning of the loan you receive a tax-free monthly income payment. The amount of income to be received will be determined on your age and the valuation of the house. Again the loan, being the capital and the interest accrued, is not repaid until the death of the borrower or when the house is sold. The amount to be repaid at the end of the loan will be smaller than with a lump sum. Interest will only accrue on the income actually received by the borrower. As you not are receiving all loan monies at the beginning of the loan the interest will be less.

3. Protected Equity

For those people wanting to ensure that they leave an inheritance to their family this may be the preferred option. With this product you agree the debt will not exceed a certain percentage of the value of you house. This guarantees that you can leave the protected percentage of the property to your family.

4. Fixed Option

You know at the outset exactly how much the debt will be at the end of the loan. This figure does not change, notwithstanding the length of the loan. Obviously if the borrower lives a long time this can be the cheaper option. If, however, you have to pay sell the house and repay the loan early, through ill health or death then you will lose out financially.

5. Draw Down

At the commencement of the loan you agree with the lender the maximum percentage of the valuation of your house the lender is prepared to lend against. Instead of receiving the full agreed loan at the start of the loan it allows the borrower to draw down the funds when they require them. Interest will only run on the funds actually drawn down. The facility will only be available for a fixed period of time. Repayment of the loan will be on similar terms as with a lump sum mortgage.

INTEREST RATES ON LIFETIME MORTGAGES

All the above types of Lifetime Mortgage can be taken on a fixed rate of interest or on a variable rate of interest.

If you decide on a fixed rate, this rate will be guaranteed for the lifetime of the loan. You can therefore project, using an estimated life expectancy, the actual repayment figure which will be due at the end of the loan. The fixed rate option is slightly more complicated for the draw down option. The fixed rate of interest will depend on the fixed rate of interest set at the time when the monies are actually drawn down and therefore it is harder to predict the repayment figure.

If a variable rate of interest is chosen then the interest rates can go down as well as up and will be linked to the Bank of England's base rate. If you choose this option it will not be possible to accurately forecast the amount of debt due at the end of the loan.

ADVANTAGES AND DISADVANTAGES OF LIFETIME MORTGAGE

With a lifetime mortgage you retain full ownership of the property so you will benefit in any increase in value of your house if property prices increase during the lifetime of the loan. On the other side of the coin if property prices go down you will be at a disadvantage. Please remember that even if the value of your house decreases the loan will be covered by a no negative equity guarantee, so the loan will never be greater than the actual valuation of the property.

It should be pointed out that if the property prices remain static or decrease during the lifetime of the loan, there is always the possibility that after repaying the capital and accrued interest at the end of the loan there will be no equity remaining. This is a point you should consider if you are wishing to leave an inheritance to your family.

As interest accrues annually the longer the lifetime of the loan the larger the eventual debt will be. When entering into a Lifetime Mortgage you need to think very carefully as to exactly how much money you require. If too much is borrowed you will be paying unnecessary interest.

It should be remembered that Lifetime Mortgages can be used in conjunction with tax planning. The amount outstanding at the date of death will form a debt on your estate and could reduce your Inheritance Tax liability.

A frequent question is whether the borrower has the option to repay the loan earlier. Yes there is always this option, however, there will be early repayment provisions contained in the loan agreement and accordingly not a cost efficient option. The terms and conditions of a Lifetime Mortgage are devised with a loan for life in mind and not a short term loan. The financial consultant advising you on the Lifetime Mortgage will always bring these penalty provisions to your attention and demonstrate how they are calculated.

HOME REVERSION SCHEMES CONSIDERED FURTHER

As explained earlier in this guide you sell a percentage of your house to the equity release company in exchange for a tax free lump- sum. You do not pay any repayment instalments during the lifetime of the scheme. Instead when the house is sold, either on death of the homeowner or earlier, the sale proceeds are divided between the homeowner and the equity release company according to the equity shares they own.

Although the homeowner sells off part of his property he will be given the right under the scheme to live in the property until death or when the property is sold, whichever is the earlier. If there are joint homeowners this right will extend to the death of second homeowner or when the second homeowner sells the property.

It is now possible to enter into this type of scheme on a draw down basis. You agree with the equity release company the percentage the company is prepared to buy from you. You transfer a proportion of this percentage to the equity release company with the ability to transfer further shares at some time in the future.

It should be noted that the homeowner does not receive the full market value of the share of the property which is transferred to the equity release company. The market value will be discounted to take into account the age, health and anticipated life expectancy of the applicant. Whether you are a sole or joint applicant will also be relevant. As a general rule you will receive more equity if you are single as opposed to a couple. In addition you are likely to get more equity the older you are. This is only a general rule and each case will be determined on its own set of circumstances.

You do not receive the full market value from the equity release company as they will have to lend you the money but won't receive payment until the property is sold, which could be a very lengthy period. Furthermore the equity release company is taking a risk on future house prices. If house prices go down they will lose money on their investment in your property.

ADVANTAGES AND DISADVANTAGES OF HOME REVERSION SCHEMES

As you do not receive full market value of the share of your house transferred home reversion schemes are not suitable for short term borrowing.

As you are guaranteed to still own a proportion of your house at the end of the scheme this may be an attractive option to those wishing to leave an inheritance to their family.

Any rise in value of your house over the lifetime of the scheme will be shared between you and the equity release company. Following on from this any depreciation in value will not be borne solely by your estate but will be shared with the equity release company.

It is possible to buy back the share sold to the equity release company but this will be a very expensive exercise and not recommended. Remember the loan entered into was intended to last for life. You will have to pay the full market value of the share at the time of repurchase. As you sold the share at a discounted price it is likely that you will make a loss.

CAN I TRANSFER THE LOAN TO A NEW PROPERTY?

It will depend on the terms of each particular loan but generally these loans are portable and can be transferred to a new property if certain conditions are met.

With a Lifetime Mortgage the equity release company will have to ensure that the new property meets their lending conditions.

It might be slightly more complicated with a Home Reversion Scheme. Again the property will have to meet the equity release company's requirements. In addition the share owned by the equity release company must be equal to that of the old property. If it doesn't then the homeowner may have to pay back some of the loan.

WHO WILL BE RESPONSIBLE FOR THE MAINTENANCE OF THE PROPERTY?

You will be responsible for keeping the house in good repair. This responsibility lies with you whether you have entered into a Lifetime Mortgage or a Home Reversion Scheme. If you do not maintain the property you are in breach of the agreement with the equity release company. The scheme provider can arrange for repairs to be carried out but will insist that you pay any costs involved.

HOW DO I CHOOSE WHICH PRODUCT IS RIGHT FOR ME?

There are no hard and fast rules and it will very much depend on your own personal circumstances. The main points which will be taken into consideration are:-

- How much equity you require
- How much equity you can unlock
- Your age
- Your health
- Your life expectancy
- Whether you need a lump sum or regular income
- How much inheritance you wish to leave
- Your attitude to risk

Your financial consultant will discuss these considerations with you fully and advise you whether a Home Reversion Scheme or a Lifetime Mortgage is the better option for you.

SHIP statistics show that Lifetime Mortgages are more popular than the Home Reversion Schemes. If you have a relatively low house value or you are in your early 60's, it may be the case that the Lifetime Mortgage does not provide you with sufficient equity or is not cost efficient.

The equity release market is an ever popular market and there are now over 20 providers of such schemes. Once you have decided to enter into a Lifetime Mortgage or a Home Reversion Scheme your financial consultant will guide you through the various products on offer. Each provider of equity release will have their own products with different interest rates and lending criteria. Your financial consultant will be able to guide you through this minefield to find the best product to suit your individual circumstances.

COSTS INVOLVED

There will be an arrangement fee to be paid to the lender. You will also be responsible for the valuation fee and for all legal fees and outlays. You will be given a full breakdown of all costs by your financial consultant.

All costs will be deducted from your lump sum.

Please note charges vary from plan to plan as do fees charged by different advisers.

PROCEDURE

You will meet with your financial consultant to discuss your personal circumstances and discuss the various options, including alternatives to equity release. The financial consultant will then draw up a personal plan based on your individual circumstances. The plan will detail all costs and potential repayment levels based on different lengths of loan and different interest rates.

If you decide to proceed a valuation of your property will be arranged. If a satisfactory valuation is obtained, your case will be forwarded to our specialised legal team. With the loan agreement there will be a certificate signed by the borrower verifying all the costs, conditions and confirming all the implications have been explained to them by their financial consultant. In addition the members of our team will again go over the conditions of loan to ensure that everything has been understood and our client's best interests have been met. Our team will then obtain the title deeds over your property to check that everything is in order. They will ensure that all relevant searches are obtained. They will prepare all necessary legal documentation and have them signed by the applicant. From receiving the title deeds and the lender's instructions normally the whole legal process should not take more than 28 days.

As these products have been become very popular with our clients in the last few years Caesar & Howie have set up our own highly specialised team to advise clients in this area. To put our clients' minds at rest Caesar & Howie will only deal with financial bodies, consultants and brokers who are registered with the Financial Services Authority (FSA). In addition the majority of those who we deal with have signed up to Safe Income Home Plan (SHIP) Code of Practice. Furthermore all the financial consultants that we deal with are highly knowledgeable on the financial products available and will be able to help the client decide which product will be the best for them.

You should also note that clients do not have to live locally to be able to utilise our efficient service. Instructions can be received long distance and there will be no requirement to visit our offices. In fact we have handled cases throughout Scotland and the Islands. Only in rare circumstances are clients required to be seen in person.

WHAT SHOULD I DO NOW?

We hope you have found this guide informative and helpful. If you would now wish to proceed with an Equity Release product please contact our team who will be able to get the ball rolling for you and put you in touch with one of our highly professional financial consultants.

If, however, you only have a query relating to anything in this guide again do not hesitate to contact our specialised team who will be more than happy to help you. Senior Issues Team 0845 855 3300.