A detailed history of equity release

Retirement Plus Ltd asked writer Zoe Hyde to research and write the history of equity release in the United Kingdom. Here is the article, recorded in full, it provides a real 'warts-and-all' overview of the birth and growth of the industry to date.

How it all began

1965

The equity release market started in 1965 when the first plan was introduced. Equity release helps people who find themselves in the position of being "house rich" but "cash poor" – those owning a valuable property, with little or no mortgage, but living on a relatively low level of income or having a need of money for other things. Statistics from the Council of Mortgage Lenders show that the average property was worth around £4,000 in 1965. At that time there were 9.7 million people in Britain over the age of 60, with a predicted life expectancy of 68 years for men and 74 years for women. Back then many older people wanted to find a simple line of borrowing that they could draw on to help make ends meet – anything from paying the TV licence to simple grocery shopping.

Nowadays equity release often goes to fund lifestyle items, such as a holiday, a new car, a new kitchen, a conservatory, or replacement doors or windows. It also appeals where people in poor health are struggling to make ends meet, but want to stay in their own homes and be cared for there. Equity release schemes offer the opportunity for homeowners to raise extra income or a cash lump sum (or both) by giving them access to the capital value tied up in their home without having to sell their home outright or move out.

The first home income product

1972

In 1972 Allied Dunbar launched the Home Income Plan, which offered customers an increased income for life, with special advantages for tax payers. The plan comprised of two parts – a fixed rate interest-only mortgage and an annuity providing a fixed income for life. Customers took out a mortgage with Allied Dunbar – typically for up to £30,000. The money raised by that mortgage would be used to purchase a lifetime annuity also with Allied Dunbar. The customer would pay interest at a fixed rate on the outstanding loan. The interest on the first £30,000 of the loan attracted a tax relief – M.I.R.A.S (Mortgage Interest Relief At Source) – which effectively reduced the amount of interest that the customer had to pay. The interest (net of MIRAS) was deducted from the annuity payment and the remainder of the annuity was paid direct to the customer's bank account each month. Because the mortgage interest was fixed and deducted from the annuity payment, customers did not need to worry about a change to the interest rate or falling behind with interest payments. And because the net income was, subject to any change to income tax or MIRAS rates, the same, customers could plan their finances with some certainty. Loans were typically re-paid, from the proceeds of sale of the property, by the Personal Representatives following the customers' death. Following changes announced in the 1991 budget regarding the taxation of annuity business, the plans were no longer available.

What went wrong?

1988

A new style of equity release plan, introduced in 1988, was later banned, after it left many elderly people in severe financial difficulties. These plans, also known as "home income" plans, involved buying an annuity or some form of investment bond alongside an interest-only mortgage loan, usually at a variable uncapped interest rate. The annuity was intended to pay off the monthly interest and provide an additional regular income. But in the early 1990s, rapidly rising interest rates, fixed annuities and falling house prices left borrowers in both monthly arrears and negative equity – making it almost impossible to move and potentially leaving their families with serious debts to pay. These disasters were the catalyst for the formation of the trade association SHIP, when life expectancy was 73 years for men and 79 years for women.

SHIP, whose members now account for 90% of the equity release market, was first formed by Ecclesiastical Life, Hodge Equity Release, Home & Capital Trust and GE Life.
All member companies have to abide by a strict code which includes clearly explaining terms and conditions including all costs which the consumer has to bear in setting up the scheme, the position on moving, the tax situation and the effect of changes in house values.

Share appreciation mortgages (SAMs)

1990s

Share appreciation mortgages (SAMs), which emerged in the mid-1990s, brought another damaging blow to the market. SAMs enabled borrowers to release equity from their home by an interest-free loan. In return, homeowners would hand over a substantial slice of the future growth in the property's price to the bank – typically a three-to-one share in favour of the bank.

Of course, property prices have rocketed since then, leaving SAM holders owing sums to the bank that far outweigh their initial loan. Barclays and Bank of Scotland offered this type of mortgage predicting how much would be owed assuming house prices would go up by 4.5 per cent per year. In fact, that figure has been around 11.7 per cent a year. These schemes did not comply with SHIP rules.

Welcome all the major players

1999

In 1999 Norwich Union joined SHIP and became responsible for the development of the first "roll-up" Lifetime Mortgage which gave a significant boost to the market. These schemes allow homeowners to take out a loan on the property in return for a tax-free lump sum. Although in some cases, they can receive the money a bit at a time. This is known as drawdown.

The interest on this loan rolls up and only needs to be repaid, along with the capital borrowed, when the customer dies or moves into a care home. Rates of interest were high at around 9% at the time. The longer the loan is held for, the more the interest stacks up, which is why the SHIP guarantee, that the customer will never be in negative equity, is so important as it means their heirs will not have to find extra cash to meet the equity release bill.

Lifetime Mortgages also introduced the option of taking money bit by bit, rather than a lump sum. Drawdown mortgages enable people to agree the size of an equity release mortgage when they first take out their loan, but they only borrow the money when they need it, meaning they can draw it down gradually.

How the market changed

2003

In 2003 interest rates were at their lowest for more than 10 years, credit was easily available and buy-to-let mortgages were taking off. At this time, lenders indicated that the gap between borrowers' incomes and the value of their homes had never been higher. Coupled with the fact interest rates were at around just 3.5% there was a strong temptation for many families to withdraw equity from their home.

Over 25,000 Lifetime Mortgages worth over £1 billion, were advanced in 2003, a significant increase on the 16,300, worth £655 million, advanced in 2002. But a lack of regulation and control continued to over-shadow the equity release sector as its reputation had been blighted by the continuing memory of the mis-sold home-income plans in the 80s.The equity release market had almost doubled between 2002 and 2003.

Regulation of Lifetime Mortgages

2004

So it was good news when the Government announced that Lifetime Mortgages would be regulated by the Financial Services Authority from 31st October 2004. FSA rules stipulate only properly qualified advisers can recommend schemes, and that fees and potential costs are fully explained. The other main advantage of regulation is that consumers gain access to both the Financial Ombudsman Service and the Financial Services Compensation Scheme, to which they can complain if they feel they have been mis-advised and have lost out as a consequence. Previously, the only course of redress open to these homeowners was to pursue a case through the small claims court, which can be an expensive process.

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Development of Home Reversion products

2000s

Home Reversions involve customers selling part of their property in return for tax-free cash, plus a lifetime lease giving them the right to remain living in their property until they and their partner die, or have to move into a nursing home. Any increases in the property's value will be shared between the customer and the scheme's provider when the plan ends, which means they will only miss out on part of any house-price growth. When the homeowner dies or has to move into a care home, the house is sold and the proceeds split according to the proportions allocated in the original deal. The first Home Reversion plan was launched in 1965 but back then they looked very different to how they work now.

Regulation of Home Reversions

2007

In April 2007 Home Reversion schemes joined Lifetime Mortgages under the watchful eye of the FSA. Home Reversion schemes had been excluded from regulation because they fall under the category of property sales, rather than loans. But the plans triggered concerns about potential mis-selling, perhaps by unscrupulous salesmen who offered them to customers instead of Lifetime Mortgages to avoid the extra burden of regulation. Also, given that the customers tend to be elderly and usually in financial need, they may have been particularly vulnerable to bad advice. It is also fair to say that home reversion providers were keen to see a regulatory level playing field. As a result the appeal of Home Reversion schemes increased and providers recorded a significant jump in the numbers signing up this year.

Customers can claim compensation of up to £25,000 from SHIP if they are mis-sold a Home Reversion scheme between October 2004 and April 2007 – but all business arranged after April is now fully regulated by the FSA so this is no longer needed. SHIP can also fine and strike off members which break its code.

Negative perceptions

Today's equity release plans are a far cry from those issued in the 1980s and early 90s, owing to a combination of strict regulation, and a wider choice of more competitive equity release plans to choose from. But the chequered history of the equity release market still gets plenty of media coverage both in newspapers and on television programmes exposing many customers that have been victims of mis-selling. Many of the cases featured date back 20 years when SHIP didn't exist – and when equity release was unregulated by the FSA.

The equity release industry has widely acknowledged the problems that have occurred in the past and taken bold steps to ensure consumers are now protected against commission-hungry salespeople. The FSA comes down hard on companies which stray from its strict guidelines. In October 2007 it fined one advice firm £10,000 for putting customers at risk of mis-selling Lifetime Mortgages. One of the main criticisms comes from the fact equity release plans seriously erode any future inheritance, which can upset remaining family if they were excluded from the decision to take out a plan. This, of course, can work both ways.

Of course there are other options for those who want to release some cash from their home. Advisers are required by the FSA to clearly spell out these alternatives to potential clients. The most obvious of these options is trading down – selling a present home and purchasing a cheaper house in which to live, leaving a lump sum to use as an income or to spend as wished. The problem with this is that a house half the size will not cost half the price, and it might be necessary to move to a different area, away from friends and family which can be very unsettling.

Beware sale-and-leaseback schemes

2007

A recent addition to the market, sale-and-leaseback schemes, have been likened to Home Reversion equity release plans. But be warned as they come with crucial differences. These companies, which often have a heavy presence online, promise to buy a customer's property at a cut price (around 75% of the value of their home) but stay in their home by paying rent to the company at a rate less than their previous monthly mortgage payments.

One big difference is that home reversion equity release plans commit to customers occupying the property, until they move into a care home, or until they die. There is no such commitment from sale-and-leaseback schemes, which could evict their tenants at any time and some schemes charge rent.

While their proposition is essentially equity release, their method differs greatly from the original home reversion equity release plans that are regulated. Where a financial product is regulated by the Financial Services Authority, consumers have the right to refer any complaints, such as being badly advised, to the Financial Ombudsman Service which resolves disputes, awarding compensation where necessary.

Changing weather

House prices have tripled over the past 10 years which has bolstered the equity release proposition for many older people who are property rich but cash poor, and are struggling to make ends meet, or simply want to treat themselves or help family members into property ownership. The average home in Britain was worth £55,810 in 1997 and has risen to an astonishing £175,554 in 2007.

In fact, over the last 30 years the equity release market has been growing because of this impressive house price growth. A new report says that those who are still working are increasingly turning to equity release to help with income. However, this year property prices have slowed considerably. Predictions for growth in 2008 are very flat at around 1% – some argue there will be no growth at all.

In such an environment, Lifetime Mortgages become unattractive because interest rates on these loans are higher which makes it more expensive; the longer the loan is held for, the more the interest stacks up. Also, with the threat of house prices falling, the amount of inheritance left to loved ones would take a serious nose dive. If the total rises to more than the value of the property, it would result in negative equity unless you choose a scheme with a no negative equity guarantee. Home Reversion schemes, however, are growing into a decent proposition.

Latest demographics

Estimates say that today there are more than 13 million people aged 65, who own property worth a staggering £1.1 trillion. A retirement study found only 12 per cent of savers were confident they would have enough cash to fund a comfortable old age, while a third of workers were failing to put aside any money at all. This suggests more and more people are likely to be finding other ways to boost their income in later life. Life expectancy is now 76 years for men and 80 years for women. Although people are working longer due to inadequate pensions, this still leaves a large proportion of retirement – where older people do not want to have money worries.

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The views of the author are not necessarily those of Retirement Plus.

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