A detailed history of equity release

Equity release has proved to be a much-talked about financial product over the years and has helped thousands of older people cash in on the equity tied up in the bricks and mortar of their treasured family home. Here Retirement Plus provides an independent, clear breakdown of how it started, how it looks today, and everything in between.

1965

How it all began

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.

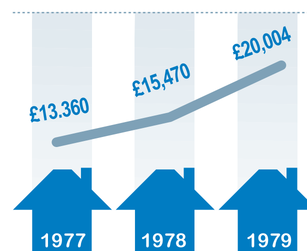
Nowadays equity release often goes to fund lifestyle items, such as a holiday, a new car, a new kitchen, a conservatory, or replacement doors or windows. It also appeals where people in poor health are struggling to make ends meet, but want to stay in their own homes and be cared for there. Equity release 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.

1972

The first home income product

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.

House Prices 1970s
1977 to 1979

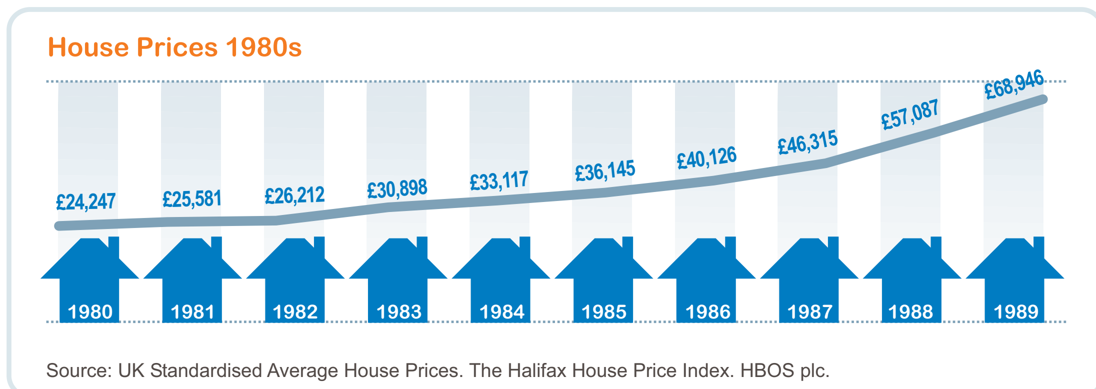


Source: UK Standardised Average House Prices. The Halifax House Price Index. HBOS plc.

1988

What went wrong?

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.



Source: UK Standardised Average House Prices. The Halifax House Price Index. HBOS plc.

1991

Formation of SHIP

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. *See back page for full details.*

1995

Share appreciation mortgages (SAMs)

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.

1998

Welcome all the major players

In 1998 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.

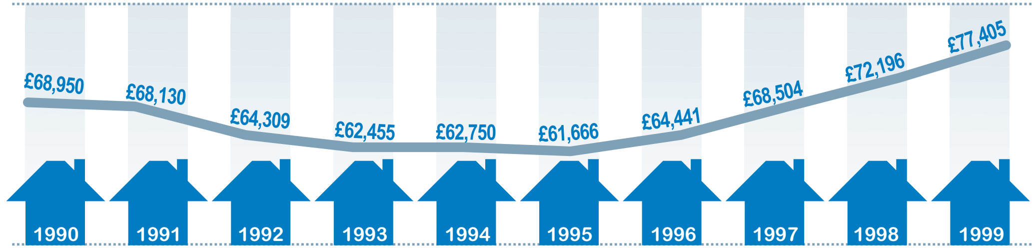
2003

How the market changed

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.

House Prices 1990s



Source: UK Standardised Average House Prices. The Halifax House Price Index. HBOS plc.

2004

Regulation of Lifetime Mortgages

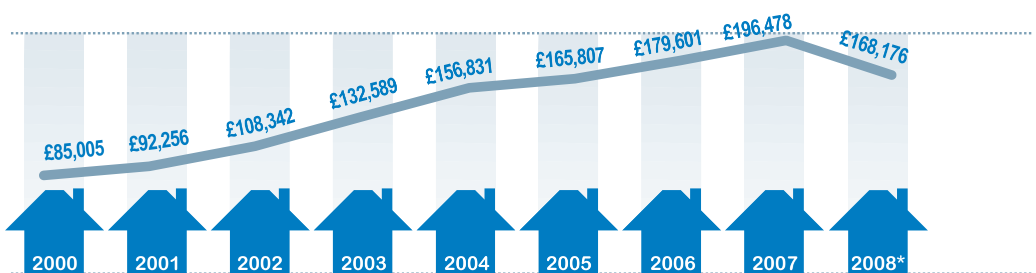
So it was good news when the Government announced that Lifetime Mortgages would be regulated by the Financial Services Authority from 31st October 2004. FSA rules stipulate only properly qualified advisers can recommend schemes, and that fees and potential costs are fully explained. The other main advantage 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.

2000s

Development of Home Reversion products

Home Reversion plans involve customers selling all or part of their property in return for tax-free cash, plus a lifetime lease giving them the right to remain living in their property for a nominal rent until they and their partner die, or have to move into a nursing home. Any increase in the property's value will be shared between the customer and the plan 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.

House Prices 2000s



*2008 is the average price for October 2008

Source: UK Standardised Average House Prices. The Halifax House Price Index. HBOS plc.

2007

Regulation of Home Reversions

In April 2007 Home Reversion plans joined Lifetime Mortgages under the watchful eye of the FSA. Home Reversion plans 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 poor 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 plans increased and providers recorded a significant jump in the numbers signing up.

Customers can claim compensation of up to £25,000 from SHIP if they were mis-sold a Home Reversion plan between October 2004 and April 2007. But all business arranged after April is fully regulated by the FSA and, as such, is covered by the Financial Services Compensation Scheme (FSCS). Compensation Limits for Home finance advice and arranging is £48,000 per person: 100% of the first £30,000 and 90% of the next £20,000.

2007
Continued

Negative perceptions

Equity release plans were 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 received 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 dated 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 occurred in the past and took bold steps to ensure consumers are protected against commission-hungry salespeople. The FSA came down hard on companies which strayed 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 came 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.

There were other options for those who wanted to release some cash from their home. Advisers are required by the FSA to clearly explain 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.

Sale-and-leaseback schemes

A new 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 (typically 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 tripled over the past 10 years which bolstered the equity release proposition for many older people who are property rich but cash poor, struggling to make ends meet, or simply want to treat themselves or help family members into property ownership. In fact, over the last 30 years the equity release market has been growing because of this impressive house price growth.

The average home in Britain was worth £68,504 in 1997 and rose to an astonishing £196,478 in 2007.

However, during 2007 property prices slowed considerably. There was a marked drop in the number of people taking out equity release plans in 2007 thanks to rising interest rates, higher mortgage rates and increasing doubts about future house price strength.

Demographics

Estimates say that 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.

2008

The Credit Crunch

The beginnings of the credit crunch can mainly be traced back to America, where people with a poor credit history had been allowed to take out mortgages, called sub-prime mortgages, which they were later unable to repay. With falling house prices and rising interest rates, these missed repayments led to a vast increase in repossession levels. Several American and UK financial houses were, in many cases, unwittingly exposed to this high-risk market, resulting in massive losses.

This created the snowball effect that financial institutions around the world are now experiencing due to a lack of available money across the market. As money becomes tighter, banks are no longer able to lend or borrow from one another, and as the credit crunch effect worsens, financial institutions compensate for this shortfall through their customers by increasing fees and rates on their mortgages – as well as loans, and credit cards.

House prices in 2008 dropped significantly after years and years of growth. The latest figures show the value of the average UK home fell by almost 15% in 12 months. At the same time, the entire UK economy was rocked by several dramatic events. High street banks have been nationalised by the Government when they suffered at the hand of the credit crunch, and the stock market has wiped billions off the value of pensions and investments.

OFT calls for sale-and-leaseback regulation

The Office of Fair Trading has now recommended that sale-and-leaseback become fully regulated. The OFT said it had the potential to “cause serious and permanent harm to often vulnerable homeowners”. In the wake of the OFT report, the Treasury is consulting on how best to regulate the industry, with responsibility set to be handed to the Financial Services Authority. But regulation will come too late for many that have already sold their homes and face eviction.

SHIP has recently called on Trading Standards to take action against sale-and-leaseback companies. SHIP says many websites are misleading because they fail to inform consumers up front the risks associated with entering into a sale-and-rent back scheme. Secondly, it claims sale-and-leaseback providers are making misleading comparisons with FSA regulated equity release products.

The economy and growing old

One third of the UK workforce has no provision for retirement other than the state pension. Yet, life expectancy is now 76 years for men and 80 years for women, which means people are going to spend an average of 24 years in retirement.

Pensioners continue to suffer more than the average man on the street. Statistics show that while the average UK consumer below retirement age has seen outgoings increase by 5.4% in 2008, pensioners have seen theirs rise by 7.4%. This is because their main living costs – gas, electricity, petrol, food and so on – have all increased.

Long-term care is also of growing concern, with over 100,000 people entering care each year. A lack of state funding means much of the onus is on UK consumers to finance this type of care in retirement. The availability of funds to safeguard health while at the same time enjoying a higher standard of living seems to be the ideal combination. Indeed, a survey by Retirement Plus showed that one third of people were using money raised through equity release for nursing homecare. While some consumers choose sheltered accommodation, many others look to equity release as a source of funding for adapting their home, paying for long term care needs or financing medical procedures.

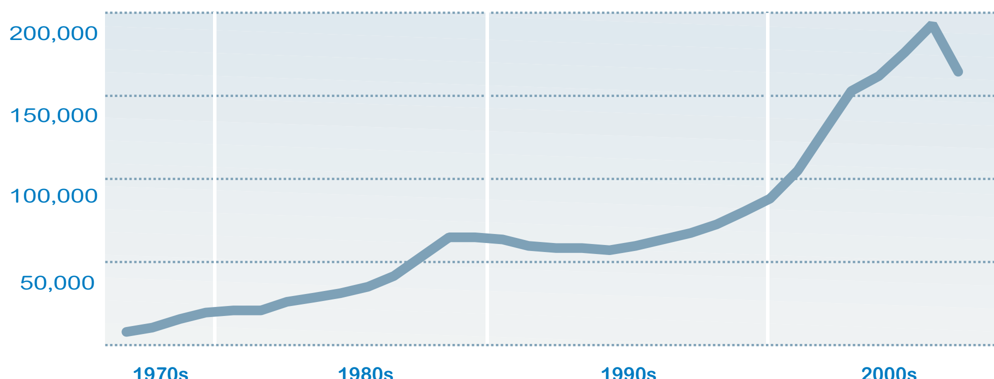
The stock market has plummeted in recent months as a result of the current financial crisis, wiping billions of pounds off the value of pension funds, leaving many with far less to live on in retirement than planned.

Silver lining

Equity release has fared well in the credit crunch and shown resilience by offering competitive interest rates throughout. In a market where borrowing is difficult, equity release has remained an available line of credit. Crucially, it is regulated which gives peace of mind in an unstable wider economy.

This has helped keep equity release a popular option for those struggling in their older years. So far, in 2008 more than 20,500 equity release plans have been arranged, releasing around £820 million. New research says people aged 65 and over are today holding up to £692 billion pounds of un-mortgaged equity in their homes. A new report predicts equity release will become far more popular over the next few years as people come to call on assets to boost their pensions.

House Prices
1977 to October 2008



Source: UK Standardised Average House Prices. The Halifax House Price Index. HBOS plc.

Visit SHIP website at www.ship-ltd.org

SHIP – Safe Home Income Plans

Safe Home Income Plans (SHIP) is a company supported by the leading providers of home income and equity release plans. It was launched in 1991 and is dedicated entirely to the protection of planholders and promotion of safe home income and equity release plans.

All participating companies are pledged to observe the SHIP Code of Practice. Members display the SHIP logo in their brochures and other printed material as a guarantee to their customers.

The SHIP Code binds these companies to provide a fair, easy-to-understand and full presentation of their plans. Any scheme endorsed with the SHIP logo will be properly explained and safe.

As a further safeguard, your own solicitor, who will oversee the transaction on your behalf, must sign a certificate to acknowledge that the essential features and implications of your chosen SHIP Plan have been brought to your attention. No SHIP protection plan can proceed without a signed certificate.

SHIP Code of Practice

- The members of SHIP agree to provide fair, simple and complete presentation of their plans. The benefits, obligations, variables and limitations must be clearly set out in their literature, including all costs which the applicant has to bear in setting up the scheme, the position on moving, the tax situation and the effect of changes in house values.
- The client's legal work will always be performed by the solicitor of his or her choice. In all cases, prior to the completion of the plan the solicitor will be provided with full details of the benefits the client will receive. The solicitor will be required to sign a certificate to the effect that the scheme has been explained to the client.
- The SHIP certificate will clearly state the main cost to the householder's assets and estate e.g. how the loan amount will change or whether part or all of the property is being sold.
- All SHIP plans carry a "no negative equity" guarantee i.e. you will never owe more than the value of your home.

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

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Unlock Home Equity Fairly

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