EQUITY RELEASE

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What you need to know

Rising property prices over the last 15 years has led to an increase in the number of pensioners and retirees owning valuable property assets. This has come at a time when many pension schemes are failing to deliver the promised returns, and the cost of living continues to increase. This gave rise to the phenomenon of an 'asset rich, cash poor' generation.

What is Equity Release?

The idea behind equity release is to allow older property owners, who have often paid off all or most of their existing mortgage, to cash in on a home's value without selling and trading down to a cheaper property.

There are now at least 40 providers of equity release mortgages in the market, including many large and respected banks.

There are two basic types of scheme and they both share a common feature: they both allow homeowners and their spouses/partners to remain in their own home for life whatever happens to interest rates or the economy. The two types of scheme are as follows:

(a) Lifetime Mortgages:

With lifetime mortgages, homeowners take out a loan secured against the property in order to raise a lump sum. The interest rate is not unreasonable but becomes more expensive than with an ordinary mortgage as it is simply left to accumulate in addition to the original capital borrowed. This is known as compound interest. It is repaid from the proceeds of the sale of the house on the death or permanent non occupation of the house of the survivor of the scheme holder, or the surviving spouse or partner.

If the value of the original loan, plus the interest, is higher than the money raised by the sale of the house, the equity release company takes on the burden of the loss. The scheme holder's heirs or estate do not have to make up the difference. However, if the property is sold for a figure exceeding that of the loan value plus interest, the remaining proceeds will be added to the scheme holders estate and distributed according to their Will.

(b) Home Reversion Plans:

With home reversion plans, homeowners agree to sell a share of their property in return for a lump sum. When the survivor of the homeowner or surviving spouse partner dies or no longer permanently resides in their property the company receives the agreed proportion of the sale proceeds.

So if a homeowner gives up 30% of the house value in return for a lump sum, the company will receive 30% of the value of the house on the death/non occupation of the last partner, whether that value is higher or lower than when the deal was signed.

It is important to remember that this lump sum will not necessarily relate to the market value of that percentage, so if a homeowner gives up a 30% stake in their property valued at £300,000, the lump sum is likely to be much less than the £90,000 market value of that 30% share.

Eligibility:

To be eligible for most schemes you and your spouse/partner will have to be:

A) Over 55

B) Own a property that is worth at least £30 - £40,000

C) Own the freehold or long leasehold on your property.

What are the Drawbacks?

The major flaw with both these schemes is that homeowners risk giving up a lot of equity in return for what can sometimes be a surprisingly small lump sum. Plans can be very complicated, so working out which type of plan best suits your circumstances can be difficult. When considering any scheme, it is wise to take legal advice at a very early stage.

Considerations When Choosing an Equity Release Scheme

You should think carefully about the following points, to help decide whether or not equity release is the right option for you, and what type of equity scheme would best suit your circumstances:

- Are you better off with monthly payments or a lump sum?
- Are you able to move house under the scheme? This might be important if, at some stage, you want to move to be nearer to your family or need sheltered housing or residential care
- If you are living with a younger partner, relative or friend, they may, depending on the details of the scheme, need to seek alternative housing in the event of your death/permanent non occupancy of your home
- If you receive cash from a home equity release scheme this may cancel out your eligibility for means-tested benefits or help with paying for care

Most schemes sell your home when you die, so you will not be able to leave it to your family. Any equity release scheme will also reduce the total value of your estate on your death, leaving you less to pass on to your family. Finally, it is extremely important to discuss your plans with your family before making any final decisions.

You should consult with a solicitor who will explain the impact of the home equity release scheme on your family to make sure your decision is based on all of the appropriate information.

What are the Alternatives to Equity Release Schemes?

Downsizing to a Smaller Property

This is one way of releasing equity and avoids any on-going commitment to lenders. The money released can then be reinvested to ensure that it retains its value, and generates growth or an income into the future.

The downside is the upheaval and costs involved in moving house. The question also has to be asked as to whether downsizing will release enough of a lump sum (minus the costs of moving) to provide a realistic amount to live on for any long-term period.

Selling Part of Your Home to a Relative or Friend

You might be fortunate enough to have a relative or friend prepared to re-mortgage their property to buy a proportion of your home. This effectively becomes a 'private' equity release arrangement, whereby the relative or friend passes on a lump sum in return for a loan to be repaid when the borrower's home is sold or he/she no longer permanently resides there.

In such a situation, it is important to agree exact terms and seek to get a binding contract drawn up which deals with issues such as interest repayments on the lump sum to ensure the sum paid does not lose its real value. It is also wise to ensure that any such arrangements are also mirrored in the borrower's Will. If close family members are involved, there could also be inheritance tax or family complications.

How we can help?

Our experienced team of lawyers can help you evaluate the legal aspects of equity release options, offer advice on the suitability of specific legal agreements and act on your behalf if you purchase an equity release scheme. We can also help you to ensure that your Will ties into any such arrangements and draw up agreements on your behalf where family members or friends opt to engage in a 'private' equity release arrangement.

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