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The Smith Grandparents and Equity Release

In this month's newsletter, we are going to turn our attention back to the Smith Family Grandparents, Harvey and Maggie, and review the process they recently went through when making the decision to move into their new apartment in a modern retirement village.

As a reminder, Harvey and Maggie have recently sold their family home and downsized, buying a brand-new apartment in a retirement village and, thereby, releasing equity of £300,000.

The move was prompted by the fact that, although their combined pension income met most of their outgoings, they had virtually exhausted all of their liquid capital and were struggling to pay for such things as holidays and helping members of their family.

As a result, they went through a process of considering their options with regard to releasing equity from the family home.

In this newsletter, we review these options and the factors that the Smiths took into consideration when finally making the decision to downsize.

The Options

There are three main options for how an older couple (60 years or older) can release equity from their family home:

1. Move to a smaller home as the Smiths have done.
2. Take out a lifetime mortgage.
3. Take out a home reversion plan.

Releasing equity by downsizing to a smaller home is an obvious option.

The other two options are described below.

Lifetime Mortgages

You take out a mortgage secured on your property, provided it is your main residence. You retain full ownership of the property.

Usually, you do not have to make any interest payments. Instead, the unpaid interest rolls up and is added to the loan. This means that the debt will increase at the compound interest rate.

Lifetime mortgages are targeted towards retired clients, so the minimum age at which you can take out a lifetime mortgage is typically around age 60.

The maximum amount you can borrow increases according to your age. For a 60-year-old, the maximum percentage would be approximately 25% of the value of your property increasing to approximately 50% once you reach your 80s like Harvey and Maggie Smith.

Interest rates must be fixed or, if they are variable, there should be a ‘cap’ (upper limit) which is fixed for the life of the loan.

You have the right to remain in your property for life or until you need to move into long-term care, provided the property remains your main residence and you abide by the terms and conditions of the mortgage contract.

Lifetime mortgages offer a ‘no negative equity guarantee’.

This means that, when the property is sold, if the amount left is not enough to repay the outstanding loan to the mortgage provider, neither you nor your estate will be liable to pay any more. You can probably see that this is one reason why providers limit the maximum loan to around 50% of the value of the property.

You have the right to move to another property, subject to the new property being acceptable to your provider as continuing security for your lifetime mortgage.

Some lifetime mortgages allow you to withdraw the equity you are releasing in small amounts as and when you need it rather than having to take it as one lump sum. The advantage of being able to take money out in small amounts is you only pay the interest on the amount you have withdrawn.

Home reversion plans

A home reversion plan allows you to sell some or all of your home to a home reversion provider. In return, you will either get a lump sum or regular payments.

Your home, or the part of it you sell, now belongs to someone else. However, you are allowed to carry on living in it until you die or move out, paying no rent.

You will normally get between 30% and 60% of the market value of your home (or the part you sell) because the buyer allows you to carry on living there rent free and cannot sell the property until you die or move into care.

The older you are when you start a home reversion plan, the higher the percentage you will get of your home’s market value.

You get the rights to carry on living in the home under a lifetime lease.

According to market research, home reversion plans only represent 1% of equity release schemes sold in the UK with lifetime mortgages representing the other 99%.

It is difficult to say exactly why this is but it probably has quite a lot to do with people being reluctant to give up ownership of their property.

Harvey and Maggie's considerations

Once they understand the key features of each of the options, Maggie and Harvey can then start to look at the pros and cons of their options given their unique personal circumstances.

The pros and cons of downsizing

The most straightforward and logical way of releasing equity from their home is for Harvey and Maggie to downsize.

However, this does not take any account of the financial and emotional considerations.

Financially, there are the costs involved in moving such as legal fees, removal charges and Stamp Duty.

Emotionally, it can be very difficult to leave the family home. Like many couples in their 80s, Harvey and Maggie might have raised their family in the home whilst also accumulating numerous chattels and personal possessions with strong emotional ties. It may be very difficult to give up these memories and move into a smaller home with, for example, no garden.

The pros and cons of an equity release scheme

The greatest benefit of an equity release scheme is likely to be that Harvey and Maggie are able to continue living in their own home, thus avoiding some of the stress, hassle and costs involved in downsizing.

However, lifetime mortgages normally charge a higher rate of interest than you would pay on an ordinary mortgage and the debt can grow quickly as a result of the effect of compounding interest.

Home reversion plans will usually not give you anything near to the true market value of your home when compared to selling your property on the open market.

The money you receive from an equity release scheme might affect your entitlement to State benefits.

There may also be the costs involved with setting up an equity release scheme such as mortgage arrangement fees.

Equity release schemes can be complicated to unravel if you change your mind which could involve early repayment charges further adding to the expense.

How to make the best decision

As you would expect us to say, it is critical to seek advice from a suitably qualified financial adviser!

As suitably qualified financial advisers, the first thing we would advise Harvey and Maggie to do would be to discuss the situation and their options with their children.

Not only is there the argument that two brains are better than one but it will also help each generation to understand the other and ensure that decisions are not being made on incorrect assumptions.

In our experience, if Harvey and Maggie are able to overcome the emotional hurdles of 'packing up' a house (with the help of the children!), leaving behind years of fond memories and moving to a smaller, unknown space, then downsizing will more often than not be the best option.

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Market data

Market	Value at start of 2019	Current situation	Comments
Interest Rates (BOE base rate)	0.75%	0.75% at 31/07/19	The official bank rate is 0.75%.
House Prices (Nationwide)	House prices increased by 2.6% in 2018	House prices up by 0.3% at 31/07/19	Annual house price growth remains subdued at 0.3%
UK Share Prices (FTSE 100)	7142.83	7586.78 at the close on 31/07/19	The FTSE 100 made an increase of 161.51 points in July.

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