holden and partners

Your guide to equity release

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Although equity release has been around since the 1960s, it came to prominence in the late 1980s and has often received a mixed press.

Since then, the market has developed significantly; there are now in the region of 300 different products available[1], which increases the competitiveness of product terms significantly. It is common practice for products to offer no negative equity guarantees, so that you will not owe more than the equity left in your home. Equity release has continued to grow in popularity as a way of providing money later on in life and is often used to fund areas like home improvements, going on holiday, repaying debt, funding care in your own home or providing a 'living gift'.

In 2018, almost £4 billion was released from bricks and mortar via equity release. Between 2017 and 2019, the number of new plans taken out increased by 28%.[1]

Alongside the development of the equity release market, there are now mortgage products that can allow borrowers to continue paying their monthly mortgage costs into retirement, unlike most traditional mortgage contracts which are often redeemed by age 65 or 70.

Equity release explained

Equity release is the process of accessing money tied up within your home.

Before equity release, if someone had a large proportion of their total wealth tied up in property and did not have other significant assets, then downsizing was the only realistic way to provide a cash lump sum. However, moving out of the family home is of course not always something people wish to do.

Equity release can allow homeowners aged over 55, that meet eligibility criteria, to release tax-free funds from their property without having to move house.

There are two types of equity release: lifetime mortgages and home reversion plans. Holden & Partners are not authorised to provide advice regarding home reversion plans.

Footnotes
1. https://www.equityreleasecouncil.com/documents/equity-release-council-autumn-market-report-2019/

Why choose equity release?

If you do not have significant assets outside of your property, do not want to ask family or friends for help, are not willing to downsize or have insufficient income, then equity release provides the ability to generate a lump sum or an income (depending on the product selected).

You may wish to provide a lump sum to help a family member onto the property ladder, or to fund a once in a life-time holiday for you and your family. Equity release allows you to see the benefit of your gifts, while you are still living.

Lifetime mortgage

There are two types: **lump sum** and **drawdown**.

The **lump sum** product is just that; you will receive a tax-free lump sum to spend on what you wish. The interest rate is fixed for the duration of the plan.

The **drawdown** product provides a degree of flexibility allowing you to borrow up to a maximum level of funds, which is called a Facility. You can access up to this maximum amount in either one, or a number, of payments as and when required. Like the lump sum option, the withdrawals are tax-free. Each time you access more funds, the prevailing interest rate at that time will be applicable to the new funds drawn, and you are only charged interest on what you have borrowed, not the remainder of the Facility you have available.

- Depending on the product taken out, you may be able to make repayments to bring down the amount owed. Alternatively, the interest can be left to roll-up and will be added to your original loan amount.
- You retain ownership of your home. The loan, and any rolled-up interest, also known as Compound Interest, is repaid by your estate when you either die or move into long term care.
- If you are part of a couple, the repayment is not made until the last remaining person living in the home either dies or moves into care, meaning that both you and your partner are free to live in your home for the rest of your lives.
- Early repayment can be possible and further details relating to the applicable charges are discussed below.

Who can qualify for a lifetime mortgage?

The following points need to be met before equity release can be considered by the lender[2].

- **Aged 55-95**
- **No mortgage (the equity released can be used to repay an existing mortgage)**
- **Property is UK based**
- **Property is worth over £70,000**
- **Leasehold properties usually need an unexpired lease of more than 75 years**

The list is not exhaustive and can vary from lender to lender, however these are usually the main criteria.

After consideration of your objectives and personal situation, if you wish to go down the equity release route then the next step is to decide which provider to use. This requires careful deliberation and is best achieved with the help of a financial adviser. Each provider will have their own specific criteria when it comes to factors such as the applicant's age, property location, property value, property type etc. and each of these factors can have an impact on the applicable interest rate on the loan. Where one provider may accept a property, another may not.

As a general rule of thumb, providers will typically loan up to 40% of the value of the property (this will be less the younger you are). So, if your property is worth £500,000, you could release £200,000 as a tax-free lump sum. This is a guide only, and the figures may be higher or lower depending on the property, the person borrowing and provider in question.

Footnotes
2. https://www.equityreleasesupermarket.com/what-is-equity-release/do-i-qualify

What are the risks of lifetime mortgages?

Compound interest
One of the main risks associated with a lifetime mortgage is how quickly debt can build up. It is true that you will only repay the loan once you pass away or move into long term care, however the size of your estate to leave to beneficiaries could be significantly reduced.

Unlike a usual mortgage, where monthly payments are made to slowly erode the outstanding balance, the interest under a lifetime mortgage is compounded. This means the interest owed can very quickly build as each year passes.

For example, if you took a lump sum of £80,000, by the end of the 10th year you would owe just over £124,000 (based on an interest rate of 5% and excluding any applicable fees). If you couple the effect of compounded interest with a dip in property values, the residual equity left once the loan has been settled may be minimal.

Early repayment charge (ERC)
Another potential downside to a lifetime mortgage is the charges applicable if you wish to exit the arrangement early. For example, an ERC may be applicable if you wanted to move into a home that did not meet your existing provider's property lending criteria.

Broadly speaking, there are two ways of determining an ERC. Which approach is used will depend on the provider.

- Fixed, tapering charges. For example, some lenders will charge a 5% ERC between years 1-5, and 3% between years 6-10.
- An ERC linked to government yields. In short, if gilt yields stay the same or increase higher than the rate at which you took out the policy, there will not be an ERC. Conversely, if yields decrease, then you may be liable to an ERC. To put this into context, typically as an economy 'does better', gilt yields are higher or increasing.

Access to benefits, grants and tax allowances
Using equity release could affect access to state or local authority benefits, council grants for areas such as home improvements, or additional allowances (for example age allowance), both now and in the future.

Loss of funds for other uses
If equity is released from a property, you may not be able to rely on further monies from the value of the property, and you may not be able to be certain that there will be any value to provide to your family.

Provider conditions
Some lifetime mortgage providers may place conditions that need to be adhered to while you live in the property.

Changing your mind
If you change your mind, it can be complicated to unravel a lifetime mortgage scheme.

A personalised illustration should be discussed prior to establishing a lifetime mortgage plan, which will help to explain these, as well as other features and risks.

Can you move home?

Many lenders allow customers to move from one property to another. The new property would need to comply with your existing provider's suitability criteria at the time of moving. Moving may be more difficult if the new property is of lower value because your existing provider may not be willing to lend the same amount against the property. In this scenario, you may be required to repay part of your loan which can often lead to early repayment charges.

It would be advisable to talk to your existing provider and to a financial adviser before any formal commitments are made to purchasing a new property.

Lifetime mortgages and estate planning

If you take out an equity release policy, the amount borrowed is essentially a debt on your estate, and thus your net estate shrinks for inheritance tax (IHT) purposes.

Currently, the nil rate band for IHT is £325,000 per person. In addition, eligible homeowners have a residence nil rate band of up to £175,000 per person in the 2020/21 tax year (the property must be left to direct descendants). This means that on second death, a married couple (or couple in a civil partnership) could have a net estate of up to £1 million in 2020/21 before IHT is payable.

While a lifetime mortgage can reduce the value of your estate, it should not be relied upon purely for IHT purposes.

Should you seek advice?

Every individual's circumstances are different, and where equity release may be suitable for one person, it may not be appropriate for another. As a very simple exercise, if you can answer 'yes' to any of the following questions, it may be beneficial to receive advice before committing to releasing equity from your property.

Yes	No	
☐	☐	Do you have other assets to draw funds from or can they be utilised more appropriately?
☐	☐	Do you have beneficiaries you would like to leave a legacy to?
☐	☐	Are you likely to receive an inheritance or gifts of capital in the future?

It's essential to remember that a lifetime mortgage will reduce the funds that are available to pass to your intended beneficiaries, so you should consider discussing this with your family.

There is a fee for equity release advice provided, which will depend upon your circumstances. Typically, we estimate a fee of between £1,500 and £5,000. Do get in touch if you would like more information.

Contact Us

Over the years, we've helped many people reduce the Inheritance Tax paid when they die. We are experienced, highly qualified, and STEP (The Society of Trust and Estate Practitioners) affiliated advisers, demonstrating our estate planning specialism.

If maximising the amount you leave to loved ones and good causes is important, please contact us. We'll listen to your concerns, understand your ambitions, explain your options and make recommendations.

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