Briefing Paper BP6-2017

The future role of housing equity as retirement finance[1]

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July 2017

The UK equity release market reached a milestone in 2016, with sales surpassing £2bn for the first time and the largest number of new plans agreed (27,500) since 2008[2]. Relative to the mainstream mortgage market, these figures remain small, but new product developments and flexibilities, as well as changes in the wider retirement landscape, suggest the possibility for wider uptake of equity release among an increasingly diverse consumer population.

This briefing paper examines these changes, and considers where the market has made progress in meeting consumer needs and preferences, as well as exploring remaining challenges.

Current and future drivers of demand for equity release products

Inadequate pension income

Inadequate pension income, particularly from Defined Contribution savings, may well be the most significant driver of future demand for access to equity release products. But we also know that since the pension freedoms were introduced, there has been a considerable decline in annuity sales now that purchases are no longer compulsory[3]. This suggests that retirees are opting against a guaranteed, secure income, for life. If these trends continue, more people will need to find alternative sources of income or capital later on, and housing wealth could play a key role here. Conversely, and in light of the recent increase in lifetime

[1] This briefing was produced as part of a funded project from the Equity Release Council: Equity Release Rebooted: the future role of housing equity as retirement income http://www.equityreleasecouncil.com/document-library/equity-release-rebooted-white-paper-april-2017/

[2] Equity Release Council Market Report, Spring 2017 http://www.equityreleasecouncil.com/document-library/equity-release-market-report-spring-2017/

[3] Pensions Policy Institute (2014) How complex are decisions that pension savers need to make at retirement? http://www.pensionspolicyinstitute.org.uk/publications/reports/transitions-to-retirement---'how-complex-are-the-decisions-that-pension-savers-need-to-make-at-retirement

mortgage sales coming after savers have been given greater access to their pension pots, it may be that rather than delaying the use of equity release to later in retirement, the reforms could incentivise earlier use of housing equity.

Restrictions on access to mainstream mortgage finance

In the wake of the 2008-9 financial crise, the Mortgage Market Review implemented significant changes to the FCA's rules governing the sale and approval of mortgages to residential consumers[4]. While the (then) Financial Services Authority (FSA) explicitly stated that it did not wish to encourage an excessively cautious approach on the part of lenders; restricting availability and increasing the cost of mortgages into retirement, in practice, lenders have responded cautiously, and older consumers have experienced difficulty gaining access to conventional mortgage borrowing.[5]

These restrictions are part of a wider trend towards responsible lending, but for the increasing number of older people carrying mortgage and non-mortgage debt into retirement, either as a deliberate asset management strategy or through little choice, this shift has placed greater, unnecessary, strain on household budgets as income declines. A number of providers, notably building societies, have since loosened some of these restrictions, primarily by increasing the maximum age for lending money on a mortgage. However, at the beginning of 2017, the Financial Ombudsman Service indicated that more still needs to be done, with a significant minority of older people continuing to experience (perceived) unfair treatment and discrimination from mortgage providers relying on strict, inflexible rules.[6]

These trends position retirement borrowing towards more specialist equity release providers, who do not operate such restrictions. However, the FCA's requirements have also had implications for new 'hybrid' equity release products that give customers the option to make interest repayments initially with the option to revert to roll-up interest at any point. Within the last year, the FCA has recognised that its responsible lending rules could have contributed to restricted development and take-up of hybrid mortgages, and has subsequently modified the affordability rules so that they do not apply if the customer wants to service the interest but has the safety net of roll-up in the background.[7]

[4] FSA (2011), Mortgage Market Review: Proposed Package of Reforms (CP11/31); online at www.fsa.gov.uk/library/policy/cp/2011/11_31.shtml

[5] Overton, L. and Fox O'Mahony, L. (2015) Consumer Demand for Retirement Borrowing, London: CML

[6] http://www.financial-ombudsman.org.uk/publications/ombudsman-news/139/139-mortgages-and-age-whats-in-a-year.html

[7] FCA, Feedback Statement, Call for Inputs on Competition in the Mortgage Sector, May 2016, Quarterly Consultation No.14, September 2016 and Handbook Notice 40, January 2017

Looking to the future, and at how older consumers can make the most of their overall wealth, the challenge now is for the FCA, and the industry, to look at where there may be remaining barriers to mortgage product innovation, while at the same time ensuring any moves towards facilitating greater innovation do not run the risk of compromising appropriate protection for more vulnerable consumers.

Ageing in place and paying for care

In theory, one option for older people wanting to access the equity tied up in their homes is to trade down to a lower value property, but there are limited opportunities for this in the current UK market. The government's recent White Paper, *Fixing our Broken Housing Market*[8], points to a number of options for making it easier, and more attractive, for older people to move. But the paper stops short of offering detailed plans, or indeed fiscal incentives, for realising these policy goals. Furthermore, moves to improve the supply of accessible housing will be welcomed by those able and willing to move, but they will do little to overcome the emotional and psychological attachments many older people have to their homes[9]. There is thus likely to be a continuing need for options that allow equity release in situ.

The role of accumulated housing wealth has also been an important, and controversial, theme within care funding debates for some time, and recent Tory party proposals placed housing wealth even more firmly centre stage. Under current arrangements, the value of the home is only taken into account when determining the cost of residential care. Now, fuelled in part by the concentration of housing wealth in the older generation and a desire to address intergenerational inequalities, discussions have focussed on incorporating housing wealth into the means test for domiciliary care. While these plans have been called into question, and there is now even greater uncertainty over the future of social care funding, we know that the probability of needing domiciliary care is much higher than the probability of needing institutional care[10], and that local authority funding pressures have resulted in a substantial decline in the number of people receiving home care[11]. It is likely, therefore, that such plans will be revisited.

Housing wealth cannot fill the gap borne by diminishing public resources; but equity release could play a role in reducing the growing level of low to moderate unmet need, thereby preventing escalation to more substantial and/or critical needs. Currently, the Universal Deferred Payment Scheme (where older people requiring care have the right to defer

[8] https://www.gov.uk/government/publications/fixing-our-broken-housing-market
[9] Fox O'Mahony, L. and Overton, L. (2015) 'Asset-based welfare, equity release and the meaning of the owned home', Housing Studies, 30(3), pp.392-412
[10] Mayhew, L., Karlsson, M. and Rickayzen, B. (2010) 'The Role of Private Finance in Paying for Long-term Care' The Economic Journal, 120: 548, 478-504.
[11] Age UK (2014) Care in Crisis 2014, London: Age UK

payment until after death) is set to apply only to care in an institutional setting, leaving open the opportunity for commercial equity release products to play more of a role in enabling people to receive/pay for care at home.

Product development and innovation

Overcoming consumer concerns about debt and insecurity

Recent research with equity release consumers revealed the unease and anxiety that some owners feel as a consequence of the progressive impact of accumulating interest and dwindling equity[12], and the study showed that the 'fear of ending up with nothing' was particularly prominent among less well-off consumers. With traditional product offerings, consumers could expect the debt to double every ten years, and this hasty erosion of equity has a greater impact on those with lower value properties, especially if modest house price rises do little to offset the accumulating debt. However, recent new developments and flexibilities look set to make equity release more attractive and better suited to the needs and preferences of a wider range of consumers. Interest rates of 4.5 per cent or lower are also becoming more commonplace, extending the period of time before the debt doubles to 17 years or more. Furthermore, with an increasing range of providers offering options for paying interest on the loan and the flexibility of making voluntary (partial) repayments without penalty, more consumers may be able to feel financially secure for longer.

Remaining barriers to wider uptake of equity release

Future proofing equity release

While progress is being made to provide greater flexibility, it is not yet clear that the industry has responded sufficiently to the vital issue of portability. Our research on the long-term experience of equity release revealed that some customers find themselves unable to move to a more suitable property when the need arises. Deteriorating health, isolation, and/or having too much space to manage were among the main reasons consumers wanted to transfer their equity release plan to a different property, typically an apartment or specialist retirement property. At the time of enquiry, however, consumers either found that that this had never been possible, or, that changes in provider policy meant such properties were no longer in the 'acceptable' category.[13]

[12] Overton, L. and Fox O'Mahony, L. (2015) The Future of the UK Equity Release Market: Consumer Insights and Stakeholder Perspectives, http://www.birmingham.ac.uk/research/activity/social-policy/chasm/publications/index.aspx

[13] Fox O'Mahony, L. and Overton, L. (2014) 'Financial Advice, Differentiated Consumers and the Regulation of Equity Release Transactions', Journal of Law and Society, 41(3), 446-469

These findings raise important questions about whether or not equity release products can be considered future proof, and indeed whether warnings about risks and costs during the advice process constitute sufficient consumer protection. They also resonate with recent work by the FCA on consumer vulnerability[14], which noted a general need to improve inflexible financial products (not specifically equity release) designed for the standardised perfect consumer, reporting that 'a frequent consumer complaint related to products taken out in good faith before the onset of vulnerability – which at a later date turned out to be unsuitable in some way for the situation they found themselves in.'

Until equity release products have genuine long-term suitability, their potential as a vehicle for later life finance will remain limited in the new retirement landscape.

Advice and guidance

There are currently three government-backed financial guidance providers which all aim to help individuals navigate financial decision-making, but there is some evidence of low awareness and uptake of these services[15]. For older people to make the most of their overall wealth in retirement, and be better informed about equity release and other retirement planning options, money guidance needs to reach older people more effectively. The creation of a new, single body, for public financial guidance[16] has the potential to provide a more joined-up approach across the equity release industry and other key players in the market, making it easier for consumers to consider their income and asset portfolio holistically.

Plans revealed by the Treasury in February 2017 for a new Pension Advice Allowance[17] may also have an important role to play here, but largely for those able to pay for regulated financial advice. The aim is to introduce a new authorised payment for up to £500 withdrawn from a pension pot and used to pay for pensions advice or retirement advice. 'Retirement advice' is intended to include a consideration of other factors, including housing and other assets, reflecting the fact that it is not possible to make decisions about pensions in isolation from other aspects of an individual's finances.

Enhancing the social acceptability of equity release

While steps are being taken to offer more attractive and suitable equity release options, arguably the greatest challenge facing the sector going forward lies not only in getting the products right, but in reducing he stigma associated with equity release.

[14] FCA (2015) Consumer Vulnerability – Occasional Paper No. 8, London: FCA
[15] The Financial Capability Strategy for the UK, October 2015
[16] HM Treasury and DWP (2016) Public Financial Guidance Review, London: HM Treasury
[17] HM Treasury (2017) Introducing a Pensions Advice Allowance: response to the consultation, London: HM Treasury

Our research suggests that one of the consequences of the positive status attached to home ownership in the UK and, in particular, outright ownership in later life, is that those who engage in equity release are reluctant to 'admit' that they have taken out a plan, and are more likely to feel a sense of shame and/or guilt, rather than pride in their decision[18]. Though this sentiment was slightly less common among some of the better-off participants, perhaps because they were not relying on the money to get by but had instead chosen to release equity to enhance their lifestyle and/or support family, there was nevertheless widespread agreement on the difference between 'acceptable' debt, for example, mortgage acquisition debt, and 'unacceptable' debt – the debt accumulated under equity release. This notion that surrounds equity release perpetuates a (false) belief that later life debt is 'abnormal', and has a number of important implications, not least preventing wider up-take of equity release, with adverse implications for those who might benefit most.

It is possible that future generations of retirees will have a different set of attitudes, enabling them to feel more 'at home' with housing equity consumption and secured debt in retirement. In the meantime, enabling more people to benefit from what equity release has to offer will require more than raising awareness and getting the products right (greater flexibility and innovation): it will also require specific strategies to normalise equity release as a socially accepted vehicle for retirement finance.

The views expressed in this Briefing Paper are the views of the author and do not necessarily represent the views of CHASM as an organisation or other CHASM members.

[18] Overton, L., Fox O'Mahony. L. & Gibson, M., 'The emotional dimension of trading on home in later life: Experiences of shame, guilt and pride' in Thinking Home (eds. Bahun, S. and Petric, B.), Home Studies series, Palgrave Macmillan, forthcoming 2017