Failure: Equity release

Rather than pay out Improvement Grants, government hopes that homeowners – including those who are 'income poor but capital rich' – will make use of the hidden assets tied up in their existing property.

The Joseph Rowntree Foundation decided to assist homeowners on low incomes to raise funds for repairs and improvements by releasing the equity tied up in their homes. It failed. The following lessons emerged from this piece of action research:

- older homeowners are deeply reluctant to take out loans secured on their property, even if there are no repayments until they die or leave the property;
- the commercial products on the market – capital appreciation loans and mortgages with interest rolled up – are not suitable for those in less expensive property and/or needing around £10,000 for improvements/repairs. Moreover, the terms on offer are not attractive to the majority, particularly for those in the cheapest property who would loose a substantial proportion of all equity in their home;
- there are legal obstacles facing attempts by housing associations, local authorities or home improvement agencies to make equity loans (ie loans re-paid from eventual sale proceeds). These legal obstacles prevent lending even on non-commercial (part-subsidised) terms.

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What happened

The Joseph Rowntree Foundation set aside £60,000 to be drawn down by its housing association, the Joseph Rowntree Housing Trust, in loans (or a combination of loans and grants) to demonstrate how equity release could work in practice.

The City of York was approached to obtain a list of homeowners who had applied for Improvement Grants but who, in the absence of sufficient funds, were not being considered because they were not in receipt of benefits (and were not registered as disabled).

Because of cut-backs in spending, these households were unable to obtain Grants, even though their incomes were not sufficient to cover the costs of a mortgage. Their properties were deemed to be in a state of sufficient need for repairs/improvements to merit a Grant if resources had been available.

Forty applicants were identified and the Joseph Rowntree Housing Trust approached them. About half dropped out: they were not interested in loans at all; some had got the funds they needed from other sources; some could not face the disruption of building works. The remainder were visited and their properties inspected. Some of these – or their children – were also against the idea of borrowing on an equity release scheme. Some others had become ill and others did not satisfy one or more of the basic criteria: mostly because the cost of the works was under the £5,000 threshold chosen for organising equity loans.

For the four remaining applicants, a more detailed schedule of works was drawn up covering basic repairs (e.g. to the roof, windows, gutters and damp proof course) and improvements identified (e.g. central heating and better insulation). The cost of works varied from £6,500 to £10,500.

In these four cases, applicants were agreeable to an equity release arrangement whereby:

- the cost of works, plus administrative and legal costs, would be translated into a percentage of the value of the home (e.g. £10,000 for this expenditure would represent 20% of the value of a £50,000 home);
- an equity loan would be advanced for this proportion of the value, interest free, with the repayment to incorporate capital appreciation on the same proportion (e.g. if the loan was £10,000 representing 20% of the value of a £50,000 house and the property doubled in value to £100,000, then the repayment would be 20% of the new value, ie £20,000);
- repayment would take place only when the occupier (or the last of an occupier couple) left the property and it was sold on the open market (or the occupier re-paid earlier on a voluntary basis).

However, legal and regulatory factors as described below made it impossible to provide the loans. Thus, from an initial pool of forty people whose application for an Improvement Grant had been rejected, not a single person took out an equity-release loan.

What we found out

There is a reluctance to borrow

Many of the forty people approached were reluctant to take out any kind of equity loan and were only interested in proceeding if a Grant was available. The reasons for this decision included:

- loss of an asset which they had accumulated over many years;
- loss of some part of the inheritance their children could expect;
- an aversion to borrowing, in whatever form and on whatever terms.

For these households, even if conditions were very unsatisfactory, maintaining outright ownership of a property, unencumbered by any mortgage or loan, was more important than improved comfort (or even savings on fuel bills).

A return to the use of Improvement Grants would clearly be the most popular mechanism for getting essential repairs, and important improvements, carried out in the homes of those

owners on low incomes. Even if grants only covered a part of the whole cost, they would be likely to attract households to find matching money – perhaps by conventional borrowing of a small sum or through use of savings or help from their family.

There are obstacles to non-commercial loans

Making loans on non-commercial terms – e.g. requiring only a third of the appreciation which a commercial lender would obtain – will restrict equity loans to those cases where a charity, voluntary body or publicly funded organisation can find the resources. Not many benevolent sponsors are likely to make mortgages available on a non-commercial basis. (A capital appreciation loan from the JRF to the individual, giving us only the increase in value with no interest in the meantime, would be likely to provide us with a return substantially below that available from other investment – particularly since property prices in the North of England have moved very little over the last decade.)

However, assuming that those interested in neighbourhood renewal – registered social landlords or local authorities or home improvement agencies – were prepared to make non-commercial **Improvement Loans** (for social reasons) there are serious legal problems in achieving this:

charities and housing associations cannot make mortgage loans unless they are registered – which none are likely to be – under the Consumer Credit Act 1974. Even with terms which are on a non-commercial basis, lending of this kind requires a special exemption order from the Department of Trade and Industry: it is very uncertain whether such exemption would be forthcoming;

local authorities can only grant mortgages on a regular re-payment basis, with a specified rate of interest, ie they cannot make equity-based loans. This is because of provisions in the Local Government Act 1985.

There is only a limited role for commercial alternatives

Commercial loans are not available on the basis of no payments of interest (and no rolling-up of interest payments) and appreciation only on the proportion of property value represented by the loan. For example, the Bank of Scotland's Capital Appreciation Loan – often regarded as the 'market leader' in the field – requires repayment of the original capital sum plus three times capital appreciation. (So, for example if the value of the property has doubled from £50,000 to £100,000 and the original loan was for £10,000, then the final repayment would be £10,000 plus three times capital growth of £10,000 = £40,000.)

There are several restrictions upon the loans available from commercial sources. For example, there may be a minimum value for eligible properties of over £60,000 (which would have counted out almost all those seeking support in York). There may be a minimum loan advance of £15,000 (which would be more than the requirement for any of those in the York scheme).

At present it seems that the commercial arrangements are unlikely to be attractive, or available, for those in the very large number of cases where costs and values are relatively low.

In conclusion

The intention of the JRF/JRHT – to demonstrate how equity loans could fund the costs of improvements and repairs for owner occupiers – has proved a failure. But the exercise has indicated ways in which current constraints might be eased: the prize remains of unlocking substantial assets held by homeowners whose properties are in serious need of some investment.

Reversing the failure

1. Continue to expand home improvement agencies, which address a number of constraints on improvement to the stock owned by lower-income households.
2. Improvement Loans may be a cheaper alternative to grants in the longer term in that one day the original sum is returned (although by then it is likely to be worth much less). Central and local government could consider Improvement Loans on this basis – even though the public expenditure conventions mean that this route has the same public spending consequences. (When loans are re-paid at some later date, these would represent a 'windfall' receipt.)

   To allow non-commercial Improvement Loans:

   Section 16 of the Consumer Credit Act 1974 should be amended to allow for a general exemption to its provisions, for non-commercial equity loans from local authorities, housing associations or home improvement agencies.

   Sections 436 and 438 of the Local Government Act 1985 should be amended to remove the requirement upon local authorities to charge regular re-payments of interest (rather than a single repayment, with or without capital appreciation, when a property is sold).

How to get further information

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