February 2004

Consultation response to HM Treasury: ‘Regulating home reversion plans’

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1. Introduction – JRF perspectives on equity release, home improvement and long-term care

JRF has in recent years taken an interest in opportunities for older, low-income homeowners to realise some of the capital from their homes, especially to meet such specific needs as home repairs and improvements, or the costs of personal care.

Home improvement and repairs

The Foundation has a long-standing interest in looking at ways of broadening the funding base for home improvements, and its research has emphasised the importance to the quality of life of lower income homeowners of being able to access finance for this purpose (see **Foundations Ref: 370** for a summary of approaches). The recent change in the structure of public support for home renewal, which places greater reliance on private individuals being able to finance the cost of improving or renewing their own homes, rather than relying on grants, reinforces this need.

In the late 1990s, the Foundation’s housing association, the Joseph Rowntree Housing Trust, experimented with making reversion loans available to lower-income homeowners in York who had been turned down for improvement grants. This experiment failed for lack of take-up, and the Foundation concluded that some severe obstacles needed to be overcome in order to make small-scale equity release for this market a viable option (see **Findings Ref: D58**).

More recently, the Foundation has been instrumental in bringing together parties with an interest in this issue to explore possibilities, and is supporting research at the University of Birmingham’s Centre for Urban and Regional Studies (CURS), monitoring the development of the new renewal regime, including the emergence of equity release products aimed at people on low incomes. A JRF-funded further project being undertaken by researchers at the Universities of Bath and Bristol is exploring the ‘demand’ side by researching, for the first time in a nationally representative survey, the attitudes of older people to the way in which they use their assets, and specifically the trade-off between ‘unlocking’ their capital in their own lifetime, or passing it on to their heirs.

Although neither of these projects is yet complete, JRF is able to make some general comments on the proposals in the consultation paper based on the discussions that it has organised, as well as on a paper by Nigel Appleton of Contact Consulting that explores the issues, and early indications from the CURS project. Mr Appleton’s paper, which gives a concise overview of the issues and developments to date, is given in Appendix 1.

Long-term care

The Foundation also has a close interest in the funding of long-term care. It sees a particular role for equity release to play in this funding, in cases where people living in their homes need relatively low levels of continuing domiciliary care services, which are not all provided by local authority social services, but that people on low incomes cannot afford. In these cases, either a progressive draw-down of an equity release product, or the purchase of an annuity, potentially enhanced to reflect shorter life expectancy due to a particular illness, look feasible ways of providing funding to low-income groups. However, simple mechanisms with low administrative costs would be needed to finance relatively small-scale loans.

A paper provided for the Foundation by Des LeGrys, discussing how equity release mechanisms might help fund long-term care costs, forms Appendix 2 of this submission.

JRF comments on consultation paper

The Foundation is not in a position to answer most of the technical questions about reversion plans posed in the paper. Rather, it can help to answer **Questions 3 and 4** by making two main points concerning the interests of lower income homeowners who might potentially benefit from the equity release market. The first is that, to date, confidence in the available product has been a major obstacle: this strengthens the case for regulation. The second is that an equally great barrier to people on low incomes who might benefit from equity release has been the relatively high administrative costs that make it difficult to release small amounts of equity on reasonable terms. This second factor makes it desirable that the extra cost imposed by further regulation is carefully considered, and that the benefits of extra protection are weighed against the risk that the cost to the consumer could become prohibitive.

2. Public confidence as a barrier to equity release

The feeling in some quarters is still strong about the unresolved cases of those who bought equity release products in the late 1980s and subsequently found themselves with insupportable debts. There are still around 200 cases from the1980s where people owe more than the property value. The Consumers’ Association in particular has continued to pursue the matter and highlight difficult cases. More widely, the ‘folk memory’ of these difficulties is ingrained and refreshed by occasional media attention to individual cases. In a Parliamentary Debate on 14th January 2003, a number of Members of Parliament drew attention to the circumstances of constituents caught in this situation, and called for lenders to act to resolve outstanding cases with sensitivity and generosity.

The refusal of some lenders to freeze interest on old agreements, products that they would not now wish to promote, is seen by some as particularly reprehensible. One respondent in the review by Nigel Appleton expressed a widely held view:

“It seems wrong for some lenders to be going out to lend again when they are still adding interest on mis-sold products from last time.”

Whilst characterising the situation as ‘mis-selling’ may not be strictly accurate, it does represent a view that comes to prominence whenever one of these cases receives media attention.

It is fair to point out that in general, the difficulties referred to above have most commonly applied to interest-based mortgage products, rather than reversion schemes, since the latter would not normally create debts worth more than people’s homes. However, consumers do not necessarily distinguish between the two, to the extent that they may be generally suspicious of equity release overall. Reversion schemes trigger particular fears and suspicions, and need to overcome a natural reluctance by homeowners to give up full control of their property, and a reluctance to accept the uncertainty of whether the scheme will be to the advantage of an individual in practice, given the unknowns of life expectancy and future appreciation of property value.

Regulation that ensures, as a minimum, that advice is fairly given may be an important element in helping to rebuild confidence in the equity release market. However, for many low-income homeowners it may be only part of the picture. A number of local authorities and not-for-profit organisations have embarked on partnership schemes to offer equity release products, and the involvement of these non-commercial bodies is a complementary way of giving more vulnerable groups the confidence that they are not being approached by ‘racketeers’. It seems desirable, therefore, that the design of regulation is compatible with and, if possible, supportive of the involvement of non-commercial intermediaries. One potential obstacle may arise if such intermediaries, many of whom enjoy trust within their communities, are restricted in the degree to which they can offer advice because of their involvement in particular schemes. A reasonably flexible framework for giving advice therefore seems desirable.

3. Regulation and cost for small-scale transactions

With a number of equity release products, administrative costs are high in relation to returns. This particularly affects the scope for drawing-down equity to fund relatively low-value, one-off expenditure – such as on home improvements – or to cover the relatively modest cost of ongoing care services. The average size of the loan for home improvements is likely to be around £10,000 (the normal range is around £3,000– £25,000, although there are a few loans larger than this). A commercial lender would not in general find these small loans commercially viable, unless a third party undertakes all the administration and just presents the commercial lender with completed applications. The cost of arranging the loan is high compared to the average size of the loan and the margins, if any, are small. Unless the cost of setting up a loan can be reduced to about £500–£600 per case, the scheme will not appear to give good value for money. Indications are that, for many products, set-up costs are much higher than this.

At present, a number of not-for-profits organisations are helping to deal with this through arrangements in which they effectively pick up the administrative costs, and sometimes also providing other forms of financial support. Yet in these cases too, the unit cost of administrative arrangements is a constraint, if only because subsidy put into this element might otherwise be available to improve the terms on which equity release can be offered.

One example identified by the CURS team is the ‘HomeImprove’ reversion product being pioneered by Rochdale and Oldham Borough Councils in partnership with West Pennine Housing Association. It is calculated that set-up costs work out at about £800 here, including a valuation, HomeImprove’s legal fees, the applicant’s legal fees, and a works inspection fee. As a result, in most circumstances it is not appropriate to make a loan of less than £5,000, although occasionally there are circumstances where a loan may be justified.

The Foundation does not have firm views about how regulation should be designed in order to avoid making costs even more prohibitive for people wishing to release equity on a small scale. It is possible that a lighter-touch form of regulation for transactions below a certain level may be found to be appropriate. However, given that entering a reversion agreement is itself a big step, which in no circumstances should be taken lightly, an alternative may be to ensure that regulations are designed to facilitate progressive draw-down of small amounts of equity. In entering an arrangement in the first instance, consumers may require a considerable level of advice and protection, but similar protection may not be appropriate at each stage in which a new sum is withdrawn. This approach may be particularly appropriate for a homeowner who wants to be able to access funds for minor repairs and improvements over a longer period, each of which is for a small amount, but which overall may add up to £10–20,000.

Appendix 1

Ready, steady but not quite go – older homeowners and equity release: An Executive Review

Nigel Appleton
September 2003

Key findings

- The most fundamental deficiency is a lack of fit between products and the potential market. The minimum value of property threshold is too high, draw-down levels are too inflexible, and administrative expenses are too costly. Many older people are looking for a simple line of borrowing that they can draw on by borrowing relatively modest amounts to finance lifestyle items, such as a holiday, a new car, a new kitchen, a conservatory, or replacement doors or windows. Even those who wish to finance more fundamental works of repair or improvement to their homes need access to sums of a few thousand pounds at a time. Some may wish to fund an operation or other episode of care, even here the need is for smaller sums than those generally offered as the minimum advance. For smaller sums especially, the administrative costs associated with these loans seem costly. Very many older people live in lower value properties, often they will be among those who might see the greatest benefit in access to this type of product, but the value of their property is too low to qualify.
- The folk memory of bad outcomes from the late 1980s is still strong, and organisations such as the Consumers' Association will keep it fresh. The knowledge that products which released equity led people into negative equity, re-possession, and financial disaster creates apprehension for many older people. Some of these cases are still not resolved, and from time to time receive notice in the press. Organisations such as the Consumers' Association are committed to keeping the issue alive. To lay this ghost, a gesture is needed from the lenders to settle outstanding cases, perhaps by foregoing all claims beyond the current value of the property, or the value at the point when the borrower died. If the introduction of regulation is to act as a springboard for the re-building of public confidence, then the gesture to settle all outstanding contentious cases should come before regulation arrives.

- There is sporadic evidence of increased promotion through the media. For example, the Daily Express recently carried a promotion with Key Retirement Solutions, which included extensive coverage in the paper and the offer of free explanatory booklets. Media attention is rarely consistently in one direction, and it is worth noting that a few weeks later the same newspaper gave prominence to negative elements of the reports on equity release contained in the August edition of *Which*.
- There is a widespread expectation that both providers and consumers will draw comfort from the introduction in Autumn 2004 of regulation by the Financial Services Agency. For providers, it will allow them to market equity release products as ‘safe’ and respectable. For consumers, it will indicate that these are mainstream financial products in which they may have the same confidence as in more familiar forms of mortgage. There are widespread concerns about the position of reversions, and a desire that the consultation which Government has proposed should result in comparable standards of regulation to that for mortgage-based products.
- Whilst Government may hope that equity based products will help people make provision for their long-term care in old age, there must be some doubt as to whether this is a realistic prospect in the current climate. The provision of free nursing care for old people in England, more generous arrangements in Scotland, and continuing debate in Wales, encourage an individual to assume that they do not need to commit themselves to making such arrangements as, somehow, the difficulties will be resolved. Natural reluctance to enter such arrangements is stiffened into resistance by the opposition of such organisations as the Consumers’ Association to the very notion that anyone but the state should shoulder the burden of financing care in old age.
- Local authorities are required to respond to the flexibilities offered them in the Regulatory Reform Order on Housing Renewal 2002 by producing a strategy statement setting out how they will use a mixture of grants and equity based loans to encourage repair and improvement in housing stock within their area. The promotion of borrowing as an alternative to grants for older homeowners will only start to bite in most areas in 2004/5 and thereafter, as local authorities work through the details of the schemes by which they will offer appropriate forms of loan. In many cases it is the Home Improvement Trust that has been cited in strategies, and success will depend on their ability to gear up to a potentially high level of enquiry in the months following the simultaneous implementation of strategies in many local authorities.
- Home improvement agencies (HIAs) are expected to play a key role in rolling out an equity loan-based strategy to finance repairs in the homes of older people. There is little evidence that the majority of HIAs are really geared up to deal with their end of the process. Foundations, the co-ordinating body for HIAs in England, is still preparing for the role it may need to play in supporting agencies. Their colleague organisation in Wales: Care and Repair Cymru, has had the benefit of working with a variety of pilot equity release arrangements through HIAs in Wales.

- In many quarters there is a perception that the balance of risk in the operation of equity release products still favours providers. Whilst consumers may be protected against negative equity if the market declines, with some products they may suffer disadvantage where the property appreciates steeply. In these circumstances, they may find themselves surrendering a proportion of the improved value that represents an astronomic effective rate of interest. In these circumstances there may be an argument for limiting such windfall returns in a sharply rising market.
- The direct involvement of one or other of the main national organisations representing the interests of older people would doubtless do much for confidence among potential consumers. Help the Aged do not see themselves as providers of these products, but do retain a close interest in the field and a concern that the interests of older consumers should be protected. The commercial and insurance arm of Age Concern England (ACE) is an obvious prospect for entry into this market, but they would need to be able to offer appropriate products that address the fundamental difficulties identified above. If such an initiative were to come from ACE it would have a significant impact upon consumer confidence and the prospect of higher business volumes.
- There is still little known about what motivates consumers to enter a contract for an equity release product. The ratio of enquiries to contracts completed is high. Greater attention might be given to the circumstances that trigger an application. Anecdotally it seems, for example, that a significant number of applicants are widows whose circumstances have deteriorated significantly on the death of their spouse. A better understanding of this and other scenarios would allow products to be refined to better match the needs and priorities of potential consumers.

Whose agenda, whose priority?

The first reversion income scheme was introduced by Home Reversions in 1965. During 1972, the first home income plan based on a mortgage and annuity was issued. Cash reversion plans were introduced in 1978 by JG Inskip & Co. (later incorporated under Home & Capital Trust Ltd). In 1986, Stalwart Assurance (later named G E Life) and Allchurches Life Assurance introduced schemes.

Unsafe schemes, including investment bond schemes and roll-up plans with variable interest rates, began to appear in 1988. These left many elderly people in financial difficulties, and were banned in 1990. Over this period, the potential for growth has been frequently talked-up, but take-up has been slow. In part, this reflects the experience of those in the late 1980s who, having taken out equity release products, found themselves with unsustainable debts when the value of their house failed to increase at a rate to match the accumulation of interest. It also suggests that older people are reluctant to sell cheaply (as they perceive it) that which has been built up through sacrifice and consistent endeavour over 25 or more years.

In public policy, and at least some parts of the finance industry, the prospect of a rising generation of older people spending their accumulated equity, rather than passing it on to their children, remains attractive. The reasons for their persistence with a product whose time always seems not quite to have come are diverse.

Government priorities – long-term care

The ageing of the UK population holds out to government the prospect of increasing demand for care and health services, with an unsustainable impact upon public finance. To quantify the likely demand and consider alternative styles of provision and means of funding, government appointed the Royal Commission on Long Term Care, chaired by Professor Sir Stewart Sutherland. Part of the political background to the creation of the Royal Commission was growing public disquiet about the circumstances of people who had been required to fund their care by selling their homes on admission to residential or nursing-home care. A dwindling minority of older people had their long-term care needs met in an NHS hospital or nursing home and were not required to contribute in the same way: this was seen to be inequitable. The report of the Royal Commission's investigations: With Respect to Old Age was published in 1999. Although government rejected the main recommendation on free personal care, most of the other recommendations were accepted – including the provision of free nursing care, whether delivered in hospital or in another setting, such as a nursing home.

The deliberations of the Royal Commission gave new currency to the notion that future generations of older people would need to provide for their own long-term care, and that equity based financial products might provide a means of doing that without the total surrender of the property. The willingness of government to fund nursing care indicated where they thought the line should be drawn. It marks a shift from a situation in which the long-term care needs of the majority of older people are wholly funded by government, to one in which the financial responsibility is shared.

Average House Price (2001) £115,700
(Council of Mortgage Lenders)

Average Retirement Fund (2001) £24,000
(Association of British Insurers)

If individuals are to meet the non-nursing costs of their long-term care then, for most, the equity in their homes will be the only likely source of funding. Although the financial products to match this particular requirement are not readily available, and older people show no marked enthusiasm to take them up, government policy in this area is likely to persist in encouraging the perception that this is the way forward.

Government priorities – the funding of major repairs and improvements to the homes of owner-occupiers.
It has been the position of government over a number of years that the primary responsibility for repair and renewal to owner-occupied property lies with the owner. The degree to which those with limited financial resources beyond the value of their home, and those who might be considered to face particular difficulties through age or vulnerability in discharging their responsibilities, might have work funded through grants from public funds has gradually reduced.

The Regulatory Reform Order on Housing Renewal (2002) amended the provisions of the Housing Grants, Construction and Regeneration Act 1996 in relation to grants to fund renovation and minor repairs. In place of the grant provisions of the 1996 Act, the Regulatory Reform Order on Housing Renewal gave local authorities flexible powers to make grants and to make, or facilitate the making of, loans to fund renovations and repairs. Each local authority was required to prepare a strategy setting out the needs of their own area, and how they proposed to use their new powers to meet these identified needs.

Many local authorities have prepared strategies that include the introduction of loans to owner-occupiers to finance major repairs. Some have signalled continuing work to bring forward loan schemes in the second or subsequent years of their strategy, others are looking to introduce them within the current year. In most cases ‘off the shelf’ arrangements are being entered into with intermediaries, such as the Home Improvement Trust. Others are seeking to establish arrangements that will re-produce the pattern established by the Aston Re-Investment Trust, generally on the basis of a local consortium of local authorities. The target set for this shift in the funding of major repairs is that 50% of renovation should, in future, be funded by loans. Whilst many local authorities now have within their statements of strategy the aspiration to move in that direction, practical steps to deliver may still be some way off.

The financial services industry – equity release is an untapped market
At present, equity release products are offered by a relatively limited number of providers. Currently, Norwich Union and Northern Rock are believed to have about 80% of the market, although some sales are through smaller building societies selling Norwich Union products. It is still perceived to be a niche market, and the apparent reluctance of the general public to buy means that potential new entrants to the market are less enthused. Set against this is the recent entry of new providers: membership of the trade organisation SHIP (Safe Home Income Plans) has grown by 50% in a year.

An awareness of past adverse publicity for providers when things have turned out badly means that new entrants will be likely to stick to a limited range of products already on offer. This strategy gives the reassurance of knowing others are already in the market, and if things go wrong the consequences for commercial reputation will be widely shared, rather than being visited upon them alone.

Quite apart from inhibitions that may arise from public reluctance to buy, or past adverse publicity, there are also technical difficulties for lenders in this market. Roll-up mortgages present a problem, as nothing comes in through the period of the loan and there is no set term. In conventional mortgages, money comes back quite quickly as people move, pay off their loan and start again. These loans cannot be readily securitised, as other mortgage lending can be, they therefore remain on the balance sheet of the lending organisation.

Some potential new entrants to the market are believed to be awaiting the regulation of mortgage-based products, which will come into force in the autumn of 2004, believing that the public will have greater confidence in products formally regulated by the Financial Services Agency (FSA). Mortgage-based products are already covered by the Council for Mortgage Lenders Mortgage Code, but FSA regulation is believed by some to offer the public greater perceived reassurance.

Nevertheless, at a time when the rest of the market is seen to be static, the possibility of growth in this area is seen by some to be attractive. Although figures for the total value of products being sold are difficult to establish, it does appear that sales of mortgage-based products are growing rapidly. The sheer level of unmortgaged equity among older homeowners is held out to providers as virgin territory for business development. In Professor Philip Leather's report for the Council of Mortgage Lenders he estimated the potential market for these products at around £46bn. Along with this comes some evidence that attitudes to inheritance among those people in early old age, and those now approaching old age, are changing. Among these cohorts of older people there may be greater willingness to draw on their accumulated equity.

Consumer requirements

Many already working in this area of financial services recognise that consumer confidence in equity release products is low, and older people are generally suspicious both of the products and of the organisations promoting them. Yet they report there are high levels of customer satisfaction from existing customers. Whatever the aspirations of government policy in this area, the actual reasons for people drawing on their equity rarely seem to be connected to their long-term care needs or the repair of their home. Many current schemes are written to fund lifestyle. People aspire to maintain the standard of living they enjoyed before they retired. Even modest inflation erodes what a fixed pension provides.

A significant proportion of those taking out equity release products want to re-establish their standard of living, financing a holiday, a new caravan, or a new car. Others have non-specific intentions, such as providing 'a bit of an emergency fund'. Some wish to redeem their existing mortgage and reduce their monthly outgoings, or to consolidate other debts. At the more affluent end of the scale some people may be using equity release as a way of managing eventual inheritance tax liabilities.

Some needs arise where a husband dies and the wife has no income other than state pension. One intermediary reports that around 50% of sales are to women. Long-term care is a minority use for the money, although home repairs and improvements account for a significant proportion of cases. In many cases these will be linked to the future management of property maintenance, such as replacement windows and doors, and UPVC gutters and soffits.

Equity release products

For those who do wish to draw on the equity in their property, there is a range of products that will allow them to do so. All have conditions attached, and the choice of the appropriate product may as often be a matter of 'comfort' for the borrower, as fitness for purpose judged by financial criteria alone. Some may be more comfortable with the security of knowing how much they will owe at the conclusion of the loan, others will prefer the comfort of knowing they are minimising the cost of borrowing.

Equity release mechanisms (ERMs) are financial schemes – normally mortgage or reversion based – that enable a householder to draw-down some of the equity in the house. The amount drawn-down is repaid when the houseowner dies or moves out of the house. Repayment can be deferred until the death of the plan-holder or a surviving spouse, or the point at which they dispose of the property. In some schemes, interest is paid each year, but in others interest (or equivalent capital appreciation) is rolled up and paid when the capital is repaid. With most ERMs, the scheme can be transferred to another house if the owner moves.

Re-mortgaging with regular repayment of capital and interest

This is the product with which most homeowners will be familiar, as many will have originally acquired their property with such a mortgage. Standard mortgage conditions apply, the term will commonly be between five and 20 years, with interest at a variable rate. For those who have a reasonable level of income but want to release a lump sum to finance repairs or improvements, or a major purchase, this may be an appropriate method. Advances will generally be up to 30 per cent of the value of the property. The advantages are that it is familiar and 'main-stream', which will commend it to some borrowers.

Interest-only loans

This is the simplest method for those whose income may be too limited to service a repayment mortgage. No repayments of capital are made by the borrower until their death, when the capital sum is settled through the estate, or unless they sell the house against which the loan is secured. Interest-only mortgages are more affordable for older people than a normal repayment loan, but they may still be too expensive for many on low incomes. Those in receipt of benefits in addition to their state pension may be able to secure assistance with interest payments for loans taken out for qualifying purposes, such as to fund repairs.

Home income plans

The most common form of home income plan involves a secured loan that is used to purchase a lifetime annuity, which provides a fixed payment at regular intervals until death. The amount of the payments will depend upon life expectancy when the plan is taken out and the rates of return available on annuities at the time of purchase. The income from the annuity is intended to make the payments of interest, and provide a surplus that is available for any purpose the plan-holder chooses. Home income plans are restricted to people over 70, as only in these cases do the actuarial calculations provide a sufficient return to meet the interest payments and provide a surplus. Poor rates of return have made it difficult for new entrants to secure a return that does more than service the interest payments.

The plans came into disrepute in the late 1980s, when some used alternative mechanisms to invest the funds raised via the loan in order to secure a higher return than an annuity purchase could provide. As is generally the case, higher returns carried higher risks and in adverse conditions some schemes were unable to generate sufficient income to meet interest payments, still less to provide a surplus. Some plan holders were left with unsupportable and mounting debts, leading them into negative equity and, in some extreme cases, re-possession of their property.

Reverse mortgages or interest roll-up

These are mortgages on which neither capital or interest is repaid during the life of the loan, but interest is added to the capital sum outstanding. The major drawback to this product is that the amount owed can rise very quickly, with the total outstanding doubling in around eight years. This product is generally considered only to be appropriate for those over 75 years of age. In the late 1980s a fall in house values and rise in interest rates led to some borrowers finding themselves in negative equity. For some, this resulted in re-possession of their property. Most lenders currently offering this type of product offer a ‘no negative equity’ guarantee, so that even if the balance of capital and rolled-up interest exceeds the value of the house it will not be repossessed. The amount to be repaid from the borrower’s estate or on their sale of the property will not exceed its current market value. If the value of the property exceeds the amount of capital and interest to be repaid, the balance belongs to the borrower or their estate.

Shared equity and shared appreciation mortgages

These products provide for loans at nil interest or interest below the market rate. The margin of interest that the lender foregoes is met by the assignment of a share of future equity appreciation. Rather than a share in the whole property, the investor receives a share, if any, of the increase in property value during the life of the loan, plus the sum originally advanced. Whilst the product, when first offered, was popular with borrowers, it is less attractive to the money markets as the lending cannot be readily securitised and, for this reason, is not currently being offered. Some advisors would warn borrowers against this product, as in a time of high increase in property values the return achieved by the lender will exceed what might otherwise be regarded as a reasonable rate of interest.

Home reversion

This is not a mortgage, but a sale with conditions. The older homeowner sells all or part of their property to an investor, but retains the right to continue living in the property for their lifetime. The price at which the purchase is made represents a discount on the full market value to reflect that continuing right of occupancy. The level of the discount will depend upon the age and life expectancy of the homeowner. There is a degree of 'wager' involved for the homeowner. If they die soon after entering the arrangement they may, in effect, have sold their house at a substantial discount for a limited benefit.

What inhibits development?

The feeling in some quarters is still strong about the unresolved cases of those who bought equity release products in the late 1980s and subsequently found themselves with insupportable debts. There are still around 200 cases from the1980s where people owe more than the property value. The Consumers' Association, in particular, has continued to pursue the matter and to highlight difficult cases. More widely, the 'folk memory' of these difficulties is ingrained and refreshed by occasional media attention to individual cases. In a Parliamentary Debate on 14th January, 2003, a number of Members of Parliament drew attention to the circumstances of constituents caught in this situation, and called for lenders to act to resolve outstanding cases with sensitivity and generosity.

The refusal of some lenders to freeze interest on old agreements – products that they would not now wish to promote – is seen by some as particularly reprehensible. One respondent in this review expressed a widely held view:

"It seems wrong for some lenders to be going out to lend again when they are still adding interest on mis-sold products from last time."

Whilst characterising the situation as 'mis-selling' may not be strictly accurate, it does represent a view that comes to prominence whenever one of these cases receives media attention.

The regulation of mortgage-based equity release products by the FSA from autumn 2004 provides an opportunity for a new baseline in building consumer confidence. This will inevitably be compromised if critics are still able to point to unresolved cases and continuing hardship. The industry must surely consider whether a gesture to draw a line under these difficult cases would not be a worthwhile investment.

Much more difficult to overcome is the resistance that arises from the perception that consumers are offered a deal in which the outcome is uncertain. It may be the feeling that an early death will mean that a reversion contract has surrendered the value of the property at a significant discount with little continuing occupation in return, or that longevity may make the accumulated interest on a rolled-up interest mortgage astronomic. (At current interest rates a debt will double in ten years.) There may have been a reasonable ratio between equity surrendered and money received at the point of purchase, but steep equity appreciation will make it look less attractive. Intermediaries report that there are a tremendous number of enquiries that do not proceed, and the most common reason would appear to be that many feel it is not value for money.

There is a general recognition that the current thresholds in relation to the minimum value of the property and the minimum amount to be borrowed are too high in relation to the circumstances and financial needs of many older people. The minimum property value of £50,000 excludes many older homeowners, especially in the north of the country. The minimum amount to be borrowed of £15,000 is much greater than the cost of most projects that older people might be looking to finance. Some form of reverse mortgage with flexible draw-down has been advocated in many quarters, but the returns are unlikely to attract commercial providers. All the costs attached to this form of borrowing, from fees to interest rates, are seen to be high compared with other forms of mortgage-based borrowing.

Ironically, it is those who are 80 years of age or more who would get best return from equity release products, but they are also the most resistant to the idea. The following cohort seem to be more receptive but do not yet stand to see a good return.

For providers there are a number of inhibitions:

- There is the risk of damage to reputation by association with past, and possible future, difficulties with these products.
- With some products the administrative costs are high in relation to the returns. The average size of the loan for home improvements is likely to be around £10,000 (the normal range is around £3,000 – £25,000 though there are a few loans larger than this). A commercial lender would not find these small loans commercially viable, unless a third party undertakes all the administration and just presents the commercial lender with completed applications. The cost of arranging the loan is high for the average size of the loan and the margins, if any, are small. Only ‘not for profit’ organisations or charities are likely to want to become involved. Unless the cost of setting up a loan can be reduced to about £500–£600 per case, the scheme will not appear to give good value for money.
- With most products, there will be a considerable period before the loan starts to come back and any profit is realisable. Related to this delay, there will be difficulty in carrying the charge in the lender’s accounts. This form of lending does not provide a ready opportunity to ‘sell it on’ through consolidation and securitization.

Consumer protection

The FSA

The regulation of equity release products based upon any form of mortgage by the FSA will start on the 31st October 2004. Those organisations that are engaged in mortgage lending, mortgage administration, advising on mortgages, and arranging mortgages will need to be authorised by the FSA. This authorisation will involve a registration process. Registration will be dependent upon that organisation demonstrating appropriate levels of professional competence and compliance with the mortgage regulations.

The FSA concluded that equity release products carry more risk than other forms of mortgage, because it is much harder to start again if it goes wrong and special issues arise, for example, the impact of releasing equity on benefits, tax issues and so on. Early repayment charges are pretty substantial in relation to these products, so it is important for consumers to be properly informed.
There are six regulated activities that relate to mortgages and require authorisation or exemption if they are carried out in the UK. They are:

- Arranging (bringing about) regulated mortgage contracts
- Making arrangements with a view to regulated mortgage contracts
- Advising on regulated mortgage contracts
- Entering into regulated mortgage contracts as a lender
- Administering a regulated mortgage contract
- Agreeing to carry on any of the above.

There are a number of tests, the key one being the ‘business test’ to ascertain whether a business or person requires registration with the FSA, or whether they are exempt from registration. A person will only need authorisation or exemption if they are carrying out a regulated activity ‘by way of a business’, that is:

“(the person) arranges or advises on regulated mortgage contracts, or does both, on a regular basis and receives payment of some kind (whether in cash or kind and whether from the borrower or from some other person)”.

Another key distinction is between advice and information. The FSA takes the position that advice requires an element of opinion on the part of the adviser. In effect, it is a recommendation as to a course of action. Information, on the other hand, involves the neutral statement of facts or figures. In general terms, simply giving information without making any comment or value judgement on its relevance to decisions that the borrower may make is not advice. For example:

- An explanation of the terms and conditions
- A comparison of the features of one mortgage or another
- Leaflets or illustrations that help borrowers decide which type of mortgage to take.

If information is provided in a selective way that might influence the decision of the client, this may be regarded as financial advice. These distinctions are crucial for some actors in scenarios involving older people. For example, does a caseworker in a home improvement agency merely provide information in suggesting that repair work might be funded through drawing on equity, or do they move across the line into advice giving by suggesting a particular product as more appropriate?

The FSA will look both for competence and probity in companies and organisations seeking registration, and conformity to a set of procedures designed to ensure that consumers are given the fullest information about the products being offered. The first stage of advice is to judge if *any* lifetime mortgage is appropriate in the financial circumstances of the consumer.

The regulation of mortgage-based products deals with only one part of the market. Reversions are seen to be not a mortgage but the sale of all or part of the property, they cannot therefore be regulated by the FSA within its current range of powers. There is widespread concern that one half of the market will be regulated and the other half not. Government has undertaken, in its Pensions Green Paper, to consult on appropriate arrangements for the regulation of reversions, but there is likely to be a lack of clarity in this area beyond the implementation of regulation for mortgage-based products.

Safe home income plans

The response of some within the industry to the difficulties that arose with equity release products in the late 1980s was the creation of ‘SHIP’. Safe Home Income Plans (SHIP) is a company supported by the leading providers of home income and equity release plans. It was launched in 1991, and set out to protect planholders and to promote safe home income and equity release plans. All SHIP plans carry a ‘no negative equity’ guarantee.

All participating companies are pledged to observe the SHIP Code of Practice, which binds these companies to provide a fair, easy-to-understand and full presentation of their plans. All costs that the applicant has to bear in setting up the plan, the position on moving, the tax situation and the effect of changes in house values must be clearly set out.

The client's legal work will always be performed by the solicitor of their choice. In all cases, prior to the completion of the plan, the solicitor will be provided with full details of the benefits that the client will receive. The solicitor will be required to sign a certificate to the effect that the scheme has been explained to the client. The SHIP certificate will clearly state the main cost to the householder's assets and estate, for example how the loan amount will change, or whether part or all of the property is being sold.

The Consumers' Association

In addition to concerns about those experiencing difficulties through past sales of equity-based products, the Consumers' Association has provided assessments of the products currently on offer. Its most recent report, published in the August 2003 edition of Which? magazine, maintains the organisation's sceptical stance in relation to equity release products. They believe that substantial risks for consumers still remain, and ask if the risk is equitably shared between consumer and lender. They point to the high return available to lenders through some products in circumstances of early death after taking out a scheme, or windfall profit (equating to very high effective rates of interest) in a steeply rising market.

The Consumers' Association calls for the resolution of outstanding past cases of hardship, the regulation of both mortgage-based and reversion schemes, and the fullest information for consumers. In advice-giving, it would clearly wish to see a presumption in most cases against the assumption that any equity release product will be appropriate if there are alternative sources of funding to meet the needs of the consumer.

Help the Aged, and Age Concern England

Help the Aged

Help the Aged professes itself to be wary of offering financial services and currently limits its activity in this area to the through-selling of some basic insurance products. They see themselves as neither providers or agents of equity release products. On the other hand, they do see the need for more equity release products to be brought to market, and want to participate in consumer protection and the improvement of the quality of products.

Age Concern England

Age Concern regards equity release as a useful option for older homeowners, and believes that the development of safe equity release products should be encouraged. On regulation, Age Concern would wish to see the FSA regulating all equity release products, including Home Reversion Schemes.

Age Concern believes that there is a role for government and local authorities to ensure the provision of safer equity release products and to offer non-commercial products, including low interests loans, to make it easier for older people to release equity.

ACE has a flourishing commercial arm that already offers a wide range of financial and insurance products to older people. They rely on the credibility of their ‘brand’ to reassure older consumers as to the security and appropriateness of their products. Whilst it would be feasible for the organisation to offer equity release products, it is likely that they would wish to match those products more closely to the needs of older people. Thus, they might wish to offer their products to those owning lower value properties, to offer the possibility of smaller advances, and all within a fee structure that offered manifest value for money. If ACE were to enter the market and put the power of its brand behind these products, it might be expected to have a substantial impact on public perceptions of equity release and the overall level of take-up in the market.

Delivery issues

Aston Reinvestment Trust (ART)

ART Homes Ltd is a ‘not for profit’ company limited by guarantee, established in June 2000. The company is a wholly owned subsidiary of Aston Reinvestment Trust, the first Community Development Finance Initiative established in the UK. ART Homes has set out to provide loans for improvement and repair to homeowners who cannot access commercial loans at affordable rates. It has set up a revolving loan fund with a £250,000 grant from Birmingham Council, and over £1m low-rate private finance from two commercial lenders. Birmingham has also provided a £50,000 mortgage guarantee fund to help attract private sector lenders. Revenue support funding has also been provided by Birmingham Council, Nationwide Building Society and the Housing Corporation.

Initially, ART will offer secured repayment loans at 1.5 per cent over base rate, but is looking to develop a range of products, including small unsecured loans, finance culturally acceptable to Muslims, and equity-share products. The premise behind ART Homes is that small loans to low-income homeowners are uneconomic in nature, and can only be delivered with a partnership between the public and private sectors.

ART Homes aims to lever-in private finance to provide the majority of capital for its revolving loan funds, at a ratio of £1 public to between £4 and £6 from the private sector, for normal interest-bearing lending. The uneconomic cost of this lending is then covered by revenue support from both the public and private sectors.

The ART Homes Ltd product is best explained by an example:

- If a £5,000 loan is required on a £50,000 property, then ART Homes secures a loan by taking a charge against 10 per cent of the value of the home.
- When the repayment of the loan is triggered, 10 per cent of the new value of the property is repaid.
- If the property is sold for £60,000 then 10 per cent of the value is repaid, i.e. £6,000.
- The repayment of the loan is triggered by either a sale of the property, the transfer of ownership of the home, or by the homeowner deciding to repay the loan.
- The homeowner still retains 100 per cent ownership of the property, as the loan is secured as an equitable charge against value. A fine distinction, but one that seems to find favour with potential borrowers.

Home Improvement Agencies

HIAs have played an increasing central role in the delivery of Government policy in relation to the housing circumstances of older homeowners. For many agencies, the cornerstone of their operations has been the provision of support to those seeking renovation grants to fund repairs and improvements to their homes. They have also played an important part in the delivery of adaptations for disabled people. As policy has developed at the interface of health, housing and social care, the agencies have operated flexible services to make small but vital interventions in relation to safety in the home, the prevention of falls, small repairs, and minor adaptations. Major changes in the arrangements through which local authorities encourage repair and renovation in private sector housing were introduced through the Regulatory Reform Order on Housing Renewal 2002. As discussed above, the Order and subsequent Guidance has encouraged local authorities to see equity-based borrowing as an alternative to grants as a means of funding repairs and renovations. In the delivery of these mechanisms to older homeowners, HIAs are seen to have a crucial role to play.

The fulfilment of this aspiration is not without problems. Although prior to 1990 agencies were accustomed to seeking equity-based borrowing, to top-up the funding available through grants, most have developed in a period of almost total dependence on grant funding. By culture and experience, most existing HIAs will find the disciplines involved in providing equity release products extremely challenging.

Government has provided funding to encourage some re-configuration in the HIA movement in England, and this is likely to lead to the creation of larger agencies serving an extended area. For the moment, many agencies are small, with three or four staff. In these circumstances it is difficult to see how they would be able to meet the requirements of the FSA in relation to the giving of financial advice.

Whether it is sensible for HIAs to become involved in giving financial advice, and all that this entails, is being questioned by, among others, Foundations, the national co-ordinating body for HIAs in England. It may be the case that some of the larger agencies will take it up, but many will not wish to do so. Those who do not gear up to give financial advice may face difficulties in observing the boundary between this and the other types of advice and support they will be providing to their clients. They may be better stepping out of the loop at that point, and stepping back in again to help with filling in forms once the client has made a decision.

Foundations believe that the best way it can help HIAs is to facilitate their clients' access to independent financial advice. Foundations are talking to bodies that have networks of financial advisers, or links to networks of financial advisers. Their intention is to see if they can work together, for the financial advisers to be adequately trained and informed about HIA client groups, and then to be the contact point for an HIA whose client wants to explore options.

Care & Repair Cymru

In 2001, the National Assembly for Wales made funding available to Care & Repair Cymru and three local Care & Repair agencies (Gwynedd, Swansea and Vale of Glamorgan) to attempt to pilot workable equity release products for older owner-occupiers on low incomes.

Each pilot group was required to develop different singular products. The groups were also required to examine products that would be suitable for those on low incomes, and whicht were considered to be marketable and give value for money. The pilot projects can only be said to have secured some limited success. In large part this was due to the ongoing difficulties presented by the financial and regulatory frameworks within which they were required to operate. Nevertheless, there has been willingness by all of the partners within the groups to think flexibly and innovatively.

In order to widen the debate, and generate further renewed interest in equity release issues within private sector renewal, Care & Repair hosted a seminar on the subject in March 2003. The seminar demonstrated that there is considerable interest among Welsh Local Authorities in the subject, particularly within the context of the revision of renewal policies under the Regulatory Reform Order on Housing Renewal.

In recent years, some research has addressed the issue of equity release for older homeowners. None of this has been specifically directed at the Welsh market. Although many of the issues are similar to those in other parts of the country, there are dimensions that will have a particular Welsh context. Accordingly, Care & Repair Cymru has recommended that the National Assembly for Wales funds research in Wales directed at the identification of demand for equity release.

The National Assembly for Wales is taking steps in connection with exploring the formation of a national intermediary body, through which to funnel bulk-lending facilities for onward lending of smaller amounts. Care & Repair Cymru is actively involved in this, and regards the proposal as a positive step in securing cost-effective borrowings for older people.

House Proud/Home Improvement Trust

The Home Improvement Trust (HIT) is a ‘not-for-profit’ organisation based in Nottingham, operating nationally. It works with lenders, local authorities, and HIAs to offer a range of equity release products to older homeowners, to fund improvements and repairs carried out through HIAs.

HIT was originally established with funding from Age Concern England, and the then Department of Environment, Transport and the Regions. The organisation has a well-established record of trying to bring together the various players needed to create a robust supply chain for the delivery of equity-based borrowing, to finance repairs to the houses of older owner-occupiers. The Trust is now providing secured loans on a repayment, interest-only and rolled-up interest basis, mainly through Dudley Building Society.

Through its House Proud scheme, first developed with Birmingham City Council and now offered throughout the UK, HIT has entered into partnership with a number of local authorities. The requirement for local authorities in England, within their strategies that respond to the flexibility bestowed on them by the Regulatory Reform Order on Housing Renewal 2002, to consider equity-based loans as an alternative to grants has driven a steep increase in interest in House Proud. Membership, or the stated intention of membership, has allowed a local authority to show that they are moving in the direction of offering loans with relatively little effort on their part. This surge of interest, not necessarily immediately followed by resources in the form of sign-up fees, represents a challenge to the capacity of HIT. At present, the evidence is that, whilst attracting local authorities to the scheme is an achievement, seeing a high volume of applications for equity release products from older homeowners may be a quite different matter.

Local authorities joining the scheme pay HIT £10,000 per annum for a period of two years towards the running costs of HIT for the service. They also undertake to pay £500 in respect of each loan arranged by HIT, as a contribution towards the costs incurred by the applicants in obtaining a mortgage, which includes legal and valuation fees and other associated costs. HIT will facilitate the provision of information, by way of literature, visual aids, and the training of those involved in administering the scheme. The scheme also provides a confidential Freephone Call Centre and Helpline facility for Applicants and their families.

HIT will arrange for the provision of the services of an independent financial adviser, to provide written advice, free of charge, on the options that may be appropriate, based on the individual circumstances of the applicants. Discounted valuation and legal fees are available to HIA clients seeking loans through HIT. All loans offered have a guarantee of no repossession.

HIT will arrange for the necessary legal services to secure a mortgage, through solicitors appointed by HIT and the loan providers at specially negotiated rates. This will include all local authority and Land Registry searches, registering charges and arranging payments to contractors as appropriate. A valuation service, undertaken by the Valuation Office, is provided at specially negotiated rates.

In addition to its financial contribution, the local authority undertakes to ensure that details of applicants who appear to have sufficient equity in their properties and require loans to finance service charges and/or necessary repairs, improvements and/or adaptations are provided to HIT. The local authority also accepts responsibilities in relation to the work to be undertaken with the finance raised, although these responsibilities will generally be discharged through their local HIA. They will ensure that applicants are advised in respect of the works that appears to be required to their properties. They will recommend good quality builders, and see that the repair, improvements and/or adaptations are inspected to ensure satisfactory completion, which will allow payments to be made to contractors. These inspections will generally operate in accordance with procedures that would have been used in relation to grants.

Appendix 2

Can equity release mechanisms fund long-term care costs?

Desmond Le Grys
CCC – Seminar for members
20 June 2002

Introduction

1.1 Scope

This paper attempts to explain why equity release products have rarely been used, up to now, to solve the problem of funding long-term care for the elderly. A significant influence is elderly people's reluctance to use the equity in their home.

1.2 Equity Release Mechanisms (ERMs)

The majority of people in the UK save over their working lifetime to buy a house and pay off the mortgage. Seventy per cent of people over 65 live in owner-occupied accommodation, largely free of mortgage. Over the years, they have made considerable amounts of capital appreciation, as house prices have steadily increased with only a few downturns in value. However, although they are asset-rich, their wealth is tied up in the house.

Equity release mechanisms (ERMs) are financial schemes, normally mortgage or reversion based, which enable a householder to draw-down some of the equity in the house. Essentially, there are two types of ERMs:

1 Mortgage-based product – the customer borrows a lump sum from the product provider under a mortgage. On most contracts, the borrower does not pay interest on the loan, but the loan increases by the amount of interest. When

the customer dies or moves house, the outstanding loan with the rolled-up interest is repaid.

If the customer lives to extreme old age, then the rolled-up loan could exceed the eventual sale value of the house, and most modern ERMs have a ‘no negative equity’ guarantee. The customer or spouse can stay in the house until the eventual death of the survivor, and the repayment to the provider is limited to the sale value of the house – the provider has no recourse to any other assets in the customer’s estate, nor would beneficiaries be expected to meet the short-fall. The amount that can be borrowed initially is normally restricted to a low percentage of the house value.

2 Reversion product – the customer effectively sells a share of his house for an immediate lump sum - e.g. a customer sells 50% of his house worth £100,000 and receives a lump sum of £20,000 now. No interest or rent is paid but when the customer dies or moves house the reversion provider receives 50% of the house-sale proceeds. The amount of the immediate lump sum depends on the provider’s view on how house prices will move over the long-term future, market rates of interest and longevity trends. Reversion products are only taken by people who think they will live a long time.

With most ERMs, the scheme can be transferred to another house if the owner moves. A full description of the various types of ERMs is shown in the Age Concern fact sheet 12 – ‘Raising Income or Capital from your Home’.

1.3 Use of ERMs

The planholder of an ERM can either take a capital sum or an income from the plan. The majority use the ERM to provide extra income in retirement, or lump sums to fund urgent repairs or maintenance to the house. Alternatively, they can use the money for leisure, or to pay for long-term care or the cost of medical treatment. ERMs are of no use to people who do not own a house.

1.4 Customer concerns

The majority of older people are reluctant to use the value of the house to provide capital or income. Consumer confidence in ERMs is low, and older people are generally suspicious of the products and of the organisations promoting them. Yet there are high levels of customer satisfaction from existing planholders. The legislation covering ERM products and the way that they are sold is very patchy – some schemes are totally unregulated. Comprehensive regulation would improve customer confidence. Some potential providers hold back from issuing ERMs until regulation is in place.

However, there is some evidence that peoples' attitude to ERMs is changing and some ERM providers are recording good growth in business.

Government response to the Royal Commission

2.1 Royal Commission's recommendations

The announcement in 1997 that the incoming Labour Government was to set up a Royal Commission on funding long-term care was widely welcomed. The Royal Commission has reported and made significant recommendations on how the current system could be improved.

The government rejected the main recommendation of the Royal Commission on free personal care, but adopted most of the Royal Commission’s other recommendations. Free personal care was rejected because of the uncertainty of future cost, especially if the balance between formal care – currently 30 per cent, and mainly paid by the state, and informal care, perhaps 70 per cent of the total – was disturbed, or if the pattern changed over the future. The Government did, however, agree to cover the cost of all nursing care, whether this is delivered at home, or in hospital or nursing home. In addition, the government introduced the concept of ‘Intermediate Care’, which covers both prevention and rehabilitation after a stay in hospital. The means-testing limit was raised to £18,500, and a three-month disregard was introduced before people are obliged to pay for care costs in a nursing home.

2.2 Loans (deferred payments)

Local authorities are now empowered to give loans when a person enters a nursing home, to help cover care costs other than nursing care. They already had the power, but no money to make the loans. Under Government proposals, local authorities will have a delegated budget from central government to operate the loan schemes. How effectively local authorities will operate the scheme, and whether budgets will be sufficient (£85 million over a three-year period) is difficult to forecast. Under the loan scheme (deferred payments), people would not be forced to sell the home to pay care costs.

Attitudes to equity release

3.1 Paying for long-term care

Previously, long-term care was often financed through the sale of the home. A single elderly householder without substantial income going into a nursing home would be requested to sell the house and pay care costs out of the proceeds. The run-down of the person's assets would continue until the £18,500 limit is reached. Very few people have substantial income to cover nursing home fees, and many would pay out of income and using the house value.

3.2 Unfair

This arrangement is considered unfair by the majority of the population and their children/inheritors. To most people, outright ownership of the house is a major achievement. It represents the end result of significant saving over a long period of years. Ownership provides a sense of independence and security. People will not lightly compromise this satisfaction and they have an emotional attachment to the home.

3.3 Survey result

People are very averse to using the house for care costs. In response to the question in a Millennium Debate of the Age survey, ‘Older people should be allowed to leave any savings they have including their house to their children rather than using it to pay for care to look after themselves’; roughly 75 per cent of men and 67 per cent of women agree with the question, less than 20 per cent disagreed.

Operational difficulties

4.1 Co-operation

These deferred payment schemes will be difficult for local authorities to operate. It is not part of their culture to grant loan facilities to elderly and infirm people with an uncertain life expectation. They will be required to give good advice, and will have to contend with potential inheritors who see their inheritance dwindling away. In effect local authorities will be operating equity release schemes.

This may present an opportunity for the private and public sectors to co-operate. The private sector could provide third-party administrative support, give advice, and advise on viable solutions. The private sector could also provide the funding for the scheme, as the delegated budgets sanctioned by Government appear low.

4.2 Co-operation – an example

This type of co-operation is evolving with the funding of repairs, maintenance and improvement to houses of elderly homeowners. Grants from local authorities are strictly rationed, and homeowners are expected to fund the costs through loans or equity release scheme. This is part of the Government's policy on Private Sector Housing Renewal.

An example of this co-operation is Birmingham City Council's ‘Houseproud’ Scheme. The local authority advertises and endorses the scheme, a non-profit organisation undertakes the administration and gives the necessary advice, and a building society grants the loans. The type of scheme could be replicated for loans to cover personal care and accommodation costs in a nursing home.

4.3 Domiciliary care

The deferred payment concept could be expanded significantly to cover domiciliary care costs. At present, domiciliary care provided by the local authority is hard to obtain and does not often cover peoples' expectations. However, many people are living in houses of considerable worth but do not have free assets or income to cover a reasonable amount of domiciliary care. Equity release of some kind could provide the necessary funding and could also reduce the strain on local authorities’ resources.

4.4 Enhanced annuities

One drawback of the deferred payment approach is that the ultimate amount of loan is uncertain. It depends on how long the person will live. The uncertainty can be overcome by the use of an ERM to release funds that can be used for a single premium for an ‘enhanced annuity’ from an insurance office. The enhanced annuity provides, at a fixed cost, an income to pay care costs. (Several commercial providers already offer such schemes.)

The terms of the enhanced annuity take into account that likely reduced longevity of the person in care, and the insurance office takes into account the person’s age, gender, and state of health.

With enhanced annuity products, (also called immediate needs insurance) the longevity risk is borne by the insurance company. With the loan type arrangement from a local authority or elsewhere, the borrower has the risk he/she will survive longer than expected and, consequently, the cost of care steadily runs down asset values. The use of immediate needs' annuities to cover long-term care has been increasing, but only a handful of offices issue these contracts. It had the advantage of postponing any decision of funding long-term care until it was clear that care was required.
The enhanced annuity can be tax free if it is paid direct to a recognised care provider or nursing home.

4.5 Value for money

Up to now, these schemes have been sold generally via an independent financial adviser (IFA) who not only has to ensure that the customer is claiming all the relevant State benefits, but also that the client is receiving good value for money. If local authorities are to promote these schemes they will be obliged to give similar levels of advice.

The good value for money aspect is hard to judge – insurance offices have limited experience of this class of business and few statistics to guide them. The IFA would generally ask a panel of offices to quote terms for each case, and the insurance offices would, in turn, ask a panel of competing reinsurance offices to quote terms. The customer probably gets the best terms in the market, but in time the terms may be seen to be very conservative, or far too liberal.

4.6 Possible change in attitude

It is not clear at this stage what impact the government proposals will have on equity release or on long-term care insurance. It may have a detrimental effect, to the extent that people who are homeowners may now think there is no need for ERMs to cover care costs. On the other hand, if government promotes its own version, via local authorities, of an ERM scheme, it could bring much-wanted public confidence to the whole ERM market and to the private sector. Private providers will see an attraction in co-operating with local authorities to provide for care costs, since local authorities will be in touch with a large sector of the public that private providers have difficulty reaching through their present distribution systems. Furthermore, the loans would be attractive to private providers, since the loans would be relatively large (compared to loans for house repairs).

Prefunded long-term care plans

5.1 Typical plan

Another type of long-term care insurance is a prefunded insurance plan (also known as a Future Care plan). This policy is taken out at relatively young ages – 65 to 75 years old – by people in reasonably good health. The benefits are paid if a person cannot perform a number of defined activities of daily living (ADLs), such as washing, dressing, toileting, eating, or mobility. The qualifying conditions vary from office to office: again, only a limited number of offices issue this policy. A typical plan would give a low level of benefit if the client cannot undertake two ADLs, and a higher rate if the client cannot undertake three or more of the defined activities.

These policies can be effected on a single premium, or on a regular premium basis. The benefit is a defined income not an indemnity of care costs. Market pressures and competition dictate that the insurance company has to guarantee the terms on benefit payment at the outset, especially on single premium contracts. The guarantee of terms adds to the cost of an already expensive product. The benefit levels are fixed to around the cost of nursing home fees (less an allowance for the client's ongoing income or pension). The benefits can also be index linked.

It is possible to use an ERM to release cash to pay the single premium cost of a prefunded long-term care product.

5.2 Value for money – prefunded contracts

The use of ERMs to pay the single premium cost of a prefunded long-term care insurance policy has been promoted by some providers, but has not proved popular with the public – two contracts are involved, a mortgage or reversion and an insurance policy. The combination of two profit and safety margins on interest rates, two sets of expenses and commission, and different assumptions on longevity does not lead to an attractive looking overall package to many potential customers, especially if the client is relatively young and just retired. This type of arrangement was rejected by the Royal Commission as a solution to meeting long-term care costs.

It has been evaluated that the cost of the double margins and guarantees take roughly 30 per cent for females and 20 per cent for males of the released value of the house if a person is around retirement age. A significantly better product is required with considerably better 'value for money' before a prefunded contract is a viable way for providing long-term care costs.

6 Conclusion

6.1 Many of the current private equity release plus insurance do not offer good value for the elderly clients. However, more providers are likely to enter the market with different products. This extra competition should improve value for money.

6.2 Private providers have not yet overcome people’s poor perception of equity release, and of releasing the house value. This is a major challenge for them.

6.3 Local authorities are now required to provide loans (deferred payments) and quasi equity release schemes to cover long-term care costs. They may have difficulty adapting to the new culture, and may be unable to cope unless they co-operate with the private sector in some way.

6.4 The combination of equity release and an enhanced annuity can result in a viable solution to cover long-term care costs for a defined capital cost (as opposed to deferred payments), and could give reasonable value for money.
The combination of an ERM and a prefunded contract does not look feasible unless providers introduce products that give better value for money.

6.5 Research and dialogue are required between private providers and local authorities to explore methods of co-operation for using the house to cover the cost of care (other than nursing care) in an institutional or a domiciliary care setting.