Please release me!
A review of the equity release market in the UK, its potential and consumer expectations
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Peter Williams

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Executive Summary

- This review seeks to examine the current state and future direction of the equity release market in the UK. The report is based on a short desk-based exercise.
- The market is generally regarded as having under-performed to date, in relation to the underlying demand, and there is a view that this will not change until the major high street lenders formally enter the market.
- Chapter 2 examines the different estimates of the current market and its growth potential. There is some evidence to suggest the market is now beginning to grow more rapidly but this will need to be revisited in the light of the changing housing market conditions. In addition, and following the Pensions Commission report, it is clear that equity release is, at best, only a partial solution to the pressures being faced by older households.
- A review of Australia, New Zealand and the USA in Chapter 3 suggests that in those countries the market has developed more strongly and there is clear evidence of strong demand from younger households. The US case is interesting because the government has played a key role in developing the market. It is suggested that there is a need for better market data in the UK.
- Chapter 4 examines the different arguments as to why the UK market has developed more slowly than some expected. All are found wanting but it is suggested a more positive stance from government and the involvement of more major players would be significant.
- The concluding chapter puts equity release in the context of the other ways households use their property assets. What this shows is that there is widespread use of housing equity but only part of this is via equity release in the formal product sense. This suggests households are comfortable with using their property and that the equity release market needs to learn from this. The chapter closes with a short consideration of possible solutions including a stronger role from government and a more integrated, coherent and sustained stance from the industry.
Chapter 1

Introduction

2007 will go down as an unusual year for the equity release market in the UK. It was characterised by continued, modest growth in the market (and thus disappointment that the upturn still seemed to be some way off), increased regulation as reversion schemes joined lifetime mortgages in the FSA’s ambit, global market turmoil and a complete about turn in terms of the value of mortgage-based assets (including much reduced expectations about the future of house prices) while at the same time underlying demographics (and pension shortfalls) continue to point strongly towards a strong equity release market sometime in the future.

Chart 1: Value of new business completed by SHIP members, £m

This provides a challenging context for the market going forward. The industry's collective view on equity release is that this market has underperformed against what appear to be strong fundamentals that should drive significant annual growth. The CML itself has offered the view that a number of factors have played their part in this below expectations performance. They include -

- Reputational issues associated with an earlier generation of equity release products, such as home income plans, sold in the 1980s and early 1990s
- Media concerns about value for money considerations and the attractiveness to consumers of products that allow them to borrow against their home equity
Wariness on the part of consumers about equity release as a proposition especially when viewed by older, and typically more cautious, households.

It has led all suppliers to ask whether limited growth is a result of inappropriate products, lack of confidence in lenders and brokers, or something else. It is this uncertainty which has prompted this short research exercise. Given the strength of the underlying fundamentals in terms of the number of potential users, the potential demand for cashing in assets to support poor pensions and high expectations of the actual build up of equity holdings in housing assets, the underperformance of the market remains an important unanswered question, as is evident from these quotes from market analysts, Datamonitor and Mintel.

"Given the attractiveness of the equity release mortgage market, the past few years have seen many industry pundits predicting the entry of major mainstream lenders into the sector. However, such entry has not materialised and the fact remains that the equity release mortgage market is a long way from fulfilling its growth potential. So, why is this niche mortgage sector stagnating? What are the factors that are delaying the market from taking off? What will be the size of the equity release mortgage market in five years time?"

*Datamonitor 2006*

"Equity release schemes continue to occupy a high profile within the financial services industry. High and growing concerns over retirement incomes have highlighted the potential solution offered by equity release schemes to asset-rich/cash-poor pensioners. However, many consumers still regard the industry with tremendous caution following the negative publicity following the sale of risky plans to elderly home-owners in the early 1990s. This is despite the efforts of many within the industry, including the trade body SHIP, to improve the public perception of equity release schemes. Although the prevailing economic and demographic trends, such as growth within the housing market and an ageing population, suggest that equity release schemes are destined to become a core financial product, this long-held prediction has yet to materialise. The equity release market remains a relatively niche sector, with many mainstream high street financial providers reluctant to join the immature market."

*Mintel, 2007*
In seeking to understand why the market has not developed more strongly, the CML has rightly identified consumer expectations and attitudes as a key factor. The CML has asked in particular for a review of issues in relation to the following -

- What does the current body of research tell us about consumers' understanding of lifetime mortgage products, and how these differ from earlier offerings?
- What are the major considerations influencing current attitudes towards lifetime mortgage products and how these might change over time?
- To what extent do the views of children influence the appetite of the elderly for equity release?
- How important are pensions or the regime for inheritance tax in influencing attitudes and behaviour?
- Does a greater awareness of/willingness to consider releasing housing equity by younger households feed through into actual behaviour as they get older?

While the focus is very clearly placed upon a review of current equity release literature, it is important not to neglect the wider context and the analytics associated with that. In particular, we should pay regard to the changing nature of home-ownership and the wider issue of indebtedness.

This report works through a number of issues. In Chapter 2, it examines the overall shape of the current market and views as to prospects for growth. In Chapter 3, it then moves on to consider consumer expectations for equity release and seeks to explore underlying consumer issues. The barriers to the equity market are considered in Chapter 4 before moving on to Chapter 5 where the report draws conclusions and seeks to put equity release in the context of wider use of property equity and asks what might be done to develop this market further.

The context

The broader market context is well known but worth repeating here in summary -

- The UK has an ageing population. The proportion of people aged 65 and over is projected to increase from 16% in 2006 to 22% by 2031. This is an inevitable consequence of the age structure of the population alive today, in particular the ageing of the large numbers of people born after the Second World War and during the 1960s baby boom (ONS, 2007). In-migration may change this picture modestly but the numerical growth will continue.
- By 2031 over 28% of the population of the UK is projected to be aged 60 or over (up from around 21% in 2006). In England and Wales 29.4% of women will be over 60.
Life expectancy at age 65 in the UK has reached its highest level ever for both men and women. Men aged 65 could expect to live a further 16.6 years and women a further 19.4 years if mortality rates remained the same as they were in 2003-05 (ONS, 2006).

The number of people 65 and over was estimated by the Wanless review (Wanless, 2006) to increase by 47% by 2026 (period 2002 to 2026) with the number of persons aged 85 or over to increase by 86% over the same period.

In England, the number of one person households aged 55-64 will rise from 980,000 to 1,768,000 by 2026 (increasing by 36,000 per annum), the 65-74 old group will rise to 1,544,000, up 22,000 per annum and the 75 and over group to 2,372,000, up 32,000 per annum (DCLG, 2007).

The Pensions Commission suggests the number of childless pensioners will double from 10% to 20% in the next 20 years.

According to the Wanless report on care, some 45% of the current retired population of home-owners have inadequate retirement income (Poole, 2006, p 24).

The Deloitte’s wealth survey undertaken in 2002 considered total housing wealth net of mortgages. This showed that the mean housing wealth by age of household rose from £79,000 in the age group 55-64 to £87,000 in age group 65-74 before falling to £66,000 in the 75 plus category.

The 2006 DWP Pensions survey indicates a high awareness of equity release schemes amongst owner-occupiers (90% of those aged 55 or older were aware of them – though lower for those born outside the UK). Of those favourably disposed to using housing to fund their retirement some 22% would consider using equity release.

Overall, the picture this paints is one of rapidly rising numbers of people and households in the 60+ age groups, increasing property-based wealth amongst these groups and shortfalls in incomes/pensions. All this suggests a growing demand for equity release.
Chapter 2

Market scale and market growth

For some years there has been an absence of authoritative figures on the overall market. The main sources of information regarding the current market are SHIP and the CML (and, of course, research undertaken by Mintel and other financial services market research firms). The CML data has covered mortgaged equity release (termed lifetime mortgages by the Financial Services Authority) and the SHIP data both mortgage products and reversion plans issued by its members. Over time as more lenders joined SHIP so their data has strengthened.

The CML (Table 1) reports a steadily growing market for lifetime mortgages. The data suggest fairly steady annual growth which sits somewhat at odds with the picture of underlying growth in demand set out in the introduction.

### Table 1: Lifetime mortgages market summary

<table>
<thead>
<tr>
<th>Period</th>
<th>1 Newly advanced</th>
<th>2 Newly advanced</th>
<th>3 Newly advanced % of total market by value</th>
<th>4 Balances outstanding</th>
<th>5 Balances outstanding</th>
<th>6 Balances outstanding % of total market by value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>H2 13,244</td>
<td>597</td>
<td>0.41</td>
<td>64,127</td>
<td>2,836</td>
<td>0.32</td>
</tr>
<tr>
<td>2004</td>
<td>H1 11,204</td>
<td>517</td>
<td>0.41</td>
<td>71,426</td>
<td>3,298</td>
<td>0.36</td>
</tr>
<tr>
<td></td>
<td>H2 15,066</td>
<td>693</td>
<td>0.43</td>
<td>83,728</td>
<td>3,998</td>
<td>0.41</td>
</tr>
<tr>
<td>2005</td>
<td>H1 10,875</td>
<td>493</td>
<td>0.31</td>
<td>93,850</td>
<td>4,612</td>
<td>0.45</td>
</tr>
<tr>
<td></td>
<td>H2 12,339</td>
<td>556</td>
<td>0.31</td>
<td>105,073</td>
<td>5,307</td>
<td>0.47</td>
</tr>
<tr>
<td>2006</td>
<td>H1 11,130</td>
<td>460</td>
<td>0.25</td>
<td>113,645</td>
<td>5,833</td>
<td>0.54</td>
</tr>
<tr>
<td></td>
<td>H2 12,656</td>
<td>512</td>
<td>0.29</td>
<td>122,087</td>
<td>6,328</td>
<td>0.56</td>
</tr>
<tr>
<td>2007</td>
<td>H1 9,287</td>
<td>406</td>
<td>0.20</td>
<td>126,599</td>
<td>6,717</td>
<td>0.59</td>
</tr>
</tbody>
</table>

Source: CML research

The CML figures do not include reversion schemes. The Safe Home Income Plans organisation produces combined figures covering both lifetime mortgages and reversion products but only for their 20 members (which do not include at least one large provider). The CML secretariat has sought to combine CML/SHIP data to give the most comprehensive estimate available of overall equity release activity, and this is shown in Table 2.
Sales recovered over much of 2007, but a slight dip in the final quarter – attributed by SHIP to the situation surrounding Northern Rock, a major equity release player - meant that for the year as a whole, estimated total sales were roughly 4% higher at £1.26 billion, a very similar rate of growth to that seen the year before.

### Table 2: Equity release new sales: combined CML and SHIP figures, £m

<table>
<thead>
<tr>
<th></th>
<th>Total value of lifetime products</th>
<th>Reversions</th>
<th>Total value of lifetime products and reversion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>1,115</td>
<td>129</td>
<td>1,244</td>
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<tr>
<td>2004</td>
<td>1,226</td>
<td>41</td>
<td>1,267</td>
</tr>
<tr>
<td>2005</td>
<td>1,114</td>
<td>55</td>
<td>1,168</td>
</tr>
<tr>
<td>2006</td>
<td>1,140</td>
<td>74</td>
<td>1,213</td>
</tr>
<tr>
<td>2007†</td>
<td>1,177</td>
<td>83</td>
<td>1,260</td>
</tr>
<tr>
<td><strong>Quarterly</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Q1</td>
<td>263</td>
<td>58</td>
<td>320</td>
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</tr>
<tr>
<td>Q4</td>
<td>288</td>
<td>15</td>
<td>303</td>
</tr>
<tr>
<td>2004</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q1</td>
<td>247</td>
<td>11</td>
<td>259</td>
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<td>272</td>
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</tr>
<tr>
<td>Q4</td>
<td>356</td>
<td>12</td>
<td>369</td>
</tr>
<tr>
<td>2005</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q1</td>
<td>252</td>
<td>13</td>
<td>266</td>
</tr>
<tr>
<td>Q2</td>
<td>268</td>
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<td>Q3</td>
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<td>14</td>
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</tr>
<tr>
<td>Q3</td>
<td>293</td>
<td>18</td>
<td>311</td>
</tr>
<tr>
<td>Q4</td>
<td>312</td>
<td>23</td>
<td>335</td>
</tr>
<tr>
<td>2007</td>
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<tr>
<td>Q1</td>
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<tr>
<td>Q3</td>
<td>317</td>
<td>22</td>
<td>339</td>
</tr>
<tr>
<td>Q4</td>
<td>280</td>
<td>21</td>
<td>301</td>
</tr>
</tbody>
</table>

Source: CML, SHIP

SHIP/Mintel (Mintel, 2007) estimate total equity release related lending in 2006 to be £1,154 million, of which £1,081 million (94%) was lifetime mortgages and £74 million (6%) reversion schemes. Mintel forecast annual sales of £1,744m by 2012, a 51% increase over 2006 though the annual rate of growth remains quite subdued until 2009/2010. Mintel describes this as steady
growth and some way short of what the Institute of Actuaries had indicated was the market potential from a demographic and economic point of view. Its report published in 2005 (Institute of Actuaries, 2005) suggested the market could double by 2010, though this was subject to major caveats about who was in the market, regulatory developments and changes in consumer behaviour and views.

The IoA figure was also cited in the major review of care for older people published in 2006 (Wanless et al, 2006) and in which equity release featured to a degree. However, the Wanless report is much more sanguine about the potential role of equity release for lower income households. Using data from the English Longitudinal Study of Ageing it notes -

- More than 40% of single people have no housing wealth to release while couples have significantly more housing wealth than single people
- Housing wealth tends to decrease as the number of daily life limiting circumstances increase

In other words, equity release cannot help many of the poorer households. This is a theme that we will return to in this report. It is a sad reality, but it should not in itself then be used to suggest equity release has no value as some studies come close to arguing. Wanless does not do this and the report concludes (2006, p245) "there appears to be scope to increase the use of equity release if the right product and providers are on offer".

In the background paper to the report (Poole, 2006), the equity release market is considered in some detail. Drawing upon Rowlingson (2005) it was noted that the scepticism around equity release tended to erode when asked if schemes were run by not-for-profit and by respected and trusted providers. The report goes on to raise the question about the role for government in equity release and explores US and UK ideas around this. Again, we return to these issues later in the report.

DeFaqto's report (April 2007) notes that the market has underperformed in the sense it has not grown as quickly as the underlying fundamentals would suggest. Citing a SHIP estimate of growth to £1.7bn of new business in 2008 (47% up on 2006), Defaqto reminds us this is still a small percentage of the total mortgage market and as Table 1 shows, on an annual basis, the equity release as a share of total new lending has gone down in recent years. Defaqto puts this down to adviser aversion given previous mis-selling and the absence of some key big name lenders from the equity release market.
Datamonitor in its report from a year earlier (2006) offered three scenarios, their central view (24% growth), an optimistic view (35% growth) and a pessimistic view (8%) regarding growth to 2010. Significantly the SHIP/Mintel figure for SHIP members for 2006 was £1,154 million and this was above Datamonitor’s more pessimistic forecast (£1,057m) but below its central view (£1,214m) and well below its optimistic view (£1,264m).

Although not offering forecasts on growth, it is important not to ignore the regular reviews of the market undertaken by Key Retirement Solutions (KRS), one of the major IFAs offering equity release and with around 30% of market share. KRS provide quarterly reports on the market giving a regional breakdown in the sales of all types of plans (number, value, property value, and amounts released). KRS comments on current trends and in its latest report (January-September 2007) a 9.7% growth in the market is noted.

How then do the various commentaries explain the failure of this market to develop as quickly as the fundamentals would predict? In reality, all the reports reviewed offer a mix of the same ideas but none is entirely convincing and further research is needed to develop these issues.

The view is that a past reputation reinforced by somewhat negative reports from Which? and others have created a situation where neither consumers nor advisers are confident about the product. Though Mintel explore consumer attitudes in some detail it does not really expand on these issues beyond reiterating concerns about the past and the view that equity release schemes were ‘dodgy’.

Datamonitor (2006) explores a number of hypotheses regarding the slow take-up. These include -

- Life insurers and pension providers are better placed to offer equity release schemes because of the actuarial skills involved
- The fact that there is a higher level of risk involved is delaying entry of mainstream lenders
- A lack of qualified distribution personnel is acting as a deterrent
- The fear of mis-selling scandals is keeping mainstream lenders away
- Mainstream lenders are simply waiting for the equity release mortgage market to take off

However, they offer no analytics to suggest which, if any, offer an explanation and of the five hypotheses, three relate to the mainstream lenders. While the absence of HBOS, Nationwide and Abbey might be deemed significant, in reality the market does have Northern Rock, Norwich Union, Prudential and Scottish Widows, all of which are well-established names in the market along with a number of smaller suppliers. For some, Northern Rock’s subsequent difficulties
may call into question its continued participation in this market. Although it recently announced the sale of its existing £2.2 billion portfolio of lifetime business to JPMorgan, it will continue to service the portfolio on behalf of JPMorgan and continue to originate new lifetime loans onto its balance sheet.

In reality, a number of other major lenders are active in the market albeit not in an obvious way (lending to firms who are players, owning retirement home providers and offering products for older people that are not labelled as lifetime). The view that the absence of more major high street lenders is key is certainly strongly held and it is argued this would give greater confidence to potential customers and to brokers.

**The Pensions Commission**

Between 2004 and 2006 the government's Pensions Commission was exploring the long-term requirements for pensions and the ways these might be funded. Equity release and property inheritance featured in their research and reports but was ultimately not seen as having a significant role in terms of those with poor pension provision.

As the appendix to the Second Report (page 118) makes clear, of respondents expecting to rely on non-pension sources, 20% expected their income to be from non-pension state benefits and some expected property to be their main source of income. The Commission's findings from the individual focus groups suggested that people saw it as a "natural" solution to fund their retirement though only a minority had actually invested in property for this purpose. Their survey results found only 5% of respondents expected their main income source to be property.

A significant proportion of people indicated that that they saw equity in their home as an alternative or additional retirement asset. It was noted that this attitude was growing, both among the majority of people who own and occupy one home and among the small but rapidly growing minority involved in buy-to-let activities. As the Commission then comments -

"These attitudes reflect the reality that housing is potentially a far more important source of retirement income than non-pension financial assets for two reasons. First, it is in aggregate much larger, £2,250 billion of net housing equity compared to £1,150 billion of non-pension financial assets. Second, housing equity is much more evenly distributed. While inevitably, higher income people own more valuable houses, and while there are still 26% of people over 40 who do not own their own house, among non-retired 55-59 year olds who do, the net value of housing equity rises slightly less than proportionately with income, ie, middle income people have slightly larger
housing assets, relative to their income, than high income people. Housing equity at middle income levels is, as a result, significant in relation to the pension adequacy. People with income of about £21,000 have on average about £96,000 of net housing equity by the time they are 55-59 years old. If this were all available to fund retirement, it could give an inflation indexed pension of around £4,800, making a significant contribution towards the benchmark replacement income of £14,000, when combined with approximately £4,100 of BSP”.

At best around 40% of this value might be usable, but it does show that the Commission did recognise the potential of housing equity. They also recognised that the potential importance of housing assets

“… is likely to increase further as the large increase in owner-occupation that occurred during the 1970s and 1980s … works through the age profile of the population. At present, owner-occupation is highest among 45-59 year olds (78%) and then falls to 58% among those age 80 years and older. But it is increasing most rapidly among the older age groups. ”

The Commission goes on to examine the nature of housing assets and their use. Having noted that the purchase and sale of houses could perform exactly the same role as funded savings via equities and bonds and lead to a resource transfer between generations with housing assets accumulated by one generation and sold on to the next generation, providing the resources to finance consumption during retirement, the Commission then made much of what it saw as the risks in this process. In summary, it identified two areas of concern (the detailed argument is in Appendix 1) -

- Housing assets deliver one specific category of consumption, while the business assets which lie behind a diversified portfolio of bonds and equities support the delivery of the full range of all other categories of consumption. The view was that despite housing’s recent performance there was an additional exposure to risk regarding market cycles and regional housing market performance
- The second distinctive feature of housing is that buying and then keeping a house, rather than liquidating it during retirement, provides protection against uncertainty over the future cost of housing. As the Commission goes on, the implication of this is that if housing is to play a role in providing retirement income, it needs to do so in ways which do not require pensioners to give up their right to rent-free living, that is their hedge against volatility in house prices and rents.
The Commission is rightly cautious about housing assets and their use and it reaches this cautiously positive conclusion

"… while housing assets, either via equity release techniques or via inheritance, will clearly be an important source of retirement income for some people, they cannot be considered as providing a general and sufficient solution to the problem of deficient pension provision".

This would be widely shared but it does not in itself undermine the case for an expanded equity release market.

**Conclusions**

The various market assessments point towards continued steady growth in this market even though the underlying context would suggest a stronger performance. In one sense this suggests the Pensions Commission is correct to take a fairly sanguine view of the likely significance of equity release as a mass market alternative or part supplement to pensions though we should not ignore the fact that it still thought this was an important market.

However, as we go on to show in the next chapter, attitudes are changing and this might suggest a steadily increasing rate of take-up and for a period of significantly increased growth in the equity release market.
Chapter 3

Consumer attitudes to equity release; a cross national perspective

The market context would suggest a much bigger market for equity release than has so far emerged. A number of explanations have been put forward as to why it has so far failed to meet expectations. In this chapter the aim is to explore one of the central issues, consumer attitudes, to see if we can identify some underlying factors which result in consumers holding back rather than taking out equity release plans in the way the data would suggest they should.

In undertaking this task it is important to note that although the research on consumer attitudes to equity release has no doubt expanded in recent years, access to much of this work is difficult and, where it is available, the coverage of that research and the results appear similar to previously published work. Partly, this is because much of it has been within the somewhat narrow confines of the work undertaken to produce the market overview reports already referred to. However, we have a small number of studies that have reached a little way beyond these. They include a Scottish Widows report published in 2005 and the CML research published in 2004 and 2005. There are without doubt other studies but many remain confidential to the commissioning firms.

Separately we have had successive FSA mystery shopper exercises on the performance of independent advisers, a key part of the equity release chain and the mechanisms through which consumers form opinions. We will consider these later in the chapter.

Though we will all have views about consumer attitudes to equity release it is important to consider what the available empirical research tells us.

In 2005, a Scottish Widows survey through YouGov explored what 1,472 home owners aged between 55 and 75 thought about equity release. The headline results were as follows -

- High awareness of equity release (97%) overall and this is rising across the age groups from aware to very aware
- However, only 46% were willing to use the product and this was related to levels of equity and to gender. Women were less keen than men, perhaps for the reason they live longer and in the family home
A concern to leave an inheritance was a factor for 37%, though the 'family' effect was very varied, with 19% saying they wanted to leave everything to their children and 35% who said they would leave nothing! There was a strong awareness of the role of equity release in mitigating inheritance tax liability.

42% said they did not trust the product and one in five said they felt it was risky and they would never use it. (Though this was not associated with house price falls)

There was strong support for more guidance and advice, not least about the risks. Most respondents felt that they would need to access further income in retirement (especially women and divorcees)

The CML’s own work on attitudes is best summed up in Smith (2004). This draws upon the findings from a BMRB survey of 2,268 adults aged 45-80 and undertaken in June 2004 (though it only uses responses from home-owners). The article highlights a number of issues -

There were widespread concerns about incomes in retirement and over half indicated they intended to work part-time post retirement (with those on lower incomes saying they would have to work and those retiring early, ie, at 60, indicating a desire for part-time work)

There were an increasing number of people planning to use property to support their retirement with many planning to trade down (with the better off most likely to do this and this, in turn, had a regional dimension)

As with the Scottish Widows survey, there was high awareness of equity release though this diminished in the lower social groups, particularly D&E.

There was low usage of equity release schemes at present and limited appetite for it in the future. Only 11% of mortgage holders and 6% of outright owners said they were likely, or very likely, to use it (and this was linked to age with younger households having a stronger appetite)

Asked why they were unlikely to use equity release, some did not need it, but others (around 30%) of each age group (45-54, 55-64 and 65-80) were wary of the schemes (with women more wary than men). This was their reaction pre-regulation – what we don’t know is how it has changed now.

The CML survey pointed towards changing attitudes around the use of property. This was explored in more detail in a subsequent article by Rowlingson (2005) which drew upon a wider study of attitudes to inheritance in Britain (Rowlingson and McKay, 2005). Rowlingson noted that attitudes to inheritance were softening and there was a greater willingness to use assets during a person's lifetime, reflecting, not least, concerns about pensions. Property was seen as a
useful addition to the pensions 'armoury', though mainly as a substitute. She explored how people had then sought to access this equity.

Some 12% had borrowed against the home, 12% had moved to a cheaper area/home, 3% had sold up and moved into renting and 1% had used equity release. This suggests extracting capital from the home is quite widespread and 46% of those thinking about this said that is what they would do (by moving to cheaper home/area/renting). If one added to that the 11% who would borrow against their home and the 5% who would sell a share to a relative, we can see there is a significant willingness to use the property asset. However, only 5% said they would sell to an equity release company (although it is not very clear what this meant).

Rowlingson went on to explore equity release schemes. 39% thought they did not offer good value for money and over 50% did not trust the providers even though nearly 60% of respondents thought equity release schemes were a 'good idea in theory'.

The picture to be drawn from these three studies is as follows -

- The asset value of homes is well recognised and there is a considerable willingness to use it across all age groups
- Most consumers clearly prefer to access the asset value directly by selling and extracting equity rather than by using the indirect equity release solution
- Why this is the case has not been explored nor has there been any detailed examination of the strengths and weaknesses of that strategy but the issues of control and certainty would appear to be central
- Attitudes to the use of home equity in lifetime and to reduce inheritance are changing with younger households wanting or needing to use that equity in lifetime (sometimes to help their own offspring)
- Poorer households often occupy lower value homes and have a lower expectation that they can use its value in lifetime

As hinted at the outset of this chapter, and indicated above, there are a number of areas where further and more detailed research is required. However, before exploring those in more detail it is helpful to take a wider view of consumer attitudes and look at other countries.

**International perspectives**

Drawing upon the value of the home is a universal phenomenon. However, the way this is done is very culturally specific, for example the French "en viager" system where the owner sells the
home but has a life tenancy. Drawing upon evidence from Australia, New Zealand and the USA, it has been possible to paint a modest picture of how the market operates in those countries. All have substantial and mature home-ownership markets but in each case the equity release market (also known as reverse mortgage market) is small – well under 5% of the mortgage market.

In both Australia and New Zealand there is an active equity release market and this has been the subject of recently published research. The findings are summarised here.

Both Australia and New Zealand have mature home-ownership markets with the consequence that there are a lot of older home-owners without mortgages and who have considerable equity in their homes. There is a thriving equity release market in both countries (eg, Datamonitor, 2005, Trowbridge Deloitte, 2007) though both would have some echoes of the UK experience.

The Trowbridge Deloitte study points to an annualised 43% growth in the market based on the six months to June 2007 with a substantial number of sales taking place directly via branches rather than through brokers. Given the Australian home-ownership market is more ‘mature’ than the UK (Holmans, 2001) this might suggest that market has now moved to a ‘take off’ point.

A major study was undertaken in Australia with reports being issued in 2004 and 2005. The study Ageing in place? Intergenerational and intra-familial transfers and shifts in later life was funded by the independent Australian Housing and Urban Research Institute and undertaken by Diana Olsberg and colleagues. The first report, AHURI positioning paper 79 (Olsberg et al, 2004) explores the background context and the underlying reasons why the extraction of housing wealth is important, not least because of the country’s ageing population. The main study report published in 2005 (Olsberg and Winters, 2005) reports on a national survey of nearly 7,000 older Australians.

Although there is a degree of survey bias in the results, in that the survey population was self selected (they were respondents to a questionnaire placed in the bi-monthly journal of the National Seniors’ Association along with focus groups, chat rooms), the numbers have allowed for considerable detailed analysis (and other evidence does suggest the findings have been replicated in more conventional studies). The study focused on three age cohorts – baby boomers (50-59), young-old active (60-74) and older-old (75 plus).

For the purposes of this report there are a number of findings to highlight which give further support to emerging views in the UK regarding the equity release market. They are as follows -
There was a notable shift in the values and priorities of older Australians with independence, flexibility, consumer and lifestyle choices taking precedence over rather more traditional views of old age and family obligations. These are partly being driven by longevity, changing family relations, greater social mobility and increased diversity. More people are living alone, especially women, with home-ownership being seen as the key to lifestyle choices. Ageing is moving towards an attachment to location rather than the family home. Moving house, especially by baby boomers, is accepted. Friendship communities offer alternatives to those families that are not able or willing to have older relatives living in the family home. The conduits to wealth extraction include downsizing and equity conversion, with over 25% of respondents expecting to use up all their assets before they die. However, it should be noted over 33% had already helped their children. Basically the desire to bequeath assets is diminishing, not least because re-marriage and new relationships have created considerable family complexity. None of this meant a 'carte blanche' for equity release. Banks and their products were viewed with suspicion. Fees and charges were seen as punitive, as was the compounding of interest.

What the Australian research pinpoints is the way attitudes are changing and how households are moving towards much more active use of their housing equity. Equally, it suggests there is still considerable room for the development of products that can meet those desires.

In July 2006, a report on consumer perspectives toward home equity release schemes in New Zealand was published (Davey and Wilton, 2006). Most of the respondents had become aware of equity release schemes via the media and most were happy with the advice subsequently received. However, it is worth noting that two-thirds had not looked at any other option (see Table 3 for both clients and enquirers) and typically they only considered one firm. 75% of respondents had no worries about the dependability or safety of the scheme.
Table 3: Clients and enquirers – alternatives to equity release

<table>
<thead>
<tr>
<th>Alternatives to equity release</th>
<th>Clients</th>
<th>Enquirers</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>66</td>
<td>43</td>
</tr>
<tr>
<td>Less expensive house</td>
<td>17</td>
<td>24</td>
</tr>
<tr>
<td>Retirement village</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>Less expensive house and retirement village</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Rates postponement</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Asset sale</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Less expensive house and sell assets</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Other combinations</td>
<td>4</td>
<td>9</td>
</tr>
</tbody>
</table>

Source: Davey and Wilton, 2006
Notes: Based on responses from 695 clients and 42 enquirers in mid socio-economic categories.

Though the report does have significant weaknesses, given its heavy weighting towards consumers who had taken out equity release plans, we do get some small insights into reasons why enquirers had not gone ahead. Table 4 below summarises the results.

Table 4: Enquirers – reasons for not going ahead with equity release

<table>
<thead>
<tr>
<th>Age or other restrictions imposed by firm (10 cases)</th>
<th>Applicant and/or spouse too young</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>House value too low</td>
</tr>
<tr>
<td>Interest rates or costs (12)</td>
<td>High interest rates</td>
</tr>
<tr>
<td></td>
<td>High set up costs</td>
</tr>
<tr>
<td></td>
<td>Return payment (with compound interest) too high</td>
</tr>
<tr>
<td>Took up alternatives (10)</td>
<td>Family provided needed money</td>
</tr>
<tr>
<td></td>
<td>Borrowed from bank instead</td>
</tr>
<tr>
<td></td>
<td>Child purchased 5% of property</td>
</tr>
<tr>
<td></td>
<td>Moved to less expensive property</td>
</tr>
<tr>
<td></td>
<td>Sold asset</td>
</tr>
<tr>
<td>Fears about losing home/equity (5)</td>
<td>Feared would lose home</td>
</tr>
<tr>
<td></td>
<td>Would lose too much equity</td>
</tr>
<tr>
<td></td>
<td>Not enough equity left to move later</td>
</tr>
<tr>
<td>Other (9)</td>
<td>May proceed in future, not suitable at present</td>
</tr>
<tr>
<td></td>
<td>Didn't like lack of control</td>
</tr>
<tr>
<td></td>
<td>Changed our mind</td>
</tr>
<tr>
<td></td>
<td>Misleading advice from firm’s agent</td>
</tr>
<tr>
<td></td>
<td>Advised against equity release by legal adviser</td>
</tr>
<tr>
<td></td>
<td>Concerns about inheritance</td>
</tr>
</tbody>
</table>

Source: Davey and Wilton, 2006

Clearly the numbers are quite small but they are indicative of some of the concerns that exist. The report picks up on a number of issues that have not been explored in any detail in the UK. These include -
Clear evidence and understanding of the compounding of interest over time

On being widowed, consumers find they are in a plan they do not understand

A real concern about the lenders’ stake in the property rolling-up faster than the rise in house prices, and the individual will end up owning none of the home, significantly reducing future options. Consumers were clearly trying to use plans to enhance their lifestyle, but then still pay off the plans by selling the home, possibly at the point they might move into a residential care home. There is a complex calculus at play here

An underlying concern about lack of control

The USA also has a well-developed and long-running equity release market (Canner et al, 1998, Caplin, 2000). The government has supported the creation of HECM - home equity conversion mortgages. It allows home-owners of 62 or older to access a line of credit through their homes with the government guaranteeing the lenders against loss. Borrowers have to go through an HECM counselling programme to access these funds. HECMs make up about 90% of the market. Recent press releases by Financial Freedom, a reverse mortgage specialist in the USA, suggests the market in the US grew by around 70% in 2006 and HUD data taken from the National Reverse Mortgage Lenders Association website would support this. By calendar year, there were 8,127 HECMs made nationwide in 2001, 14,181 in 2002, 21,636 in 2003, 47,266 in 2004, 48,493 in 2005, and 85,639 in 2006. Clearly 2005 was a poor year but 2006 saw record growth.

A recent survey of 1,129 seniors (65 years old and above) by the company suggested only around 25% were planning to leave their homes to their heirs, compared to 42% the year before. However, only 13% of seniors indicated they would use a reverse mortgage, though it is worth noting some 83% were confident, or somewhat confident, about their post-retirement income being adequate for their needs.

Caplin’s review of the US market (Caplin, 2001) is a little dated now but his analysis is useful in pointing towards a number of possible explanations for the slow growth in the UK market (he was writing at a time when growth rates were very slow in the US). He pointed to a number of factors -

- Transaction costs and moral hazards - the first is self evident but the second picks up on the point if the borrower needs income, will the borrower spend it on maintaining the home which underwrites the loan?
- Healthcare, mobility and precautionary savings – here the point is that taking out a loan may inhibit choices/needs later in life
Complex psychology of reverse mortgages – a lifetime paying off debt and then to take debt on – Caplin suggests this in itself could be a limiting factor in the market. He notes the tendency to be reluctant to face up to realities, 'spend today' for future benefits

The more advice there is, the more it suggests to consumers this is a product to avoid!

All of this takes him towards an argument which suggests equity loans may be more important for funding emergencies than day to day consumption. He then goes on to suggest supply is a further factor (HECM fees paid by government are low), the fact that these loans sit at the intersection of many 'different, confusing and incomplete' regulatory systems. There are echoes of the UK here.

Conclusions

Clearly understanding consumer attitudes to equity is a complex task. What this chapter has suggested is -

- Consumer survey data in the UK has been somewhat limited in its scope and rather repetitive. It has not opened up many new issues nor explored the sub texts inside key issues
- The evidence from other countries with more mature markets is that, at long last, the equity release market is growing significantly. Thus Australia saw the market go up by 80% on the previous year and in the USA the market effectively doubled between 2004/05 and 2006. Despite this increase in the sale of products, it is still well behind its potential but the evidence suggests that younger households entering the market are coming with a different view and are more open to the concept and product
- Younger households are more comfortable with using their housing assets in their lifetime and less concerned about inheritance. There is also a greater willingness to move home to exploit market price differentials
- More thought needs to be given as to how people are seeking to manage their housing assets and where equity release sits in that spectrum. Regulatory intervention is potentially both part of the solution but also part of the problem and we should not expect UK regulation to transform the market
- In that regard efforts by the industry to take forward the consumer information agenda should be noted. The CML introduced FINTAL, a financial calculator which helps brokers and consumers evaluate any likely interaction between equity release and state benefits and it published its Lifetime mortgage sales process guide for brokers and lenders. SHIP has published a 10 point guide for advisers and other advice for borrowers
Chapter 4

Equity release – a glass half empty?

Although the market has argued strongly for equity release to grow in the UK, the reality is that others have taken a much more negative view. There are a number of issues and agendas at play here. First, government and others have often articulated the view that equity release has limited relevance because it cannot help the poorest. Second, there is a steady stream of negative press around equity release built, in part, upon previous difficulties in this market (notably home income plans in the 1980s but also including shared appreciation mortgages more recently). Third, for some this feeds into the view that equity release carries significant reputational risk and this in turn deters some major firms from entering the market. In this chapter we briefly explore these issues.

Not all can benefit

By definition, the potential for equity release turns on the value of the home from which equity is being released. Across all products, reversion or lifetime, there have been restrictions on the type, condition and value of the home pledged as the security against which to raise the capital. This has meant that some lower income households in poorer low value property have not been able to access equity release schemes and this has then in turn been used to make the argument that equity release is not adequate as a universal tool for managing income/capital shortfalls.

A recent report *Overcoming obstacles to Equity Release* (Terry and Gibson, 2006) highlights some of the difficulties that older lower income households face in accessing the equity value of their homes. Although almost all home-owners have seen the value of their homes increase over time we have to recognise that market based equity release schemes set minimum value limits for homes that can be considered for inclusion. The consequence of this is that some properties are excluded by virtue of price, type or condition.

Although government has a significant interest in a safe and orderly equity release market for the majority of consumers, it is at the intersection between poor property and poorer households that this takes on particular significance. This is because government also has significant housing responsibilities, not least in relation to older people.

Sodha (2006) using 2002/03 data from the English Longitudinal Study of Ageing (ELSA), estimated there were around one million pensioners who had housing wealth in excess of
£100,000 and who live on incomes below the Age Concern Modest but Adequate Level (defined as a healthy lifestyle with the opportunity to play a full part in society) and over two million with over £50,000 of housing assets but incomes low enough to ensure they qualify for means tested benefits (Terry and Gibson, 2006).

A third of older people live in what the government defines as 'non decent' housing and the consequences of this spill over into health costs, risks of fire and much more. Reflecting these concerns the government has consulted on a National Strategy for Housing in an Ageing Society (DCLG and other departments, 2007) though no final strategy has been published yet.

The government has a clear interest in improving such homes though it has moved to place the burden of doing this from home improvement grants onto loans – a transition that has been problematic in a number of ways but not least around whether commercial equity release schemes can play a part in this sub-market.

Although equity release is readily available for the majority of older home-owners, at the lower end of the market, the conjunction of poor people in poor homes does make this a difficult proposition. Lenders have explored this issue in some depth but the risks are high in terms of the long-term value of the home and the costs of setting up what might in effect be a small loan are disproportionate. The upshot is that lenders need to find ways of offsetting some of these costs/risks before they can enter this market. In addition, DTZ Pieda (2007) also suggest wholesale-funded lenders would be looking to do at least 2-3,000 loans per annum with an average value of £15,000 if they were to engage seriously.

A number of local authority related equity release schemes have been developed with varying levels of private sector support. This 'non commercial' market is briefly reviewed in Terry and Gibson (2006) and DTZ Pieda (2007). To date most local authorities have continued to offer grants with relatively few moving towards loans. However, progress is being made in this direction in the Midlands and the North West where consortia of local authorities have formed and work is underway to secure private funding to contribute to a mixed public/private loan pool. This is in addition to two existing loan schemes, one operating through the Home Improvement Trust in conjunction with the Dudley Building Society and the other through ART Homes, a subsidiary of the Mercian Housing Group.

As the DTZ Pieda and Terry and Gibson reports make clear, equity loans for poorer older home-owners require a lot of work around advice and guidance to avoid mis-selling and also to overcome the household's own concerns about such products. Terry and Gibson set out a number
of recommendations about how this might be achieved and not least amongst them is the question of how government currently treats any income raised from the home. The basic problem is that for anyone on benefits, any extra income will be discounted against those benefits. Terry and Gibson recommend that government should allow households to draw down up to £3,000 in income per annum from their home without impacting upon their benefit entitlement.

**The risks of mis-selling, inadequate advice and guidance**

Today’s equity release industry has been built around a strong recognition that it is a product area where there has been past abuse and where, without appropriate safeguards, there are serious risks to both borrowers and lenders. These concerns flow out of a number of issues -

- Potentially vulnerable customers
- Potentially complex family dynamics around inheritance
- Complex products not least in illustration and understanding terms and where house price dynamics can produce unexpected outcomes
- Limited number of specialist brokers with full understanding of the market, risks and alternatives and relatively high commission payments
- A regulatory regime that has taken some while to get fully into place
- Taken together, a market place where risks for all parties are seen by some to be too high.

Counterbalancing this, the simple reality is that households have a major asset, their home, which many need to access. The question therefore is not whether to have an equity release market or not but rather how best to structure it.

Since April 2007, when home reversion products became subject to FSA regulation, almost all equity release related products are now regulated. However, it is evident that this in itself has not transformed perceptions of the market place. In part this is because there are still problems with the way the product is sold.

The FSA has conducted two 'mystery shopping' tests and provider visits in 2005 and 2006. The results, though based on a small sample of mystery shops, were discouraging in terms of adviser performance, both in terms of relevant information sought from the consumer and subsequent product recommendations.

The key findings from the two surveys (42 shops in 2005 and 75 in 2006) were as follows (the total number of mystery shops was 117 over the two years; the percentage figures given below are for the combined responses) -
• 53% of advisers failed to ask the shopper whether they had existing savings and/or investments
• 55% of advisers failed to ask about the shopper's preferences for their estate
• 72% of advisers failed to ask what the shopper's monthly outgoings were
• 61% of advisers failed to ask the shopper about their state of health and life expectancy
• 62% of advisers failed to ask if the shopper received or would be eligible for any other type of Benefit
• 66% of advisers failed to ask if the shopper received or would be eligible for Pension Credit
• 50% of advisers failed to provide the shopper with an Initial Disclosure Document (IDD)

As a rule the results in the second year were more favourable than the first and adviser performance had improved. The FSA found that borrowers were often advised to invest released funds in potentially unsuitable products that were likely to have lower yields than the mortgage interest rate. The FSA noted the improvements between surveys and the expectation is that with new regulations still bedding down in this sector this trend should continue. The industry has responded with more guidance and better training and the benefits of this will build up over time. However, it remains a serious problem, not least because any intermediary regardless of expertise and experience can arrange an equity release loan, and this is one of the reasons why consumer bodies such as Which? continue to recommend that households use other means, such as trading down, to access their home equity (we return to this in Chapter 5).

It is important to put these negative views and images in perspective. Complaints to the Ombudsman about equity release products are limited (in the 2006 report there were 45 regarding lifetime products (60 in 2005) compared to 69,419 complaints about mortgage endowments and 3,942 about other first mortgages) and consumer research points to high satisfaction rates amongst those who actually use the products. With SHIP increasing in membership, taking on full-time staff and promoting higher standards in products and sales processes and a growing number of trained advisers the market is moving forward in terms of safeguards for customers.

The government

Underneath both of these concerns is a question about the role of the government. The government has 'damned' equity release with faint praise. Although home-ownership and asset accumulation sit high on the government's agenda and it has embraced equity loans for house purchase, it has been much more circumspect on the equity release side. Moreover, its policies, especially in relation to taxation and benefits continue to do little to encourage this market to develop.
The current public interest in inheritance tax and the competition between political parties to tackle what is seen as a growing injustice highlights the fact that more households are coming into the tax regime through the increased value of their homes. Although government recognises equity release can be used to increase borrowings and thus reduce IHT liabilities on death, it has never given any explicit recognition of this strategy (indeed privately it has argued if the market for equity release grows it may have to take action to diminish such effects – as a by product the recent increase in IHT thresholds has this effect). Moreover, on the benefit side and as already noted, any increase in capital or income as a result of a drawdown on the value of the home will result in some households losing their state benefits and thus nullifying at least in part the benefit of using equity release.

Across government, we can identify a range of different departments who want households to use the equity in their homes in order to reduce the call on government. But despite this, across government, there is no clear or integrated view on how this should be done, how it might be encouraged, how disincentives might be reduced and no evident appetite for developing a public role in this market place.

This lack of direction within government and lack of leadership in relation to this market is a third negative that has to be dealt with. Given all the concerns there can be no doubt a stronger sense of ownership by government would help this market to develop. The evidence from the USA is very clear where the government's role via HUD in relation to the HECM market is very pronounced and quite deliberately designed to add confidence and strength to what is seen as a sensible mechanism for citizens to use. In the UK, improved regulation represents a helpful start but there is much else still to do (and that might include further regulatory support for example by introducing a standard for equity products?)

The market lacks major players

Finally, the fourth argument that is often used is that the equity release market is notable for who is not in it and that this, by extension, suggests there is something seriously wrong with it. Although there are a large number of smaller providers both in terms of reversion schemes and equity release mortgages, the reality is that there are a number of major players active in the market from both the insurance/investment and mortgage sides – these include Norwich Union, Prudential, Standard Life, Bradford and Bingley, Northern Rock and Bristol and West. In addition, other major players are active in a secondary sense, funding some of the firms operating in this market. It is worth noting that HBOS is in the equity release market in Australia, owns McCarthy and Stone (a major retirement home provider in the UK) and through several of its brands offers interest-only mortgages which can be used by older households. Abbey does
likewise and Nationwide is one of 12 lenders listed in Moneyfacts who provide a specific age related interest only product for older households.

As this suggests, there is major brand participation in the broad market place even if not for specific named lifetime or reversion products. Given the history of this market the perception that major brands avoid this market is unhelpful and adds to the aura that major players view it as a risk thus giving little encouragement for potential customers or their advisers to take a different view. As the paragraph above suggests, in reality, participation is wider than the common perception and one challenge is to build a better understanding of the sector's engagement with the needs of older home-owners.

The issues are perhaps less about providers, but more about products and processes, and the nature of an evolving and developing market. As the market builds up, as it will, we will see more players enter, make explicit or rather extend their offerings. Major firms have been building their wealth management services and of course equity release sits very comfortably within that. As the number of property equity rich increase so there will be a natural pressure to engage with this market.

**Conclusion**

The glass half empty scenario characterises a common stance on equity release. Government has been at the fore of this and the absence of coherent policy from the government on equity release is a key factor that needs to be addressed. The current debates around inheritance and property-based wealth and their conjunction with the government's desire to promote home-ownership and asset-based welfare provide an important opportunity for developing this. Like the market itself the number of players in the lifetime and reversion markets continues to grow and it is only a matter of time before more big names become more explicitly engaged. Taken together, a more positive stance from government and more engagement from major players would have a transformative effect on this market.
Chapter 5

Releasing the equity release market

This report has examined the equity release market, consumer attitudes and the ways they are changing and some of the identified weaknesses of this market. The purpose of this final chapter is to bring these issues together, to examine some of the alternatives to equity release and to set out a series of conclusions and recommendations.

Clearly there is a strongly held view that the market has under-performed in relation to its potential as measured by the number of older owners, the amount of home equity they possess, income shortfalls via pensions and the need/desire for extra cash and resources. Annual market growth has been limited. As a percent of the total new mortgage lending, equity release has been falling (though this reflects the sharp growth in some other sectors, not least Buy-to-Let (where an investment motive is strong and where older home-owners are active participants). Table 5 shows very clearly that the market has not been expanding in line with the rise in housing equity or house prices.

Table 5: Housing equity, house prices and lifetime mortgage market, 2003 - 2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Housing equity (£m)</th>
<th>DCLG average house prices (£)</th>
<th>Lifetime mortgages (£m)</th>
<th>Housing equity % change</th>
<th>Average house prices % change</th>
<th>Lifetime mortgages % change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>2,094,444</td>
<td>155,485</td>
<td>1,115</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>2,343,811</td>
<td>172,788</td>
<td>1,226</td>
<td>12</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>2005</td>
<td>2,369,182</td>
<td>183,966</td>
<td>1,114</td>
<td>1</td>
<td>6</td>
<td>-9</td>
</tr>
<tr>
<td>2006</td>
<td>2,617,816</td>
<td>192,648</td>
<td>1,140</td>
<td>10</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>2007</td>
<td>213,900</td>
<td>1,177</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: CML research, Department for Communities and Local Government

Going forward, published market assessments continue with the view that this will remain a slowly growing market albeit that in the medium to long term the view is taken that significant growth will take place. However, as any expert in this sector will know, this has been the view for some years!
There is also a view that not only is the market under-performing but that it will continue to do so because consumers do not trust the market and are deterred by the combination of the absence of major players and clear support from the government. The report will return to this.

At the same time the substantial international evidence, and a small but growing body of evidence in the UK, suggests that though the current older generation of home-owners (65 plus) are quite conservative in their views on equity release schemes per se they actively think about how to utilise home equity. When younger generations of older people are considered, there is a more positive view of equity release itself as well as a more positive view of how to use the capital tied up in their homes. In other words, there is change underway and that change should result in a bigger equity release market. The evidence from this work and other sources is that the demand from 50 year olds is increasing substantially. Part of the task is therefore making it clear this option is both available and attractive with known limited downsides. Indeed, for such households the downsides (primarily the roll up of interest) can be actively managed and mitigated through careful choice of product (allowing interest payment and partial repayment).

However, before moving to the recommendations it is useful to stand back and recognise that there is now widespread use of housing equity, if not equity release. Sequential surveys make it very clear that there are a range of ways households in their lifetime can use housing assets to fund their retirement without selling out and moving into rented homes. These are trading down, buy-to-let, mortgage equity withdrawal and equity release. While we recognise the scale of these may be strongly related to the phase of the housing market cycle and therefore might be less evident as we move into a falling market, they remain potential options.

**Trading down**

Many people retire with larger houses or flats than they need, or indeed want, and in theory could trade down, releasing funds to support consumption in retirement. The Survey of English Housing (SEH, 2007) reported that for 20% of people moving between un-mortgaged properties, the main reason to move was that they wanted a smaller or cheaper house, as did 19% of people moving from a mortgaged property to one which is owned outright (and the average number of rooms per house does fall slightly for age groups over 60, among owner-occupiers). Clearly the scale of funds releasable by trading down is limited by the nature of the property owned and the nature of the move made (area/property bought) and by the costs of the transaction. A recent Department of Work and Pensions report makes clear (DWP, 2007) that trading down was the favoured strategy of people aged 50 and over and that it was particularly supported by those in more expensive property (because obviously they had more ‘room’ for manoeuvre).
The Australian evidence is that people will be keen to stay in familiar areas and this may also limit the financial benefits of trading down. The Pensions Commission (Pensions Commission, 2005) notes that 61% of the English housing stock is semi-detached or terraced and that the great majority of those with inadequate pension savings are likely to live in such houses. It estimated that "the value releasable by trading down from a semi-detached house to a terraced one varies by region, but on average would deliver assets equal to around only 30% of the implicit value of the state pension".

**Buy-to-let and trading**

The buy-to-let market has grown rapidly in the last few years. The CML’s latest figures show that this market is now about 10% of the total mortgage market and makes up around 12% of advances in the first half of 2007.

Given that most buy-to-let investors are also owner-occupiers and thus have no need to retain the buy-to-let property to provide rent-free living in retirement, their housing investments are in essence a property based retirement fund which they can run or liquidate to produce an income/capital. The Pensions Commission (Pensions Commission, 2005) argues that buy-to-let is likely to remain relevant to only a minority of those who lack good pension provision. At the first half of 2007 there were 938,500 buy-to-let mortgages outstanding valued at over £100 billion. The number of investors is lower, with an estimated 46% of investors owning more than one rental property. Clearly the market is to some extent limited by the number of renters and as the Commission notes "Buy-to-let can only become a major savings asset for some people if housing equity becomes a less significant asset for others".

**Housing and mortgage equity withdrawal**

According to Bank of England data, housing equity withdrawal has fallen from its peak levels in 2003, but has continued to run in excess of £10 billion per quarter since mid 2005. The latest figure is one of £10.5 billion for the third quarter of 2007.

Housing equity withdrawal is defined by the Bank as "when lending secured on housing increases by more than investment in the housing stocks" and "is new borrowing secured on dwellings that is not invested in the housing market (eg, not used for house purchase or home improvements), so it represents additional funds available for reinvestment or to finance consumption spending". The Bank's published measure represents a net estimate of equity withdrawal.
Holmans (2001) provides a detailed examination of housing and mortgage equity withdrawal. This includes estimates of the various components of gross withdrawal that may be more relevant here. Focussing on last time sellers (that is, deaths, moves to other tenures, emigration etc), he estimates that in 1999 it had a value of just over £22 billion. This work is currently being updated, but is now probably in excess of £30 billion per annum – massively bigger than the conventional equity release market. Even the moves to private renting were estimated to release nearly £4 billion per annum in 1999.

**Equity release**

We have discussed this in previous chapters. The Pensions Commission (Pensions Commission, 2005) notes that it is difficult to assess the scope for further development. Clearly for some people, including for instance the 10% of the population who are childless at retirement age (a figure likely to grow closer to 20% in the next 20 years), it could be an attractive option. However, arguing a strong bequest motive remains, it goes on -

"This makes it likely that for many owner-occupiers, equity release will be seen as a distress option rather than as part of their pre-planned approach to retirement. And as long as equity release is a product for a small minority, who may be a self-selecting group of poorer credit risks, its unattractive interest rates are likely to continue. Equity release may therefore remain trapped in a small, high-price sub-sector of the market”.

This statement requires a little unpicking. The 'unattractive' interest rates are ever less present with competition bringing them down significantly. Certainly there is a premium over the standard mortgage rate but this is not a specific reflection of the client group or their credit status. Rather it reflects a number of factors including the no negative equity guarantee, the time value of money, property risk and longevity risk.

**Going forward**

As this discussion suggests, using property is widespread and it is clear that many households are already comfortable with including property within their broader financial planning and have it firmly embedded in their minds as part of their future income strategy. The question then becomes, why is it that households, who recognise using property assets as part of their forward strategy, do not then use equity release as part of the way of doing that.

Part of the answer lies in what the other routes provide that equity release does not. At the heart of it seems to be the issue of control and views about value for money.
Remortgaging and extracting some equity is popular and easy and is accomplished at a conventional mortgage rate, albeit it presumes an income to service the mortgage obligations. Structured on an interest-only basis, borrowers are in a marginally different position in that repayment is expected at the end of the loan period rather than on death (the parallel is the small number of equity release products that are interest-only for a limited period with reversion to roll up after that). Borrowers who are expecting lump sums of some kind might find this an attractive alternative to equity release because the time horizon is limited, no equity value is given away and the interest costs are lower.

Trading down likewise has considerable merits, albeit there are transactions costs and the risk of a variety of disruptions to normal life through moving. Potentially trading down allows a household to reduce living costs/pressures by moving to a smaller home and to extract a cash sum. Subject to the actual circumstances, it is a clean and controllable transaction in terms of timings and costs. It is unlikely to be repeated very often and in that sense lacks features which other options allow.

For the purposes of this discussion we can put buy-to-let on one side, except that it shows a large number of people have moved some considerable distance in terms of treating property as tradable assets and this will ultimately have some bearing on their understanding and acceptance of what they might wish or need to do with their own home.

The first generation of equity release products was very much structured from a producer perspective. There was little flexibility and they simply produced large cash sums which the borrower could use/invest. The solution created a problem in that the money raised had to be parked somewhere if it was not used immediately and the rate of return might have been lower than house price inflation.

Product flexibility has now increased, with more flexible draw downs in terms of both income and capital. This gives borrowers more control over what they get and when. Similarly, products which combine features of a conventional mortgage and an equity release product allowing partial repayment in lifetime are attractive because they allow borrowers to structure their borrowing efficiently from a cost point of view as well as allowing them to structure the product according to their expected resources.

What this suggests is that the problem for many regarding equity release is not reputation or the absence of major players but rather the absence of control, an uncertainty about total costs, and an inability to manage the product in line with their resources and needs. A discussion that
begins with statements about the repayment can never exceed the value of the home is comforting to someone who believes this reflects their circumstances but for others for whom this is not within their expectation it is a threat! It also suggests that there may be better ways of managing the situation.

This then takes us towards a number of possible ways to develop this market -

- Equity release providers and brokers should be clearer about the options available within their product ranges and beyond, the ‘pick and mix’ potential and the potential to vary the strategy over time. This would suggest there is a need for advice on a continuing basis rather than just at the point of ‘sale’.
- Simply arguing equity release is a great product does not fit with where most people are as the evidence shows. They need to be taken through the options they may have for dealing with income or capital shortfalls and in which equity release is one possible solution. Table 6 below seeks to capture the diversity of settings and possible solutions. It is illustrative rather than exhaustive. The key point is one of diversity.

### Table 6: Illustrative household planning scenarios

<table>
<thead>
<tr>
<th>Age band</th>
<th>Income position</th>
<th>Capital position</th>
<th>Pension position</th>
<th>Unmortgaged equity position</th>
<th>Strategies available</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 55</td>
<td>OK</td>
<td>Poor</td>
<td>Poor</td>
<td>Low</td>
<td>Limited</td>
</tr>
<tr>
<td>55 to 65</td>
<td>OK</td>
<td>Modest</td>
<td>Modest</td>
<td>High</td>
<td>MEW</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Trading down</td>
</tr>
<tr>
<td>66 to 75</td>
<td>Modest</td>
<td>Modest</td>
<td>Good</td>
<td>High</td>
<td>Trading down</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>equity release product</td>
</tr>
<tr>
<td>Over 75</td>
<td>Poor</td>
<td>Poor</td>
<td>Modest</td>
<td>Modest</td>
<td>equity release product</td>
</tr>
</tbody>
</table>

- Product development needs to get closer to an asset management strategy for older people rather than a one off hit. This suggests a suite of products which take account of the fact that many households have a 'lumpy' income profile which may allow for more options. Perhaps more thought needs to be given to how one might link to children. Parents are typified as being relatively capital rich but income poor, while children might be relatively income rich and capital poor. Could the interplay between the two generations be further levered into the product mix and payment profile?
- Given the medium/longer term certainty of house price inflation there may be ways of capping the impact of interest roll up and more clearly sharing risk. Is there a role for insurance? No negative equity guarantees means lenders are taking risk but in reality in quite a limited context.
Some of the conclusions drawn in this chapter are quite speculative in nature. A key issue is the need for better and more fundamental consumer research. Most of the work to date has been superficial and repetitive. We need to get behind why people prefer one strategy over another and why there is widespread use of property equity, but not equity release. It feels as though we have been asking the wrong questions and are still stumbling towards the right answers! This suggests a programme of work, both qualitative and quantitative in nature, with the former being used to work up potential questions to be rolled out in wider surveys.

It is easy to see why the Pensions Commission and others reach the conclusions they do regarding equity release. Taken in the round, the market appeal of the current offerings is quite limited. However, that is not to say more cannot be done and it is evident some providers are beginning to push out the boundaries of the equity release market.

Indeed, looking at the wider context it is clear equity release will continue to grow. The reality, however, is that it will grow much bigger and faster if the industry moves forward in more creative ways.

There is certainly huge potential looking ahead over the next 20 to 30 years. Beyond that it is rather more difficult to say. Later entry to home-ownership, more mortgages into retirement, real interest rates and more accumulated debt all begin to suggest that the level of unencumbered property equity held in retirement will eventually decline in relative terms.

Near-term demand for equity release products could be speeded up and extended if government played a more creative and active role around the issue of helping home-owners access the value of their homes. At the moment, users of equity release face the risk of losing benefits because they exceed income or capital rules, and if they convert any drawdowns to income they may face income tax charges. Although equity release can ease inheritance tax obligations, the overall picture, and especially for lower income households, is one where equity release is treated negatively in tax and benefit terms.

If government took a more rounded view of equity release it would recognise the many benefits that might flow from it and which could serve government policy objectives and not least in terms of potential problems and calls on public expenditure. But perhaps more importantly government should recognise that, given its concern to build a society in which the ownership of assets is a priority, it should help create and sustain ways in which people can exploit those assets and not least in older ages when income might be reduced and pressing needs emerge.
There is a strong case for developing a sustained dialogue around equity release with government. This will be difficult as is evident from the recent JRF work. However the case for doing this is building by the day and it requires a sustained campaign. The problem so far is that efforts have been fragmented and of short duration. This suggests the need for a new coalition around equity release, with a view to building an agenda and taking this inside government. This would suggest the CML, SHIP, the Institute of Actuaries and others need to come together to take this agenda forward.
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Appendix
An extract from the Pensions Commission

(a) Housing assets deliver one specific category of consumption, while the business assets which lie behind a diversified portfolio of bonds and equities support the delivery of the full range of all other categories of consumption. Therefore, while in the very long run a diversified portfolio of business assets should deliver a return and trade at a price linked somewhat to the growth and efficiency of the whole economy, irrespective of any change in relative demand for one or other category of consumption, housing assets should trade at prices linked specifically to the demand for accommodation. Over the last 50 years, these prices have moved in ways which have made housing a very attractive investment. While the increase in prices alone has not matched equity returns, the underlying return, after allowing for the rent-free accommodation enjoyed but also deducting the cost of maintenance, has compared well with equity returns and shown much lower variance over 20 year periods. However, the Commission notes the possibility that there could be lower house prices as the baby boomers, or those who inherit from the baby boomers, seek to sell off houses to the next, smaller generation. House prices are therefore as exposed to potential demographic effects as equity prices: indeed even more so since houses, far more than equities, are bought and sold in largely closed national markets, with only minimal overseas investment. Even absent the thorny issue of whether house prices today are at a cyclical and unsustainable peak, the long-term evolution of house prices is highly uncertain and debatable both nationally and even more so in specific regions or localities.

(b) The second distinctive feature of housing is that buying and then keeping a house, rather than liquidating it during retirement, provides protection against uncertainty over the future cost of housing. Demand for housing and market rents may go up or down, but owner-occupiers, notionally paying themselves an imputed rent, are protected, or in financial terms hedged, either way. It is therefore economically rational for people who have accumulated net equity in a house by age of retirement, to maintain the right to rent-free retirement through continued ownership of a housing asset. Retirees gain benefits from owner-occupation via rent-free living, reducing the income replacement rate below what would otherwise be required. Economic rationality as well as emotional ties to the family home and a desire to bequeath therefore lie behind the observed phenomenon that housing equity, unlike non-pension financial assets, is not liquidated during retirement. The implication of this is that if housing is to play a role in providing retirement
income, it needs to do so in ways which do not require pensioners to give up their right to rent-free living, ie, their hedge against volatility in house prices and rents.
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