



**ROSE**  
Financial Planning

## **EQUITY RELEASE – WHAT IS IT AND WHY MIGHT IT SUIT YOU?**

The general term 'equity release' is used to describe various products to access capital within a property and, in view of recent events and product development both here and in the UK, it is worth explaining the various interpretations, uses and (no small issue) the risk associated with it.

The first point I would make is this. Accessing any element of equity in your home should never, never be actioned lightly. In most cases the property isn't just any property; it is your home! To endanger your future by accessing large hunks of capital in your home, perhaps capital that can never be replaced IF something goes awry, will potential have dire consequences for you and your family.

So you must always, always follow these golden rules;

- Consult with a solicitor, especially for complex products. They will take an independent view on your behalf.
- Discuss it with your family. What you are doing may impact them and, you never know, they may be able to assist in some way!
- **ONLY** use a regulated financial advisor for product advice.

The last point is important as most products, in the UK and Spain, require such advice to emanate from someone who has proven their professional expertise and has been approved by the country's financial watchdogs. In the UK it is the Financial Services Authority. In Spain, depending on the product, it is either the DGS or the CMNV.

You can take that further. Many products in and around general financial services are not regulated in Spain. But surely it is common sense to **ONLY** refer to a firm that is regulated in some one. It will offer you that extra peace of mind! Regulation is not easily achieved so, if the regulatory body is happy with the firm, so should you be! Rose FP, as an example, are regulated to give advice in Spain and all of our advisers are highly qualified and experienced.

So, to the issue in hand! What is 'Equity Release' and how might the various products help you?

## 1) UK

In recent years, it has become apparent that, as with many other parts of the world on the back of increasing property values, that valuable equity can be accessed and used by the property owners for various reasons. Invariably, this has translated into a burst of new products via a variety of mortgages for debt consolidation, freeing funds to build property portfolios and, in particular (and this is where the phrase is normally associated) for elderly folks who need capital to improve their lifestyle, perhaps by investing that withdrawn capital for income.

Let me first quickly cover off standard remortgages to release equity to debt consolidate and invest in other property. These tend to be based on affordability i.e. the client will have an income and be able to afford monthly repayments. For debt consolidation, total monthly outgoings will be reduced (that is the sole reason for effecting the remortgage) whilst the new property investment will likely have a rental income when let, and that will pay for the cost of the new mortgage.

The products that are used for real Equity Release (i.e. for elderly clients needing capital or income) fall into 2 camps;

- 1) 'Pure' Equity Release, referred to as Lifetime Mortgages.
- 2) Home Reversions

Lifetime Mortgages, a rather obscure title invented by the Financial Services Authority as part of their regulation of the mortgage industry in October 2004, are simple to understand. The borrower takes a mortgage in the normal way, generally limited to a percentage according to age, but with no need for proof of income. The mortgage risk is taken based upon the expectation that house values in the UK will continue to rise. The important point is that interest on the mortgage is not paid monthly but 'rolled up' i.e. the mortgage debt increases and compounded annually or even monthly. The danger with this is clear; that the growth in the debt will not be met by increasing house values, but the counter argument is that the lenders use very carefully produced weighted analyses to support their lending philosophy so, while the property market has been depressed of late, it is reasonable (based upon history) that the price movements will improve and counter the increasing debt.

Reversions are a little more complex and, frankly, of greater concern because a) the products are not (yet) regulated by the FSA and b) the owner of the property is effectively handing such ownership over to the would-be lender (buyer). I personally have never liked these products, but I have to say in their defence that they do have their uses.

As an example as to why I prefer the 'straight' Lifetime mortgage option, I will explain a very new product that has just been launched in the UK. The

principle is the same; an agreed percentage is advanced based on the market value. An annual rate of charge (effectively an interest rate) is added every year and again compounded. BUT, and here is the rub in my opinion, after some years, say 15, the lender will own approximately 71% from an original advance of only 30% of the then value. The BUT is that they own 71% of the future value! In other words, not only have they had the compounded (interest) growth rolled up over this term, but they will also benefit from the potential growth in the market price.

Let's put some numbers on this example. If the property was valued at £100,000 when the original £30,000 was advanced and, 15 years later, it is valued at, say £200,000, the 71% for their part is now worth £142,000 for an advance of £30,000. That is a compounded growth rate of circa 11%. Not bad business I would say and I think I am being a little conservative on my expectation for £200,000!

The criticism that is levied with these products, Lifetime mortgage and Home Reversions, rotate around the risk to the client if market property trends go against them. Property prices can fall! But also there is some concern that inheritances are being spent and that is a whole different can of worms. I am not brave enough to get into that issue! And lastly, where capital is withdrawn from a property to put into investments to generate an income, again there is the fear that the investment will fail and the capital be lost (or at least reduced) and hence, the home threatened as a consequence.

All very real fears but, sometimes, a little over done in my opinion! The CRITICAL issue is this; if the client has a genuine problem i.e. they cannot live within their existing means, then something has to be done. Life is a risk so, what is needed at the outset, is a full and frank exchange of views, hopes, fears, wants and needs, and an understanding of risks, preferably with the client and his family or eventual benefactors, to decide what route and product to take.

## **2) Spain**

In Spain, standard mortgages are now fairly readily available although we do not yet have the depth of lenders or products that we see in the UK. This is time driven; the mortgage market here in Spain is infantile in comparison to its UK equivalent. The dynamism and competition can be seen already, primarily courtesy of British lenders and professional advisers, such as Rose FS, pushing the development of much needed products. But we have a long way to go!

But, for normal purposes (such as debt consolidation, general capital raising and for property portfolio building) we have pretty much all the tools to do the job. 'Interest Only' (which is the key fundamental for any property related transaction in Spain) is now here in a big way. So we are getting there!

But, for 'pure' Equity Release products, especially an equivalent to Lifetime Mortgages as explained above, we are not even in the starting blocks let alone being out of them on the road to full market competition.

The closest we can get to this is where a mortgage is placed on the property, perhaps an element of cash released to the client, but where the bulk of the funds are invested a) to meet the mortgage debt in its entirety and b) for an income. These are often referred to as 'Equity Release' products here in Spain and, more often than not, they are promoted to assist in the mitigation of Inheritance Tax in Spain.

Subject to the usual scrutiny as to product provider and risk/reward attitudes, these products can achieve the desired end which should always be to improve the lifestyle of the client. The criticism of these products comes from a) how they are sold (i.e. are they sold for the right reason) and b) are the risks fully understood by the client. At the end of the day remember the investment capital should not be under threat at all and preferably guaranteed. But house prices cannot be guaranteed and neither can investment returns, so very careful calculations and judgements have to be made to determine whether such risks are understood and are acceptable. So caution is the key and, to repeat a suggestion made in the last issue, such decisions should really be taken with the end beneficiaries to an estate. Why? Because we all want to avoid politics, especially inter family ones, and there may be other options open which avoid or mitigate the risks suggested.

For example, as part of the process of general financial planning that we at Rose FP take on for our clients, it is not unusual to come across the issue of 'capital rich but income poor' clients. Translated that means that the clients want to improve their lifestyle, but also want to retain a balance against the preservation of capital for their eventual beneficiaries (children, grand children). I have found that the use of the same beneficiaries as mortgage co-applicants or even acting as a 'guarantor', in conjunction with the use of long term 'interest only' products, can put into place a natural 'inheritance plan' where the cost to the client (the parents or grandparents) today is affordable and controllable (perhaps even zero) and the inheritance of the beneficiaries assured and understood. What is necessary is to be prepared to have a full and frank conversation, and to have an open mind to ideas that you may not want to hear!

So, in summary, whilst we are not yet blessed with the depth of product that the UK has (and some would say that is a good thing) the reality is that we do already have solutions that can serve just as well.

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