



ROSE
Financial Planning

ASSET RICH BUT CASH POOR?

DO YOU NEED A 'LIFETIME MORTGAGE' ?

Whilst this article will cover off the detail of this newest breed of mortgages or 'Equity Release' schemes, it is such a large and important subject, that it is impossible to do it justice in one issue. Therefore, this article is over two editions, so make sure you catch the 2nd part in the next run!

Part 1

There has been much discussion in the UK in recent years about a very, very simple issue that confronts many home owners, and how to do right by them in providing a solution that is both ethical and financially viable. The UK financial market is the most diverse in the world, the most dynamic and the most heavily regulated. It is therefore fairly safe to say that if a product works over there, then it can also work here in Spain.

So, what on earth am I rambling on about? In simple terms it is that there is a massive and common problem for many home owners in the UK and in Spain; that is they are often 'asset rich and income poor'. That is to say they have an awful lot of money tied up in the home, which goes up year after year fairly consistently, but very little savings or income to live off!

The effect is that their property really is now being used to their benefit; it is more for their eventual benefactors; their children and grandchildren. But with the increasing value comes a hidden monster via Inheritance Tax. But that is for another day!

And, in Spain, this issue is highlighted by the simple fact that many retirees here insist on paying for their new home in cash, normally leaving themselves short in savings for that 'rainy day', and expecting to live on limited pension income.

And they come with an overly optimistic expectation of a low cost of living, believing they are able to live on a relative shoestring. That is often proven to be a belief 'built on sand' and then they struggle!

I have a fairly severe view on this part of life and it is this! I appreciate that it is a wonderful objective in life to leave an inheritance to your children free of encumbrance or lien i.e. no mortgage. BUT that should never mean that the

parents live the remaining retirement years of their life out in abject poverty. Because that is close to what some people do!

No! I believe that most children or would-be beneficiaries of an estate would far prefer their parents to enjoy those latter years, and if that then means that they get less of the end inheritance, then so be it! I think most readers and even their own beneficiaries would agree with my view, and I know that from innumerable conversation with the clients of Rose Financial Services, that is the majority view also.

Now that example and an explanation as to the strange mentality of many home owners (strange to me that is!) leads me very nicely into explaining what a 'Lifetime Mortgage' (LM) actually is and, perhaps more to the point' why the product has been developed.

Firstly, I need to introduce the concept of 'Equity Release' because that is what the LM is; it is releasing back to you some of the capital (equity) you have locked in your home.

There are now is whole barrage of products that achieve the same goals which are commonly a) giving you a cash lump sum to do with what you want and/or b) an income, often to supplement retirement lifestyle.

So what are these products?

1) An ordinary Mortgage.

We all now what these are and they are often deemed necessary BUT certainly not wanted. Home owners can now release up to 60% of the value of their property without stringent underwriting (risk assessment) and certainly with no age limitation whatsoever! This product is very similar to the 'new' LM but differs in one important area; the mortgage interest has to be paid!

Now, to some that is not a problem, especially where perhaps they have adequate pension income and even some savings and the object of the mortgage is release a lump of money for a bigger item, often home improvements. But to many that debt service could hurt or even be impossible to consider.

But there are ways around that! By borrowing more than is needed, the balance can be invested to beat the underlying mortgage rate, thus effectively contributing if totally meeting the cost of the whole mortgage. So the 'cash out' bit can come at zero cost!

In Part 2 I will cover off the other types of 'Equity Release' schemes and get into the detail and benefits of the new baby, the 'Lifetime Mortgage'.

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In the last edition Part 1 of this 2 parter gave a general introduction to the massive issue of family homes, struggling retired individuals and can be done in order to ease the financial pain of parents sitting on vast sums of capital locked into their homes. What are the options of those that are 'asset rich and cash poor'?

This is a very common theme here in Spain; perhaps 50% of the enquiries that we receive at Rose Financial Services are linked, in part at least, to this issue.

So to the products that you can consider.

The first item I covered off last time was the simple mortgage. The good, old 'vanilla' version. I will recap on that as it is important to do so.

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2) Equity Release schemes.

These products are often used to assist in the mitigation of Spanish Inheritance Tax, and combine a mortgage, 'cash out' and an investment, the latter's target being to meet the overall mortgage cost. In other words there is no debt service requirement placed on the client. The 'cash out' element comes at zero cost.

These can be useful products to consider, but they are more complex to understand so need very careful consideration. The risks attached are limited and controllable providing you are sensible in a) the size of the total mortgage being considered and b) where the net investment is placed. The golden rule

is never to let greed come into your thinking; you are considering the scheme to allow a) an element of cash to be released and then b) for the investment to 'wash the face' of the mortgage interest payable. That's it. Do be overly aggressive in your requirements (a large cash release and/or a substantial income over and above) requires the investment to work that much harder. That means that you cannot invest cautiously, and that implies taking on a higher risk. So care needed here I think!

3) Home Reversion schemes

These are even more complex in their make up, but in simple terms effectively mean that your home is sold for a cash sum, but you retain the right to live in the property until your demise. At that time, the home then passes to the reversion company, sometimes with a further payment made to your estate.

I personally do not like these products a great deal. I accept that they have their uses but I also believe that that newer ideas, such as the 'Lifetime Mortgage', have surpassed Reversions because they offer the same end goal (cash now), are more flexible (you can exit easily and more economically) and you retain the 'upside' with rising property values. Some Reversions offer the latter; many do not, and that could mean forfeiting an awful lot of your eventual beneficiaries inheritance.

But they should not be discounted in your search for the right scheme for you.

4) Lifetime Mortgages

So to the newest addition to the products generally referred to as 'Equity Release'.

This is actually little different from an ordinary, plain vanilla mortgage except that you do NOT have to pay the lender interest. It is simply added to your borrowing and 'rolls up'.

Now there is simple element of risk that has to be understood with this product and it is this. The interest rate is often more expensive than an ordinary mortgage (it is deemed a higher risk to the lender after all!) and the compounded effect of that means that over time the interest on the interest on the interest will be a significant sum. And the risk is therefore that, if the underlying property value does not keep pace, the percentage of the end debt versus the percentage taken at the outset will obviously be higher. That's it!

Common sense maybe, but to many it needs mapping out.

Now why would anyone want to consider such a product? Well, it comes down to my opening introduction as to attitudes in estate planning i.e. are you happy with the concept of passing less to your beneficiaries in order to benefit from your retirement years? If the answer to that is yes, you are, then this product can work for you and it removes the obligation of paying the mortgage interest.

I happen to like these products, providing some basic rules are adhered to!
Those are;

- a) Only take out a percentage that is really needed or for which you have a plan. Do not take the maximum sum otherwise. For example, at age 60 with a property value of Euros 300,000, you could access upwards of 25% or Euros 75,000. What would do with that? Spend it today or look to invest part?
- b) Look to ensure that the scheme is realistic in its charging structure. For example, I have seen one product charging currently 8.3% versus another charging just 6.3% or 5.99% fixed for life! You tell me which seems the most attractive bearing in mind that compound effect of that interest rate over many years? And also note that an ordinary, vanilla mortgage rate can be as little as 5%!
- c) They must be flexible i.e. if you want out, you do not want to be looking at massive penalty charges.

There has never been a better time to look at the fundamental issue of what you want to do with your retirement home. That is, is for you to enjoy the value now and in your retirement years or do you really, really want to struggle to ensure that the end inheritance remains at 100%.

The reality is that a balance can be arranged; you can benefit now and for the rest of your years, and still do right by your children and grandchildren in leaving something for them to look forward to.

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