YORKSHIRE BUILDING SOCIETY

OUR MONEY MOVEMENT

HOW DOES EQUITY RELEASE WORK?

Equity release schemes provide a way to access money that's locked away in your home without having to move.

Put simply, equity releases are loans – there are different types and you can choose how you take the money. Some people take a lump sum, while others take smaller amounts over a longer time period.

Most equity release products come with arrangement fees.

While it's easy to focus on the short-term gains of equity release, it's worth considering the longer-term impact it could have on factors like inheritance and care costs.

This helpful guide will help you decide if it's appropriate for you and the good news is that there are plenty of advisers out there to help you make an informed decision.

"4 out of 5 homeowners would rather stay in their homes than downsize"[1]

The amount of equity you can release depends on your property value and any outstanding mortgage or debt. See the examples below.

PROPERTY VALUE	MORTGAGE / DEBT	YOUR EQUITY
£150K	£0	£150K
£225K	£40K	£185K

AMOUNT OF EQUITY YOU COULD RELEASE

IS EQUITY RELEASE A BAD IDEA?

You may have read mixed reviews about equity release. In recent years, there have been a number of changes to many equity release products to provide greater flexibility and enhance the protection they provide.

Most equity release schemes now have a No Negative Equity Guarantee. This means your lender, rather than you, would take the financial hit if, when your house is finally sold, your outstanding debt is more than the value of your home.

In addition, many equity release lifetime mortgages now allow you to pay off some of the interest during the course of the loan, while others offer the option to 'ring-fence' some of the value of your property as an inheritance.

Before you enter into any kind of equity release agreement, it's wise to take independent financial advice, and look at cheaper alternatives like downsizing, taking out a conventional mortgage or simply remortgaging.

Lenders are increasingly offering a wider range of options that have been specifically designed for the later life needs of older borrowers.

WHAT IS EQUITY?

MARKET VALUE OF HOUSE − OUTSTANDING MORTGAGE BALANCE = EQUITY

Equity is the difference between the current market value of your house, and your outstanding mortgage balance. In essence, how much of your home you actually own. For example, if your outstanding mortgage balance is **£150,000** and the current market value of your house is **£200,000**, you have **£50,000** equity in the property.

AM I ELIGIBLE FOR EQUITY RELEASE?

55+   >£70,000

To be eligible for equity release you will normally need to be aged over 55 (65 for a home reversion scheme) and a homeowner with a home in the UK worth at least £70,000. Other factors that lenders will take into consideration are the type of property, your age and your health.

WHAT KINDS OF EQUITY RELEASE SCHEMES ARE THERE?

There are two types of equity release; lifetime mortgages and home reversion plans, both of which are ways to release equity and stay in your home.

SOLD

LIFETIME MORTGAGE

A lifetime mortgage is a loan secured against your home which will provide you with a tax-free lump sum, or regular monthly payments. There are no monthly payments to make and you retain 100% ownership of your home. Instead the interest on the mortgage is compounded or 'rolled up' over the term of the loan. The mortgage and compound interest are repaid when you sell your home, go into long-term care, or pass on.

HOME REVERSION PLAN

With a home reversion plan, you sell all or part of your home to the provider at less than its market value, in return for a tax-free cash lump sum or regular income. Meanwhile, you continue to live in your home, rent-free.

The difference between this and a lifetime mortgage is that you no longer own all of your home. When you pass away, or when you move into a care home, the reversion company gets its share of the proceeds from the sale of your home. Anything that's left becomes part of your estate. This form of equity release can be expensive and only accounts for less than 1% of the equity release market.

WHAT ARE THE PROS AND CONS?

LIFETIME MORTGAGES

PROS

- Access value that is tied up in your home to fund your retirement
- A tax-free lump sum or monthly payments
- Stay in your own home
- You can still move house
- Own 100% of your home
- Most schemes now offer a 'no negative equity' guarantee – this guarantees that even should house values fall, you will never owe more than the market value of your home and won't leave your inheritors the problem of paying off the accumulated debt.

CONS

- As the interest is compounded you could end up owing more than you originally borrowed
- Having a lump sum in your bank could affect your eligibility for other state benefits
- It's likely that there will be less for your family to inherit

HOME REVERSION PLANS

PROS

- Access value that's tied up in your home to fund your retirement
- A tax-free lump sum or regular income for life
- Stay in your own home
- Retain a share of your home to pass on to loved ones

CONS

- You won't be the sole owner of your home
- You will only receive a maximum of 60% of the full market value of your home – in fact, you will often receive much less than this
- It's likely that there will be less for your family to inherit
- Your home would usually need to be vacated very quickly after your death, at what will inevitably be an emotional and upsetting time for your family.

WHAT ARE THE COSTS?

A typical interest rate for a lifetime mortgage is currently around 5%, which although mortgage rates are currently low, is still higher than most standard mortgage rates. This rate must be either fixed or, if variable, must have a 'cap' beyond which the rate is guaranteed not to rise during the term of the mortgage. Since the interest is compounded, in other words 'rolled up' into your overall debt, you end up paying interest on interest. You could easily find the amount you owe doubling every 14 years![2]

There are also arrangement fees of between £1,500 to £3,000, legal fees, early repayment fees and surveyor fees to take into account.

HOW LONG DOES EQUITY RELEASE TAKE?

The timescale for equity release, assuming there are no issues with the legal paperwork.

LIFETIME MORTGAGE
4-6 weeks

HOME REVERSION PLAN
6-8 weeks

HOW MUCH COULD I BORROW?

UP TO 60%

With a **lifetime mortgage**, you can normally borrow up to **60%** of the value of your property. This is dependent on your age, and the value of your property. Some lenders will release more to older borrowers, and will often also take your medical history into account.

20% → 60%

With a **home reversion scheme** you will normally only receive between **20%** and **60%** of the value of your home. Again, lenders will often offer you more the older you are. This is why this form of equity release accounts for only 1% of the market, with most borrowers opting for some form of lifetime mortgage.

IS EQUITY RELEASE RIGHT FOR ME?

Here's why equity release might be right for you:

- Your savings and any other sources of income won't be enough to meet your retirement needs
- You have no beneficiaries or are not concerned about reducing what you can leave as an inheritance
- You can't downsize, or would prefer not to
- You have received independent financial advice that this is the right option for you

Reasons to consider other options:

- You already have a financial plan for your retirement that meets your needs
- You would be happy to release money from your home by downsizing
- Leaving as much inheritance as possible to your family is a priority for you
- You have been advised against equity release

THE IMPORTANCE OF GETTING INDEPENDENT ADVICE

Equity release is a lifelong financial decision that can be expensive to get out of should you change your mind. Many schemes carry Early Repayment Penalties. This means it's vital to take independent financial advice before committing to any kind of scheme.

A further way to protect yourself when choosing an adviser is to check that they are authorised and regulated by the Financial Conduct Authority.

You can do this by looking them up on the Financial Conduct Authority register. You should also check that they are a member of The Equity Release Council which will give you the reassurance of knowing they are specialists in equity release guidance and will help you to make the right decisions for you.

[1]www.mortgagefinancegazette.com/lending-news/equity-release-majority-equity-release-customers-want-stay-home-rather-downsize-11-02-2020
[2]www.moneysavingexpert.com/mortgages/equity-release