What Is Equity Release?

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The value of residential property has increased significantly over the past 20 years, even though prices have fallen more recently. As a consequence, many pensioners find themselves in the position of being "asset rich" but "cash poor". With increasing food, utility and fuel prices and smaller pension pots, equity release can offer a solution.

How does equity release work?

There are a number of different schemes available but they essentially fall into one of the following two categories:

1. Lifetime mortgages

With a lifetime mortgage, a loan is taken out which is secured on your home. When you die or move out of the property, the scheme will normally end and your home will be sold. The outstanding mortgage will be repaid out of the proceeds of sale. Under this arrangement, you continue to live in your home for as long as you want to.

Lifetime mortgages can be arranged in a number of ways:

Roll-up mortgage

Under this arrangement, no interest or capital repayments are made until the property is sold. When the property is sold, the proceeds are used to repay the initial loan together with the interest that has accrued. The excess will be returned to you or your estate. It is important to note that with this arrangement, interest is compounded which means that the debt can increase very quickly - the table above shows the amount you will owe after 5, 10, 15, 20 and 25 years if you take an initial lump sum of £45,000 and the mortgage interest rate is 5%, 7% and 9% a year.

No. of years since you took out the loan	Interest at 5%	Interest at 7%	Interest at 9%
5	£57,433	£63,115	£69,239
10	£73,301	£88,522	£106,532
15	£93,552	£124,157	£163,912
20	£119,399	£174,136	£252,199
25	£152,387	£244,235	£388,039

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Home income plans

With this arrangement, the lump sum released is used to buy an annuity which generates a guaranteed regular income, usually fixed for life. From this income, you pay the interest on your loan, usually at a fixed rate, and the remaining balance is yours to use as you wish. The capital sum is repaid when your home is sold.

2. Home reversion schemes

Home reversion schemes allow you to sell all or part of your home to a reversion company in return for either an income or a lump sum. Under this arrangement, when the property is sold, you or your estate will only receive a percentage of the sale proceeds, with the remainder belonging to the reversion company.

You will normally be paid less than the full market value of your home - this reflects the fact that the reversion company will be unable to sell the property until your death, or until you move into permanent long term care.

The percentage of the proceeds that you or your estate will receive depends upon your age and health - essentially, the older you are when you start the scheme, the higher the percentage you will get.

Under these schemes, legal ownership of the property is transferred to the reversion company. You will then get a lease of the property back, giving you the right to carry on living in the home for the rest of your life.

Ship - safe home income plans

SHIP (www.ship-ltd.org) is an organisation supported by the leading providers of equity release schemes. It is dedicated to the protection of those who take out equity release schemes. Companies that subscribe to SHIP guarantee that you or your estate will never owe more than the value of your property (the no-negative-equity guarantee) and that you will be allowed to live in your property for the rest of your life, or until you have to go into long term residential care or until you decide to move.

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Important considerations

Before committing yourself to a particular equity release scheme, it is very important that you consider whether there is a more efficient way of raising the required funds. In particular you should take account of the following:

- Will the extra income/capital affect your tax position and your entitlement to state benefits?
- What is your attitude towards inheritance for your heirs - should you discuss things with your family first?
- Do I need a lump sum or regular payment, or both?
- Are there any hidden costs - i.e. survey fees, legal fees or an arrangement?
- Is there an early repayment charge if you repay your lifetime mortgage before you die or go into care?

Most importantly, take advice from a financial advisor who is regulated by the Financial Services Authority (FSA) and who is familiar with dealing with equity release schemes. Firms regulated by the FSA must only recommend schemes that are suitable for you and take into consideration your needs and circumstances.

Your advisor should give you two documents. These documents contain important information that you should understand. The first will explain the service being offered, whether you will be required to pay for it and the product range they offer. The second document will be prepared specifically for you, summarising the important risks and features of the particular scheme.

We can recommend an FSA regulated advisor to you. For further information, please contact Martin Cooper.