Boomers and Beyond...

What is Equity Release and Who is it For?

"The largest generation within the Australian population are now aged between 45 and 60. Many of them are poorly prepared for retirement and arrive at the end of their working life Asset Rich but Cash Poor".

"The recent changes to super rules combined with innovative products that allow access to equity in the family home through Reverse Mortgages provide Financial Planners with a range of strategies to assist their Baby Boomer clients", states Kevin Conlon, CEO Senior Australians Equity Release Association of Lenders ("SEQUAL").

In this article, Kevin Conlon provides an overview of the rapidly-growing Australian equity release market and explains some of the key issues for Financial Planners wishing to develop an efficient and ethical Equity Release practice.

In November 2005, an ASIC Report on the Australian equity release market brought to light some of the issues arising from:

- A rapidly emerging market,
- Unfamiliar products, and
- Somewhat vulnerable consumers

The debate around equity release has centred on the need to ensure that product and process is developed in such a way that senior Australians are well-placed to make informed decisions.

The SEQUAL® Trowbridge Deloitte Reverse Mortgage Study found that the reverse mortgage market at 31 December 2007 consisted of more than 33,700 reverse mortgages loans with total outstanding lending of over $2 billion. This represents a 34% growth since the corresponding period of 31December 2006.

Summary of Key Findings Dec-05 Outstanding Market Size $848m	**Dec-06** $1513m	**Dec-07** $2023m
Number of Loans 16,584	27,898	33,741
Average Loan Size $51,148	$54,219	$60,000
Settlements $315m	$520m	$466m
Facility (settlements) $519m	$714m	$627m
Additional Draw downs N/A	N/A	$125m
Discharges N/A	N/A	$(203)m

Much of the market growth has been achieved through the finance broker channel. However, Financial Planners are increasingly facing the challenge of providing appropriate advice to clients wishing to consider a Reverse Mortgage.

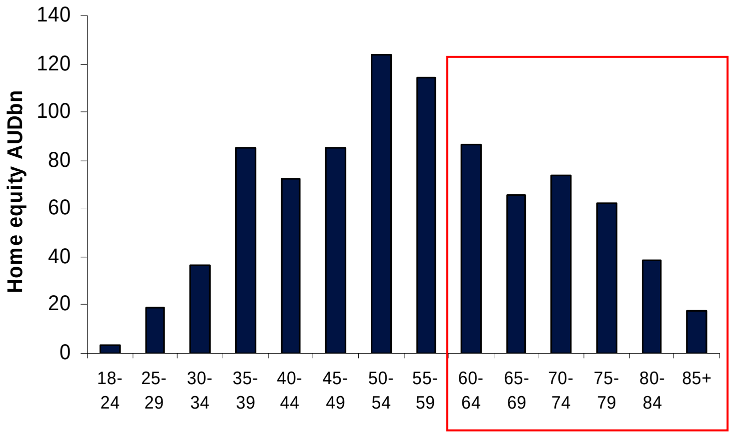
SEQUAL requires its members to strongly encourage their clients to seek independent financial advice and financial planner participation in the Australian equity release market is growing.

Informed intermediaries are now increasingly supporting borrowers in deciding how and when to access reverse mortgage funds. “The financial planning and broker communities now represent over 50% of all sales of reverse mortgages, with the use of financial planners increasing markedly from 2% of new loans in 2006 to 9% in 2007,” said James Hickey, Partner, Trowbridge Deloitte.

The two primary investments for many Australians will be superannuation contributions and their family home.

For the Boomers now approaching retirement, compulsory super came too late for a generation that can expect to live longer than any generation before them and intends to live well in retirement.

The good news is that the majority of Baby Boomers have achieved the “Great Australian Dream” of owning their own home. Total Home Equity (Owner Occupied) was $887 billion, at the end of 2005. The Over 60s accounted for $345bn (39%).



Source: Australian Bureau of Statistics

However, the Boomers have relied heavily on property ownership as a wealth creation strategy and this has made them asset-rich but cash-poor. In the past, a any retiree in this difficult position, had two choices; reduce their living standards or sell the home (often having to then move away from family and friends).

With the emergence of the Australian equity release market, the Boomer generation have another option –tap into the stored wealth of their home.

ASIC considers that the two main types of equity release products for older people are Reverse Mortgages and Home Reversion Schemes.

Equity Release Product Road Map:

Reverse Mortgage

- A loan advanced as a lump sum or regular payment to a home-owning senior enabling them to access the equity in their own home.
- No repayments are made during the life of the loan.
- The Borrower must consider Interest Rate and Property Value Risk.
- The No Negative Equity Guarantee limits Client Exposure
- The Security is provided in the form of a Mortgage Charge

Home Reversion Plan

- Home reversion plans allow homeowners to receive a lump sum or regular payment in return for a share in the value of their home.
- Homeowners do not make regular payments to the provider or incur interest as there is no loan involved.
- Instead, when they sell the property, when they die or move into care they give the provider the stated share of the sale proceeds.
- The Security is provided in the form of a Conveyance (sometimes Deferred Sale)

The vast majority of Equity Release transactions in Australia are undertaken in the form of a Reverse Mortgage and this method provides for a number of draw down options, as follows:

Lump Sum

The Borrower can draw down the full Facility Amount at Settlement. The Loan to Valuation Ratios for most Reverse Mortgage Products are reasonably low (e.g. 29% if the Borrower is 74 years) and the average Facility Amount is currently $60,000.

Instalment Draw Down

The Borrower can choose to receive the proceeds of the Reverse Mortgage as a regular payment over time (e.g. monthly instalments over ten years).

Combination Option

The most popular form of Reverse Mortgage draw down is a combination of a modest Lump Sum and a reduced Monthly Instalment.

A Client Example:

If the Youngest Borrower is 70yrs, the Maximum LVR = 25%

If the Property Value is $500k, the Maximum Loan = $125,000

Draw Down Options:

Lump Sum = $125,000

Income Plan = $1,000pm for 10 years

Combination = $50k Lump Sum and $625pm for 10 years

Capitalised Interest

A key feature of Reverse Mortgages is that regular repayments are not required. As such, interest is charged on the loan balance and is capitalised over the term of the loan. The draw down option chosen by the client may have a significant impact on the cost of the Reverse Mortgage due to the compounding effect of interest.

It is important that brokers and advisers can accurately calculate the costs associated with a Reverse Mortgage.

Transaction Size

Even a modest draw down under a Reverse Mortgage can provide the opportunity for senior Australians to significantly improve their standard of living in retirement.

The ‘It’s on the House’ SEQUAL-RFI Reverse Mortgage Study, found that a modest increase to their income would significantly improve the lives of most retirees, with 50% of those surveyed indicating that as little as $300 a month would be sufficient.

The study showed that a third of retirees (31%) expected to rely on their home as a source of retirement funding and revealed that baby boomers are not optimistic about their ability to fund their retirement, with a third fearing their funds would last only five to 10 years.

Social Security Benefits

Not surprisingly, 65% of retirees rely on the aged pension for their primary income.

Despite the significant cash flow improvement that might arise from equity release, most Borrowers are sensitive to any impact a Reverse Mortgage may have on their entitlement to Social Security Benefits. This is an important aspect of equity release that must be carefully considered by the financial adviser.

Centrelink Rules

Retirees who receive any Government Income support, such as the “Age Pension”, should carefully consider what they plan to do with the funds from an equity release loan.

In general if the loan amount is spent immediately on day to day items or repairs or improvements to the principal place of residence, a retiree’s Age Pension may not be affected.

If, on the other hand the loan amount is invested, a retiree’s Age Pension may be affected. Generally speaking these implications are the same whether you borrow a lump sum of money or elect to receive regular monthly payments.

The Phases of Retirement Planning

The journey towards retirement begins well before our clients approach the end of their working life and the strategies for using Reverse Mortgages will depend on the phases of retirement planning:

Transition into Retirement

Financial planners often debate whether the family home should be included as “under advice” and therefore included in the asset allocation or whether the home sits outside the scope of advice.

Traditionally when setting up an account-based pension or investment advice, financial planners use a smooth average expected rate to show projections. In reality, we know that a client will experience volatility. For account-based pensions, the returns experience of the first few years can make a significant difference to how long the money will last.

Traditionally the home has been left out of the scope of advice. But the reality for many clients is that they are “Asset-Rich but Cash-Poor”. At some point in time, they may need to access the equity in their home.

Living well in retirement

Retirees that desire an active retirement and intend to not only live long but live well, access reverse mortgages for a range of reasons, including:

- regular income to improve their standard of living
- pay medical expenses
- home maintenance
- pay for holidays, or
- replace a car or other physical assets.

The Challenge of Aged Care

When a person moves to an aged care home, the decision whether to include the home as an active asset or not may be made for you. The home will become an assessable asset and is considered available to fund the entry fee unless the spouse or eligible person still lives there.

The entry fee for a hostel is paid as a lump sum bond. Anecdotally, the bonds in the major capital cities average around $250,000- $350,000, and can be even higher.

The average age of a person moving into aged care is in their early 80s. This is also a time when other assets may be running out, potentially leaving the home as the only source of capital for paying the bond.

ASIC Consumer Guide:

Whichever phase of retirement your client is in, the role of the Financial Planner remains as a trusted adviser who will have proper regard for the client's overall financial circumstances and carefully consider the clients immediate needs and how those needs may change over time. The ASIC Consumer Guide provides a useful checklist of key client issues:

- What are their Financial Needs (Now and the Future)
- What are their Other Options?
- Do they have Dependents that need to Occupy?
- Do they (or expect to) Receive Benefits?
- Do they need a Lump Sum or Income Stream?

Providing Reliable Advice

The family home is now an intrinsic part of the planning process. There is good reason to explore the options, risks and rewards of equity release.

The strategies for Reverse Mortgages are diverse. For some retirees they are an effective means to supplement income or to provide access to capital. For others, they can be a tool to help manage market volatility. For frail retirees with poor health, it can provide them with choices for accessing the care they need and provides the ability to pay the aged care fees.

Equity Release is not a last resort to access money when all other sources dry up. When used effectively, Reverse Mortgages can help a client to access the significant wealth they have accumulated in an illiquid asset in order to more effectively live the life that they choose.

SEQUAL Equity Release Planner Program

SEQUAL and the Financial Planning Association (FPA) have announced a professional development program designed to ensure that financial planners are well placed to advise clients on reverse mortgages.

SEQUAL has accredited nearly 1,500 Reverse Mortgage Consultants (RMCs) throughout Australia. This network of Brokers, Planners, Accountants and Legal Advisers represents a valuable resource for consumers wanting to easily identify and access properly-trained Equity Release practitioners.

For more information or to register for the next workshop, visit: www.SEQUALeducation.com.au

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Kevin Conlon the CEO of SEQUAL is highly regarded for his ability to combine technical knowledge with strong communication skills. He holds a Master of Finance degree and has broad experience in both domestic and international financial markets and is an acknowledged expert in Australia's rapidly-growing Equity Release market.