Nationwide Not-for-Profit Equity Release Scheme – Fair Money for Homes

(the current position; where we want to get to; how we might get there)

Draft paper arising from a meeting at the Which? offices on 11 August 2006. Those present included: Teresa Fritz, Doug Taylor, Pula Houghton, Melanie Green, Camilla Bennett (all representing Which?); Naomi Kingsley, Warren Garrett (London Rebuilding Society); Graham Wood (ART Homes); Andrew Wallace (Wessex Reinvestment Society); Robin Keyte (Fair Money).

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1. The Current Position

Which? has published successive reports in 2003 and 2006 on equity release, the conclusions of which were highly critical of the product terms on offer, and the sales process distributing those products.

Also in June 2006 the Social Market Foundation published a report titled "Home Made Money – a co-production approach to equity release" the conclusion of which was that some form of government backed national equity release scheme was required.

The consensus appears to be that the product terms and distribution process in the retail equity release environment are presently failing consumers.

The view of product providers appears to be that they are unable to improve their terms because of the cost of the capital that they are using to distribute and administer their equity release products. In short, there is a minimum return they require on the capital which is at the cost of the consumer.

Looking at the not-for-profit sector, there are at least three existing offerings that relate in some way or another to equity release.

1.a) Wessex Reinvestment Society

Using a consortium of 10 local councils in the Wessex area, WRS has developed a home loans product aimed at home owners with low incomes whose properties are in disrepair, or at risk of falling into disrepair. There are three variations of the home loan product:

i) a capital and interest repayment loan from £1,000 to £15,000. The homeowner is subject to an interest rate of 3% pa. There is no minimum age and the maximum term is 15 years.

ii) an interest only loan from £1,000 to £15,000. The homeowner is subject to an interest rate of 3% pa. There is a minimum age of 66 and no maximum term is 15 years. The loan is repaid when the property is sold or the homeowner dies.

iii) an interest only loan from £1,000 to £15,000 where the interest is 'rolled up'. The homeowner is subject to an interest rate of 3% pa. There is a minimum age of 71 and no maximum term is 15 years. The loan plus accumulated interest is repaid

when the property is sold or the homeowner dies.

WRS are able to offer the low rate of 3% to homeowners as the local authorities subsidise this and pay a further 3% to WRS. Given that councils would normally pay grants to such homeowners, subsidising the low interest is a much cheaper and more cost effective method of funding essential maintenance and property repairs for such homeowners.

1.b) London Rebuilding Society

Using an award in excess of £5 million from the Invest to Save Budget at HM Treasury, LRS are piloting their social co-ownership scheme. Again this scheme is aimed at home owners with low incomes whose properties are in disrepair, or at risk of falling into disrepair.

A survey of the homeowners property is undertaken to establish its value and the items of work that are required. LRS will then pay contractors to carry out the work in return for an equivalent percentage share in the equity of the homeowner's property.

The equity share is repaid when the property is sold or the homeowner dies.

1.c) ART Homes

ART Homes aims to help homeowners repair and improve their properties by using their loan products. Their loans are only available in boroughs where the local authority has entered into a partnership with ART Homes, and indeed the loan offered can be tailored to meet the specific needs of the relevant local authority. There are five variations of the home loan product:

i) a repayment loan with flexibility over the term and the interest rate. The term and the interest rate can be set to suit the strategy of the local authority.

ii) an interest-only loan where the term and the interest rate can be set to suit the requirements of the individual.

iii) a ‘Faith’ loan for homeowners with religious objections to conventional loans. The cost of providing the loan is met by a charge made for the service.

iv) a property appreciation loan (PAL) which was developed following research by the Birmingham University Centre for Urban and Regional Studies. The loan is calculated as a percentage of the value of the property (similar to LRS). The PAL is repaid when the property is sold or the homeowner dies.

v) a discounted version of the PAL, developed to encourage take up of home improvement loans in a regeneration area, to fit in with the strategy of a local authority and reduce the use of direct grant.

PALs are not subject to age restrictions, however the amount lent is generally limited to a minimum of £2,500 and a maximum of £40,000, or 50% of the property value if less

Common features of the providers are access to cheap capital in the form of ‘invest to save’, or grant funding or subsidised loans. Distribution is typically through local authorities or referral networks linked to them. The products were created because there

was a serious demand for these types of approach that was not being met by the retail market.

2. Where We Want To Get To?

As a result of their work on equity release Which? were able to scope out the terms they would like to see on equity release products, as follows:

i) no exit penalties
ii) no early redemption penalties
iii) no initial charge
iv) low minimum of £1,000
v) ability to 'drawdown' equity release
vi) minimum age 65
vii) low interest rate (i.e. NOT exceeding Bank of England base rate) OR equity share. (Please note, equity share to be directly related to amount released, and NOT shared appreciation mortgage or anything similar).

Whilst retail terms are a long way from the above at present, the not-for-profit offerings presently available do meet most if not all of these requirements. Why is this?

Aside from the more socially responsible approach to the product design, the main differentiator is the cost of the capital being used by the not-for-profit providers to award these loans / releases of equity. The cost of the capital is cheaper thanks to the award of grants or subsidies related to the capital and / or interest.

Whilst this has allowed the pilots to develop and create mechanisms that can be repeated and developed, given the potential size of the market that needs to be served, it is in no way sustainable.

The most fundamental problem is to establish a mechanism through which patient and low cost capital can be acquired.

3. How We Might Get There

The most desperate need is to provide a not-for-profit equity release product aimed at homeowners on low incomes to help them repair and maintain their properties. We view this as more important at present than dealing with a not-for-profit equity release product aimed at lifestylers who want to supplement their income or generate capital. So, we propose that this project has two phases:

- Phase 1 – home repairs and maintenance product

- Phase 2 – lifestylers product to provide additional income or capital

Given that local authorities might only have a potential interest in Phase 1, it is likely that we would need to keep the funding of the two phases separate.

Focusing on Phase 1, the first thing to consider is how patient low-cost capital might be raised. Given the potential size of the market we are aiming to serve, grant funding and such like is not sustainable. We need a repeatable mechanism that is cheap and easy to run.

So, in the broadest terms, we need primary investors willing to tie up their money for 15 years or more without receiving interest or income in the meantime. Ideally, we might also be able to create a secondary market so any primary investors wishing the sell their investment early have a way out.

ART Homes has already spent a lot of time and effort courting the private sector in search of leverage, only to be repeatedly told that the organisation must be authorised and regulated by the FSA and licensed under the Consumer Credit Act. This may be a barrier to low cost terms for the customer unless we can find ways around it.

To keep costs down, we would like to promote this investment opportunity in an unregulated environment thus ensuring as much as possible of the money raised is passed on to equity release customers.

However the experience of ART Homes points to a further concern on the investor's potential interpretation of risk and return. If investors assume low house price inflation and high interest rates, they might want an additional margin as a buffer, which again would be a barrier to low cost terms for the customer. To some degree this many be about balancing the returns to the investor with low cost terms for the customer, and perhaps also about the financial literacy of the investor and managing their expectations.

An initial hypothesis is that the lowest cost route might be achieved by a vehicle like an Industrial & Provident Society which is an ideal not-for-profit vehicle (however this does not stop returns being distributed to investors), and which can invite investment in a manner that is outside the financial promotions regulations.

It is conceivable that the withdrawable share capital issued by Industrial & Provident Societies might also be subject to a secondary market on a matched bargain basis, whereby the secondary investor buys new withdrawable shares and the money received is used to pay out the primary investor. The one drawback here is that the Industrial & Provident Society assets would have to be valued regularly.

Finally, whilst there are many social investors that might be willing to support such an investment, they are far too small in number compared to the investment that is required. Therefore some enticement is needed to encourage investors into this, such as tax relief.

The natural choice in the present environment is Community Investment Tax Relief (CITR), reducing the investor's income tax bill over the 5 years following the investment by an annual amount equivalent to 5% of the original investment amount. HM Treasury would need to be persuaded to widen the application of CITR to investments in Industrial & Provident Societies that provided equity release products aimed at repairing and maintaining properties for low income homeowners.

4. Next Steps

We propose to circulate this paper to other interested parties including Age Concern, CAB, Social Market Foundation, charitable foundations, HM Government & Treasury etc

Thereafter we will arrange a second meeting at Which's offices using their conference / seminar suite aimed at bringing together up to 50 participants to establish momentum and push this project forwards.