Equity Release

Quick reference Guide Chapter 6

By the end of this guide you will understand the equity release application process.

The equity release application process

Definitions

There are a number of terms that you need to be familiar with in relation to this chapter:

Lifetime mortgage	• The generic term that applies to a wide range of products targeted at elderly borrowers such as home income plans, cash plans, capital drawdown schemes and open-ended mortgages.
Home reversion plan	• Enables a homeowner to sell all or a proportion of their property to a reversion provider in order to raise funds, with the customer continuing to live in the property, as a tenant, until they die or it is permanently vacated.
MCOB rules	• Mortgages and Home Finance: Conduct of Business rules. Relevant to providers of regulated mortgage contracts, lifetime mortgages and home reversion plans.

There are also a number of abbreviations used as follows:

IDD	• Initial Disclosure Document
FSCS	• Financial Services Compensation Scheme
FOS	• Financial Ombudsman Service
HMRC	• Her Majesty's Revenue and Customs
KFI	• Key Facts Illustration

6.0 Introduction

The equity release application process may be summarised as follows:

- Consideration of equity release options.
- Obtaining appropriate advice.
- Application.
- Sanction or decline of application.
- Legal conveyance of the property (both products) and creation of mortgage (lifetime mortgages).
- Creation of lease (home reversion plans).
- Drawdown of funds.

6.A Consideration of equity release options

Options available are:

- Trade down.
- Sell the property and rent another or live with relatives.
- Conventional mortgage if eligible.
- Borrow from relatives or low-cost sources of finance.
- Take out a lifetime mortgage.
- Let part of property.
- Let whole property and make alternative living arrangements.
- Take out a home reversion plan.

6.A.1 Trading down

Trading down involves simply selling the existing property and buying one of lower value.

6.A.2 Sell the property and rent

Sell the property and rent is not always viable as it can be at least as expensive to rent property as to own. Many agreements are fixed term and not guaranteed to be renewed on the same terms and conditions.

6.A.3 Conventional mortgage

A Conventional mortgage may be a suitable way forward if monthly repayments are affordable and if the borrower is eligible under a provider's lending criteria.

6.A.4 Borrowing from relatives

Borrowing from relatives is probably the least expensive source of funds but most difficult to contemplate for personal reasons. However, there are very few **sources of low cost finance** and interest rates tend to be higher if the lender considers the risk to be higher so it should at least be considered.

6.A.5 Lifetime mortgage

There are a number of **benefits** of **lifetime mortgages:**

- Customer can choose a capital sum or income.
- Can be set up with or without repayments.
- Property ownership retained and there may be some wealth to pass on to beneficiaries.
- There is no emotional problem with selling the property.

The Risk factors to be considered are:

- Value of estate is reduced.
- Rolled up interest can quickly dilute estate value.
- Interest rate usually higher than for conventional mortgages.
- If repayments made, borrower has to be sure of affordability.
- Lifetime mortgages are not designed to be repaid early.
- Potential for loss of entitlement to State benefits and home improvement grants.

6.A.6 Letting all or part of the property

By letting all or part of the property it may be possible to generate a regular income. The customer may be entitled to tax breaks under the **'Rent a Room' scheme** but there are many risk factors that the potential landlord should consider.

6.A.7 Home reversion plan

The main advantage of a **home reversion plan** is the ability to obtain a large sum more readily than through alternative means and also to remain in the property.

Customer can choose to:

- sell all or part of the property
- opt for higher rent in favour of a larger capital sum
- use funds for whatever purpose.

Risk factors are:

- loss of ownership and appreciation in value passes to reversion provider
- immediate reduction in wealth as reversion provider pays substantially less for property than the market value
- on early death, the estate is diluted to no great benefit
- loss of entitlement to means tested State benefits and home improvement grants
- may prove to be an expensive way of releasing money if death or long-term care occurs early.

6.B Obtaining advice

Equity release is a major step so it is vitally important that advice is sought from appropriately qualified persons and firms.

Lifetime mortgages and home reversion plans are regulated by MCOB rules so firms are required to make disclosures throughout sales cycle including the **IDD** and the **KFI**.

As regulated products, additional protection is available from **FOS** and the **FSCS.**

6.B.1 Sources of advice on taxation and benefits

Sources of advice on taxation and benefits:

- Product providers
- Financial intermediaries
- Internet
- HMRC on income tax, capital gains tax and inheritance tax
- DWP
- Jobcentre Plus
- Citizens Advice Bureau
- Money Advice Centres

6.B.2 Independent legal advice

The Equity Release Council code of conduct requires firms to advise customers to seek **independent legal advice** from a solicitor of their choice and the lender will not instruct the same firm. It is also advisable that joint applicants seek advice independently of each other (In **Barclays Bank plc v. O'Brien (1994)** it was asserted that the parties to the contract were subject to undue influence by a spouse or partner).

6.C Application

The **application** process and details required for equity release products resemble a conventional mortgage application.

6.C.1 The applicant

The Provider gathers the following information in relation the **applicant**:

- Personal details
- Financial circumstances
- Supporting documentation to validate above information
- Details of professional advisers

The process under a **home reversion plan** legally transfers the asset for less than market value. Under the **Insolvency Act 1986** this is a **transfer at an 'undervalue'**. Providers need to confirm that insolvency proceedings are not imminent and unlikely in the foreseeable future.

The basis of ownership must be established. **Joint tenancy (joint property in Scotland)** where on the death of one party, the whole property is already owned by the survivor and does not form any part of the estate of the deceased; or, **tenancy in common** where each owner has a share of the property and on the death of one person, their share passes to their estate and not automatically to the survivor.

Details of **the property** have to be gathered and a search of **H M Land Registry** (if the property registered) or Land Charges Register (if unregistered) carried out.

Solicitor prepares an abstract of title with details of ownership and other matters affecting the property in the previous 15 years.

6.C.2 The property

Matters to be considered are:

- Type of property
- Tenure (freehold, leasehold, commonhold or absolute in Scotland)
- If leasehold, the number of years remaining
- Age of property
- Method of construction
- Condition
- Location
- Rights over property
- Conditions of title (easements, positive and restrictive covenants)

Local development plans must be checked and an independent valuation carried out.

6.C.3 The features of the product

The customer must be informed of:

- Maximum that can be raised.
- For lifetime mortgages, method of repayment, term of years, fees, charges, interest rate etc.
- For home reversion plans, any rent to be paid under the lease.
- For home reversion plans, whether possible to sell all or part of the property and any implications.
- Product options such as drawdown or whether possible to pay a higher rent in return for a larger capital sum.
- Investment options if product required for income.

Rights and obligations under any lease.

6.C.4 Sanction or decline of the application

The provider will make a decision to **sanction or decline the application** based on assessment of the customer's circumstances, suitability of the plan for the customer and acceptability of property.

6.C.5 Legal conveyance of the property

For lifetime mortgages, on the completion date:

- Property becomes charged to the lender under a first legal charge (standard security in Scotland).
- All fund movements are completed including release of mortgage to the borrower and repayment of any existing debts that have to be discharged as a condition.
- The lender's interest noted in Charges Register of the **Land Registry**.

A home reversion plan requires a **legal conveyance** transferring legal ownership or a proportion of it to the reversion provider.

If only a proportion is transferred, the reversion provider and customer become joint owners on a tenants in common basis.

Details of ownership must be registered at **HM Land Registry**.

Stamp Duty Land Tax (SDLT) is chargeable on the purchase of property in England and Northern Ireland.

It must be paid within 30 days of the transaction being completed, the payment being made, or the person moving into the property, whichever is the earliest.

In most circumstances the legal representative acting for the purchaser of the property will complete the necessary documentation.

Current rates for SDLT on residential land or property are:

Value of Property	% payable on total value
Up to £125,000	0%
The next £125,000 (£125,001 - £250,000)	2%
The next 675,000 (£250,001 - £925,000)	5%
The next 575,000 (£925,001 - £1,500,000)	10%
The remainder (over £1,500,000)	12%

The amount payable is rounded up to the nearest £5.

It is not paid on items in the purchase price related to carpets, curtains, fixtures etc. Nor is it paid on the sale of a house in connection with divorce or separation, but only if the transaction is made between former spouses.

For the purchase of a property in Scotland, Land & Buildings Transaction Tax is payable. The current rates are:

Value of Property	% payable on total value
Up to £145,000	0%
Above £145,000 to £250,000	2%
Above £250,000 to £325,000)	5%
Above £325,000 to £750,000	10%
Over £750,000)	12%

And for properties in Wales, Land Transaction Tax is payable. The current rates are:

Value of Property	% payable on total value
Up to £180,000	0%
Above £180,000 to £250,000	3.5%
Above £250,000 to £400,000	5%
Above £400,000 to £750,000	7.5%
Above £750,000 to £1,500,000	10%
Over £1,500,000)	12%

6.D.Conditions under equity release contracts

For both types of product, conditions apply in respect of:

- Good repair and material changes
- Repairs and maintenance
- Duty to insure property
- Duties of compliance
- Sub-letting

The contract may permit occupancy by persons, not party to the plan, subject to them waiving their rights of residence. This protects the provider from any overriding interest created under the **Land Registration Act 2002** (England and Wales only).

6.D.1 Mortgage conditions

The following **mortgage conditions** apply under most lifetime mortgages:

- Legal charge
- Interest, fees and charges
- Repayments
- Condition subsequent
- Events of default

6.D.2 Leases under home reversion plans

Leases under home reversion plans set down:

- **Rights** of each party
- **Obligations** of each party

Typical lease should contain the following:

- **Names of parties to the lease**
- **Date**
- **Property**
- **Rent**

Condition subsequent which states events in which the lease will be terminated and trigger right of the reversion provider to sell.

Dilapidations clause not always included but enables lessor to reclaim costs of restoring the property to its original condition if lessee has made major alterations.

Events of default clause sets out conditions under which rights of the lessee are terminated and rights of the lessor to terminate the lease. Some provisions of the **Commonhold and Leasehold Reform Act 2002**, prevent the lessor's exploitation of this clause.

Equity Release Chapter 6 (ER06) – End of Module Test

Multiple Choice Questions

Question	**Answer**	
1 - One essential difference between a conventional mortgage and a lifetime mortgage is the:	A.	open-ended nature of the lifetime mortgage
	B.	open-ended nature of the conventional mortgage
	C.	sale of all or part of the property to the lifetime mortgage provider
	D.	creation of the lease between the occupier and the mortgage provider

2 - When a property is owned on a tenancy in common basis, this means that:	A.	both persons own all of the property
	B.	each owner has a specified share of the property
	C.	each owner has a 50% share of the property
	D.	on the death of one person, the property is owned by the survivor

3 - Adrian has just taken out a 70% home reversion plan. How much of the buildings insurance premiums, if any, will he have to pay?	A.	Nil
	B.	100%
	C.	70%
	D.	30%

4 - When a lifetime mortgage is taken out with interest rolled-up, when is the interest element usually repaid?	A.	At the end of the agreed term
	B.	Monthly, quarterly or annually
	C.	When the loan to value ratio reaches 100%
	D.	On the death of the borrower or when the property is sold

5 - Ann, aged 80, lives alone in a property worth £450,000 and has a very low income. She needs to raise £45,000. What option should she be advised to consider first?	A.	A lifetime mortgage plan
	B.	Trade down to a smaller property
	C.	A home reversion plan
	D.	A home income plan

6 - Which of the following is not part of the lifetime mortgage process?	A.	Application
	B.	Creation of a mortgage
	C.	Creation of a lease
	D.	Obtaining appropriate advice

7 - Which of the following is not a benefit of a home reversion plan?	A.	Ability to obtain a large sum of money
	B.	Property does not form part of the estate on death
	C.	Use the funds for whatever purpose is required
	D.	Ownership of the property is retained

8 - A transfer at an 'undervalue' may take place when which of the following plans is taken out?	A.	Home reversion plan
	B.	Lifetime mortgage
	C.	Home income plan
	D.	Shared appreciation mortgage

- **End of Questions** -

Answers

Question	Answer	
1 - One essential difference between a conventional mortgage and a lifetime mortgage is the:	A.	open-ended nature of the lifetime mortgage
2 - When a property is owned on a tenancy in common basis, this means that:	B.	each owner has a specified share of the property
3 - Adrian has just taken out a 70% home reversion plan. How much of the buildings insurance premiums, if any, will he have to pay?	B.	100%
4 - When a lifetime mortgage is taken out with interest rolled-up, when is the interest element usually repaid?	D.	On the death of the borrower or when the property is sold
5 - Ann, aged 80, lives alone in a property worth £450,000 and has a very low income. She needs to raise £45,000. What option should she be advised to consider first?	B.	Trade down to a smaller property
6 - Which of the following is not part of the lifetime mortgage process?	C.	Creation of a lease
7 - Which of the following is not a benefit of a home reversion plan?	D.	Ownership of the property is retained
8 - A transfer at an 'undervalue' may take place when which of the following plans is taken out?	A.	Home reversion plan