THE LINK BETWEEN INCOME, SAVINGS AND PROPERTY IN FUNDING RETIREMENT

FINAL REPORT FOR THE FINANCIAL SERVICES RESEARCH FORUM

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Abstract

This report on research into funding retirement is particularly topical given the government's commitment (12th May, 2008, The Today Programme, Radio 4) to find a solution to the problems of caring for the elderly in ways that do not discourage personal saving for retirement. Some key findings of this report are as follows: the research confirms that people regard the equity in their homes as an important part of their financial planning for retirement; people have more confidence in property than in pensions; while downsizing their homes may be the optimal financial solution, for reasons of physical, psychological and social attachments to the home and close neighbours, it is often not a feasible option; equity release thus has a valid role to play but the challenge is how best to reconcile the risks and rewards for both providers and consumers; and finally, the research indicates how uncertainty regarding future changes in government policies and, in particular, the taxing of savings undermines people's confidence in planning for retirement.

Executive Summary

- Around 12 million Britons are off target for a comfortable retirement; (FSA, 2003)[i];
- Around three quarters of the UK population over the age of 55 are home owners;
- People see their residential home equity as a key aspect of retirement finance;
- Almost half the home owners in three age cohorts (aged from 45 to 80) expect to access some of the equity in their homes in retirement (Smith 2005:11);
- In 2005/6, 59% of UK pensioners, couples and single pensioners were drawing occupational pensions at a mean amount of £191 per week for pensioner couples and £98 per week for single pensioners (DWP 2007, 41);
- Half of our respondents expected to be, or were, working beyond normal retirement age but level of income seemed not to determine this decision suggesting that work is perceived *not* just as a source of economic well-being;
- Equity release remains a small market but is expected to expand. Until recently, the most popular schemes were lump-sum lifetime mortgages suggesting that they were used for home improvements;

- Currently draw-down lifetime mortgages where the customer accesses a regular income, rather than a lump sum, are the most popular suggesting that supplementing pension income has become more important;
- The combination of home-ownership and a private pension reduces the expectation of insufficient income in later life by 10-20 per cent in comparison to owning just one or the other (Banks et.al., 2004);
- Despite State intervention in encouraging investment in personal pensions, property is perceived as a better investment than personal pension plans for the pre-retirees (Barker and Healey 2004) and is a more important part of income for sixty per cent of equity release respondents in this research;
- While the industry believes that the market for equity release has shifted from necessity to lifestyle, our research does not entirely support this;
- Our respondents saw equity release as providing income, facilitating home improvements, or as a buffer against future costs of personal, dental and healthcare, or a downturn in their investments;
- Lower income customers expected equity release cash to supplement income and enable home improvements whereas the wealthy saw it more as a way of passing money onto the next generation and beyond;
- A gender split is evident in that men see income and nest eggs for the future as a priority whereas women were more interested in home improvements and expensive consumer goods;
- The market for equity release products is likely to expand not least because of the effect of the credit crunch on pension and other investments;
- The US and Europe do not offer much evidence of a future bonanza for these products;
- An exception could be to target expatriates whose property abroad could be seen as a resource for maintaining lifestyles.
- Uncertainty surrounding government policy undermines confidence in saving for future retirement.
- People in retirement and in different age cohorts vary significantly in their perceptions of personal financial well-being from pre-retirees.

Introduction

Older consumers are subjected to a range of competing communications regarding the kind of lifestyle they may expect in retirement. On the one hand, lyrical advertisements suggest that retirement should be a time when older homeowners need not have financial worries. You will have:

> ‘Enough money to fulfill those dreams you’ve always had about what you would do when you came to retirement – travel the world, build that conservatory you‘ve always wanted, take up a new hobby or just have enough money to afford those little luxuries which make life worth living’ (Equity Release advertisement).

Here, consumer power and aspirations can extend well into later life. On the other hand, this is a time when the retired may feel the full force of a lifetime of under-saving. This is because risks have been individualized (Bauman 2001b, Beck 1992) so that each person has responsibility for their own financial and social security no longer being able to rely on care funded by state welfare.

It is unarguable that there are significant shortfalls in the current provision of retirement funding especially as people's health improves. Such improvements have resulted not only in increased life expectancy – the average for those aged 65 is to live into their mid 80s (FSA, 2007) but also greater abilities to maintain active post retirement lifestyles with associated costs. The Financial Services Authority's financial risk outlook paper estimated that around 12 million Britons are off target for a comfortable retirement (2003)[ii]. Clearly, a sound financial planning and investment strategy is crucial in the provision of adequate retirement income especially as life expectancies continue to increase.

The overall structure of the UK pension system has changed in the last few years. There has been an accelerated trend away from Defined-Benefit (DB) or "final salary" schemes towards Direct-Contribution (DC) or "money purchase" schemes, effectively transferring the risk of non-performance from employers and pension funds to individuals.

Given the uncertainty of the future, and in the context of declining state and occupational pensions, many individuals will be forced to use wealth other than pensions to meet various needs as they grow older. Indeed, Deaton (1999) asserts that saving up for house purchase is nowadays analogous to saving up for retirement.

Property is predicted to play a crucial role in funding retirement. A Study by CML and Hanover Housing Association shows that nearly half the homeowners in three age cohorts (aged from 45 to 80) expect to access some of the equity in their homes in retirement (Smith 2005:11). Among homeowners aged 70 years plus, 27 per cent currently have incomes below 65 per cent of the average. Equity release would reduce this to 16 per cent and could cut the proportion of home owners aged 80+ in this income bracket from 34 per cent to just 12 per cent.

Whether equity release is the panacea to the problem of inadequate planning and saving for retirement, or offers consumers the opportunity to prolong consumption into old age is debatable. Such products have come under negative scrutiny by a variety of commentators for poor value, high costs and poor advice from intermediaries (Appleton 2003; FSA 2005; Which? 2006).

This research inquires into the concerns that individuals both in, and approaching, retirement have about financing their later years. There are wide variations from those that have adequate pension and savings to provide a reasonable income in retirement to those who expect to work beyond retirement in order to maintain a desired lifestyle. For a set of our respondents, boosting their incomes in retirement may have included releasing some of the value from their homes and this research seeks information on how they utilized the money – whether it can be rightly said that these products are sold on lifestyle and bought out of necessity. Although a majority of pre-retirees and the retired participating in this research have not gone down this route, property may still be seen as an alternative source of funding post retirement at some later point in their lives.

After providing a brief summary of the research method, the report outlines the background to the research in terms of the problems of a growing older population, under-provisioned in terms of pensions and savings and the possibilities that income could be released from property to plug the gap, or from an alternative perspective, to enhance late life and extend consumption. The next section studies how individuals, both pre and post retirement are approaching their later years, their concerns regarding income and their perceptions on property as a support to pension income and, in the case of equity release consumers, how they have utilized this income. Since the US economy suffers similar problems in terms of a growing and under-saved older population but is a relatively more mature market, a comparison is made to establish whether it might serve as a guide to future conditions in the UK. Due to economic, social and cultural reasons, continental Europe, has yet to embrace equity release although given the exodus of large numbers seeking sunnier climes, the expatriate population could prove a fruitful market. We conclude with some suggestions on the implications of this research for policy makers, employers and the financial services sector as well as future directions for research in the area of equity release.

Research Method

In seeking to identify the kinds of decisions made by people over 55 years of age about funding their retirement years, this project set out to explore the link between income, savings and property. Because equity release schemes have been seen as a potentially strong growth area for financial services firms, there has been a concentration on seeking information concerning the experiences of, and reasons for purchasing, these schemes and their viability as an alternative to other forms of retirement income. Other alternatives proposed by the Turner Commission (2005) will also be considered in the research. These include extended work and flexible or gradual retirement, an improved state pension through individually owned retirement accounts, reducing the level of means testing, improved benefits for women, carers or others with interrupted paid work records, and increased saving partly through automatic enrolment into a national scheme and employer pension schemes.

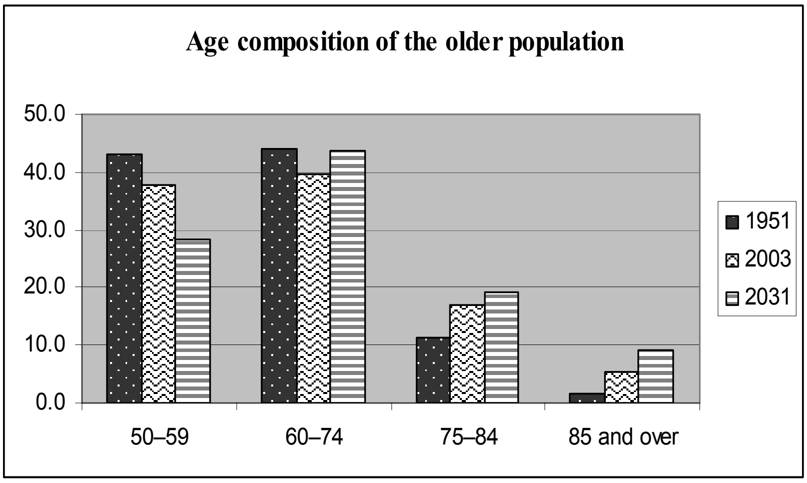
The sample comprised 49 purchasers of equity release products recruited through one producer of these products and a large firm of specialist independent financial services advisers. Two specialist intermediaries were interviewed in depth, as was an executive from a medium sized producer and a senior staff member of the trade body, Safe Homes Income Plans. For the 55-70 years non- purchasers of equity release products, participants were recruited from public and private sectors through a Pre-Retirement Association and a medium sized manufacturing company (15) and members of a Midlands Over-Fifties Forum participated in 2 focus groups (15 and 17 respectively). Follow-up interviews took place with six focus group participants. The methods used included administration of a semi-structured interview schedule with equity release consumers and the Pre-retirement Association. Face-to face interviews were carried out with eight employees of the manufacturing company aged from 55-59 years. Two focus groups took place with the Midlands Over-fifties groups and follow up-telephone interviews with six focus group members.

1. Background

1.1. The Ageing Population

In mid-2006 the resident population of the UK was 60,587,000, of which 50,763,000 lived in England. The average age was 39.0 years, an increase on 1971 when it was 34.1 years. In mid-2006 approximately one in five people in the UK were aged under 16 and one in six people were aged 65 or over. http://www.statistics.gov.uk/. The absolute number of older people is mainly a result of the number of births five or more decades earlier and increasing survival rates. The role of international migration has been far less important in changing the age distribution of the UK than the role of fertility and mortality (DWP 2005). As the chart below demonstrates, the number of people who are over sixty years old is projected to rise steadily over the next two decades.

Figure (1): The Age Composition of the Older Population in the UK



Source: Office for National Statistics; Government Actuary's Department

1.2. Pensioner Incomes

According to the Department of Work and Pensions, in 2005/6 59% of UK pensioners, couples and single pensioners were drawing occupational pensions at a mean amount of £191 per week for pensioner couples and £98 per week for single pensioners (DWP 2007, 41). Pension Trend figures for 2004/05 show that:

- 39 per cent of the 35.4 million working age population were members of a private pension scheme (occupational or personal), down from 40 per cent in 2003/04. More men (44 percent) than women (37 percent) were members;
- Between 1997 and 2005, employee membership of defined benefit pension schemes fell from 46 to 35 percent, while membership of the more risky, defined contribution schemes increased from 10 to 15 percent (DWP 2006);
- The total number of occupational pension schemes in the UK fell from 105,320 in 2000 to 66,710 in 2006 (DWP 2006);
- Of the 3.6 million self-employed individuals, 44 per cent of men and 27 per cent of women in 2004/05 belonged to a personal pension scheme, down from 45 and 28 per cent respectively in 2000 (Pension Trends, http://dwp-gov.uk).

From the 1970s employers have been retreating from occupational pensions as rapid increases in life expectancy coinciding with the end of the high equity market pushed the anticipated costs of occupational pensions higher than was expected when the schemes were designed' (DWP 2006, 22). The withdrawal from defined benefit schemes occurred just after the Chancellor's withdrawal of tax relief on dividends paid into pension funds. These changes are predicted to impinge on private and occupational pensions affecting 11 million people in the UK with company pensions and seven million with personal pension as the value of pension funds falls (Nugent 2007). Two further measures are expected to devalue private pensions even more: The Accounting Standards Board proposes radical changes in the reporting of pension liabilities on the accounts, liabilities under these proposals would be calculated using the risk-free rate based on gilt or treasury bond rates, rather than on the value of the high-quality corporate bonds required by current accounting standards (Challis 2008). In addition, in the search for greater transparency, there will be a requirement to include supplementary information about assets and company liabilities in the company's accounts which may increase volatility in the measurement of deficits and surpluses. The National Association of Pension Funds predicts that there is a risk that these changes may undermine employer's willingness to continue to sponsor defined benefits schemes (NAPF 2008). Furthermore, the government's planned system of personal accounts may lead to a decline in occupational schemes resulting in smaller pension pots and lower retirement income if employers change their arrangements when the rules come into force (Osborne, 2008). In the future, self-provisioning, or enforced self-provision is unlikely to provide the same type of security blanket that occupational pensions have for present retirees, the majority of whom are, undeniably, male.

In the year 2005/06 the average gross weekly income for pensioner couples under seventy-five was £529 (for those over 75 years it drops to £380). For single female pensioners under seventy-five, the figure is £252 and for those over seventy-five, £211. The figures for single male pensioners in 2005/06 were £264 and £261 respectively (DWP, 2007).

The Pensioner's income series for 2005/6 gives the proportion of the various components of income as in Table 1:

Table 1 Source of post retirement income	
State pensions and benefits average	45%
Occupational pension	25%
Earnings from employment	16%
Personal pension	12%
Investments	9%

Source DWP 2007

In retirement, people rely upon pensions and accumulated savings as well as earned income and the state pension, the value of which depends partly on the salary earned at the end of a working life. In 2005/6, 71% of pensioners, both couples and single pensioners, had some investment income, for example from cash savings or stocks and shares, although for most pensioners this was a relatively small amount. For example, half of pensioner couples who had investment income, received £10 a week or less from it. Whereas

59% of pensioner units had income from an occupational pension at an average amount of £146 per week , but

only 12% had personal pension income in 2005/6 with the mean amount of £97 - £105 for couples and £97 for single pensioners (DWP 2007: 8).

1.3. Working On

In the 2006 White Paper, 'Security in Retirement: Towards a New Pension Scheme', the Government set out measures to gradually raise the State Pension age in line with gains in average life expectancy. The State Pension age for women is already due to rise from 60 to 65 between 2010 and 2020, to equate with men's State Pension age. There will be a subsequent rise for both men and women, beginning with a rise from 65 to 66 over a two-year period from 2024, then again by one year over a two-year period from 2034 and from 2044; and measures will be taken to support a longer working life (DWP 2006, 18). On the legislative table for 2008, if enacted, these actions will accelerate an existing, but small trend in working beyond present state pension age (SPA) of 60 years old for women and 65 years for men. This would go some way towards reversing the decline in employment that has defined the overall labour market for workers over 50 years for the last two decades. The following table illustrates the small, but growing development of post-SPA working, especially for women over 60 years, many of whom will have less in the way of pension provision and accumulated savings and investments.

Table 2: Increases in Employment Rates for Older Workers in thousands

Year	**Males 65+**	**Females 60+**
2003 July	338	624
2004 July	343	655
2005 July	358	705
2006 July	387	785
2007 July	420	813

Source: LFS in Employment UK: Male Aged 65+, Female: Aged 60+, http://www.statistics.gov.uk/statbase Updated on 11/1/2008

Nationally, the proportion of older pensioner couples with income from employment was 26% in the year 2005/6. For older single pensioners the figure was much lower – six percent. As could be expected, the percentages of recently retired pensioners with income from earnings in that year was much higher, thirty-five percent for couples and twenty-two percent for single recently retired pensioners (DWP 2007, 47).

People retire from the workforce for a variety of reasons and at different stages in their fifties and sixties. Poor health and disability are the most common push factors for early retirement (Phillipson and Smith, 2005). Those who have achieved a state of financial security that allows them to maintain a desired lifestyle, through careful planning and/ or generous occupational pension provision may also take the final step out of paid employment (Irving, Steels and Hall, 2005). In the future, switches from defined benefit to defined contribution pensions combined with Government policy on retirement age may restrict this choice to higher income earners and their partners. For the majority, working on into their late sixties would seem to be inevitable and may even be a lifestyle choice partly made possible by the rise of the service economy and better health into old age and made more necessary because of longevity.

1.4. Homes as Realisable Assets

Over seventy-five percent of UK over-fifties owned their homes in the year 2003/04. Fifty-two percent owned their homes outright and a further twenty-three percent were buying their home with a mortgage. The percentage of owner-occupiers declines with age since the figure is seventy-nine per cent for the 50-64 age group, whereas only sixty-three per cent of those aged 85 and over. (http://www.statistics.gov.uk/).

Table 3 Tenure: by age of household reference person, 2003/04				
Great Britain				Percentages
	50–64	65–84	85 and over	All aged 50 and over
Owner occupied				
Owned outright	*39*	*66*	*61*	*52*
Buying with mortgage	*40*	*7*	*2*	*23*
Social rented	*15*	*24*	*29*	*20*
Private rented	*6*	*4*	*8*	*5*
All tenures[1]	*100*	*100*	*100*	*100*

1. Includes accommodation that goes with the job of someone in the household or that is rent free.
Source: General Household Survey, Office for National Statistics

The combination of home ownership and private pension can have a significant impact on how pre-retirees perceive their future, by reducing the expected chances of having insufficient resources to meet needs at a later time by up to 20 per cent. However, it is interesting that even when owning both a house and a pension, there is a more than 30% likelihood of having insufficient funds to meet needs in retirement and having just a pension but no property seems to leave people feeling that they are little better off than those with neither property nor pensions.

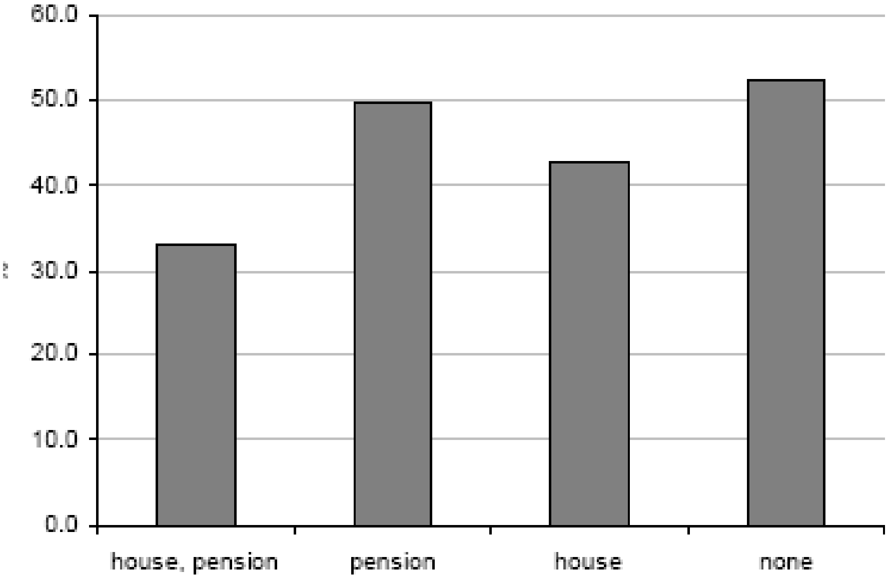


Figure 2 Mean expected chance of having insufficient resources to meet needs at some point in the future, by portfolio status: all aged under 60: Source: Banks et.al. (2005: 31).

Owning a house and a pension provides a level of financial security for the future, but as this research shows, over thirty per cent of respondents aged under 60 years felt that they were under-provisioned for the future. This pessimism might well be much greater if the research were repeated in 2008 when the economy has started to turn down and food and energy price inflation has risen sharply. Examining the trajectory of financial assets including housing wealth for house owners around retirement age, Disney et al (2002) confirm the view that UK pensioners retained substantial housing wealth into old age[iii]. Housing wealth is a key source of potential retirement funding. Recent estimates by the Actuarial Profession[iv] suggest that the aggregate housing wealth owned by pensioners in the UK is currently around £1,100 billion. Whilst trading down to a smaller property may be the more likely means to tap into the most valuable asset held by most people in their latter years, equity release mechanisms of various kinds are a small, but growing element of the consumer market for older people.

1.5 Equity Release

Six types of equity release product dominate the market The first four involve mortgaging the property whereas the other two are home reversion schemes.

- mortgage loan with interest payments only;
- mortgage loan with interest paid by an annuity purchased with the loan, in a home income plan ;
- mortgage loan with rolled up interest (or lump sum lifetime mortgage);
- mortgage loan with no interest payments and repayments linked to capital appreciation or some other measure;[v]
- sale of home for a lump sum and or an income, i.e. a home reversion scheme;
- sale of part of the home for a lump sum and/or an income, i.e. a partial home reversion scheme. (Terry and Leather, 2001: 29).

The second and third types come under the rubric, ‘lifetime mortgage’. Lump-sum lifetime mortgages headed the market at the turn of the century; Safe Home Incomes Plans figures suggest that draw-down (in some cases from an annuity purchased with the loan) lifetime mortgages in which the customer accesses a regular income rather than a lump sum have come to top the market (Hodge Equity Release 2006).

Setting up costs in terms of arrangement and legal fees can vary between £600 and £1,300. The overall interest on a loan of £45,000 can be very high, especially in the case of a lump-sum lifetime mortgage:

- For a lump sum lifetime mortgage over 15 years, the compound interest totals £70,000 – and the total payable including the original mortgage would be £115,000 when the borrower dies, or goes into permanent residential care.
- For a lifetime drawdown mortgage over the same period that is based on the borrower drawing down £250 income per month, the interest comes to £39,087 – the total payable, £75, 087 - costing less than a lump sum lifetime mortgage as sums drawn-down reduce the amount of interest payable over the life of the loan resulting in a lower overall cost (Money Made Clear 2007).

Home reversion plans involve selling part, or all, of the property to an investment company (called a reversion company) that, in return, gives the customer a cash lump sum or an income for life and sometimes the option of both. The customer then transfers legal ownership of the property to the home reversion company, while any remaining portion that has not been sold is held in trust. It is claimed that customers do not receive the market value for the portion of the home that is sold ('Which', 2006), but this does depend on the age of the customer at the time at which the loan is taken out. Home reversion plans have some distinct disadvantages: if the customer sells all of the home, then the customer may become a tenant in his, or her own home, possibly on rolling assured short-hold tenancy agreement, if at a later stage the customer needs to move house this may pose problems and, if the property increases in value, the home reversion company is the greater beneficiary.

Equity release products have been treated negatively in the press and, as our research demonstrates, are regarded with suspicion by both pre-retirees and retired people. An HM Treasury consultation exercise asserts that the 'folk memory of bad outcomes from the late 1980s is still strong… and the knowledge that products which released equity led people into negative equity, re-possession and financial disaster creates apprehension for many older people' (Appleton 2003).

A number of small Home Improvement Agencies (HIAs) arrange smaller equity release loans for vulnerable and older people to improve their homes and bring them up to the level of the Government's Decent Homes standard. These are small, locally based not-for-profit organisations. The Nottingham based Home Improvement Trust is a typical example of these small intermediaries. HIT arranges loans and equity release products with commercial lenders (e.g. Norwich Union and Dudley Building Society) for the purpose of financing home improvements (Foundations 2006). Although Home Improvement Agencies do not benefit from the same level of Government support as the Government sponsored Home Equity Conversion Mortgage Scheme in the US, some cash in the form of short-term Government grants is sparingly made available to Home Improvement Agencies in the UK. William's report for the Council of Mortgage Lenders suggests that lower income homeowners would benefit from a service supported by Government in which small scale equity release products are made available by not-for-profit organisations and responsible and trusted providers (2008:13) Home Improvement Agencies fulfill this function in a limited way. They provide money for necessary home improvements, but not for other purposes. Unfortunately, time constraints precluded further research into these agencies.

2. The Link between Income, Savings and Property

2.1. Working on - Income from Earnings

A surprisingly large proportion of respondents from all the groups participating in this study: pre-retired, retired and retired equity release consumers either planned to continue working, or had continued working past their employer's customary retirement age. Putting aside home-carers, those who took early retirement either due to redundancy or ill-health, with or without a lump sum, the couple of respondents who had resigned and failed to seek further employment and the few who did not answer the question, the approximate figure for continued working was 50 percent across the equity release consumers, retired focus group members and the pre-retired respondents.

The reasons given for continuing in employment varied according to age. However, the older set of lower income, retired focus group members most frequently cited financial concerns as the reason for continuing to work beyond normal state retirement age. With the equity release consumers (age span early 60s to early 90s) there was a balance between meeting existing financial commitments, the need to top-up retirement income and the desire to maintain their current lifestyle for as long as possible. This applied to those on annual incomes from £11,000 up to £35,000 suggesting the pervasiveness of 'consumerism' that encourages people to consume beyond their existing levels of income. These issues also relate to the rationales that many of our respondents gave for purchasing an equity release product, as examined later in this report.

The set of pre-retirement respondents can be seen as members of the first wave of the 'baby boomer' generation who are now reaching retirement age. This group is characterised as having different expectations of retirement where it is seen as less of a cut-off between work and non-work and more of an attenuated process moving from full-time to part-time work and, eventually into active leisure. Although this was the smallest group, it displayed the greatest variety in responses to questions about their intentions regarding retirement. This is also the group who have been the most exposed to fluctuations and change in the investment and pension market, and changes in the legislation regarding age discrimination in recruitment and promotion in addition to proposed changes to the age qualification for the payment of the state pension (http://www.agepositive.gov.uk). These are people who, on the whole, are presently earning from £20,000 upwards and in receipt of some form of private pension. Responses suggested that maintaining their current lifestyle and companionship was as important as paying off mortgages and topping up savings and investments. It seems that this group is pragmatically approaching continuing work as a response to trends in society around both individualised risk and consumerism. As this pre-retiree says of her choice to work on after SPA:

> "It's nice to have the extra cash, but it isn't a necessity, but because I want to maintain our present lifestyle. I feel as if I might vegetate if I retire, I've seen my mum do it." (Female clerical assistant, 58 years).

A male project manager with an income of £80,000 per annum and a full set of occupational pension, savings and investments expects to have a comfortable retirement. He does not expect to work after retirement He says:

> 'I am ready to start the rest of my life. My father at 60 was very old in outlook and did nothing new in the 30 years before he died - what a waste!'

There were other examples of pre-retirees who were, seemingly, well prepared for retirement, with occupational pensions, topped up with AVCs, savings, and investments. Others, mainly female and earning under £25,000 per annum expected that they would work on beyond SPA and also be reliant on the State Pension and Benefits in retirement. Reasons they gave for working on included:

- To maintain current lifestyle;
- To pay off existing mortgages;
- To top-up occupational pensions;
- For the social aspect of working;
- Because they enjoyed their work and preferred to keep active.

Research carried out by the Council of Mortgage Lenders found that the likelihood of working past SPA did not seem to be affected by either social group or income (Smith, 2004: 24). However, we found a gender dimension in that, although all the pre-retirees had an occupational or company pension, six out of the eight female respondents said that they would either be working for their present employer after SPA, or seeking part-time work for another employer, but only three of the eight male respondents plan to work on. These three male respondents planned to work on a self-employed basis as consultants. The level of pre-retirement income does not seem to influence the decision to continue in employment beyond normal retirement age since both highly paid and moderately paid employees claimed a similar desire to continue working. What this means is that while some may want to work beyond normal retirement age for financial reasons, those who are reasonably well off may want to do so either because they enjoy their work or out of a fear of retirement creating a vacuum of empty time and space in their lives.

Where the retired focus group members were concerned, the circumstances were different for two main reasons: the focus group took place in a Midlands industrial city in which manufacturing had provided the bulk of employment and more of this group had been forcibly retired due to redundancy or ill-health. For these people, working beyond normal retirement age was more a matter of necessity than of choice.

2.2. Pensions, Savings and Investments

Two of the male respondents had worked on to pay off an existing mortgage and two of the female respondents were single and on low incomes, without pension provision. Otherwise, all of the retired respondents have occupational pension provision and some savings and investments. The focus group members live on incomes of between £5,000 and £15,000 per annum. All bar one are homeowners. This was the group least likely to consider releasing equity from their homes, given that only one had made enquiries in this direction. Sixty-five percent of respondents to this research had an occupational or company pension (79 percent of men and 52 percent of women) and forty-seven percent had a partner with an occupational pension. Of these, 33 percent of all our male respondents and 60 percent of the females had a partner with an occupational pension
This includes pre-retirees, retirees and those who had purchased an equity release product.

Table 4 sets out the pension, savings and investments held by equity release consumers who were participants in this research both before they retired and afterwards[vi] In addition to assets held by these groups the table also gives figures for mortgages, equity release products and loans for equity release consumers. As can be seen from the table, the assets held by equity release consumers both pre and post-retirement are broadly in line with those held by the general population, with minor exceptions – slightly more equity release consumers have a bank or building society account, slightly less own shares or a Personal Equity Plan (P.E.P) and double the number of equity release consumers have life insurance in the form of with profits, or term assurance. Although these are smaller numbers, the moderate variation does not explain why these older people chose to take out an equity release product.

Table 4 Pensions and financial products held by respondents who had purchased an equity release product pre and post retirement

Equity Release respondents: savings and investment pre-retirement			Equity Release respondents: savings and investments Post-retirement		
	n	%		n	%
Personal pension	18	37	Personal pension	8	16
AVC	8	16			
Healthcare plan	14	29	Healthcare plan	8	16
Bank or building society savings account	37	75.5	Bank or building society savings account	31	63
Shares or P.E.P.	17	35	Shares or P.E.P.	8	16
Bond or other investment vehicle	11	22	Bond or other investment vehicle	19	39
Cash ISA	21	43	Cash ISA	22	45
Life assurance with profits	11	22	Life assurance with profits	8	22
Term assurance	2	4	Term assurance	3	
Repayment mortgage	15	31	Lifetime mortgage	44	90
Endowment mortgage	7	14.	Home reversion plan	5	10
Loan	1	2.0	Loan	3	6
			Annuity	9	18

2.3. Concerns about Income in Retirement

Past surveys of consumer attitudes towards the provision of an adequate income in retirement have shown that conceptualising the link between pensions and savings is difficult for most people (King, 2003, FSA 2004). Whilst there was some recognition of the broad concepts and purpose of pensions, this did not translate into identifying how much was needed to fund retirement. Many people surveyed had no clear idea how much they needed to save and no clear ideas regarding their income in retirement. Evidence from these studies suggests that some people thought that the idea of getting on to the housing ladder and releasing some equity in their old age to supplement their income from other sources might prove to be a remedy to this problem. We asked respondents a) about their concerns regarding their income in later life and, b) if property was coming to be a way of replacing pension income in funding retirement. The table below shows that for our equity release consumers, having sufficient income to maintain their homes is the most significant concern they have about their own later years, followed by future legislation on pensions and benefits. Maintaining the home also came high on the list regarding the uses that our respondents made of the income released from their homes through equity release schemes. We asked the younger group of pre-retirees aged 50- 59 years what they thought would be the concerns of people coming up to retirement in the next five years. Government policy on pensions and benefits is a major concern for those who have retired and is also perceived to be by those coming up to retirement. As the table below illustrates, seventy-five of the pre-retiree respondents were worried about income shortfall in retirement. Even though not yet retired, this group perceive that maintaining the home can be problematic in retirement. This age group have been more exposed to the vagaries of the pension arena and, not surprisingly, forty-four percent foresee problems in this area for people retiring in the next five years.

Table 5 Equity Release Consumers/ Pre-Retirees: Concerns about income in later life

	Equity Release Consumers	Pre-retiree
	Percentages	
Maintaining the home	70	56
Government policy on pensions and benefits	59	62
Income short fall	53	75
Concerns about children's inheritance	43	n/a
Disappointed pension and investment expectations	22.5	44

2.4. Equity Release as a Support to Pensions and Savings

According to Banks et.al. (2004), the combination of home-ownership and a private pension reduces the expectation of insufficient income in later life by 10-20 per cent in comparison to owning just one or the other. Occupational or company pensions only meet most needs for 43 percent of respondents and savings and investment and personal pensions do not reach 25 per cent. Despite State intervention in encouraging investment in personal pensions, property is perceived as a better investment than personal pension plans for the pre-retirees (Barker and Healey 2004) and is a more important part of income for sixty per cent of equity release respondents in this research. Most respondents to this research had taken out a lump-sum lifetime mortgage. The amount that can be taken out with this type of mortgage varies according both to the value of the house and the age of the borrower. In the table below we give typical loan-to-value ratios for two of the market leaders. The maximum loan-to value generally falls between £200, 000 - 250,000.

Table 6 Typical Loan to Value Ratios for Roll–up Lifetime Mortgages

	Percentages	
	Company A	Company B
Aged 60 years	20	n/a
Aged 65 years	27	25
Aged 70 years	32	30
Aged 75 years	35	35
Aged 80 years	37.5	40
Aged 85 years	40	45

We asked participants who had purchased an equity release product what percentage of the value of the property they had taken out either as a lump sum attached to a lifetime mortgage, or as a home reversion loan; figures are given below, but can only be taken as a general indication as most respondents who had taken out a lifetime mortgage had not taken into consideration the ultimate cost of the loan, which as we demonstrate includes rolled-up compound interest in addition to the original loan.

Table 7 Percentage of Value of the Property Borrowed by Equity Release Consumers	
	Percentages
Up to 10 per cent	12.2
Sixteen to twenty per cent	22.4
Twenty to thirty per cent	24.5
Thirty-one to forty per cent	8.2
More than forty per cent	8.2
Don't know	24.5

Home reversion plans also take into account the value of the property and the age of the consumer, but, since there is no interest charged over the life of the loan, the benefits to the seller come through two sources: Since the buyer cannot re-sell the home until The purchaser's death or movement into a care home, the purchaser will be paid less than the full market value – typically between 35% and 60% for the proportion of the house sold to the home reversion company. The older the purchaser is when starting the scheme the higher the percentage received. In comparison with the purchaser's heirs, naturally, the company then benefits to a greater extent from rises in house prices over the lifetime of the loan.

2.5 Sold on Lifestyle and Purchased out of Necessity?

In line with the significance that these authors place on property as an asset that can be drawn on to support the lack of income from private pensions, both occupational and personal, we asked all respondents whether property is an alternative to pension saving. The responses were quite ambiguous. It could be expected that our equity release consumers would reply in the affirmative since they are the people who have shored-up income by realizing a percentage of the value of their properties. However almost fifty per cent gave a negative response to this question, which could possibly suggest that realizing some of their property assets is more a matter of lifestyle than necessity. If this was so, advertisers and sales staff are probably then on the right track in promoting equity release products as providing life style enhancement. A senior advisor from one of the primary independent financial advisor firms says that the market has evolved from the time when such products were sold to needy customers. In the early days:

> ‘Some people might call it a product of last resort – the reversion plan. Someone would sell a portion of their property in return for a lump sum. Quite often it would be used as a regular income, so in the 70’s and 80’s it was really the reversion plan sales and linked to some other form of product, normally an annuity. This has changed a lot over the last 20 years. Originally, the equity release industry was aimed at the distress sale, somebody wanting to have a reasonable lifestyle in retirement. Originally equity release was for people struggling to make ends meet.’

The market has changed:

> ‘What’s basically happened this decade is the fact that attitudes have changed, these days people want more from retirement and, although there are certain people who take equity out of their property out of necessity, the majority of business these days we would classify as a lifestyle choice. People who want to go on three holidays a year instead of two. That’s where attitudes have changed quite dramatically – research shows that only 15-18% of 80 year olds said that they would use their assets to improve their lifestyle; ask the same question to people in their mid to late 50s and over 45% said they would seriously consider using equity release to improve their lifestyles. I suppose, looking at it from a different perspective with the 70s and 80s – quite a lot of them did have the benefit of a final salary pension and their pension has been of a reasonable amount. These days many people have found that their money purchase pension is not going far, their investment returns aren’t fantastic and they don’t have as much coming in compared to some of the older ones if you look at the number of companies who have withdrawn their final salary pensions. We’re getting to the point now where more – I suppose the real issue is that lifestyle expectations have increased more and more and the ability to be able to service that lifestyle is going down rather than up, whether by investment returns or pensions.

Perceptions may vary as to what constitutes ‘lifestyle’, but our research does not support the view that the market has changed to the extent that this respondent suggests. The majority of respondents in this research said that the money from their equity release product is an important part of their income, is used to provide improvements to their properties that they could not otherwise afford, or as a buffer against future costs of personal, dental and healthcare, or a downturn in their investments. An executive of the Safe Homes Income Plan industry body gave a more realistic appraisal of the market, dividing consumers of these products into two loose socio-economic groups. For the higher income consumer, releasing some equity is a lifestyle choice and the money is spent on holidays, cars, and other consumables. For those at the lower end of the market, it may be less a matter of choice and more a matter of necessity, to top up weekly income, or pay for personal care. But consumers at the higher end of the market are more likely to use these products to improve their properties, provide a nest egg for the future and to help children buy houses and, in a very few cases to reduce inheritance tax. As the following table shows, the money from an equity release product is a significant source of income for equity release consumers who participated in this research.

Table 8 Significance Sources of Income in Retirement: Equity Release Consumers

	percentages
Occupational or company pension meets most needs	43
Personal pension is a significant proportion of income	24.5
Relies on State Pension and Benefits	53
Savings and investments contribute to a comfortable income	2
Equity release product is an important part of income	61

The greater percentage of our equity release consumers (59 per cent) had purchased a lump sum lifetime mortgage with a facility to take out further lump sums up to a limit defined by the value of the house and their age at the time of the loan. A fair percentage (18 per cent) had taken out a drawdown mortgage and ten per cent a home reversion plan. Taking out an interest only or protected equity mortgage does not offer the same cash benefits as other equity release products; however, one respondent had used the interest only mortgage to purchase another property as a buy-to-let to generate a regular income.

Table 9 Type of Product Purchased by Equity Release Consumers

	percentages
Lump sum lifetime mortgage	59
Drawdown lifetime mortgage	18
Protected equity lifetime mortgage	4
Home reversion plan	10
Interest only mortgage	4
Don’t know	4

It could be expected that the pattern for those financially prepared for retirement would vary and demonstrate that, for the higher income savers maintaining a current lifestyle, based on the consumption of goods and holidays would predominate. Yet the data did not support this argument; we found that assuring the future came top of the list for the middle income groups and providing money for their children or grandchildren (either to help with home purchases or to reduce inheritance tax) topped the list for the highest income groups. Access to money to carry out necessary home improvement was prioritised by the lowest income savers. Not surprisingly, those with incomes of less than £10,000 per annum prioritised costly home improvements and a supplement to their regular income; the group with incomes between £11,000-16,000 per annum put home improvements at the top of their lists followed by consumer goods; the £16,000-20,000 set cited consumer goods and home improvements and those with annual incomes between £21,000-26,000 used the money gained from their equity release product most widely across the categories with nest eggs and personal care heading the list. Those whose income topped £40,000, raising money for children outweighed other uses for the cash released from their equity release purchase.

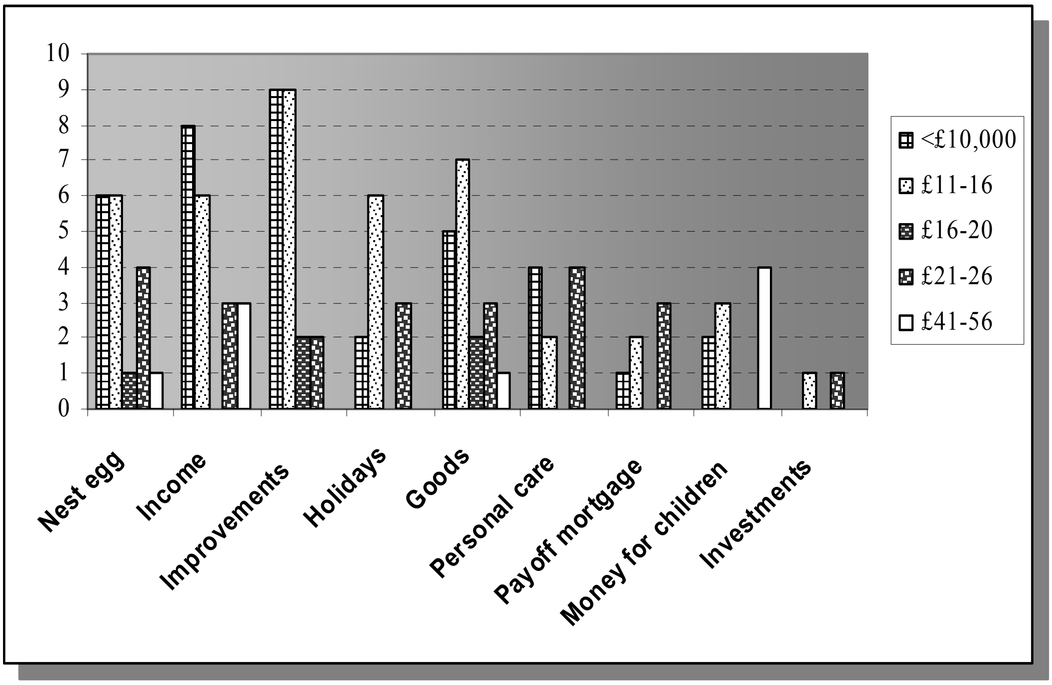


Figure 3 Distribution of Equity Released Cash related to Income per Annum

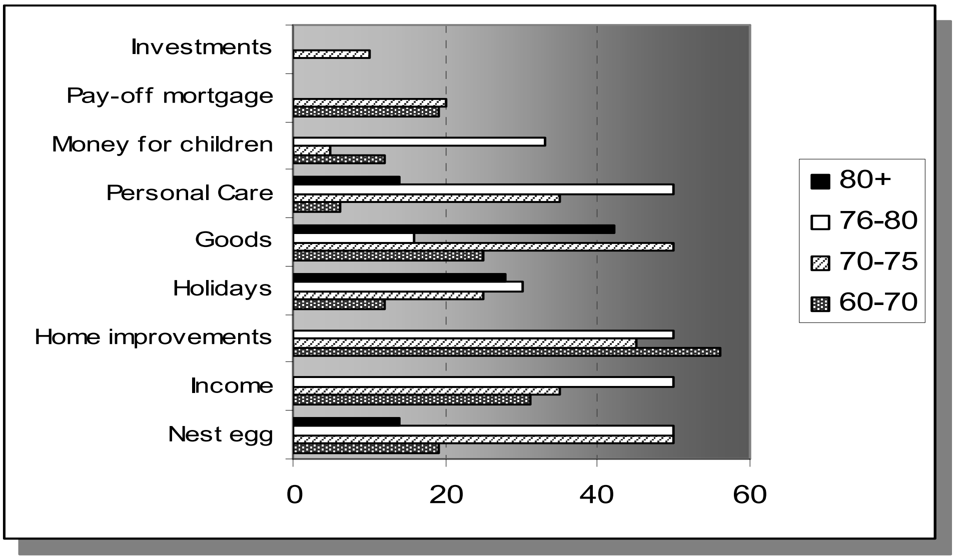


Figure 4 Distribution of Equity Released Cash by Age of Equity Release Consumer

If there is an argument for older consumers as sybarite, then it would appear to be applicable to those in their eighties and onwards as the above figure demonstrates. This is the group that said that they spent the money acquired from their equity release product mostly on expensive goods and holidays. Of course, it could equally well be argued that this is the group that have exhausted their savings and investments and can only afford life's pleasures by taking money out of their property. Depending on the age that they were when they took out the equity release product, they may also be coming to the end of their drawdown facility. For the recently retired, carrying out home improvements and supplementing their incomes is most important, providing themselves with a buffer against the future in the form of a nest egg is, perhaps, less important at this stage, but ten years on, for the 70-80 years groups, nest eggs come in the top three uses of the money from their equity release product.

This research was carried out with a sample that was 50/50 male/female although, given that females live longer than males in our society and are more likely to be short of money in retirement, it is quite possible that the majority of equity release purchases are women. We did find a gender split in how the money from the equity release product was used: males put income top of their lists, followed by nest eggs for the future, consumer goods, home improvements and holidays with small numbers citing personal care, investments, and money for children, and paying off an existing mortgage coming bottom of their list. For female respondents, home improvements came top of the list, followed by expensive goods, nest eggs, income, money for children, holidays, personal care and paying off an existing mortgage. Research for the Joseph Rowntree Foundation showed that when parents owned their home, but their children did not, the parents expected to contribute an average of £17,000 to their child's first purchase (MORI Omnibus 2004, cited in IPPR2005, 2).

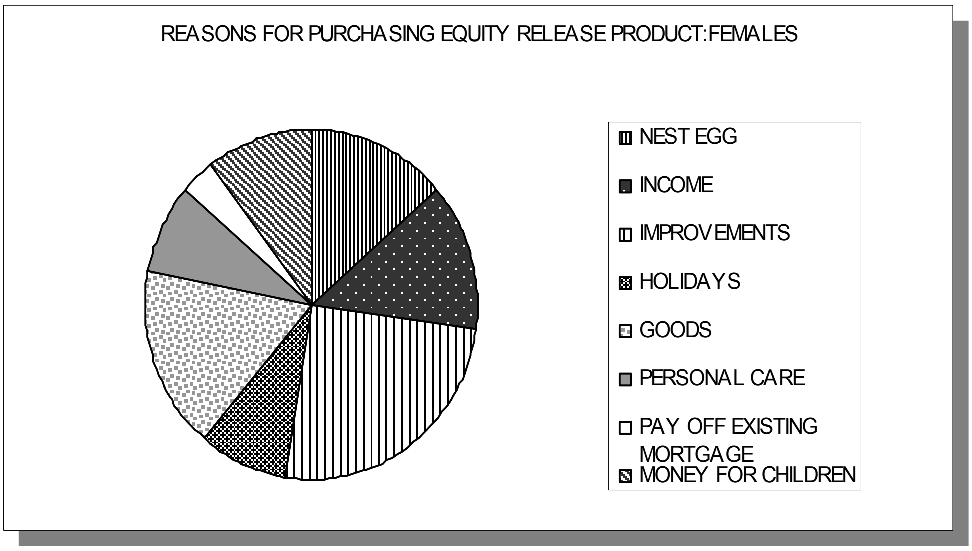


Figure 5 Distribution of cash released by sex of respondents (Female)

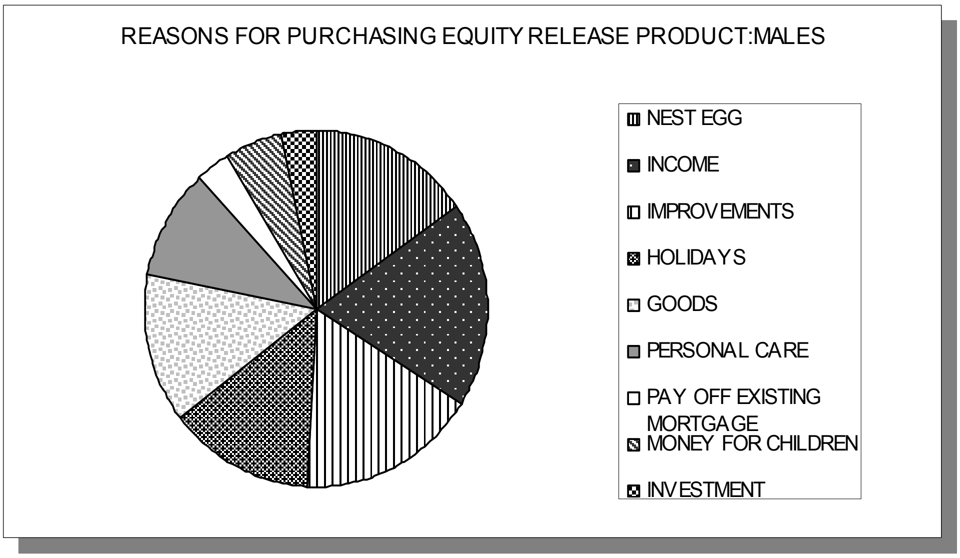


Figure 6 Distribution of cash released by sex of respondents (Male)

Although it is apparent that there is no all-encompassing pattern for the uses of the money released; it depends on income, age and gender as to how the money is distributed between the eight categories: nest egg for the future, source of income, home improvements, expensive goods, holiday, investments, paying off an existing mortgage, paying for personal care and helping children. Those on the lowest incomes are most likely to use the money to carry out improvements to their properties (something that they are required to do by the seller of the product) and to supplement their incomes. Those at the top of the earnings scale here say that they use the money to reduce inheritance tax and give a boost to their children at a time when they need it most. In terms of age, it is the over eighties who seem to be the most likely to spend the money on conspicuous consumption, not the predicted baby boomers.

2.6. Attitudes to Equity Release Schemes

All of our respondents were aware of equity release products, but they and especially the pre-retiree group were very distrustful of them. .In the NCC national survey of homeowners aged 55-70, eighty per cent had heard of equity release. But only 13 per cent felt the products offered good value, only nine per cent trusted the providers, and only four to six per cent would consider taking out such a product (2007: 10). They have proved attractive with a significant number of homeowners, whether purchased as a solution to an immediate financial problem or for other reasons. To establish whether their attitudes to these products were positive, ambivalent or negative, we asked our equity release consumers what they perceived as the advantages and disadvantages of equity release products (see Table 10). In the plus column are the advantages of these products that we identify as born out of necessity heading the column and those that could be perceived as about lifestyle and consumption follow on. The comments on the issues of value and trust are to be found in the ‘disadvantages’ column. Generally, consumers of these products were much more likely to make positive, rather than negative comments about these products, although, as we recognize, there may be some element of self-justification in these responses.

Table 10 Advantages and Disadvantages of Equity Release Products

Advantages	Disadvantages
I was able to pay off existing mortgage	Less to leave heirs
Cash to improve our property	Borrowing your capital
Cash for medical and dental fees	Cannot take out other loans with property as security
The ability to replace expensive items	The amount they let you take out
Avoiding going into debt	Be careful about checking how the interest rate goes up
Avoiding becoming homeless	Taking it out too early- repayments mount up too much
Stability	Taking out too much
A buffer against my investments going down	
Money to fund my grandchildren through university	Living too long and worrying about having to pay nursing home costs if taken too much out (home reversion)
Financing children’s housing	
--	
Going on holiday	People don’t understand the ramifications and the property values may be in excess of the value equity release puts on it.
Reducing or avoiding inheritance tax	
Comfortable lifestyle	Not understanding the product
Avoiding the need to downsize	
Ready cash while we’re physically able to enjoy it	

The results of mystery shopping exercise carried out by the Financial Services Authority revealed that more than 70 per cent of advisers in these firms did not gather enough relevant information about their customers to assess their suitability for lifetime mortgages and more than 60 per cent of the mystery shoppers reported that their adviser had not explained the downsides of equity release (FSA, 2005). Questions in the survey related to: whether IFAs had properly assessed the suitability of the product to the customer's needs, whether customers had been informed about the costs of the product and its impact on benefits amongst other areas. This was pre FSA regulation of the products and the findings were quite negative. The following table gives the percentage of our equity release respondents who were very satisfied, or satisfied with the selling process, characteristics of the products, the appropriateness of the product for their needs and its impact on benefits that they might claim and the equity left for their heirs.

Table 11 Equity Release Consumer Satisfaction with the Release Product Purchased

	percentages
Satisfied, or very satisfied with the information given on the product	98
Aware of the impact on benefits	75
Satisfied, or very satisfied that the product was the right one for respondent's needs	96
Satisfied, or very satisfied with the cost of the product	61
Satisfied, or very satisfied with the security that the product provides	82
Satisfied, or very satisfied with the equity left for heirs	71
Would recommend to a friend or relative	83

As the table indicates, most of our respondents who had purchased an equity release product were highly satisfied that the product was the right one for their needs, and with the information given at the point of sale, even so:

- 25 percent of our equity release respondents were not aware of the impact that an equity release product would have on benefits that they might claim;
- 39 percent were not satisfied with the cost of the product;
- 29 percent were not satisfied with the equity left for their heirs.

According to the Financial Services Authority website, regulation and the increase in the numbers of IFAs selling these products (http://www.fsa.gov.uk) should improve the information that customers receive on the impact on benefits. Little can be done about the dividing up of the equity left in the property between the equity release company and the inheritors to the property except deferring the purchase for as long as possible and considering other options such as downsizing or borrowing from family These products are expensive, on this, the 'Which' survey advises potential purchasers that:

> Equity release schemes should come with a warning: they are very expensive and can leave you with little or no equity left in your home if you keep one for 20 or 25 years, say. Consequently, you might not be able to pass on anything to your children and you might find your choices are limited if your circumstances change. For example, you might not be able to move later on should you want or need to. Hefty early redemption penalties can make it impossible to switch to a cheaper scheme if yours isn't very competitive (Which, 2006, 31).

Pre-retirees and members of the retired focus group, although aware in a vague way that these products could be used to raise cash, were more likely to express unfavourable attitudes to these products. In our focus group research, only one pre-retiree and one retiree had made enquiries about equity release products. These are some typical observations from the rest:

> 'If they're fixed term read the penalty clause for early repayment' (Focus group member).
>
> 'The best way that I can describe it is fraud. Well, I've had several quotations done, I started off by enquiring and then when I started getting different sources and the way that they presented the information, even if you were a financial genius you would have spotted that it's a fraud, because you don't get the genuine value of what the property is worth.' (Focus group member).
>
> 'You would have to read the small print. The problem is how long you would live in the property before you die?' (Pre-retiree).
>
> 'What would be the position of my younger partner?' (Pre-retiree).
>
> 'I don't understand the terms and conditions and the legalities. If you sell 50 percent and the other 50 percent remains the children's – it's like a mortgage in a sense, but it may reduce the selling price and the children may lose out at the lower price. Investment banks are only interested in profit' (Pre-retiree).

> 'There is quite a big cost initially. It can be rolled-up, but it's not cost free as you pay for them, even though it's your own money – to get the money out of your property' (Pre-retiree).
>
> 'People say they are all sunshine and the papers say they seem fine, but there's always someone to do you down, you need to read the small print' (Focus group member).

3. The Future for the Equity Release Market

At present the market for equity release products is very small in comparison to mortgages in general. Sales of home reversion plans rose by 19 per cent between 2005 and 2006. The total new business figure for 2006 was £1,153.3.million, but drawdown mortgages continued to rate as one of the most popular features for consumers in the Safe Homes Income Plans survey for 2006 (SHIP, 2007). As Table 10 shows, lifetime mortgage sales grew almost 60% between 2002 and 2004 rising from 16,302 to 26,270, but there was a dip between 2004 and 2005, although the market picked up the following year. Even so, equity release schemes' share of the total mortgage market is small. The over 75 age group is destined to increase by 70 per cent over the next 15 years (Baker, 2008) and, in the light of the current credit crisis, the market might expand considerably in the future. When or whether this will occur is hard to predict according to our IFA respondents. Equity release provider Stonehaven, however, asserts that, 'the value of equity release sales rose by 23 percent in 2007' (MacErlean 2008). At first glance this does appear to be a positive step in the market for these products. However, taking into account the fact that seven new providers have entered the market during the last twelve months, and that Stonehaven, along with other companies, has introduced products targeted at potential purchasers in their mid-fifties (MacErlean 2008), this still represents a rise of only 2,986 purchases on the Council of Mortgage Lenders figures for 2004. It is possible that this rise in sales may represent an ongoing trend in new products targeted at people who are facing retirement in the next 5-10 years, especially if the collapse in the value of shares continues and pensions are less secure. However, it is probably too soon to tell whether people in their fifties will buy an equity release product to shore up poor investment performance and reduced pension expectations, or whether they will decide to work on beyond retirement, as approximately 50 percent of our pre-retirees predicted. The rise in numbers of equity release products sold in 2007 may rather represent a recovery in the market from 2004 and a very moderate improvement in sales. This respondent from one of the largest specialist IFAs gives a rather more nuanced response to the question of market expansion:

> 'If you look at the equity release market, the demographics would suggest that it should mushroom by 2020 when 40% of the population will be of an age where they could take on an equity release plan. The experts tend to all agree that it will certainly increase. The real question is when and how? If you look at when, most of the experts are saying by 2008 the number of plans will double to £2bn. Most of the experts are saying that if you look at a 10-14 year period, logic would say that it will increase massively, but if you think back, they were saying that 12 months – 18 months ago, two years ago and the market is still bobbing around £1bn and even this year, it should probably be no more than £1.4bn. So, the reality of the market doesn't seem to be holding out much hope of change'.

Lifetime mortgage summary

Table 12 Lifetime Mortgage Market Summary 2002-2006

Period	1	2	3
	Lifetime mortgages newly advanced	Lifetime mortgages newly advanced	Lifetime mortgages newly advanced as a % of total market by value
	Number	£m	%
2002	16,302	655	0.24
2003	25,114	1,101	0.38
2004	26,270	1,210	0.42
2005	23,215	1,048	0.30
2006	23,786	971	0.28

Source: CML Research

Home ownership, unhampered by mortgage debt (as was the case for most respondents to this study – prior to taking out an equity release product), confers upon the owner both an investment and consumption good, but it is a good that is highly valued and has social and cultural meanings to people which they may be reluctant to give up. For many old people, moving is an option that is only reluctantly taken up[vii]. The Disney et.al. panel survey of 2002 asserts that only seven percent of two waves of older people had moved between 1988 and1994 and this was a problem for them as housing costs outweighed the income they had coming in from other sources. But, for older people, their homes fulfil the needs for security and safety in an insecure world (Dupuis 1998). In response to the question, ‘what does your home mean to you?’ nearly all the respondents in this research, equity release consumers, pre-retirees and retired members of the focus group viewed their homes as providing safety and security, but also they valued the familiarity of, being near to neighbours and services, ‘having things nice’ and, nostalgically, of memories of raising a family in their present home. In short, they were physically, psychologically as well as socially attached to their homes and this, combined with general inertia and not wanting the upheaval, perhaps explains the reluctance to take the most rational economic decision of downsizing in retirement. Nevertheless, the Institute of Actuaries predicts the percentage of homeowners who will purchase an equity release product to have doubled between the years 2005 and 2013, but, as Table 13 demonstrates, after reaching a peak in 2004, the market showed a decline for the following two years and as we have noted, a small increase in 2007.

Table 13 Projected Sustainable Market Sales of Equity Release Products in the UK

	2005	Short-term (e.g. 2010)	Medium-Term (e.g. 2015)	Long-Term (e.g. 2013
Population aged 60 or over (1000s)	12,776	12,076	15,067	19,492
Proportion who are homeowners	70%	72%	73%	78%
Proportion of homeowners who will buy equity release scheme at some time	6%	10%	13%	15%
Stable market size (in force cases)	370.063	698.946	953.239	1,466.576
Sustainable annual sales (number)	20.000	40.000	50.000	80.000

Source: Institute of Actuaries, cited in CML (2005, 3)

4. Comparative Perspectives: Mature and Emerging Markets for Equity Release Products in the US and Europe

4.1 Equity Release (Reverse Mortgages) in the USA

Equity release schemes have a longer history in the US than the UK or Europe and may provide some indication of how the market could evolve in this country. This must take into account, however, that the equity release, (or as it is referred to in the USA, 'reverse mortgage') market in the USA has one profound difference from the UK market in that 90 per cent of reverse mortgages are sold by approved lenders under a Government programme instituted by the Department of Housing and Urban Development (HUD). The Home Equity Conversion Mortgage (HECM) emerged from the National Housing Act 1987 when Congress authorised HUD to institute the programme and issue 2,500 reverse mortgages in 1991. The programme was extended over the next 10 years and became permanent in 1998 when the number of allowable outstanding loans was increased to 150,000 (Escher and Tron, 2001). HECM reverse mortgages are sold through a number of HUD approved intermediaries. There are private sector reverse mortgages on the market: Fannie Mae offers RM Homekeeper with a higher borrowing limit and Financial Freedom Senior Funding targets wealthier homeowners, but these are small players in comparison with HECM sales. However, the American Association of Retired People predicts growth in the private sector market from 2007 (**www.aarp.org/money**.)

Reverse mortgages have most of the same characteristics of lifetime mortgages in the UK: borrowers can take the money released as regular payments over a fixed term, or as long as they stay in the house, as a lump sum or as a line of credit, the latter being the most popular (Escher and Tron, 2001). As HECM reverse mortgages are targeted to the lower and middle income purchaser and there was a lending limit of $362,709 in 2006. The homeowner pays as part of the closing costs a two per cent mortgage insurance premium, which not only guarantees that the loan is secured if the lender defaults, but also that the borrower will never owe more than the value of the house. In addition, the annual premium is equal to 0.5 per cent of the loan amount (**www.reversemortgagepage.com**).

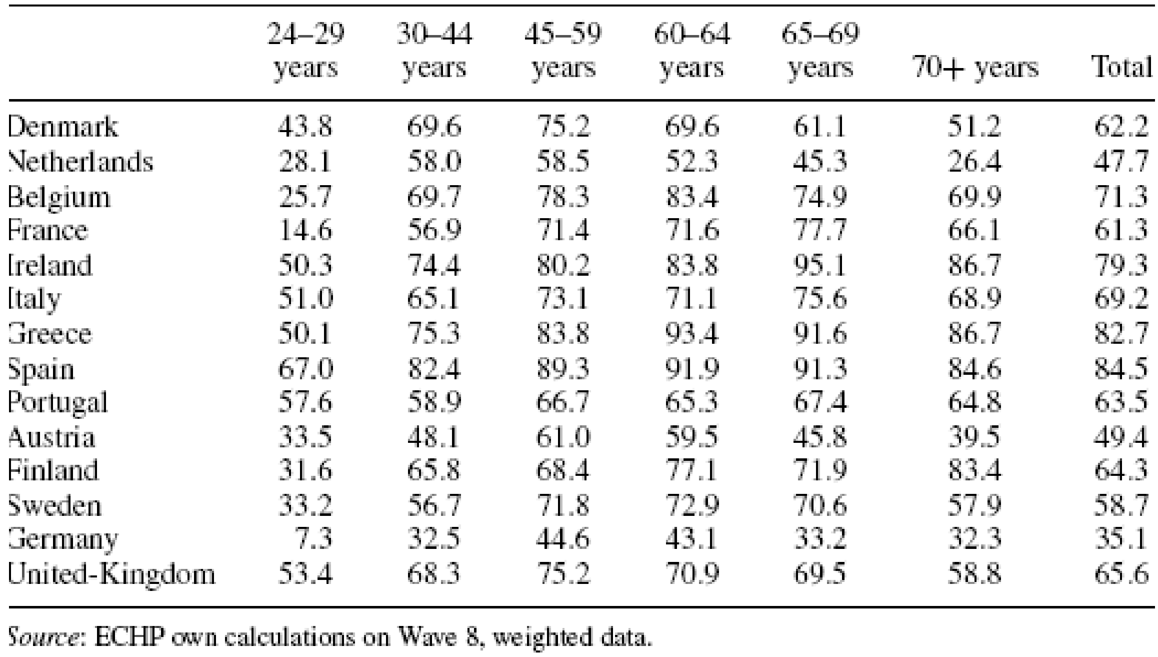
Shared appreciation mortgages[viii] were early entrants into the equity release market in the US, but were dropped when there was an outcry from borrowers who were faced with negative equity and huge loan repayments as a consequence of rises in real estate values. The problems re-occurred in Britain and the market was abandoned here for the same reasons.

The US (as with the UK and EU economies) is sharing a set of problems associated with insufficient retirement income. In the US a rapidly changing retirement landscape, rising Social Security retirement age, a sharp decline in traditional pensions coupled with modest balances in 401(k) employer-sponsored defined contribution plans, low savings rates and longer lifetimes are posing problems for the Government and the individual (Eschtruth, Sun and Week, 2006). If equity release products were sufficiently attractive to consumers, the gap in retirement savings could be resolved by releasing the value embedded in real estate. Indeed the latent market for reverse mortgages is enormous, over 20 million households could, potentially, use the product and the numbers are growing fast with baby boomer entering their early sixties (**www.reversemortgagepage.com**). Yet, reverse mortgages have been available in the US since the late 1980s and the market is still decidedly sluggish. The total number of HECM reverse mortgage loans issued since 1990 is only 217,837. After four-figure growth from 1990 to 2001, there has, however, been stronger growth more recently and 55,659 new HECM reverse mortgages were issued in 2006 (**www.reversemortgagepage.com**), still modest growth considering the prospective market. It seems fairly obvious that new lenders would not be attracted to a seemingly tepid market given that entering that market would necessitate employing specialised staff. Despite Government sponsorship and promotion, reverse mortgages have proved a relatively unattractive prospect to the lower and middle income under-saved retirees in the US. Private equity release schemes have not managed to make much of a market amongst higher earners anxious to preserve an accustomed lifestyle either. Potential borrowers may be deterred by a lack of information, the high-up front costs, concerns about inheritance and an aversion to debt after a lifetime spent paying for their homes (Eschtruth and Tron 2001).

4.2 The Emerging European Equity Release Market

Homeownership in Continental Europe does not follow a particular pattern, as Table 14 shows. High levels of homeownership across all the age groups from mid-twenties onwards to seventy years and onwards is most likely to be found in southern Europe and Ireland and least likely to be found in the younger age group in northern Europe and France with the UK occupying a middling position. Ideally, this would suggest an open market for the sale of equity release products, especially as there will be a sharp increase in older people towards the middle years of the 21st century (European Central Bank, 2006).

Table 14 Share of home owners (all) in different age groups across European countries in 2001 (Turner and Yang 2006, 281).



	24–29 years	30–44 years	45–59 years	60–64 years	65–69 years	70+ years	Total
Denmark	43.8	69.6	75.2	69.6	61.1	51.2	62.2
Netherlands	28.1	58.0	58.5	52.3	45.3	26.4	47.7
Belgium	25.7	69.7	78.3	83.4	74.9	69.9	71.3
France	14.6	56.9	71.4	71.6	77.7	66.1	61.3
Ireland	50.3	74.4	80.2	83.8	95.1	86.7	79.3
Italy	51.0	65.1	73.1	71.1	75.6	68.9	69.2
Greece	50.1	75.3	83.8	93.4	91.6	86.7	82.7
Spain	67.0	82.4	89.3	91.9	91.3	84.6	84.5
Portugal	57.6	58.9	66.7	65.3	67.4	64.8	63.5
Austria	33.5	48.1	61.0	59.5	45.8	39.5	49.4
Finland	31.6	65.8	68.4	77.1	71.9	83.4	64.3
Sweden	33.2	56.7	71.8	72.9	70.6	57.9	58.7
Germany	7.3	32.5	44.6	43.1	33.2	32.3	35.1
United-Kingdom	53.4	68.3	75.2	70.9	69.5	58.8	65.6

Source: ECHP own calculations on Wave 8, weighted data.

However, establishing a comparative picture of equity release in Europe would be difficult since mortgage markets differ widely from country to country in the EU. In addition, distinct systems of housing finance intermediation have evolved in the different countries. Turner and Yang group the financial systems in Europe as: the bank model, as in Finland and the UK; the mortgage bond model, as in parts of Germany; and the state model, as in Norway and in parts of Finland. Not only are there divergences in financial markets, they also reflect the influence of local and national policies and the national legal framework, such as loan-to-value ratios and market interest rates (Turner and Yang 2006, 284).

In most European countries the equity release mortgage market is still at an early stage of development. Specific legislation on mortgages, including equity release has recently been enacted in Spain, France, Finland and Sweden. Legislation enabling the sale of equity release mortgages was introduced in France in 2006 (Mortgage Finance Gazette 2008). Denmark and Belgium have similar legal concepts – a life annuity based on the immediate sale of a house – the purchaser has to pay interest and capital amortization together and has the right to stay in his or her home for life. This product is not offered by banks (European Central Bank 2006). The halting progress of equity release products in the UK and US suggests that these changes to European legislation may not have much of an impact on the market for equity release products in the immediate future. However, the expatriate market may prove more fruitful. Spain, (amongst other southern European coastal regions) is a highly popular retirement destination where currently two million of the 23 million real estate properties are owned by foreigners and the market potential for both local and foreign credit entities is obvious (Perotto and Gómez de Tojeiro 2008). Northern Europe may be a harder nut to crack as not only are there lower levels of homeownership, but earnings, welfare provision and pensions provide more of a safety net for retired people than is found in southern Europe (Turner and Yang 2006).

4.3. Summary

Despite US Government sponsorship the market for reverse mortgages has failed to progress as expected amongst the under-saved low to medium income earners. Equally, the products offered by private companies have not attracted high-end consumers. If the UK follows in the footsteps of the US, the sluggishness of the market in this area does not bode well for the future of equity release for older people in the UK. However, the HECM model in the US may be the way forward for the very under-funded Home Improvement Agencies in the UK.

Due to economic and social factors equity release products may not prove attractive to Northern Europeans who benefit from a more closely knit safety net. Culture and tradition in Southern Europe does not provide fertile ground for a growing equity release market targeted at the indigenous populations. On the other hand, expatriates whose retirement income falls short of their expectations or needs may offer more fruitful target market for sales of these products in continental Europe.

5. Conclusion

This report covers the link between income, savings and investments and property in the planning for the later years of individuals both pre and post retirement. Income released from property is being perceived as a potential solution to the problem of a growing population of under-saved older people in the UK, US and Europe, and we have paid particular attention to attitudes to these products and what are seen as their perceived advantages and disadvantages.

Perceptions of older consumers have undergone some changes in recent times, reported both by commentators and the media. The idealized view of retirement is as a time of hedonistic leisure and extended consumption – fostered by a stream of cash released from bricks and mortar. An alternative view that this research would support is rather less optimistic – for there is a trend where risk is individualized, shifting the responsibility for self-provision in terms of retirement saving and welfare increasingly away from the state and on to the individual[ix]. This research shows that individuals are attempting to negotiate their way between positive and negative views by holding upbeat views on retirement in general, but having extensive concerns about their own particular retirement experience. The response to this shift in responsibility varies obviously across different income ranges but it includes a concern to work beyond normal retirement age to maintain a desired standard of living and/or to fill one's time with meaningful activities rather than simply vegetate. However, attitudes to saving for retirement are heavily influenced by worries about Government policy on pensions and benefits and its negative impact on their confidence to plan financially for retirement. Another major anxiety among retired people is that they may outlive their incomes due to longevity, rising costs of living, or having to fund health and personal care.

Although our IFA respondents emphasized lifestyle as the reason that people purchase these products, we are not convinced. Our research suggests that these products may be sold on lifestyle, but are bought for other reasons not associated with conspicuous consumption, but this varied according to income and gender.

We found a high awareness of equity release products, but also a high level of mistrust and suspicion from most of the non-purchasers of these products. They were not seen as a solution to the savings and investment gap in retirement income, though some pre-retirees planned to downsize or move abroad when they reached retirement. Equity release consumers, on the other hand, were, on the whole, positive about their purchase decisions, though there are aspects that between 25-40 per cent of respondents found unsatisfactory – the costs of the product, the amount that they were persuaded to take out and the value remaining in the house for their heirs to inherit. If the next generation of products offers smaller loans along with an increase in drawdown products, it will go some way to ameliorate these problems. Certainly there is a need for better provision for smaller loans to vulnerable consumers. These Home Improvement Agency schemes need better sponsorship from public and private sectors. At present very few financial services organizations are taking much of an interest in these areas.

As to the future of equity release schemes in the UK, the increase in older population of homeowners combined with economic and social factors would appear to offer almost limitless opportunities for companies to move into the area, but the US experience is not encouraging and it would appear that the products are going to have to undergo some development to attract UK consumers. Much of the potential for equity release resides in the reluctance of older people to take the more economically rational decision of downsizing. The security of being within a community, and enjoying a cultural, social and support network that is known and understood and that can ease daily life may preferred to the financial security facilitated by downsizing. Probably people on lower incomes are even prepared to exist in relative financial poverty – knowing that the state will provide the minimum subsistence – rather than lose the density and richness of their social support networks, which cannot easily be reinvented or replaced. It seems to be a case of which can be tolerated most easily – the upheaval and social poverty derived from downsizing or the financial deprivation of remaining in one's own home long after it has served its functional purpose? Clearly, equity release can provide financial resources without people having to sacrifice the non-financial benefits of the physical, psychological and social comforts associated with the familiarity of home and community networks.

We conclude with some suggestions on the implications of this research for policy makers, employers and the financial services sector as well as future directions for research in the area of equity release. The current concern that the UK Prime Minister, and his government, is showing towards toward the problems of funding care for the elderly in the next 20 years makes this research highly topical. We have discovered that pre-retirees are very anxious about their futures in retirement and uncertainties over government policies add significantly to their insecurity. They also feel that they should be able to work beyond normal retirement age either out of necessity to fund their needs, maintain their lifestyles or simply in order to remain active. Government policy sends mixed messages on this front. On the one hand, it argues that retirement should be gradual rather than abrupt but, on the other, it passes legislation (the Employment Act 2006) that violates the spirit of the European Directives on age discrimination by allowing employers to enforce retirement at 60 or 65. This is clearly also incompatible with employees' preferences and it is possible that the European Court Heyday challenge to the legality of the Employment Equality Regulations aspect of that legislation on grounds of age discrimination will result in its repeal. Certainly the findings from this research and the Prime Minister's concern with the costs of caring for the elderly suggest that the government scored another of those own goals in failing to comply fully with the European Directives on age discrimination. For in avoiding upsetting employers by reducing their flexibility to retire employees, the financial responsibility for the elderly tends to fall back on the state. We recommend that the government thinks again, rather than being forced to by a successful challenge in the European Courts or simply by the clear evidence that a fixed date of retirement is inappropriate when elderly people are so much healthier and live longer than in the past. Employers might find it more sensible to plan for offering part time contracts to their staff when they approach retirement age. Although this is speculative, many employees would probably prefer going part time long before normal retirement age as long as they could guarantee working beyond it.

The negative stigma attached to equity release products is ameliorated substantially for those purchasing them so the providers need to improve their terms and conditions if only to secure their status as a mass consumer product. A loss leading strategy would, of course, have long-term benefits for both providers and consumers since the costs of provision would clearly diminish with increased volumes of sales. This research suggests that the conditions in the market place are conducive to expansion since majorities of people are reluctant to downsize despite it being probably the most economically rational of alternatives. While lifestyle selling is appropriate for those who are not struggling with the basics of life, there is a market for equity release among the less affluent that see it as a way of supplementing the basic pension. Obviously the market is incredibly diverse and age is a major factor for as people are reaching the end of their lives they seem more inclined to spend on luxuries perhaps as a last flurry.

As to future research into this area a number of potentially fruitful areas suggest themselves:

1. The inter-generational factor: when planning their own retirement do children of parents who have purchased an equity release product have a more favourable attitude toward equity release than other pre-retirees?;
2. New generation products which target different groups with smaller loans;
3. The potential for increasing public/private partnerships to foster the market for smaller loans to vulnerable homeowners;
4. Analysis by age cohort to determine how perceptions and practices relating to savings and equity release vary as people age.

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Notes

[i] A comfortable retirement income was defined as half final salary for those earning more than £12,000 a year and two-thirds of final salary for those earning less. The B&W Deloitte analysis modelled the savings shortfall for everyone in Great Britain (27 million people) other than the retired and those under 25. Around 15 million people were found to be on target for a comfortable retirement income while 12 million were off target, with a savings gap of £39,000 on average. Of this 12 million, the 7 million with an individual annual income of under £12,000 had an average savings gap of £27,000.

[ii] The methodology used to model people's savings gap took their current wealth plus a (discounted) estimate of their future pension contributions. A savings gap was generated if there was a shortfall between this and the (discounted) estimate of how much they would need to buy an annuity at retirement to provide a comfortable retirement income. Some individuals had a savings surplus but these were not counted so as to avoid one person's surplus offsetting another's gap.

[iii] The data was taken from late 1980s to mid 1990s UK Housing Budget Share (HBS) figures from the,

[iv] The Actuarial Profession, *Equity Release Report 2005* by the Equity Release Working Party

[v] But shared appreciation mortgage loans fell foul of the downward movement of shares in the 1990s and are no longer sold in the UK:

[vi] National figures on savings and investments held by older people are available in Alferoff, C., D.Knights and C. Odindo (2006) 'The Link Between Income, Savings and Property in Funding Retirement, a positioning paper for the Financial Services Research Forum.

[vii] However, Norwich Union have just launched 2 new schemes to assist older people in moving house. Assisted Move just manages the whole process whereas Optional Fund Release is given 80% of a valuation of the property before the sale and if the house sells above that rate, there is a 50/50 share of the additional amount secured but, in addition, NU takes 2% of the sale price as a fee.

[viii] In a shared appreciation mortgage the homeowner sells part of their home – usually well below the market value – at the end of the loan term, the homeowner pays back the loan and the interest accrued and takes the minor share of the profits if house prices have risen. On the sale of the house, the seller receives their original loan, the interest on that loan and a larger share of any increase in value. These products can only work out to the purchaser's advantage if the housing market is flat, or house prices have fallen, otherwise, they can only lose out and are left supporting huge repayments.

[ix] Another piece of research sponsored by HSBC confirms these findings especially for the UK but also our other findings regarding the problems of uncertainty about government policy regarding saving for retirement and the desire or necessity to work beyond normal retirement age (HSBC Research reported on Radio 4 Today Programme, May 13th 2008).