Teachers Financial Planning

Equity release

This guide gives an overview of equity release, how it works and key issues to consider.

Equity release is a way of unlocking the value of your property to provide you with a lump sum or income without having to move home. You borrow money against the value of your home but don't pay it back until your home is sold – either after you die or when you move out, for example into long-term care. There are different types of equity release available so it is important to choose the right type for your circumstances.

Eligibility

Homeowners aged 55 or above with little or no mortgage left to pay may be eligible for equity release. There will also be criteria, depending on the type of equity release, which depend upon the property's condition and value.

Advantages and disadvantages

As with any financial product there are pros and cons to equity release. Because your home is involved it is vital that you fully understand equity release before committing. Please speak to your financial adviser who will be able to tailor their advice to your specific circumstances.

Some of the potential advantages of equity release include:

- You can use the lump sum or income to supplement your income
- You don't have to move house
- You will normally be able to remain in your home until you die or go into long-term care.

Some likely disadvantages of equity release include:

- Some plans add interest to the amount you owe
- You will get less than the full market value for your home if you sell it through some types of equity release
- A lump sum or regular income could affect your entitlement to some benefits
- If you are married or in a civil partnership your partner may have to move out if the plan ends on your death
- You may not be able to transfer the scheme to a new property if you wish to move.

Some of those who have entered into an equity release arrangement have found that their debt has escalated more than they expected.

Main types

There are two main types of equity release, which are lifetime mortgages and home reversion plans.

Lifetime mortgages

There are different types of lifetime mortgage available but, typically, you take out a loan that is secured on your home based on the understanding that the lender will get their money back by selling your home. You are allowed to continue living in your home but will have to pay back the mortgage plus the interest charged by the lender. The mortgage is repaid through the sale of your home when you die or move out.

When taking out a lifetime mortgage you can choose to borrow a lump sum or opt for a drawdown facility. Flexible drawdown may be for you if you want to take regular or occasional small amounts as opposed to one big loan. This means that you only pay interest on the money you actually need.

Types of lifetime mortgage

Roll-up mortgage

You receive a lump sum or regular amount and the interest charged is added to the loan. This means that you don't have to make any regular payments and the full amount, including all accrued interest, is repaid when your home is sold.

Fixed repayment

You receive a lump sum but interest isn't added. Instead you agree in advance the lump sum that will be repaid, which is higher than the lump sum borrowed. When your home is sold the pre-agreed fixed payment goes to the lender.

Interest only

You pay monthly interest on a lump sum loan instead of allowing the interest to add up. The interest can be fixed or variable and the amount you originally borrowed is repaid when your home is sold.

Home reversion plans

Home reversion plans involve selling all or part of your home to a reversion company in exchange for a cash lump sum or an income. You can continue to live in your home as a tenant and the reversion company cannot sell the property until you die or move out.

Because of these factors, you will normally only receive between 20 and 60 per cent of the market value of your home, depending on your age. For example, if your home is worth £200,000 and you decide to sell 50 per cent to a reversion company at 20 per cent of its value, you will get £20,000. When you die, the reversion company will own 50 per cent of your home, regardless of its market value, including any increase in the value of the property.

The amount of rent you will have to pay will depend on the reversion you choose but it is usually nothing or a nominal amount. You will also be responsible for maintaining your home.

After you die or move out, the proportion of your home you sold belongs to the reversion company and anything else passes to your estate.

Key considerations

Equity release schemes can be complicated and there are several key considerations to take into account, including:

Tax position

Before starting an equity release scheme you will need to consider whether your income tax position or entitlement to state benefits will be affected. For some people equity release could have a significant impact and leave them less well off.

The future

Think about how an equity release scheme could affect your future plans. For example, you may be looking to downsize but you may not be able to transfer your equity release scheme.

Inheritance

How will an equity release scheme affect what you will leave behind for your loved ones? What are the consequences of this?

Fees and costs

As with many financial products there are fees and costs involved. These include arrangement fees, valuation fees, legal costs and insurance. Make sure you take all of these into account to understand the true cost involved.

Charges

Depending on the type of scheme you choose, there might also be a rental charge or early repayment charge to consider.

Investing

Will you invest the lump sum you receive? If so, where will you invest it and will your lump sum be protected?

Professional advice

Equity release is one way to free up some of the value of your home but there may be other options that suit your circumstances better. It is important to seek professional advice. Please contact us so that we can discuss your specific circumstances.