## 2007 Review of Retirement Income Policies

# Home Equity Release Products in New Zealand: Risks and Opportunities

## Report to Retirement Commission

## 21 June 2007

**Judith A. Davey**
**For the New Zealand Institute for Research on Ageing**

## Contents

**Summary**

Commercial equity release schemes are an option for older home owners who wish to remain in their homes, but require additional funds for everyday expenses or specific purchases. Reverse mortgages, in various forms, are the main form of commercial schemes available in New Zealand, although one firm offers home reversions. Equity release schemes have been available here since the early 1990s. Take-up has been extremely slow until recently and the range of offerings has expanded considerably in the last few years. The schemes vary in their features, but have become more flexible in terms of conditions such as interest rates, loan to value ratios, systems for repayment and subsequent draw-downs. New Zealand clients of equity release schemes fit the “asset rich, income poor” profile and their general characteristics reflect those of the older population as a whole. Released funds are used for a variety of purposes, often housing-related.

Barriers to the take-up of equity release schemes apply on both the supply and demand sides. Providers must contend with some negative attitudes towards the concept, long-term commitment of capital, longevity, property price and interest rate risks. They are affected by government regulation, actual and potential, and with the implications of policy, both directly and indirectly.

The main barriers on the consumer side relate to attitudes – suspicion of the schemes and lack of knowledge about options, attitudes towards inheritance, fear of indebtedness and expectations of government support. Surveys of equity release clients have, however, found high levels of satisfaction.

Given demographic trends and the socio-economic characteristics of present and oncoming cohorts of older people, the market for equity release schemes is potentially huge, even with falling home ownership rates. Opportunities for development also depend on environmental factors. Providers seek stable economic conditions and consistent policy settings. Some policies may facilitate equity release and inspire confidence, for example moves to increase consumer protection. As new types of providers enter the market and new products are offered, regulation will become an ever more complex challenge.

Measures which call for greater individualisation of responsibility provide incentives to make use of capital tied up in homes. Policies may develop which call for the mobilisation of housing wealth to provide for the care of older people, in the community as well as institutional care, to meet health costs and to maintain the housing stock. These could help to ease the strain on the public sector budget in the face of population ageing. They could, however, be unpopular with older people if they are seen as government falling short of its obligations.

The future of home equity release depends on attitudinal factors and the building of trust. It relates to how responsibility will be shared between individuals, families and the state when numbers of very old people are much increased. The paper concludes that equity release, now and in the future, has the potential to improve the quality of life of older people. At the same time it highlights many issues which need examination, and the limitations of the concept, especially in relation to contributing to the well being of older people who are not home owners.

## Introduction

A review of retirement income policy is being carried out by the Retirement Commission in 2007. The terms of reference for the review include a list of aspects of policy relevant to retirement income which are to be covered in the review. One of these is “commentary on the risks, opportunities and barriers relating to the use of home equity products and any suggestions for change”.

The Retirement Commission has contracted the New Zealand Institute for Research on Ageing (NZiRA) to prepare a report to meet this requirement and the preparation of this report has been subcontracted to Dr. Judith Davey, Senior Research Associate of the Institute of Policy Studies, Victoria University of Wellington.

The following report draws on a body of information on home equity release accumulated by Judith Davey since the early 1990s, including original research on providers and consumers of equity release schemes in New Zealand and the UK, as well as literature on other countries. Reports previously prepared for the Retirement Commission have been important sources of information, along with a large-scale survey of equity release clients in New Zealand, undertaken by NZiRA for the Retirement Commission and the Office for Senior Citizens in 2005-2006 (Davey and Wilton 2006). In addition to this, new information has been added, with updates on equity release products which have only recently entered the local market. This has entailed consultation with appropriate agencies, including commercial home equity product providers.

# Part 1: Home Equity Release Products in New Zealand

## The Concept of Home Equity Release

Housing wealth in the form of home equity can be used in various ways. Most people do nothing and the equity is preserved for transference by inheritance or as security for a loan as and when a special need becomes apparent. If older people wish to mobilise their housing wealth, they must first choose whether they wish to remain in their homes. If they move, part of the capital may be released by "trading down" to housing more suited to their needs. A change of tenure to renting or boarding will make all of the home equity available for use or re-investment. Moving in with family members may provide care and support as well as accommodation. There is considerable evidence, however, that older people prefer to remain in their own homes and in familiar surroundings.

The further set of options entail remaining and borrowing against the equity in the home. An orthodox mortgage may not be attractive (or available to people over a certain age), as it requires repayment of either capital and interest, or interest only. Commercial home equity release schemes allow owners to remain in their homes while converting some of their housing wealth to support their living standards and general expenditure, and deferring repayments until the house is sold, often on the death of the occupant(s)[1].

## Home Equity Release Products

**Reverse mortgages**

Reverse mortgages have been almost synonymous with home equity release in New Zealand and are the most common form of scheme currently available, provided by the main players in the market – Sentinel's Lifetime Loans, Lifestyle Security (Property Finance Group), Bluestone's and Westpac's EQUITY Tap and smaller providers including First Mortgage Trust's Senior's Cashbox Home Loans and Savings and Loans' Golden Equity Loans[2] (Table 1). Schemes may adopt fixed or variable interest rates, often linked to prevailing rates in the financial market. The loan payments and interest are "rolled-up", sometimes along with the fees associated with the schemes. The interest is compounded along with the original loan and no repayments are required until the scheme is terminated. Most schemes guarantee that the borrower's liability will never exceed the market value of the home ("no negative equity guarantee") when the house is sold at the death of the last scheme-holder or their permanent movement into residential care.

Reverse mortgages providing annuities are less common than schemes involving lump sums, for reasons associated with the local environment for annuities. However, schemes providing regular payments, for life or for fixed terms are available in New Zealand, the main provider being Dorchester Life Limited.

Line-of-credit schemes are a sub-set of reverse mortgages. This arrangement allows clients to draw down funds only as they are required, from a pre-approved sum, and pay interest only on these funds (rather than on a large lump sum, or a significant sum used to purchase

[1] These options are pursued in more detail on the *Sorted* web site - http://www.sorted.org.nz/life-stages/60plus/equity-release/is-equity-release-for-you.

[2] Abbreviated versions of these titles are used in the following discussion.

an annuity). Thus the compounding of interest has a much less severe effect. Lifestyle Security is a leading provider of this type of scheme.

**Home reversions**

Home reversions entail the sale of all or part of home equity at a discounted price. Buyers pay the vendors lump sums or regular payments with the balance due when the house is vacated or at a pre-arranged settlement date. The vendors retain rights of occupancy for life (sometimes paying rent). No interest accumulates in reversion schemes and there may be arrangements for the sharing of house price appreciation ("shared appreciate mortgages" or SAMs also have this feature). Silver Choice Limited is the only firm currently offering home reversions in New Zealand, incorporating shared appreciation.

## Equity Release in New Zealand

Equity release schemes are a recent feature in New Zealand, although they have existed in the UK and North America for decades. The Housing Corporation of New Zealand began a pilot scheme - *Helping Hand Loans* - in November 1990. Funds released could be used for housing purposes only. The scheme was soon overtaken by changes in housing policy and never extended.

Commercial reverse mortgage products were marketed through the Invincible Life Assurance Company in Wellington from 1991. There were several RAM (reverse annuity mortgage) products, with different eligibility ages and sets of conditions. They used first mortgages over clients' property to secure annuities and all costs were deferred until the mortgage was repaid, with compounding interest.

Another early venture into the area was the Taranaki Savings Bank's revolving credit facility for homeowners, its *Retired Beneficiaries Loan Facility,* which is similar to line of credit equity release schemes[3].

In the 2000s several new schemes have been introduced. Their main features are summarised in Table 1 and the subsequent sections examine some issues associated with their operation, drawing on information provided by the firms. In addition to those listed, some smaller schemes tap into home equity by using mortgages to provide funds for investment. The income is intended to cover the mortgage costs, house rates and insurance and to provide a regular income for the clients, avoiding any reduction of home equity and interest roll-up. Firms offering this type of scheme include Global Business Ideas, Sterling Home Equity Release (linked to Income Solutions) and Silver Lining.

[3] Information on these early schemes, including research on their clients, can be found in Davey 1998a.

**Table 1: Main Home Equity Release Scheme providers**

| Name | Date of entry | Min. age of client | Interest rate options | Loan to value ratios | Funds available | Minimum house value | No Negative Equity Guarantee | Member of SHERPA |
|---|---|---|---|---|---|---|---|---|
| **Sentinel Lifetime Loans** | 2004 | 60 | Variable or fixed for 5 years | 15% at 60, 45% at 90 plus | Lump sum, draw down facility | $100,000 | Yes | Yes |
| **Lifestyle Security – Property Finance Group** | 2004 | 60 | Variable | 10% at 60, 47% at 90 | Lump sum, line of credit | $100,000 | Yes | No |
| **Savings and Loans - Golden Equity Loan** | 2006 | 60 | Variable | 10% at 60, 40% at 90 | Lump sum, line of credit | $100,000 | Yes | Yes |
| **Dorchester Life - RAM Ultimate** | 2006 (in this form) | None for fixed term or 60 | Fixed for 5 years, floating or combination | 25% at any age | Lump sums and/or annuities | $200,000 | Risk of negative equity insured against | No |
| **Home Equity Release Loan** | 2007 | Ditto | Ditto | Ditto | Lump sums and regular payments | Ditto | Ditto | |
| **First Mortgage Trust – Seniors Cashbox Loans** | 2003 | 68 | Variable | Immediate access to 20% | Lump sum or draw down | $250,000 | Repay at 70% house value | No |
| **Bluestone Mortgages - EQUITY Tap** | 2006 | 60 | Choice of fixed for life or variable capped for life | 15% at 60, 45% at 90 | Lump sum, annual instalments or draw-down | None, but geographical limitations | Yes | Yes |
| **Westpac EQUITY Tap** | 2006 | 60 | Ditto | 15% at 60, 45% at 90 | Ditto | Ditto | Yes | No |
| **Silver Choice** | 2006 | 60 | NA | NA | Initial and annual instalments to settlement date | $300,000 | NA | No |

## Local Authority Rates Postponement Schemes

Using home equity to offset property taxes has been possible for several years in the USA and Australia. The first New Zealand rates postponement scheme was launched by the Western Bay of Plenty District Council in 2004, under the provisions of the Local Government (Rating) Act 2002 and the Local Government Act 2002. Fourteen district, city and regional councils are now in the consortium which provides rates postponement.

The scheme allows ratepayers aged 65 and over (both partners) to postpone rates payments by rolling them up, along with interest and fees. The scheme includes a guarantee that no liability will exceed the value of property. Participants are required to have at least one "decision facilitation" meeting with a Relationship Services counsellor. This is expected to involve family and heirs. All or part of rates can be repaid at any time without penalty. Outstanding balances may be transferred to another property in the same local authority area.

## Features of Current Equity Release Schemes

**Age of eligibility**

In general, firms have adopted 60 as their minimum age of eligibility for scheme membership, usually as the age of the youngest partner, although Sentinel will consider applications where the younger spouse is aged 55-59. The exception is Seniors Cashbox which sets 68 as the age limit. In practice people tend to enter the schemes at an older age. A recent survey showed an average age of 72 for new borrowers, but claimed that the under-70 age group was growing (Hickey and Sorbello 2007). There are no apparent age limits in the investment-related or fixed term annuity schemes.

**Loan to value ratios and loan terms**

The amount of home equity which can be borrowed generally increases with the age of the client – known as the loan to value ratio. These ratios are similar in the main schemes, as indicated in Table 1, and have been relaxed in recent years. Clients may take additional lump sums as they age and the house value appreciates. Under Lifestyle Security's line-of-credit, clients are free to draw down as much and as often as they wish within the set ratios. There is also an inflation clause, which means that the amounts not drawn will increase at 5% per annum. These ratios are intended to ensure that a sizeable proportion of home equity remains for the clients' estates.

Many equity release firms guarantee that clients will be able to remain in their homes until they choose to move or until the death (or a move into permanent residential care) of the surviving partner, but there are exceptions. Seniors Cashbox Homeloans specify that the full loan and interest must be repaid when the amount owing reaches 70% of the house value (for Trust Deed requirements). Because the maximum loan advance is only 20% of the value of the property at the time of the initial advance, the risk of consuming 70% of the equity is claimed to be small. Some of Dorchester Life's fixed term options also specify a settlement date when the loan must be repaid.

Under the rates postponement scheme, if the total charges reach 80% of the property value, future postponement may cease and rates will have to be paid, but costs will continue.

**Conditions on house type and value**

As shown in Table 1, there is considerable variation in the minimum value of houses eligible for equity release schemes ranging from $100,000 up to $300,000. Firms require houses to be formally valued at the beginning of the scheme and often at regular intervals thereafter and some specify that they must be well maintained and kept in good order. Hickey and Sorbello (2007) found that 87% of outstanding New Zealand equity release loans are secured by houses, 4% by apartments and "other" 9%.

The main schemes will cover property held by trusts as long as the trustees agree. Sentinel information is clear that rental properties cannot be covered and deals cannot be settled through a power of attorney. Other firms do not mention this restriction. Holiday and second properties have always been covered by RAMs, in fact some versions with fixed terms have these properties in mind so long as they are not rented. Sentinel offers a Retirement Village Lifetime Loan.

**Interest rate options**

Most New Zealand firms offer variable interest rates, higher than normal mortgage rates. For example, Sentinel and Lifestyle Security loans attract a variable rate, 1.5% above standard mortgage rates and capped at a level (3-4%) above the 90 day bank bill rate. Sentinel also has an option for clients to fix their interest rate for five years. Dorchester Life and EQUITY Tap offer clients a choice of either fixed or variable rates, although there may be penalties for breaking agreements with fixed rates. According to the Trowbridge Deloitte survey, only 1% of New Zealand equity release loans are taken at fixed rates, given the more recent appearance of these options in the market place (Hickey and Sorbello 2007).

**Form and size of draw-down**

The average size of equity release loans taken out in recent years is $40,000-$50,000. The recent consumer survey estimated $43,000 (Davey and Wilton 2006). The Trowbridge Deloitte survey concluded that the average new loan in 2006 was $42,500. Lump sums represent 99% of transactions, with a negligible take-up of income stream mortgages.

The consumer survey indicated that 46% of respondents had taken out the maximum lump sum and a similar proportion had taken a lesser amount, below the maximum available (Davey and Wilton 2006). People interviewed in this survey were asked whether they would take out further lump sums, if this were possible under their scheme. Over a third (37%) said that they would not take more: 18% said that they would, within limits, such as “only for health reasons”. Another third said maybe they would, depending on circumstances.

Annuities, which are an integral part of some commercial equity release schemes, are not used to a great extent in New Zealand. They had been taken out by only 5% of the consumer survey respondents (2% annuity alone, 3% annuity and lump sum). They have, however, been identified as “an important piece of the private provision jigsaw” (PRG 2003). Commentators conclude that the tax treatment of annuities (at the fund level) is a significant barrier to their development (St. John 2004; Coon 2004). Thus the extension of the annuities market, in the ambit of equity release schemes or otherwise, may depend on government action to remove some of the current disincentives. Income streams provided by annuities may also affect clients’ access to income-tested welfare benefits (see page 16).

**No negative equity guarantee**

Members of SHERPA (Safe Home Equity Release Plans Association)[4] are required to offer a “no negative equity guarantee”, and this provision is also a feature of other leading schemes. This ensures that clients, or their estates, never owe more than the sale value of

[4] SHERPA is a not for profit association, launched in May 2005, supported by several of New Zealand’s leading providers and distributors of home equity release plans (see page 14).

their home when the scheme terminates. Such a guarantee is not, however, universal. Seniors Cash Box loans allow the debt to reach only 70% of the house value. The rates postponement scheme includes a guarantee that no liability will exceed the value of property, but if total charges reach 80% of the property value, future postponement may cease.

Under some schemes (Sentinel, Lifestyle Security, EQUITY Tap) it is possible for clients to set aside some of the home equity to be protected for bequest.

**Portability of schemes**

Most equity release firms state that their schemes are portable to a new residence, subject to certain conditions. Moves may be limited to houses of similar value to the ones which clients have left, and may entail costs to facilitate the transfer. Moves to retirement villages may also be possible. The *Sorted* web site recommends that people should not rely on being able to move and transfer their equity release arrangement, and should not use equity release "until you are in the home in which you expect to live for the rest of your life" (www.sorted.org.nz).

Flexibility to move to a new house may not be possible under reversion and sale/leaseback plans.

**Fees and loan repayment**

There are variations in how fees are set and dealt with in home equity release schemes[5]. Often they can be rolled up with the loan amount and will therefore attract compound interest Some schemes entail sizeable establishment fees (alternatively termed application/placement/arrangement fees), which can be a dollar amount or a percentage of the amount borrowed and some have ongoing regular maintenance fees. Greater competition in recent years appears to have led to some changes/reductions in fees. Clients will have to meet valuation costs on an initial and probably regular basis (for example, every five years), legal fees and selling costs when the scheme terminates.

Several firms allow repayment of all or part of the loan without penalty. Break fees may be charged in the case of fixed interest deals where interest rates have fallen since the loan was taken out.

**Disclosure**

Many of the issues related to consumer protection are covered in Part 2. Submissions received by the Office for Senior Citizens on the regulation of commercial equity release (in response to their November 2006 Discussion Paper) call for high levels of disclosure. The Rates Postponement Coalition suggested that this should include information on full costs, commission, expected outstanding balance, circumstances under which loan was repayable, rights to draw down, early payment rights and penalties, and rights to transfer.

In their brochures firms often present scenarios for the draw-down of home equity, the build-up of interest and changes in house prices. Providing individualised estimates are called for in Westpac's "*A Practical Guide to Equity Release and Reverse Mortgages in New Zealand*" (Westpac and Bluestone 2007: 18). Such scenarios are often required by codes of practice for equity release overseas (Davey and Wilton 2005).

---

[5] Details of the types of fees which may be incurred are available from the *Sorted* web site.

**Taking advice**
Firms which are members of SHERPA require clients to take independent legal advice. Many also strongly recommend that people take financial advice and this is also advocated by consumer groups, such as Age Concern. The rates postponement schemes require formal counselling. Consultation with family is also recommended by provider firms although this, of course, cannot be required. In their information to prospective clients, EQUITY Tap suggests that they consult WINZ if they are concerned about the impact that "receiving excess funds may have on any government benefits".

**Ongoing requirements**
Schemes often include requirements on clients for house maintenance, keeping up insurance, notification of changes to house structure and of any additional permanent residents. There may be ongoing costs related to revaluation and subsequent drawdowns. The *Sorted* web site suggests that prospective clients should require written information about such requirements.

On their part, most of the firms provide regular loan statements to clients and some produce regular newsletters.

In the short period during which a selection of equity release products have been available in New Zealand, it appears that conditions surrounding them have become more flexible, for example options for equity protection and the types of properties which can be borrowed against. According to a Datamonitor report, flexibility is the "key for the future" of equity release (Datamonitor 2005: 144).

## Characteristics of Equity Release Clients

Recent research commissioned by the Retirement Commission and the Office for Senior Citizens aimed to investigate the circumstances, motivations and attitudes of older people in New Zealand who had entered into commercial equity release schemes (Davey and Wilton 2006)[6]. The 846 responses included 349 people living alone (109 men and 240 women) and 455 couples; 42 respondents lived in households with people other than a spouse. The couples/single people division was therefore roughly 56%/44%.

The average age of male respondents was 75 (with a range from 56-90) and of the female respondents 73 (range from 49-91). Nearly 80% of the respondents had children, with an average of three. The patterns of family size were similar to those for their age group in general, except that a slightly higher proportion - 12% - had no children. Around 80% also had grandchildren, with an average of six.

Consistent with patterns for the older population as a whole, the majority of the clients live on low or moderate incomes: 44% of both single people and couples stated that they live on New Zealand Superannuation (NZS) only. Their savings, as reported, were also modest: 56% had under $10,000 (including those who said they had none). Thirty percent had $10,001 to $50,000 and 7% more than $50,000 (7% non-response). Couples

[6] The research participants were clients of Sentinel Lifetime Loans and Save and Invest (SAI) throughout the country. Between them these firms had around 97% of the New Zealand equity release market at the time. SAI is now incorporated into Dorchester Life.

were more likely to have significant savings than single people – 21% stated over $100,000 in savings as against 8% of single people. Leaving aside what was owed on equity release, almost a quarter of respondents reported that they had some debt.

**Use of funds**

There were a variety of uses for the funds released, as illustrated in Table 2 (which allows for multiple answers) led by home maintenance and improvement, as well as living expenses. A fair proportion was used to retire debt, both that incurred by the clients themselves (often credit card debt) but also by their children. The use of funds to pay for health costs, which include elective surgery and equipment such as hearing aids and dentures, is returned to on page 24. Further details of how equity release funds are used in New Zealand is available in Davey and Wilton (2006).

**Table 2: Equity Release Clients – Use of Funds**

| | % of respondents |
|---|---|
| Living expenses | 27.5 |
| Home maintenance | 26.9 |
| Car | 24.4 |
| Home improvement | 23.0 |
| Travel | 20.2 |
| Retire debt | 15.7 |
| Health | 10.8 |
| Appliances | 5.3 |

## Development of the New Zealand Equity Release Market

Even though opportunities for commercial equity release have been available in New Zealand for over 15 years, take-up has been extremely slow until recently. Since 2004 the pace of growth has accelerated. Datamonitor estimated that, in the 2004-2005 May year, $45 million was advanced in loans (Datamonitor 2005).

Trowbridge Deloitte actuaries published a study of the New Zealand reverse mortgage sector in late 2006 (Hickey and Sorbello 2007).[7] This found that more than 4,500 loans had been issued with a value of $227 million. In 2006, $96 million had been settled in loans and hence the market doubled over the year. The Executive Director of SHERPA is predicting that outstanding loans would reach close to $500 million by the end of 2007. The same source estimated a medium term potential of $2-3 billion to be released by 2011, and a longer term market of $105 billion, based on levels of mortgage-free home ownership. Using a basis of 700,000 senior households, 600,000 owned and a take-up rate rate of one in five, a Sentinel spokesman forecasts that around 200,000 seniors will take up equity release loans over the next 15 years (Sentinel 2007).

In terms of market share, in mid 2005 Datamonitor estimated that Sentinel had 93.9% of the market, with SAI 2.8%, Lifestyle Security 2.2% and other providers 1.1% (Datamonitor 2005:140). At the end of 2006, it is likely that Sentinel had retained its dominant position, but with a reduced share – possibly 80% of the market. Lifestyle

[7] The following firms participated in this survey – Bluestone, Dorchester Life, Lifestyle Security, Savings and Loans and Sentinel.

Security has probably increased its share to 13% and Dorchester Life (SAI) to 5% (Richard Coon, personal communication). Bluestone may well challenge for second place before the end of 2007. Other providers remain minor players.

Take-up of the rates postponement scheme has been lower than expected (Rates Postponement Consortium, submission to the Local Government Rates Inquiry, April 2007). This may relate to lack of knowledge about this scheme and restricted coverage, as well as opposition from older people's advocacy groups.

# Part 2: Risks and barriers to the take-up of home equity release

## The Supply Side (Providers)

**Perceptions and image**
There is always suspicion about new financial products, and providers may be wary of offering a new product whose image is not wholly positive. In the UK some equity release schemes failed in the 1980s (mainly because of poor investment decisions and over-selling) and a recent report confirmed that "high street lenders" are still concerned that their reputations could be damaged by adverse publicity (Terry and Gibson 2006: 23). Media articles and letters to the editor have sometimes depicted equity release schemes as "ripping off" older people, based on the cost of the schemes, the effect of compounding interest and the removal of choices once equity has been eroded. No serious financial organisation wishes their products to be labelled as exploitative. Nor do they wish to contemplate, even in theory, evicting vulnerable elderly people from their homes.

Recent New Zealand media coverage has included quotes such as "retirees will carry debt to the grave - grim report on equity release loans" (*Sunday Star Times,* Money Section, 3 April, 2006); "more and more retirees are secretly tapping into their wealth…there is definitely a stigma …it seems a shameful secret" (*Dominion Post,* Your money, 21 February 2006).

On the other hand provider firms have put considerable effort into winning over the financial and other media through extensive advertising and "advertorials" and there are examples of articles which present a more balanced and positive view of equity release products, which may have improved public understanding of the concept (an example is *Equity release – boon or rip-off*? by Mary Holm, *NZ Herald*, 3 March, 2007).

A "chicken and egg' situation may develop, with the industry waiting for signs of public acceptance and potential customers needing strong reassurance of value and security. Consumer confidence would be considerably boosted if they could see that "household names" such as the major banks were behind home equity release schemes. In their submission to the Retirement Income Policy review, the Bank of New Zealand expressed their concern that less well established, less experienced and perhaps less scrupulous lenders with lower standards will "cause damage to the reputations of all providers …. thereby reducing the attractiveness of such schemes and also their ability to be offered economically." Harsh terms or inappropriate enforcement could easily become a negative media or political issue and would run risk of tarring all lenders with same brush.

Nevertheless, there are signs of change. Westpac Bank has entered the market with its own EQUITY Tap scheme and a Dominion Post article of 28 May, 2007, carried the headline "ANZ National lines up move into reverse mortgages". Commentators suggest that such institutions may become more interested as they see larger volumes of equity release schemes being sold and becoming profitable.

**Need for labour-intensive marketing**

Commentators agree that the marketing of equity release products demands a considerable investment of time and effort as older potential clients require a great deal of explanation and reassurance. This will inevitably affect the profitability of schemes and their attractiveness to intermediaries and brokers, especially when volumes of business are not high. Consumer protection measures, such as counselling, consumer education, regulatory compliance and checking for fraud or abuse, either voluntary or mandatory, will also increase costs to equity release providers. Another issue may be the availability of trained staff to deal with enquiries and transactions. In the USA, decisions to exit the market have been linked to costs associated with keeping staff trained in the process of originating equity release loans (Rodda et al. 2000:40).

**Long-term commitment of capital**

Equity release schemes entail the commitment of funds for long periods before a return is realised, especially where interest is also capitalised into the outstanding loan balance. Each matured scheme delivers a large amount of cash, but with uncertain timing. This may present liquidity problems depending on the range of other business being conducted and the likely maturity dates of portfolios (which are hard to predict given that they largely depend on the life span of the clients). To compensate for these uncertainties, providers of equity release products require higher margins than traditional loans, such as residential mortgages, and hence higher interest rates.

The availability of capital to fund the schemes may be a limiting factor even when there is a clear demand from eligible home owners. Reversion schemes are limited by the availability of individual or corporate investors. Securitisation through intermediaries is now fairly standard, turning their borrowing into bonds, but this requires financial soundness and favourable ratings in the market. The lack of a financial market in long-term debt securities in New Zealand is a further drawback (Morgan 2004).

**Longevity risk**

The payback of capital from equity release schemes depends on the longevity of the clients and when they sell their homes, which may be hard to estimate. Hickey and Sorbello (2007) estimated an annual discharge rate of 3.5% full, 5.4% partial repayments in 2006, based on number of borrowers (4% full and 1% partial based on dollar figures).

Lenders need to protect themselves against the worst case scenario – that the borrower or spouse will remain in permanent occupancy longer than anticipated and the loan balance will exceed the equity. The consequences of this will depend on the details of the scheme, whether the term is fixed and whether guarantees have been offered. Providers may take a loss where no-negative equity guarantees, security of tenure and/or lifelong annuities are involved.

The issue of remarriage has not yet been clarified in New Zealand schemes. If a scheme member loses their spouse and then remarries a much younger partner, will the scheme allow this younger partner to remain in the house after the original scheme holder dies or leaves? Coverage of new partners could lead to unanticipated losses to the lender if the result is a significant delay in scheme repayment.

Providers can protect themselves from the longevity risk through reinsurance (as is the case with Sentinel), charging clients an insurance contingency fee (Dorchester Life), maintaining reserves or adopting very conservative assumptions about longevity.

Reinsurance is expensive and will be reflected in costs to clients. Strong reserving reduces profits to owners or to support new business. Generally, providers base their calculations on expectations of mortality and moves into residential care and adopt conservative “loan to value” ratios when calculating what proportion of equity can be released.

**Property price risk**

Most equity release scheme providers depend on steady property price growth, and they must adopt some assumptions on likely trends. Despite historical upward trends, there is no guarantee that house prices will always increase, certainly not at a steady rate, and there will be regional variations. To counter this type of risk many schemes require regular reviews of house values and set minimum property values as part of their scheme conditions.

Linked to this is the concern that properties may not be well maintained, which will affect the quality of the providers’ investments. Many schemes therefore reserve the right to terminate contracts if maintenance standards are not met. In practice these are not seriously enforced, except in the context of re-valuations, and providers are more concerned that insurance and rates payments are kept up to date. Providers can take comfort in the fact that a high proportion of funds released are used for house maintenance and improvement.

**Interest rate risk**

Designers of equity release schemes also have to make assumptions about interest rate trends over a considerable period, alongside assumptions about longevity and house price trends. Interactions between interest rates and property values are complex, producing risks for both providers and consumers. High interest rates may outstrip property value rises, thus eroding equity faster than expected. In New Zealand, interest rates on equity release loans are mostly variable, as noted in Part 1. Fixed interest rates create risks for lenders and borrowers, and may attract a penalty on early termination.

In practice, interest rates and house appreciation tend to move together, driven by inflation. The critical point is the crossover, when the rising value of the loan equals and then may exceed the equity in the property.

**Regulation**

Consumer protection is an important consideration in equity release schemes. A balance is needed between achieving the highest possible ethical standards in practice and avoiding over-burdening the providers with compliance costs which will threaten their viability. Where a range of different organisations is involved - insurance companies, banks, investment houses, property management companies – several different regulatory regimes and systems of governance will be involved, making it difficult to ensure simplicity and consistency. The USA system has been termed ‘a regulatory minefield” (Caplin 2002:244).

Consumer protection can be achieved either by self-regulation or through some externally-applied control mechanisms. The latter would probably inspire a higher degree of confidence among potential clients. The former would be preferred by the industry itself. Most equity release providers in New Zealand agree that a code of practice is required, preferably one administered by the industry itself. Such concerns led to the development of SHERPA – Safe Home Equity Release Products Association

– in 2005.[8] This is an industry-created body equivalent to the British Safe Home Income Plans (SHIP, set up in 1991) and the Australian Senior Australians Equity Release Association of Lenders (SEQUAL, set up in 2005). SHERPA has a code of practice and has pledged to work with government on regulation of the equity release industry, which is currently being worked on by the office for Senior Citizens. However, given Sentinel's prominent role in setting up SHERPA and its dominant position in the market as a whole, there is reluctance to join on the part of some providers (see Table 1).

An examination of overseas industry-led equity release codes of practice reveals many common elements (Davey and Wilton 2005). They generally require a no negative equity guarantee and assure clients of lifetime tenure of their properties. They also cover disclosure of the full costs of the scheme in written form, combined with a written statement of the benefits to and obligations of the borrower; they advise potential clients to discuss the scheme and its implications with family members and trusted advisors. Some require clients to obtain independent legal advice or counselling before entering equity release schemes.[9] However, overseas experience shows that compliance to these codes can be an issue (Sharples 2004).

**Policy constraints**

Central government policy includes both general and specific provisions which produce incentives and disincentives to equity release on the supply side. Policies on the regulation of financial institutions, and economic policy in general, influence the environment for equity release either positively, negatively or neutrally. They will affect the relative attractiveness of different forms of investment and the level of competitiveness in the market.

Aspects of superannuation policy and policies relating to the funding of residential and other health care are also relevant. Policies which encourage people to stay longer in their homes will increase the risks for equity release scheme providers. Taxation regimes are crucial to providers with annuity-based schemes (or those contemplating such schemes). This includes the taxation of life companies, which may be subject to higher tax rates than the clients receiving tax paid annuities. This makes it difficult to provide good value in an annuity.

Equity release schemes which provide regular payments may find that this affects their clients' access to state benefits. An annuity is treated as income under Schedule 3 of the Social Security Act 1964, whereas a lump sum is not. That means that eligibility for any state benefit that is subject to an income test will be impacted by receiving an annuity (SHERPA submission to the Retirement Income Policy Review 2007). These include - Accommodation Supplement, Disability Allowance, Community Service Card, Rates Rebate and New Zealand Superannuation (non-qualifying partner). This is despite the fact that the funds are, in fact, the release of capital rather than income in its usual sense.

[8] The members of SHERPA are Bluestone Equity Release, Sentinel and Savings and Loans, with the Institute of Financial Advisers as an associate member.

[9] The latter is a requirement of the National Reverse Mortgage Leading Association (NRMLA) which was established in 1997 as a national trade association in the USA.

## The Demand Side (Consumers)

**Suspicion of the product**

Older people are particularly wary, with good reason, of schemes that entail risks to what is perhaps their only asset. So are their advisers - solicitors and financial advisers – who bring their own prejudices and who may also have a conflict of interest if they are linked to providers of other financial and investment options.[10] Some provider firms have gone to considerable pains to inform the public and professional groups, providing full and detailed information about their products, explaining disadvantages as well as advantages. Examples include Sentinel's working with the law and accountancy professions to draw up practice notes and Westpac's booklet *A Practical Guide to Equity Release and Reverse Mortgages in New Zealand*.

Security is seen as all-important when older people are investing their life savings. Stories about pensioners losing their homes or their assets (even if apocryphal) have enormous and long-term impact. Potential clients are apprehensive that firms providing equity release products will go into liquidation, default or be bought out by other, less reputable, concerns. They are afraid of losing their homes or incurring debt in excess of their value. This can be a worry even when no negative equity guarantees are offered. Older people express preferences for schemes from well-known and well-established companies. Even so, some people are still sceptical about guarantees and assurances and suspicious of all sources of advice on financial matters. Many of these fears were evident in submissions to the Office for Senior Citizens in their discussion paper circulated in late 2006.[11]

Requirement for independent legal advice and pre-loan counselling are intended to reassure potential clients. In the USA, however, Caplin (2002: 243) suggests that such programmes may, in fact discourage people by highlighting complexities and dangers which rarely occur.

**Lack of knowledge about schemes and options**

Understanding of how equity release works appears to be growing as provider firms seek to present their products in a "user friendly" manner, through seminars (linked to organisations for older people) and articles in relevant publications, as well as networking among professionals likely to advise older home owners. Sentinel has links with Public Trust and the Returned Services Association[12] and an extensive sponsorship programme of events from flower shows to Age Concern conferences.

Knowledge of equity release schemes and of the options available for older home owners to use their housing wealth to improve their standards of living is still not widespread among the New Zealand public, although the topic appears more commonly in media and other discussion than was the case when commercial schemes first appeared in this country (Davey 1998a).

[10] An article in the Chartered Accountants Journal of New Zealand was, on balance, against commercial equity release (Scandlyn and Bowater 2004).

[11] The *Sorted* web site suggests that there might be a slightly higher risk of default on equity release products, implicitly compared to normal loans on property, and that no negative equity guarantees cannot always be relied upon.

[12] These organisations were identified as trusted sources by respondents in Davey and Wilton (2006).

Research among local equity release clients found that most people did not know of alternatives to commercial equity release and examined the offerings of only one firm (Davey and Wilton 2006). Only 17% of clients had looked into more than one scheme, many not knowing that there were others to choose from. Several explained their lack of comparisons because they took the advice of their lawyer, or because they trusted the people fronting the particular scheme. Choice among products and flexibility to suit individual needs will benefit consumers. *Sorted* recommends shopping around to choose a product that gives flexibility and the web site offers check lists to help with decision-making.[13] The down-side of extended choice is, of course, bewildering complexity and the problem of comparing schemes.

Respondents in the consumer survey were asked if they had considered any other ways (apart from commercial equity release) to use the capital tied up in their homes. Sixty-four percent had not considered any alternatives. The most popular alternative was to move to a less expensive house, but few had considered a retirement village, rates postponement, or moving in with family. These findings may be based on a strong desire by older people to remain in their current homes.

Clients and others who had enquired about equity release schemes were asked who (if anybody) they had approached for advice: 59% had consulted professional advisors only, 29% consulted these advisors in combination with family and friends and 7% consulted family and friends only (these three categories together accounted for 95% of the responses). Overall two-thirds of respondents consulted a legal advisor and just over a quarter consulted a financial advisor (including accountants). Levels of satisfaction with professional advisors were high among the survey respondents. Two out of every three had discussed equity release with their children (this rises to 75% if people without children are excluded). In the vast majority of cases the children agreed to the proposal to take out a commercial scheme (91%). Where children were opposed an alternative to equity release was often found.

**The “rainy day” consideration**

Many people, especially older people, like to feel that they have financial reserves for unexpected expenditure and that it is dangerous to erode home equity except as a “last resort”. This may be linked with the contemplation of future health problems, views on inheritance and the ability to assist in family crises. Several New Zealand survey respondents, who took part in face-to-face interviews, said that, before they took up equity release they were eroding their “nest eggs” through day-to-day spending and thus they went into the schemes to create “something to fall back on”.

Line of credit equity release schemes allow people to draw down funds as they require them, but to leave a portion as their “rainy day” fund, so they can spend their other assets. Some (or their advisors) now consider equity release as part of later life financial planning and the orderly decumulation or divestment of assets.

**Attitudes towards inheritance**

Attitudes surrounding inheritance are central to the debate on whether housing wealth could or should be used in the lifetime of the holders. If older people set great store by bequeathing, and younger people have strong expectations of inheriting, then equity

[13] None of the respondents in the 2005 survey made reference this web site, which has extensive and accessible information on equity release.

release schemes will not be attractive. If, on the other hand, bequeathing is not considered important, then older people might consider mobilising housing wealth. As noted earlier, some schemes contain provisions to protect some funds for bequest, so equity release need not be incompatible with the desire to leave an inheritance.

There is some evidence that attitudes towards inheritance are changing. Greater longevity is increasing the possibility that assets will be required to sustain living standards in old age; older people often see their children as better placed financially that they are themselves; and they are more willing to put their own comfort in old age ahead of the desire or requirement to bequeath. Linked to this is a keen desire for independence and that they should "not become a burden".[14] Recent New Zealand research illustrates instances where equity release funds were used to help younger generations – with home ownership, paying off student debt, setting up in business – in a form of advance inheritance (Davey and Wilton 2006).

**Fear of indebtedness**

Having spent many years paying off a mortgage, people may be reluctant to take on debt (as they see it) again. The current older generation is financially conservative and risk-averse, unused to "living on credit". Reversion schemes avoid debt, but also imply loss of home ownership, which may be even more unacceptable, given emotional attachment to homes. As noted earlier, in many quarters there is an element of stigma attached to equity release, because it appears to imply dire financial straits and possibly mismanagement of personal finances. This was clear among New Zealand survey respondents, many of whom had not disclosed their membership of equity release schemes to their friends and peers (Davey and Wilton 2006).

Oncoming generations may be more used to handling debt as part of everyday money management and may be more comfortable with it. This may make them more open to borrowing against their home equity. New providers report that a significant amount of released equity is, in fact, used for paying off sums owed at much higher interest rates, such as credit card and unsecured debt, or for consolidating debt. The New Zealand consumer survey found that 15.7% of the respondents had used equity release funds to clear debt. Some use the advances to clear mortgages (in a few cases mortgages taken out to assist their children) thus avoiding regular outgoings on repayments.

**Value for money**

Concern about high interest rates and the effect of compounding interest figured significantly among the concerns of consumers in the New Zealand consumer survey (Davey and Wilton 2006) and were often the most significant factors why enquirers checking out the schemes did not go ahead They were also cited as good reasons for not taking schemes out at a young age.

---

[14] These attitudes are illustrated by consumer survey responses (Davey and Wilton 2006: 43-44).

- It is important to leave some of your assets to the next generation (41% agreed, 52% disagreed).
- My children/relatives are quite comfortable and do not need my money (82% - agreed).
- I think it is better to use my assets to help me in my old age than to leave them to other people (94% agreed).
- Older people should think more about their children and grandchildren's future than about their own comfort (84% agreed).
- Inheritance is not as important as it used to be (80% agreed).

High set up costs were also a deterrent to enquirers. Figures of around $400 for house valuations or “inspections” were mentioned by interviewees and around $600 for legal costs. They complained that these were payable even if the scheme was not taken up.

Nevertheless, two-thirds of New Zealand clients stated that they were very satisfied with their scheme, with another 31% fairly satisfied. This left under 2% not satisfied (although 1% entered “don’t know” and 8% did not answer the satisfaction question) (Davey and Wilton 2006: 34). They found that the “best” features of the schemes were the availability of funds/income to enhance quality of life and the fact that the loan incurred no repayments in their lifetime. Well over half of the respondents stated that the high interest rates and/or costs were the “worst” feature of the schemes, with few other negative features figuring in the responses. A quarter said that there were no negative features.

**Expectations and suspicion of government**

Expectations of government support for retired people have been fostered by decades of welfare state provision. Older people have often seen it as their right as citizens to receive income and services at the taxpayers' expense, given their own contributions over a working lifetime. This makes many of them reluctant to draw down on their housing assets, ignoring the assistance that many current homeowners have received during the earlier periods of the welfare state in New Zealand. There appears, however, to be a growing acceptance among younger people that the state will be less generous in future in funding income support and care in old age. The push for greater self-reliance is likely to make equity release a more attractive option.

Attitudes towards government are ambivalent. On the one hand there is a deep suspicion that government will use equity release to reduce its responsibility to provide services and support for older people (dating back to Age Concern’s research in 1990). On the other hand, government regulation of private sector schemes is seen as necessary, as epitomised in submissions to the Office for Senior Citizens in 2006.

Government policies in the areas of retirement income, health services, housing and care in old age, through to taxation and macro-economic policies affecting interest rates, will provide incentives and disincentives for equity release at the consumer level (just as was the case for the supply side). Government policy on long-term care and community care will affect choices on whether to remain in one's own home. As has already been mentioned, the tax treatment of regular income from equity release schemes will influence the attractiveness of annuity schemes and there may be implications for access to state benefits.

The interviewees in the recent New Zealand survey were divided on whether government should be involved in the control and regulation of commercial equity release schemes. While there was general support for consumer protection, roughly one-third of interviewees supported a “hands off” approach by government; a third supported some regulation and a third were interested in government developing its own schemes, with lower interest rates, subsidies and guarantees (Davey and Wilton 2006).

## Part 3. Opportunities for the development of home equity release

The market for equity release schemes is potentially huge and most commentators agree on this. They base their conclusions on trends towards population ageing and greater longevity, and the pattern of low incomes among older people, making them "asset rich and income poor". There are other factors of special relevance to New Zealand and similar countries –

- The dominance of home ownership in patterns of asset accumulation;
- The concentration of housing wealth in the older age groups;
- Recent rises in house prices;
- Changing views on inheritance (at least from anecdotal evidence);
- Higher expectations of quality of life in retirement;
- Encouragement to make private provision for retirement;
- Concern about the adequacy of state retirement income support;
- Policies aimed at encouraging self-reliance.

**Population and socio-economic factors**
Opportunities for the development of equity release products depend fundamentally on demographic and socio-economic characteristics and trends. The products are designed for older people, specifically for older home owners living in small households on relatively low incomes. Ageing trends indicate growth in the target age groups. At present just over 12% of the New Zealand population is aged 65 plus. This is projected to grow to 25% by 2039 (Statistics New Zealand medium projections) as part of a historical trend, driven by declining fertility, increased life expectancy and the ageing of the baby boom generation (Dunstan and Thomson, 2006). The 2006 Census recorded 495,612 people aged 65 and over. Projections suggest the total will reach 566,000 by 2011. After that, the increase will accelerate as the generation born during the high birth rate years of the 1950s and 1960s, begins to enter this age group, so that between 2011 and 2021 the older population is expected to grow by 215,000 and between 2021 and 2031 by another 250,000. By 2051, there is likely to be 1.18 million people aged 65 and over in New Zealand, representing an increase of 165% since the turn of the century.

Living arrangements among older people are also relevant. Around 80% of people aged 65 plus live either alone or with a spouse/partner only, that is, in a household likely to be composed of older people. The proportion of people living alone increases with age from 24% of those aged 65-74 to 41% of the 75-84 age group and 56% of people 85 plus, and is higher for women. At age 85 plus, a third of men and two-thirds of women live alone. This proportion has been growing steadily over recent decades.

Home ownership rates increase with the age of occupiers and by their sixties three-quarters of people live in homes which they own, the majority mortgage-free. The most common form of significant wealth-holding in New Zealand is home ownership and is concentrated among the older population.

There is, however, doubt over trends in home ownership for the future as noted in the New Zealand Housing Strategy (HCNZ 2005: 22). Between 1991 and 2001 the rate of homeownership fell from 74% to 68%. If these trends persist, the rate could possibly be below 65% by 2011[15].

Table 3 shows the tenure status of individuals as recorded in the 2001 and 2006 Censuses. The proportion of each age group which lived in owned housing fell overall, with marked declines in the age groups 25 to 54. Beyond age 55 the differences between the two dates are not large.

**Table 3: Usually resident population: percentage living in owned housing, by age, 2001 and 2006 Censuses**

| Age Group (years | 2001 | 2006 |
|---|---|---|
| 25-29 | 24 | 21 |
| 30-34 | 44 | 41 |
| 35-39 | 57 | 53 |
| 40-44 | 65 | 61 |
| 45-49 | 70 | 67 |
| 50-54 | 73 | 71 |
| 55-59 | 74 | 74 |
| 60-64 | 74 | 75 |
| 65-69 | 75 | 75 |
| 70-74 | 75 | 75 |
| 75-79 | 73 | 74 |
| 80-84 | 67 | 69 |
| 85 plus | 50 | 53 |
| | | |
| total 15 plus | 51 | 50 |

It remains to be seen whether home ownership rates in the older age groups will remain at high levels, suggesting that achieving home ownership is being delayed, or whether the declines observed for younger adults will persist as these groups age. If the latter, this will have an impact on the potential for equity release in the future. It is possible that a higher proportion of people will enter retirement as renters, or continuing to pay off mortgages (and with higher mortgage debts being carried into retirement).

**Income and wealth among older people**

"Asset rich and income poor" is a generalisation with respect to older New Zealanders, which suggests that equity release will be an attractive option for many. Most have little chance of enhancing their incomes and depend mainly on NZS, while having considerable wealth tied up in their homes.

Older people have lower average incomes than all adults and a significant proportion have NZS as their sole income. The Office for Senior Citizens suggests that 40% have income from savings or investment, although dollar amounts are small, and only 15% have income from other forms of superannuation and annuities (OSC 2005). *Living Standards of Older New Zealanders* (Fergusson et al 2001) estimated that 56% of single people aged 65 and over had savings and assets of less than $10,000 and 72% less than $25,000 (excluding home equity). Couples generally had higher levels of savings and

[15] The Household Expenditure Survey carried out by Statistics New Zealand reinforces the census data, indicating a fall in home ownership levels from 74% in 1989 to 68% in 2001, and 65% in 2004.

investments, but 36% still had joint assets of less than $10,000 and 51% less than $25,000.[16]

The most common form of significant wealth-holding in New Zealand society is home ownership (Scobie and Gibson 2002). The average sale value of houses in New Zealand is now well over $300,000, having risen by over 10% per annum in recent years, above the level of inflation. The average rateable value of houses occupied by equity release clients in the 2005 survey was $279,000 (Davey and Wilton 2006).

Despite economic theories which suggest that people accumulate assets throughout their working lives and then divest in retirement, empirical evidence shows that household wealth stays high even in retirement. This may be precautionary, to cover unexpected emergencies or to ensure that people can leave an inheritance.

**The environment for home equity release**

Opportunities for the development of equity release products currently depend on private sector organisations, given the reluctance of recent New Zealand governments to enter the field in their own right. Risks and barriers in this area were outlined in Part 2. The business environment must be not only profitable for owners and shareholders, but also competitive in wider financial markets.

Governments can influence the attractiveness, progress and operation of equity release schemes, both directly and indirectly, providing incentives and disincentives on both the demand and supply sides. Providers seek a stable economic environment and also consistent policy, which will allow them to design their products and plan with greater certainty. The long-term nature of equity release as an investment makes this essential for efficient and effective operation.

On the supply side, ensuring a greater degree of long-term certainty and stability in retirement income policy and also in the health and residential care area is crucial. Individuals and families need confidence to plan how their resources can be used to improve and maintain standards of living in later life. Policies in New Zealand and similar countries now call for greater individualisation of responsibility. The mobilisation of home equity to support living standards in later life may appeal to the baby boom generation who are more accustomed to taking on personal responsibility and increased risk.

An example of how policy might influence the take-up of commercial equity release schemes is the government's move to remove asset testing for residential care on a progressive basis. Greater protection of capital through the removal of asset testing may make equity release less attractive. However, any future moves to require users to contribute towards the cost of their care through their assets could have the opposite effect.

**Policy options involving equity release**

Current policy options which encourage or enforce the mobilisation of housing wealth within the lifetimes of the owners, have been outlined above. In future, given the fiscal challenges posed by population ageing (Boston and Davey 2006), such policies may be

[16] Corroborating this, the 2001 Savings Survey found that net worth, defined as assets minus debt, was closely related to age. The Trowbridge Deloitte analysis estimated the average net worth of people 65 plus to be c$210,000 in property and c$100,000 in other assets (Hickey and Sorbello 2007).

extended. If the state feels the need to reduce its fiscal obligations in relation to the support of older people, then the burden will be thrust back on older people themselves and their families. And, as already shown, the main resource available to the majority of older people is the capital which they have tied up in their homes.

Several possible policy initiatives suggest themselves -

- **Central government participation in home equity release schemes**
  It seems unlikely that New Zealand governments, in the foreseeable future, will launch their own equity release schemes although one such initiative was hinted at in the 1997 Coalition Agreement (New Zealand Government 1997). It may, however, be possible for the government to provide guarantees against default by private sector providers (as the Federal Housing Administration does in the USA) (Davey 2005). The Office for Senior Citizens is looking into control mechanisms for commercial equity release schemes, to advise on what action, if any, should be taken by government.

- **Long-term care and health insurance**
  Where governments do not fully fund long-term care, private insurance is an option, just as medical insurance may be a response to actual or perceived reductions in the availability and/or quality of public health services. The insurance approach was incorporated into policy proposals for long-term care funding in the UK in 1996 (Davey 1998b). A government consultation paper proposed shared funding through private insurance, with incentives in the form of additional protection of assets commensurate with insurance coverage and/or guarantees of government funding after a prescribed period of private payments (through insurance).[17] Another approach would be for funds raised from a house sale to be used to pay a one-off long-term care insurance premium.

- **Funding for health-related expenses, especially hospital and surgical costs**
  A growing demand for health care has been associated with population ageing (even though other factors such as technological advances and consumer expectations may also be active), but private medical insurance cover has declined, linked to rising costs, especially for older people.

  The New Zealand consumer survey found that equity release funds are currently being used in variety of ways to improve health and wellbeing, through home improvements such as installing better heating, dealing with dampness and draughts or making adaptations to improve access, bathrooms and kitchens (Davey and Wilton 2006). Help in these areas is limited from public sources and usually subject to income-testing.

  Elective surgery in private hospitals was another significant use for released funds, usually to avoid long periods on public hospital waiting lists. Funds have been extracted to pay for operations, such as cataract removal and joint replacement, and also to keep medical insurance premiums up-to-date. A further use in the health area was to pay for items such as dentures, hearing aids and mobility scooters, which for

[17] These British "partnership" proposals did not go ahead because of a change of government (Davey 1998b). For a recent comment, see Equity Release Working Party (2005:19).

many older people are essential everyday items, contributing significantly to quality of life.

Policies which encourage and/or facilitate equity release to meet health needs in this way could help to ease the strain on the public sector health budget, which is already apparent.

- **Home care costs**
  While the principle of asset-testing for residential care is well established, home care costs are currently part-paid by health and welfare systems. With increased demand for such services, consequent on ageing and also on the promotion of ageing in place, "users pays" may become adopted as a policy principle. Using equity release funds to pay for services such as home nursing and Meals on Wheels, has been raised in Britain (Davey 1998b). Research among New Zealand equity release clients shows that this is already happening informally as the extra funds are used to pay for house cleaning, gardening and general home maintenance services (Davey and Wilton 2006).

- **Improvement, maintenance and adaptation of the housing stock**
  A major issue facing older home owners is the costs of home maintenance, renovation and adaptations to accommodate disability and frailty (Davey et al. 2004: 57). This is especially important given policies to promote ageing in place, even for older people with significant disabilities. Commercial equity release schemes may be the only way for low income home owners to fund "big-ticket items" such as repainting, rewiring, re-roofing, etc. Home maintenance and improvement were the leading uses of equity release in the recent consumer survey (Davey and Wilton 2006). From government's point of view home equity release is already playing a part in achieving objectives relating to adequate housing for older people and also maintenance of the national housing stock[18].

Government policies which stress self-reliance and which reduce support for older people provide incentives on the demand side to make use of capital tied up in homes. These are the "sticks". Policy settings which facilitate equity release, even inadvertently, and inspire confidence in the concept are the "carrots". Such moves are likely, however, to be unpopular with older people if they are seen as government falling short of its obligations towards senior citizens.

[18] The recent Joseph Rowntree Foundation report on obstacles to equity release (Terry and Gibson 2006) pinpointed this potential in the UK context.

# Part 4: Issues and Conclusions

**Attitudinal factors**

The expansion of commercial equity release schemes in New Zealand and elsewhere is constrained by attitudinal factors, which Caplin (2002: 242) calls "the complex psychology of reverse mortgages". These arise mainly from the demand end, but some are reflected by the providers, such as concerns about image, financial risks and future government policy.

To generalise, currently retired people, because of their life experiences, are characterised by stoicism and risk-aversion. In particular, they are unwilling to take on what they see as debt commitments. A mortgage-free home is a strong aspiration and part of New Zealand psyche (Davey and Wilton 2006). At the same time, this generation is strongly independent and proud of their achievements in providing for and bringing up their families and becoming mortgage-free home owners. As a general rule, older people wish to remain independent of their adult children and specially to avoid "becoming a burden". This may be a factor pre-disposing them to use their own resources to achieve this, provided that the desire to bequeath is not even greater.

Passing on an inheritance, largely in the form of a family home, can be seen as a final act of providing for one's children. There is a general feeling that it is "nice" to leave an inheritance for one's children. However, some older people see irrationality in this when their "children" are in fact well-established adults. Given longer life expectancy, "children" inheriting from their parents may well be in their sixties or even early seventies.

Another important belief, influencing decisions on equity release is that older people are entitled to support from society through government. "It is my turn now". This may limit the potential of government to reduce the fiscal costs of population ageing through encouragement of equity release.

There are indications that the next generation of older people will have different attitudes. They will be more financially aware, attuned to managing credit and have lower expectations of welfare state support. With longer life expectancy many will see their children well into their own retirement. There will be more occasions upon which families could use advances on their inheritance. For example, if children or grand-children need financial help to undertake tertiary study, to buy a house, to set up a business, to re-train after redundancy or re-establish themselves after marital breakdown, what help is an inheritance which is not accessible until the parents die? Families may well consider how assets, including home equity, can be used to meet the needs of more than one generation. With greater complexity in family life and life courses, including higher levels of childlessness, inheritance may become less imperative. Most respondents in the Davey and Wilton (2006) survey agreed with the proposition that it is better for older people to use their assets to help them in their old age rather than keeping them to hand on to their heirs.

Reciprocity between the generations, whereby parents provide services to their children, and then, in middle age, the roles are reversed, may be too simple a concept in modern society. In future younger people might be willing to accept a trade-off between providing care for dependent elderly members and inheriting, or not providing care and accepting that assets will be exhausted to pay for it. Crucial policy questions include how responsibility should be shared between the family, community, voluntary and state sectors in the future when numbers of very old people are much increased (Lundsgaard 2005).

**Public discussion**

Informed public discussion is crucial in how equity release is perceived. To increase understanding and acceptance of the concept requires discussion both of equity release itself and of the ideas surrounding it, such as inheritance, individual and family responsibility, intergenerational equity, consumer protection and welfare state entitlements. This debate should cover all the options available to older people in the use, preservation or mobilisation of their housing wealth. Although commercial firms interested in providing equity release products have a part to play in this discussion, the public will be more open to material from independent sources, or those committed to the well-being of older people. This suggests that governmental and quasi-governmental agencies, such as the Office for Senior Citizens and Retirement Commission, and interest groups such as Age Concern, should lead the debate.

**Scheme design, consumer protection and regulation**

In order to address the barriers outlined in Part 2, further work is needed and this would appropriately be undertaken by private and public sector agencies working together, to ensure that equity release schemes are tailored to the specific circumstances of the New Zealand environment, in social, economic and political terms.

A high level of consumer protection is essential, when the potential clients are older people venturing their main asset and their life-savings. Consumers require assurances that provider firms will act reliably and ethically and that their interests will be protected if providers go bankrupt or are bought out. They need to be ensured of good value for money – that they will not die too early to gain benefit from schemes or too late, so that equity is used up (or the loan exceeds the value of the home) – and that inflation will not erode fixed returns from schemes. Clients look to government for legal protection and guarantees; for assurance that policy will not be changed to the detriment of clients. In particular, they are fearful that government may enforce the use of home equity instead of providing support from taxpayers' funds.

These are legitimate concerns, which can only be allayed through careful and ethical scheme design, consumer protection and education, appropriate regulation and guarantees, and more certainty in government policy towards retirement income, health and personal care.

Although no overt indications were detected in recent research, it is clear that older people could be open to financial abuse or exploitation through the use of equity release schemes. Financial gifts made to younger relatives may involve subtle (or not so subtle) duress and transfers of funds in anticipation of inheritance might occur against the wishes of the older person. Any tendencies in this area would raise alarm bells, but will be very difficult to detect, given the need to respect the autonomy of older people and privacy within the family, and to seek a balance between rights and protection. The effect of proposed changes to Enduring Power of Attorney provisions, in relation to equity release schemes, needs to be examined.

Consumer protection can be achieved either by self-regulation (following the example of SHERPA) or through some externally-applied control mechanisms. The latter would probably inspire a higher degree of confidence among potential clients. The former would be preferred by the industry itself.

As new types of providers enter the market and new products are offered, regulation will become an ever more complex challenge. Should regulations be generic or linked to the nature of the providers (banks, insurance companies and so on)? A balance will have to be reached between achieving the highest possible ethical standards in practice and avoiding over-burdening the providers with compliance costs which threaten their viability.

**Demand for and take-up of equity release schemes**

New Zealand faces a doubling of superannuitant numbers and of the cost of income maintenance, as a proportion of GDP, in the next 30 years. Capital tied up in housing wealth is likely to continue as a major form of asset accumulation, even though levels of home ownership may fall. Demographic and fiscal pressures are likely to restrain government's ability to increase retirement incomes in real terms and it will take a long while for private savings and occupational pensions to make a significant contribution. These trends suggest an ongoing situation where many older people find their incomes are not adequate for their desired standard of living, while they have considerable funds tied up in their housing. These conditions call for equity release to be available as an option for older home owners and ensure a large potential demand.

Despite the large size of the group who are potential equity release clients, take-up everywhere has been low. Research on clients in New Zealand has identified factors which influence older people’s decisions about whether they accept or reject the equity release concept:

- professional advice;
- attitudes of family and friends;
- openness to new ideas;
- understanding of the implications (Davey and Wilton 2006).

It is possible that there will be cohort differences as on-coming generations move into later life, with changed attitudes towards debt and greater financial knowledge. There may be greater use of family trusts, new forms of tenure and changes in home ownership rates. Inheritance may become less important and there could be more emphasis on the decumulation of assets as people become more accepting of private provision in retirement or as government reduces its level of support. The use of equity release products may become an accepted part of personal financial planning and management in later life. On the other hand, people may be carrying higher levels of mortgage and other debt into retirement, which will hamper their ability to make choices.

**Relevance to policy**

A range of policy options have been, or might be, adopted to encourage or enforce the mobilisation of assets, especially housing wealth, within the lifetimes of the owners. These policies frequently seek to reduce governments’ responsibilities for funding the support and care of older people. In future, especially given the fiscal challenges posed by population ageing and the current "savings gap", such policies may be extended (Boston and Davey 2006).

The "advantages" to government should not be overstated. There is danger in suggesting that equity release schemes can at the same time be instruments of government policy and also commercially viable products. The older home owners who are most in need of equity release to supplement their incomes may not be the favoured clients of commercial schemes. A growing minority of older people are not home owners. Among these Maori and Pacific Island people are disproportionately represented. Older people in rented accommodation tend to be those with the lowest incomes and the lowest material standards of living, partly because of housing costs (Fergusson et al 2001; Davey et al. 2004). This group cannot access equity release to supplement their income.

A growing policy emphasis on self-reliance is in itself an encouragement for equity release. But, coupled with fiscal constraint and a contraction of state provision, it is also an indication that the public sector is unlikely to give direct and unilateral support to equity release, unless there is a major change in policy. This highlights the need for discussion on how the public sector might work with commercial firms and possibly the non-profit sector to find ways in which equity release can contribute constructively to the well being of older people.

Public sector involvement can be used to enhance the credibility of private schemes and may extend to providing back-stop guarantees. Some of the large voluntary organisations in New Zealand, who already have interests in the housing and care of elderly people, may be able to assist with the "welfare" aspects of equity release schemes, such as improving housing quality or providing community (and possibly residential) care (Terry and Gibson 2006). The voluntary sector can assist publicity, endorsement, public education and consumer counselling[19].

There are examples overseas of local government showing an interest in equity release in relation to housing quality (Davey 1998a). In New Zealand, efforts to assist older homeowners with the burden of rates has led to the rates postponement scheme, allowing rates to be offset against home equity (Part 1). If this is accepted and successful, other local bodies may offer a similar service.

**Conclusion**

This paper concludes that equity release, now and in the future, has the potential to improve quality of life of older people through -

- greater financial security;
- health security;
- housing quality;
- supporting social connectedness by providing funds for social activities;
- support to older people ageing in place.

Flexibility in the use of funds tied up in housing can play a part in helping older people to fulfil their desire for independence and to assist their families. But the use of

[19] In early 2005, Age Concern England launched a scheme which is a branded version of a Northern Rock roll-up mortgage. The organisation has been able to negotiate competitive interest rates in a scheme which is intended to be attractive even to owners of low-value housing (Davey 2005).

commercial schemes may challenge personal beliefs and expectations about the roles of individuals, families and government. Most housing wealth is still preserved for transmission to younger generations through inheritance. We have yet to fully explore the wider social, economic and political implications of large-scale take-up of the concept of equity release through commercial schemes.

## References


Age Concern (1990) *Home Equity Conversion: Report on the Research Undertaken to Find Out the Needs, Views and Concerns of Older People*, Wellington, April 1990.

Boston, J. and Davey, J. (2006) *Implications of Population Ageing: Opportunities and Risks.* Institute of Policy Studies, Wellington.

Caplin, A. (2002) Turning assets into cash: problems and prospects in the reverse mortgage market, in Mitchell, O. S. (ed.) *Innovations in Retirement Financing*, University of Pennsylvania.

Coon, C. (2004) *Annuities*, paper prepared for an Office of the Retirement Commissioner seminar on December 2, 2004

Datamonitor (2005) *Reverse Mortgages in Australia and New Zealand*.

Davey, J. (1998a) *The Prospects and Potential of Home Equity Conversion/Equity Release in New Zealand*. Research Report prepared for the Office of the Retirement Commissioner, October 1998, Wellington.

Davey, J. (1998b) Exploring Shared Options in Funding Long-Term Care for Older People. *Health and Social Care in the Community*, May 1998.

Davey, J. (2005) *The Prospects and Potential of Home Equity Release in New Zealand*. http://www.retirement.org.nz/files/ER%20Report%20Final%20March%202005.pdf Accessed 5/5/06.

Davey, J., de Joux, V., Nana, G. and Arcus, M. (2004) *Accommodation Options for Older People in Aotearoa/New* Zealand. Centre for Housing Research Aotearoa/New Zealand (CHRANZ), Wellington.

Davey, J. and Wilton V. (2005) *The Regulation and Control of Home Equity Conversion/Equity Release Schemes: An International Literature Review.* Unpublished paper for the Office for Senior Citizens, Wellington.

Davey, J. and Wilton V. (2006) *Home Equity Release Schemes in New Zealand: Consumer Perspectives.* Wellington. http://www.retirement.org.nz/index.php?currentPage=20&file_details=1093. Accessed 5/6/07.

Dunstan, K. and Thomson, N. (2006) Demographic Trends. Chapter 2 (p. 9-50) in Boston, J. and Davey, J. (2006) *Implications of Population Ageing: Opportunities and Risks.* Institute of Policy Studies, Wellington.

Equity Release Working Party (2005) *Equity Release Report 2005.* Volume 1: Main Report. http://www.actuaries.org.uk/files/pdf/equity_release/equityreleaserepjan05V1.pdf Accessed 21/6/07

Fergusson, D., Hong, B., Jensen, J. and Travers P. (2001) *Living Standards of Older New Zealanders: A Technical Account.* Ministry of Social Policy, Wellington.

HCNZ (2005) *New Zealand Housing Strategy*, Housing Corporation of New Zealand, Wellington.
http://www.hnzc.co.nz/hnzc/dms/38120705E510503564A5AFBEC27DB0E3.doc. Accessed 15/5/07.

Hickey, J. and Sorbello, R. (2007) *Trowbridge Deloitte New Zealand Reverse Mortgage Market Study December 2006*, Press release 26 April.

Hickey, J. (2006) *The Equity Release Opportunity in New Zealand – 2007 and beyond.* Trowbridge Deloitte, commissioned by Bluestone Equity Release.

Lundsgaard, J. (2005) *Consumer Direction and Choice in Long-Term Care for Older Persons, including Payments for Informal Care: How can it help improve care outcomes, employment and fiscal sustainability?* OECD Health Working Paper, OECD, Paris.

Morgan, G. (2004) *No Backing out of Reverse Mortgages*, 3 June
http://articles.garethmorgan.com/printcol.php?id=909 accessed 11/06/04.

New Zealand Government (1997) *The Coalition Agreement 1996*, March 1997, Wellington.

Office for Senior Citizens (2005) *Briefing to the Incoming Government*. Wellington http://www.osc.govt.nz/publication/briefing-incoming-minister/ Accessed 18/6/07.

PRG (2003) *Retirement Income Report 2003.* Periodic Report Group, Wellington.

Rodda, D., Herbert, C. and Lam, K. (2000) *Evaluation Report of FHA's Home Equity Conversion Mortgage Insurance Demonstration*, prepared for the U.S. Department of Housing and Urban Development, March 2000,www.huduser.org/Publications/pdf/hecmrpt.pdf Accessed 21/6/07.

Scandlyn, J. and Bowater, K. (2004) "Personal financial management" *Chartered Accountants Journal of New* Zealand, 83(3):73-4.

Scobie, G. and Gibson, J. (2002) *Individual Net Worth in New Zealand: A Preliminary Analysis Based on a New Survey.* Paper presented to the conference of the NZ Society of Actuaries, Rotorua, 13-15 November 2002, NZ Treasury, Wellington.

Sentinel (2007) *Submission to the 2007 Retirement Income Policy Review.*

Sharples, P. (2004) Personal finance. Calls for stricter rules for home reversion too. *Manchester* 19 April
http://www.manchesteronline.co.uk/personalfinance/features/s/87/87447_calls_for_stricter_rules_for_home_reversion_too.html Accessed 16/2/05.

St.John, Susan (2004) *Thinking About Annuities in the New Zealand Retirement Income Mix*. Office of the Retirement Commissioner seminar, December 2, 2004.

Terry, R. and Gibson, R. (2006) *Obstacles to equity release*. Joseph Rowntree Foundation, York.

TPPR (1991) *Taskforce on Private Provision for Retirement: The Issues.* Interim Report of the Task Force on Private Provision for Retirement, December 1991, Wellington.

Westpac New Zealand and Bluestone Equity Release (2007) *A Practical Guide to Equity Release and Reverse mortgages in New Zealand.* http://www.westpac.co.nz/olcontent/olcontent.nsf/AttachmentsByTitle/Guide+to+Reverse+Mortgages+in+NZ/$FILE/Guide+to+Reverse+Mortgages+in+NZ.pdf Accessed 21/6/07.