Opinion **Money Mentor**

Equity release loans surge as older homeowners raise funds

Borrowers appear undeterred by rising interest rates

LINDSAY COOK

Equity release is available to homeowners over 55 © Alamy

Lindsay Cook YESTERDAY

Record numbers of UK homeowners are taking advantage of higher property prices to cash in on the value of their homes using fixed-rate equity release products — despite the rise in interest rates.

Increasing borrowing costs are not putting off homeowners over the age of 55 from taking out large loans that will be paid back after their deaths, according to the latest official data.

In the second quarter of 2022, homeowners released £1.6bn bringing the total for the first six months to £3.13bn, according to the Equity Release Council, the industry association.

Lenders are now well on track to exceed last year's record total of £4.8bn — which was itself far ahead of the previous biggest figure — £3.94bn in 2018.

As well as the amounts involved, record numbers of borrowers are looking for equity release — In the first quarter of this year a record of more than 23,000 customers were active in the market — well above the previous quarterly high of 12,891 in 2018 — and the quarterly average for last year when lenders recorded 76,154 customers.

The number of lifetime mortgage borrowers has increased while the Bank of England has raised interest rates five times and the cheapest equity release mortgage has increased from a lifetime fixed rate of 2.5 per cent last October to 4.27 per cent currently.

The average interest rate hit 5.77 per cent in August 2022, according to data provider Moneyfacts — a six-year high.

Equity release loans are available to homeowners over 55 who own their own homes outright or have only a small mortgage. There are currently 631 deals to choose from, compared to 463 in July 2020.

Borrowers can opt to release a single lump sum or to draw down money as they need it. Interest rates can be fixed at the outset for the full term of the loans, which do not need to be paid back until death or when the property is sold. So borrowers can have loans fixed for 20 years or more with the interest rolled up.

Because these loans do not require the payment of interest or capital until the property is sold the income of the borrower is not taken into account. The amount that can be borrowed depends on the value of the property, the age of the homeowners and their state of health.

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Borrowers are given a calculation of how much will have to be repaid. John and June Chalker of South Oxfordshire took out a £400,000 loan on their £2mn home. Mr Chalker, who will be 80 in September, wanted to help their four children.

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John Chalker

His wife is 63; Legal & General estimated she would have a life expectancy of 86 and told the couple that over those years the £400,000 debt will increase to £708,000.

Mr Chalker said: “We realised that home equity release suited our circumstances because my wife is 17 years my junior. We started really looking seriously at equity release some three months after the start of the pandemic in May 2020. My age put me in the higher risk group and I wanted my wife, my children and grandchildren to have the immediate benefit from the good fortune I had experienced with investments in houses, pensions and shares.”

Inheritance tax was also considered by the couple, who calculate that they will save inheritance tax on the £708,000 debt, which at the current rate of the tax would save £283,000.

A couple from Sussex who borrowed £300,000 on their £1.2mn home in December and paid a total of £2,815 in fees will repay £456,171.71 if the loan continues until the wife’s 86th birthday in 16 years.

The money was raised to provide a deposit for a son’s property purchase and also to reduce the likely inheritance tax.

There is also increased demand for Retirement Interest Only (RIO) mortgages, says Caroline Burke, associate director at Large Mortgage Loans. With RIOs, borrowers pay interest every month so the charges are not rolled up as in equity release products. Unlike with equity release, the borrowers’ income is taken into account.

Borrowers can, for example, take out a RIO mortgage fixed for five years at 3.17 per cent that would cost £1,057 a month on a £400,000 loan.

Craig Brown, chief executive of Legal & General Home Finance said: “As the number of ‘property millionaires’ across England and Wales grows we have seen a new pool of customers. These people might not necessarily consider themselves wealthy but can benefit from the value of their property. We always suggest that tax advice is sought, and customers remain mindful of current and future legislative changes.”

Rates for RIO and equity release are likely to rise further as the Bank of England Monetary Policy Committee raises the bank base rate.

For equity release there is no danger of the loan exceeding the value of the property even in a property market collapse as members of the Equity Release Council provide a “no negative equity guarantee”.

Equity release loans are crucially different from the controversial shared appreciation mortgages, popular in the 1990s, which allowed homeowners to borrow 25 per cent of their home’s value and pay nothing until the property was sold. Some borrowers — and their heirs — were later shocked to see how much capital appreciation they forfeited. Some legal cases have been settled but others are still ongoing.

The Financial Ombudsman Service last year received 208 complaints about equity release products that roll up interest. In only 9 per cent of the cases resolved in the year, did it find in favour of the borrowers.

Lindsay Cook is the co-author of “Money Fight Club: Saving Money One Punch at a Time,” and has launched the Mrs Mean Money Show podcast. If you have a problem for the Money Mentor, email money.mentor@ft.com.

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