UNLOCKING EQUITY FROM YOUR HOME

COST OF RELEASING MONEY THROUGH A TYPICAL LUMP-SUM, ROLL-UP MORTGAGE

House value	£350,000
Amount loaned	£80,000
Amount owed after 20 years	£256,571*
Amount owed after 25 years	£343, 350*

**This is paid back from the money raised when your house is sold*

COST OF RELEASING MONEY BY DOWNSIZING

Sale of home	£350,000
Cost of new home	£250,000
Maximum cost of moving	£20,000*
Equity released	£80,000
Amount owed	£0

**This amount may be considerably less*

Over 60 and worried your pension won't be enough to get by on? Before you sign up for an equity release scheme, read this

Asset rich, but cash poor – it may be a cliché, but if you're retired, there's a good chance you don't have enough cash for all your needs, but have lots of money tied up in your home. If you need to get at this money, there are various ways you can release it.

PREFERRED OPTIONS

Equity release schemes are one way of raising capital from your home but you should always explore other options first.

Downsizing Although it may be difficult emotionally to leave your family home, moving somewhere cheaper is one of the best ways to free up money to fund your retirement. As the example above shows, the costs of moving are a fraction of the cost of taking out a typical equity release scheme. If you don't want to move now, think carefully about whether you are likely to want to move in the future, as you may not be able to once you've taken out an equity release scheme.

Borrowing from friends and family Your family or friends might be willing to help you out with a loan on an informal basis, on the understanding that they will be paid back when your house is eventually sold. If so, draw up a written agreement with them.

Local authority grants If you need money for essential property repairs or home improvements, you may be eligible for a grant or loan from your local authority. Contact the housing renewal or social services department of your local council to find out more.

Check your eligibility for state benefits You may be entitled to more income through state benefits, in particular the pension credit or disability allowances. Bear in mind that if you're already claiming benefits, some of these may be affected if you take out an equity release scheme.

LAST RESORT – EQUITY RELEASE

If none of these options is possible, and you really don't have enough money to live on, an equity release scheme could be your only option. These allow you to release money from your home without having to pay anything back until your home is sold – usually either when you die or go into long-term care.

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

THE SCHEMES EXPLAINED

If you do need an equity release scheme, it's crucial that you know what you are signing yourself up for. There are two main types of scheme – lifetime mortgages (which include both roll-up mortgages and fixed-repayment mortgages) and home reversion schemes – where you sell a portion of your home to release a lump sum.

Roll-up mortgages

With a roll-up mortgage, you take out a loan secured against your home, but unlike with a conventional mortgage, you don't make any repayments until your home is sold. There are two main ways you can choose to take out the loan.

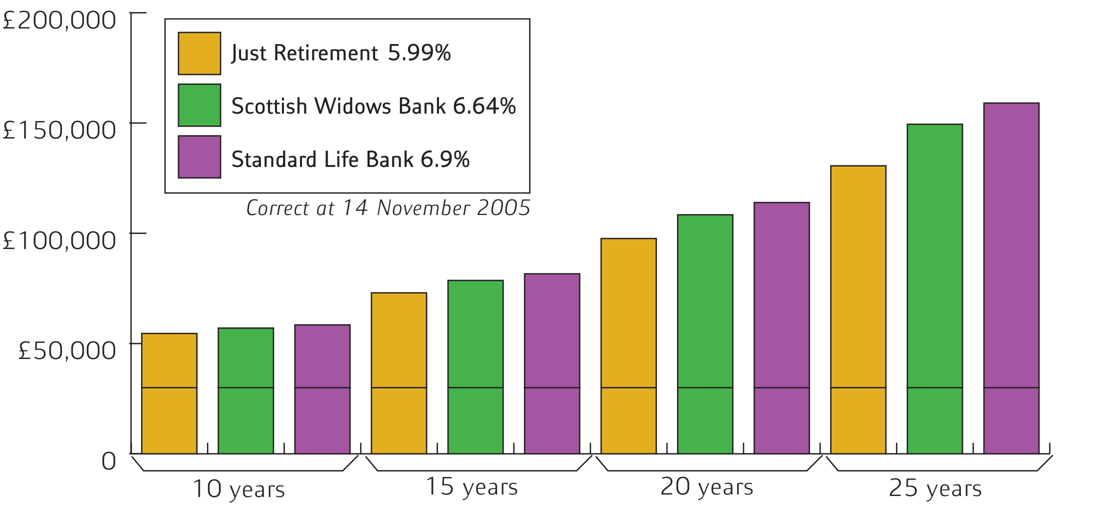
Lump sum With this method, you take out a lump sum at the beginning and the interest is compounded either monthly or annually and added to the loan (or rolled up). As the graph below shows, the amount you owe can grow quickly. Most providers offer a negative equity guarantee, which means you or your estate will never owe more than your house is worth.

Equity release schemes should come with a warning

Drawdowns With this type, you take out your loan in smaller amounts, either as a series of lump sums, or as monthly payments. The benefit of drawdown is that you pay interest only on the money you've borrowed, so the total amount you owe grows more slowly than if you took one lump

Interest on lump-sum, roll-up loans

The graph shows the interest charged on a lump sum of £30,000 released from a house worth £200,000 with three different roll-up mortgages. We've compared one of the cheapest schemes available (Just Retirement Roll-up Lifetime Mortgage) with a mid-range one (Scottish Widows Bank) and one of the most expensive (Standard Life Bank). All have fixed rates. Even with the cheapest scheme, it doesn't take long for the interest to add up – after just ten years, the amount you owe almost doubles. Small differences in interest rates make a big difference – after 25 years the 6.9 per cent mortgage costs £28,000 more than the 5.99 per cent mortgage.



Note: On each bar the line separates the amount borrowed (below) from the interest charged (above)

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Expensive way to buy luxuries

Norwich Union's advert is irresponsible in the way it sells equity release

Dream holiday, new car, new conservatory, even a face lift – companies try to sell equity release schemes as a way of paying for luxuries which previously you only dreamed of. They're a very expensive way of paying for such luxuries, though, and you could end up borrowing much more than you need. Norwich Union's ads, for example, suggest a trip to New York or 'something for the family', but its minimum loan is £15,000. If you took out the loan, you could end up with quite a surplus which you'll end up paying interest on – after ten years, you'd owe around £28,000 in interest.

We think it's irresponsible to advertise these schemes like this. They should be taken out mainly as a last resort if you can't get by on your pension and savings and have no other options such as moving home.

Scheme limits options

Ann Haig McVitty has had her equity release scheme for only three years, but it's already giving her sleepless nights. When she borrowed £50,000 in 2002 from Legal and General she thought it would make life easier, allowing her husband to buy a new car and her to decorate the house. But Ann says the future implications of the scheme weren't properly explained to her.

She's concerned about the rolled up interest. In just ten years, their debt will have doubled. Ann's husband is ten years older than her and she's worried that if he dies before her, she won't be able to manage in her home on her own and will need to move.

Ann asks: 'What if there's not enough equity left to downsize or to go into sheltered accommodation?'

FURTHER INFORMATION

If you'd like to see a table showing details of most of the equity release schemes available, you can download a PDF at www.whichextra.co.uk/equity Alternatively, call 0845 307 4000 and quote code EQUITY for a factsheet to be sent to you.

sum at the outset. As the graph opposite shows, you pay less interest in the long term by releasing money gradually than in one initial lump sum.

Fixed-repayment mortgages
This is where you release a lump sum but the amount you owe is fixed at the outset and repaid when your house is sold. The amount you owe is higher than the amount you have borrowed to allow for the fact that you are not charged interest. As the graph below shows, if the loan lasts for only a short time – less than ten years, say – it can work out quite expensive, but over the longer term it looks more reasonable. Only one provider (Just Retirement) offers a fixed-repayment scheme.

Extra costs
Charges, fees and different methods of calculating interest can cost you dearly so it's important to know what you will be charged before you sign.

- **Early redemption charge (ERC)** As our case study, Colin, found (see 'Stuck with Norwich Union', opposite), a hefty ERC (£9,000 in his case) could prevent you from switching to a cheaper scheme. We found only three schemes without an ERC – from Age Concern, Northern Rock (Cash Plus Lifetime mortgage), and Vernon Building Society.
- **Fees** Arrangement fee, application fee, valuation fee, legal fee – the list goes on. Budget for a minimum of £600.
- **Annual or monthly interest** When interest is charged annually, your debt will increase more slowly than if it is added on monthly. Always look at the APR (annual percentage rate) rather than the headline interest rate when comparing schemes.

Home reversions
With a reversion scheme you sell a proportion of your home to the reversion company in return for a lump sum or income or both. You never receive the full market value for the portion of your home you sell – around 40 per cent of its full value isn't unusual, although it varies according to your age and sex. So if your house is worth £200,000 and

You might not be able to move later on should you want or need to

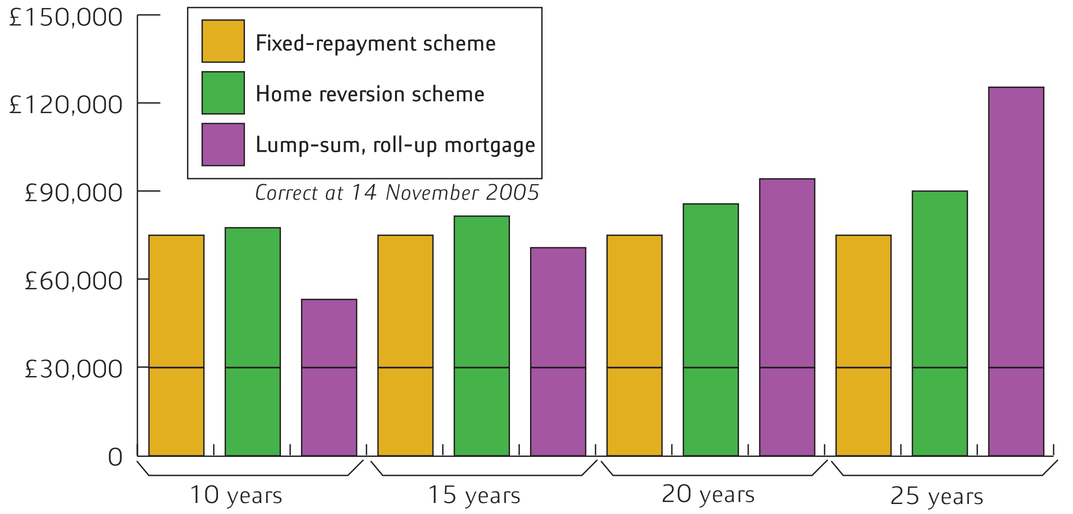
you sell half of it (worth £100,000), you could expect to receive only around £40,000. The older you are, the higher the percentage of its market value you will get. This is because the provider will probably get its money back sooner.

When your house is sold, the reversion company takes its percentage share of your home at the full market rate. So if your £200,000 home has increased in value to £300,000 when you die or go into long-term care, the reversion company will receive £150,000 (50 per cent) when the home is sold. The final cost to you or your estate in this example is £150,000 (£110,000 plus the £40,000 original lump sum you released).

How different schemes compare

Which type of scheme is cheaper depends on how long you live or stay in your home. Here, we've calculated the cost to a 70-year old woman releasing £30,000 from a home worth £200,000 with different types of scheme. For the reversion, this amounts to selling 37.5 per cent of the home. In the short term, a roll-up loan is cheaper, but it works out the most expensive option in the long term.

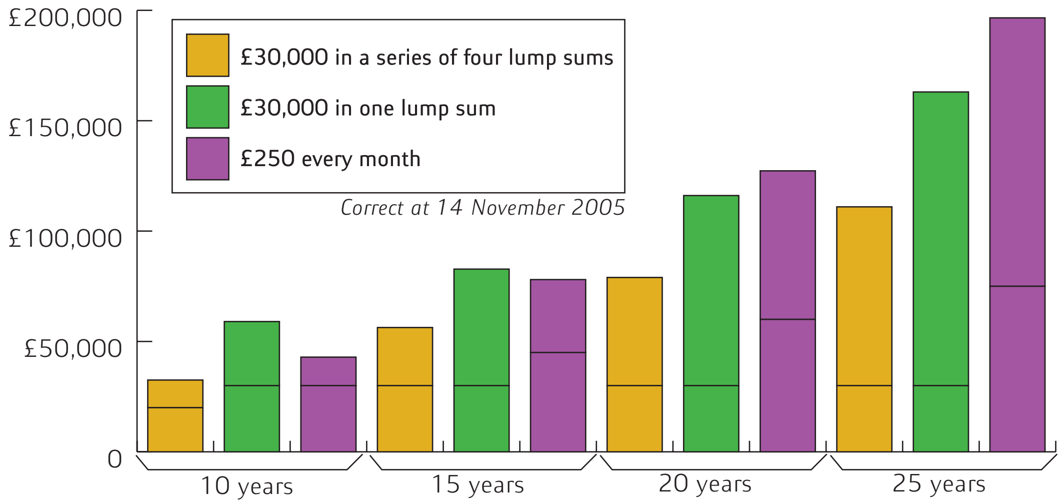
The cost of home reversion schemes is determined by house price inflation. We've assumed 1 per cent a year in our calculations, but a rise to 3 per cent a year would make reversion the most expensive option. In the long term, the fixed-repayment scheme is the cheapest.



Note: On each bar the amount below the line is the original loan or equity released

Drawdown and lump-sum loans compared

Drawdown schemes, which allow you to release your loan gradually rather than in one lump sum, can work out cheaper as you pay interest only on the money you've borrowed. We've looked at Vernon Building Society's scheme as it gives you the choice of taking your money as one lump sum, a series of smaller lump sums, or in regular monthly amounts. Taking £30,000 in a series of four lump sums (over 15 years) works out cheapest – over 25 years you'd be around £50,000 better off than if you took it all at the outset. A monthly income adds up steadily – after 15 years of taking £250 a month you'd owe nearly £80,000, having borrowed £45,000, and after 25 years you'd owe nearly £200,000, having borrowed £75,000. We've assumed the interest rate remains constant, although in reality it may vary.



Note: On each bar the line separates the amount borrowed (below) from the interest charged (above)

Even if you sell 100 per cent of your home, you continue to have the right to live there. However, you are responsible for maintaining your home, and the reversion company may carry out checks to ensure you are doing so. Home reversion schemes are not yet regulated so you have no comeback if you are sold one inappropriately. Until they are regulated, they are best avoided.

MOVING HOME WITH A SCHEME

Most equity release schemes are portable, so you can take them with you if you move to a new home. However, there are often restrictions – you may not be able to take them if you move to sheltered accommodation, for example. Also, you might have to repay some of the loan if you move somewhere less valuable. However, depending on how long you've been in an equity release scheme, you might not have enough equity left to move home.

WHICH SCHEMES ARE BEST?

If you really need an equity release scheme, you'll need to choose one carefully. Which type is cheaper depends on how long you live or stay in your home. Obviously, you can't predict this, so it's impossible to say which type of scheme will work out best. However, if you don't need a big lump sum immediately, opt for a drawdown policy – this is where the money is released gradually in smaller amounts so the interest rolls up more slowly than it would if you release a big lump sum at the outset.

However, make sure you understand what you are likely to owe as, even with drawdown schemes, the interest adds up quickly. With fixed-repayment schemes, it's clear from the outset what you will owe. These schemes tend to be expensive in the short term but more competitive compared with other types in the long term.

SEEKING FINANCIAL ADVICE

If an equity release scheme is your only option, it's best to seek independent financial advice before taking one out. But research carried out by the Financial Services Authority shows that many advisers are not selling equity release schemes properly, so it's best to be clued up about the schemes and your options before you see an adviser. We've produced a table of most of the equity release schemes available. See 'Further information', opposite, for how to get hold of a copy. To ensure you get the best advice:

- find an independent financial adviser who specialises in equity release
- make sure the firm is authorised by the FSA – you can check this at www.fsa.gov.uk/consumer
- ask for advice rather than information – this is important because it means you will be entitled to compensation if the loan is mis-sold
- read the Keyfacts document carefully
- make sure you fully understand the scheme being recommended and don't be afraid to ask questions if there's anything you don't understand.

Stuck with Norwich Union

Which? member Colin would like to switch his Norwich Union equity release scheme to a cheaper deal but can't because of the hefty early redemption charge (ERC) and interest he'd have to pay to do so.

When Colin took out the Index-Linked Cash Release plan in 2002, he felt it was a pretty competitive deal at 8 per cent. Two years on, however, interest rates had come down and he wanted to switch to a cheaper deal at 6 per cent.

Colin was shocked to learn that he would have to pay an ERC of more than £9,000. Added to the interest of £42,000 he'd already accrued, he would have had to pay back more than £50,000 on top of his original loan of £312,000.

Colin knew that there was an ERC but didn't realise the full implications of it. Norwich Union's ERC is based on the performance of gilts so it's hard for customers to work out in advance what it will be. The ERC applies for the first 14 years of the loan, and as Colin can't afford to pay it, he is stuck.