Equity Release

Quick reference Guide Chapter 9

By the end of this guide you will be able to describe the administrative aspects of changes in circumstances including leaving the property on death / long-term care in relation to equity release.

Equity release administration

Definitions

There are a number of terms that you need to be familiar with in relation to this chapter:

MCOB rules	• Mortgages and Home Finance: Conduct of Business rules. • Relevant to providers of regulated mortgage contracts, lifetime mortgages and home reversion plans.
Lifetime mortgage	• The generic term that applies to a wide range of products targeted at elderly borrowers such as home income plans, cash plans, capital drawdown schemes and open-ended mortgages.
Home reversion plan	• Enables a homeowner to sell all or a proportion of their property to a reversion provider in order to raise funds, with the customer continuing to live in the property, as a tenant, until they die or it is permanently vacated.
Shared appreciation mortgage	• A plan that enables the customer to raise capital and make no payments. The lender foregoes interest completely but takes its income (profit) from a share in the increase in the property value that has occurred between creating the mortgage and the redemption date.

9.A The lifetime mortgage contract

Lifetime mortgage contracts are set up by way of a **legal charge** (England, Wales and Northern Ireland) or **standard security** (Scotland).

Terms can only be changed:

- with agreement of both parties, and
- where lender reserves right to vary a term in the contract itself.

9.A.1 Interest rate changes

Under MCOB, a lender must:

- at pre-application stage, demonstrate impact of 1% rise in interest rates on repayments
- warn the borrower that interest rates can change by much more
- once the mortgage is active, inform the borrower of the rate changes as soon as possible
- include rates charged on mortgage and periods applicable on annual statement.

Interest rate changes do not affect:

- borrowers with mortgages that have rate fixed for entire term
- borrowers who are within fixed rate period
- borrowers with shared appreciation mortgages
- customers with home reversion plans.

9.A.2 Annual statement

Under MCOB, the lender is obliged to provide borrowers with an annual statement. Regulations set out minimum information to be included.

9.A.3 Tariff of charges

The customer is entitled to receive a **tariff of charges** and MCOB obliges lenders to inform customers of changes and when they come into effect.

9.A.4 Further advances

A Further advance(s) is a top up loan with the same lender, secured on the same property.

Under MCOB, it is necessary to issue prescribed documentation showing the effect of a further advance on total borrowing and any new repayment.

9.A.5 Second charges

A Second charge(s) is additional borrowing on the same property but usually with a different lender.

As the loan is not secured by first legal charge or standard security, it is not a regulated mortgage contract under MCOB, but is regulated under the Consumer Credit Act 2006.

It ranks after first mortgage in event of default or repayment.

Second charge often represents a change in the risk profile of mortgage account.

There is no limit to the number of additional loans that can be raised on the same security.

Covenants can be included in the mortgage deed or conditions booklet precluding raising additional finance on property without informing the lender.

9.A.6 Adding or removing a name from the mortgage

Adding or removing a name from the mortgage, sometimes referred to as **transfer of equity** or **transfer subject to equity,** requires the consent of the lender.

If a name is added, the additional person becomes jointly and severally liable for debt and the lender will carry out money laundering/credit searches on the new party to the loan.

Where a name is removed due to separation or divorce, they remain liable until lender consents to release them from the mortgage. If this is due to a death, liability passes to the survivor unless the mortgage is taken out on tenancy in common basis where a share of the obligation passes to the estate of deceased.

If payments are being made, the lender is unlikely to consent to release unless the person remaining in the property can meet the payments.

Under MCOB, it is necessary to issue standard documentation and specifically worded risk warnings.

9.A.7 Tenancies

Usually the occupier cannot take a tenant without the lender’s prior consent. This eliminates the prospect of the tenant securing right of residence.

It could also signal that the customer is no longer living in the property, which has implications for maintaining the property or can indicate financial difficulties. Building insurance may also be affected.

9.A.8 Insurance

It is normally stipulated that the property must be continuously insured for full reinstatement value.

Additional requirements may include:

- Compulsory for insurance to be effected through firm’s agency.
- Where the property is insured outside firm’s agency, the insurance company may be required to note the interest of the lender.
- Insurance company may be required to pay large claims to the lender.

Under MCOB, if insurance is tied to the product, the cost of the product and length of tie must be disclosed in the KFI and annual statement.

9.A.9 Condition of the property

The mortgage deed commits the owner of the property to keep it in good condition and meet the costs of maintenance and repairs.

A firm also reserves rights to:

- inspect the property subject to reasonable notice
- carry out maintenance and repairs if necessary
- charge these to account of the borrower.

For home reversion plans, responsibility for maintenance and repairs remains entirely with the customer.

The mortgage deed may also restrict/prohibit alterations or change of use which could adversely affect its value.

9.A.10 Arrears

Arrears can only arise on lifetime mortgages that require payment.

Lender must comply with MCOB regulations:

- Must have written policies and procedures.
- Must deal with customers fairly.
- Must adopt a reasonable approach to the time over which the shortfall is redressed.
- May pursue possession only after all reasonable attempts to deal with problem have failed.
- Must keep records.

Must provide customer with Financial Conduct Authority's Fact Sheet on arrears.

9.B The home reversion tenancy agreement

9.B.1 Raising additional capital

This is not possible where 100% of the property value is sold to the provider.

If only a proportion is sold, it may be possible to sell a further or remaining share.

9.B.2 Interest rates

Home reversion plans are affected indirectly by changes in **interest** rates due to the inverse relationship between interest rates and changes in property values.

Changes in interest rates have an effect on annuity rates.

9.B.3 Tenancies

The main aim is not to create difficulties for the occupier but to protect the position of the reversion provider so home reversion plans always contain a condition that sub-leases are not permitted.

9.B.4 Divorce and remarriage

If a couple vacate the property, this is a qualifying termination event and the property will be sold.

Any share retained by the couple which is realized on the sale will be distributed between them according to their agreement.

If no share is retained (they sold 100% of the property value), any monies remaining from the initial sale to the provider are divided according to the agreement between them and the plan provider.

9.B.5 Insurance

Similar provisions to those under lifetime mortgage.

The property value should be index-lined.

9.B.6 Condition of the property

The tenant, not owner, is responsible for maintenance and repairs.

The tenant is also responsible for compliance with national legislation and local planning laws.

9.C Leaving the property

9.C.1 Moving home

The customer is not prevented from **moving home** once a lifetime mortgage is in existence.

Under MCOB, it is a requirement that the lender informs the customer whether the lifetime mortgage is portable or not. It is a condition of membership of the **Equity Release Council (ERC)** scheme that they are portable.

Home reversion plans are not portable and choosing to vacate the property to live elsewhere is an event that terminates the lease.

Property can then be sold and the sum liquidated (that is the occupier's stake) may or may not be sufficient to purchase another property.

9.C.2 Moving into care

If there is a permanent change of circumstances, it is usually a condition that the loan is repayable and this is usually done by the sale of the property.

There may be an additional liability for the customer if a negative equity situation arises unless there is a **‘no negative equity’ guarantee**.

Under MCOB, the lender must advise the customer whether the above guarantee is included in the package and is a condition of **ERC** membership.

Permanent vacation of the property is a **‘qualifying termination event’** for all equity release contracts.

Providers protect themselves by:

- requiring an occupier to inform them of sustained periods of absence
- defining exactly what is meant by ‘permanently going into care’
- inclusion of ’adverse material change’ clause.

Long-term care is defined precisely and with reference to dementia (mental illness) and inability to perform specified **Activities of Daily Living (ADLs)**.

9.D Death of the customer

9.D.1 Lifetime mortgages

Lifetime mortgages are designed to be paid off from the borrower’s estate once they die.

Responsibility for dealing with an estate falls to the **personal representatives** of the deceased.

Laws of succession are different in Scotland to the rest of the UK so legal processes and rights of beneficiaries also differ.

It is always in the interests of customer and family to **make a will**.

Several possible scenarios on death of customer:

- If repayments made, estate will probably owe capital plus any fees and charges.
- If repayments have not been required, estate will owe original capital plus rolled-up interest and any fees and charges.
- If a shared appreciation mortgage, lender owed original capital borrowed plus relevant percentage of increase in property value or additional sum may be payable if property reduced in value.

9.D.2 Home reversion plans

Where the whole property value has been transferred, estate has no claim on property and no obligation. In fact, the provider will make arrangements for the property to be sold as they own the title to it.

Any remaining assets in relation to any un-sold share will be passed by the provider to, and distributed by, the executor or administrator.

Where partial ownership of property is retained, the proportion belonging to estate is dealt with by executor or administrator once the provider has sold the property.

Under a lifetime mortgage, the property forms part of the estate and will come to the attention of capital taxes department of HM Revenue and Customs (HMRC).

However, this only applies to home reversion plans if a proportion of the value of property is retained.

If the plan included a minimum inheritance guarantee and death occurred within the guarantee period, the beneficiaries of the estate are able to make claim for the return of some of the equity originally released.

The ER1 study text includes, at Appendices 9.1 and 9.2, the rules on succession in England, Wales and Northern Ireland and separately for Scotland. You should make sure you are familiar with the circumstances where there is a valid will and in cases of intestacy.

Equity Release Chapter 9 (ER09) – End of Module Test

Multiple Choice Questions

Question	**Answer**	
1 - Which of the following is NOT correct? Lifetime mortgages and home reversion plans are legally binding contracts which may be set up by way of:	A.	legal charge
	B.	standard security
	C.	legal conveyance
	D.	MCOB rules

2 - A further advance is:	A.	a new land with the same lender, secured on the same property
	B.	a top up loan with the same lender, secured on the same property
	C.	a top up loan with a different lender, secured on the same property
	D.	atop up loan with the same lender, secured on a different property

3 - A second charge is usually:	A.	new borrowing on the same property with a different lender
	B.	additional borrowing on the same property with a different lender
	C.	additional borrowing on a different property with the same lender
	D.	additional borrowing on the same property with the same lender

4 - Under MCOB, it is not necessary to issue standard documentation and a specifically worded risk warning to borrowers when:	A.	adding a name to a mortgage
	B.	removing a name from a mortgage
	C.	there is a transfer of equity
	D.	a name is removed from the mortgage on death

5 - Under a home reversion plan where 100% of the property has been sold to the provider:	A.	there is no prospect of further capital raising
	B.	further capital can only be raised as a result of house price inflation
	C.	further capital may be raised if a second charge can be secured
	D.	further capital may be raised by selling a further share in the property

6 - As a general rule, regarding portability:	A.	a home reversion plan is more flexible
	B.	it is an MCOB condition that all equity release plans are portable
	C.	a lifetime mortgage is more flexible
	D.	it is not a condition of ERC membership that lifetime mortgages are portable

7 - Long-term care is defined with reference to ADLs . ADL stands for:	A.	Adverse Daily limitation
	B.	All Day Long-term Care
	C.	Adverse Daily Living
	D.	Activities of Daily Living

8 - Following a first legal charge on a residential property, how many subsequent charges are possible?	A.	One
	B.	Two
	C.	There is no limit
	D.	None

9 - An equity release customer dies, leaving a will; the estate will be administered by the:	A.	next of kin
	B.	executor (England) or the executor-nominate (Scotland)
	C.	personal representative
	D.	attorney

- **End of Questions** -

Answers

Question	**Answer**	
1 - Which of the following is NOT correct? Lifetime mortgages and home reversion plans are legally binding contracts which may be set up by way of:	D.	MCOB rules
2 - A further advance is:	B.	a top up loan with the same lender, secured on the same property
3 - A second charge is usually:	B.	additional borrowing on the same property with a different lender
4 - Under MCOB, it is not necessary to issue standard documentation and a specifically worded risk warning to borrowers when:	D.	a name is removed from the mortgage on death
5 - Under a home reversion plan where 100% of the property has been sold to the provider:	A.	there is no prospect of further capital raising
6 - As a general rule, regarding portability:	C.	a lifetime mortgage is more flexible
7 - Long-term care is defined with reference to ADL. ADL is:	D.	Activities of Daily Living
8 - Following a first legal charge on a residential property, how many subsequent charges are possible?	C.	There is no limit
9 - An equity release customer dies, leaving a will; the estate will be administered by the:	B.	executor (England) or the executor-nominate (Scotland)