Accessing Wealth Accumulated in Property for Retirement Income

Supplementary Paper Number 05 to the 2015 Pension Strategic Review

Pensions Strategy Group
December 2014

Contents

76.4% of persons in Malta[1] own (freehold and ground rent) their home. For the majority of people, buying a home would be the single largest investment made in their lifetime. By the time they reach retirement age, they would have paid most of the borrowing they used to purchase their home. In owning their home as they near retirement persons would have built up considerable amounts of equity in their home. The value of the property would constitute a high proportion of accumulated wealth of many an elderly period.

The high level of property ownership in Malta means that most persons are asset rich but cash poor. Today, there is no formal home equity market in Malta that is governed and regulated. Yet, people do release value from their property as they retire. Some persons will downsize by selling their home and move into a smaller house. Others enter into arrangements with private providers of residential homes for the elderly in exchange of their property. And others may have homes worth significant equity but limited savings with the State pension acting as the main source of income during retirement.

This paper builds on two supplementary papers which were drawn up by previous Pension Working Groups. The first paper titled: "Use of Property for Retirement" was drawn up as a supplementary paper to the Final Report of the 2004 Pensions Working Group on 30th June, 2005 ("2005 Property Paper"). The second paper, also titled 'Use of Property During Retirement', was a supplementary paper to the Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pensions System drawn up by the 2010 Pensions Working Group.

Equity Release Schemes (ERS) can take two different forms. The first is Lifetime Mortgages (LM) or Reverse Mortgages, also known as Loan Model Equity Release Schemes, which provide a loan that will eventually be repaid from the sale proceeds of the property. The second is Home Revision (HR), also known as Sale Model Equity Release Schemes, which involve an immediate sale of the property but provide for the right to the former owners to remain in occupation and to use the cash price for income in retirement. [2]

In essence, therefore, an ERS must:

- Be a financial service.
- Be a source of liquidity for the future.
- Contain a strong entitlement to remain in occupation of the property.
- Rely solely on the sale of the property for repayment / payment of the funds released to be used as a retirement pension.

Payments under an ERS take the form of a lump sum or regular income, and are either secured by means of a mortgage on the property or generated by a sale. Under the LM model, repayment is made from the proceeds of the sale of the property either on the death of the homeowner or when the property is vacated.

ERS are found in the EU. The markets, to date, however, are small. In the UK, the LM has averaged at approximately 22,000 sales and just under €1b of lending annually between 2008 and 2012. This is equivalent to less than 1% of the residential mortgage market over the same period. The HR market is even smaller with less than 1,000 plans sold over the same period.[3]

[1] Census of Population and Housing 2011, Final Report, National Statistics Office, Malta, 2014
[2] Reifner, U., Clerc-Renaud, S, et al, Study on Equity Release Schemes in the EU: Part I: General Report, Project No. MARKT/2007/23/H, Institut fur Finanzdienstleistungen e.V, Hamburg, 2009
[3] Pg 9, Lord German (ed), Making the Most of Equity Release: Perspectives from Key Players, The Smith Institute, 2012

ERS are primarily issued by:

- Banks.
- Real estate providers.
- Specialist lenders.
- Insurance markets.
- Intermediaries.

Over the past twenty years the equity release market, in the EU, has changed significantly, where-in regulation by financial services competent authorities, have increased consumer confidence in ERS products. In the United Kingdom, for example, the Financial Services Authority took over regulation of mortgages in 2004 and the ERS in 2007.

This paper assesses the validity of introducing appropriate ERS, as a means to allow an aging population, to access the wealth accumulated in the form of his or her home, while being able to continue to live in it to supplement his or her pension income. Thus, an illiquid asset becomes a source of liquidity, mainly for consumption purposes during retirement.

02.1 Household Wealth

As can be seen from the Table below, household savings by means of deposits in banks (including savings by non-financial corporations (NFCs)) have been on the increase since 1987. During the period 1987 to 2013 the increase was €10,286.6m. There is a significant increase in 2013 on 2012 – €2,262.8m or 25.3%.

Table 01: Resident Deposits[4]

	1987	1997	2007	2008	2009	2010	2011	2012	2013
					€millions				
Household and Non Financial Corporations Deposits	924.5	3,414.9	6,541.8	7,899.6	7,802.4	8,196.7	8,406.4	8,948.3	11,211.1

€5,771.0m – or 51.5% of the deposits in 2013 were composed of overnight deposits. Overnight deposits expanded by 14.3% on 2012. During the fourth quarter of 2013, households' overnight balances grew rapidly, with the annual growth rate rising to 12.0% in December from 11.2% in September. Overall, this persistently strong preference for holding liquid monetary assets by households, may be stemming from the reduced opportunity cost brought about by low interest rates in recent years.[5]

A study by the Central Bank of Malta (CBM) estimated households' net wealth, which is defined as the sum of real and financial assets net of financial liabilities, at a median value of €215,932. The Survey further showed that a higher level of net wealth was reported when the reference person in the household was a university graduate or self-employed or was aged within the 55 - 64 age bracket.[6]

The median net wealth of households represented by reference persons with tertiary, secondary and below-secondary levels of education respectively was found to be €319,994, €226,126 and €129,469 respectively. The Survey shows that the median for net wealth, of all households, the median for households represented by a self-employed person was 2.5 times higher. The median net wealth of households whose reference persons were aged between 55 and 64 years was €272,625.[7]

The Survey further shows that the main residence accounted for 51% of household wealth in the form of real assets. Furthermore, the share of the main residence in the net wealth of those households in the highest 20% net wealth percentile was lower, contributing about 30% to their total real assets. For the lowest 20% percentile in net wealth terms this was more than half.[8]

[4] Central Bank of Malta, Quarterly Reviews
[5] Pg 67, Central Bank of Malta, Quarterly Review, 2013, Vol.46 No.4
[6] Pg 8, Caruana, K., and Pace, C., Household Finance and Consumption Survey in Malta: Main Results of 2010 Exercise, Central Bank of Malta, 2013
[7] Ibid
[8] Pg 9, Ibid

Table 02: Household Net Worth[9]

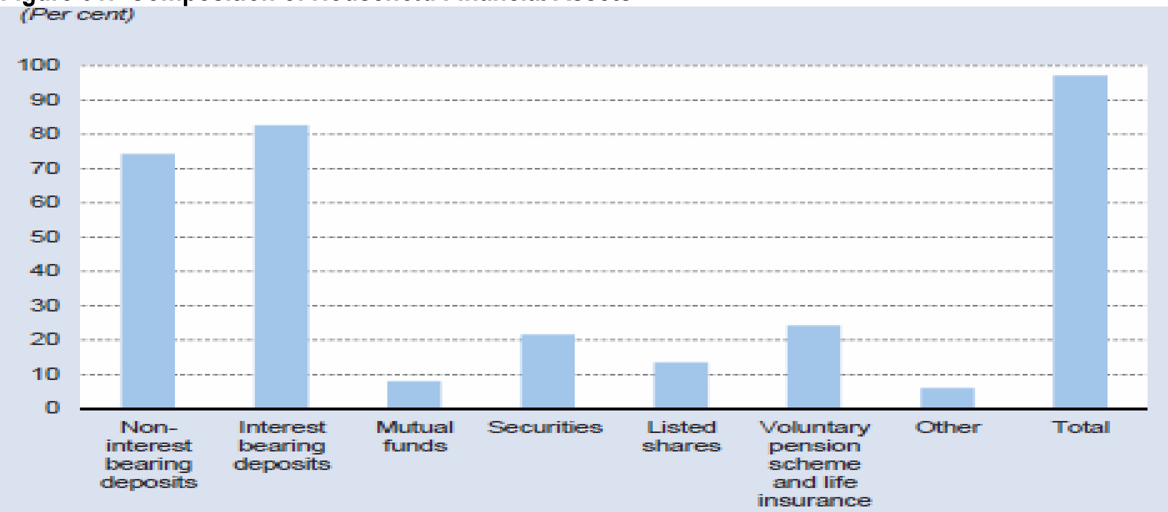
EUR

Household characteristics	Mean	Median
Gross Income Percentile		
Less than 20	180,169	125,983
Between 20 and 40	246,703	175,276
Between 40 and 60	251,483	176,447
Between 60 and 80	351,553	240,343
Between 80 and 100	800,592	380,004
Age of the Reference Person[1]		
Under 35	192,991	131,004
35 - 44	289,813	223,249
45 - 54	579,370	240,667
55 - 64	422,153	272,625
Over 65	260,502	158,311
Labour Market Situation of Reference Person		
Employee	303,346	235,587
Self-Employed	1,363,253	531,981
Retired	301,022	193,427
Other	243,176	165,965
Level of Education of the Reference Person		
Below secondary education	212,736	129,469
Secondary education	402,277	226,126
University education	453,427	319,994
Status of the Main Residence		
Ownership (Full or Part)	448,186	267,033
Other	79,107	21,739
Number of household members in employment		
None	222,413	145,774
One	457,645	200,024
Two	357,478	252,777
More than 3	535,203	343,415
Number of household members		
One	191,303	106,877
Two	326,229	202,668
Three	317,782	223,309
Four	342,636	255,101
More than five	895,611	339,110
Net Wealth Percentile		
Less than 20	20,664	16,130
Between 20 and 40	113,857	113,149
Between 40 and 60	215,476	215,961
Between 60 and 80	345,620	338,191
Between 80 and 100	1,133,827	693,081
All Households	**365,988**	**215,932**

The Survey identifies that more than 97% of households owned at least one financial asset. Financial assets represented 13.4% of their total assets. The most widely held financial asset was an interest bearing deposit with a bank, with almost 83% of households holding this type of asset. Non-interest bearing accounts (that is current accounts) were held by 74.3% of households.[10]

Furthermore, 21.6% owned some form of debt security, mainly corporate bonds and government securities. Equity was held by 13.4% of all households, while 8% also owned mutual funds. The Survey shows that 24.2% of all households were covered by a life insurance policy or participated in a pension scheme.[11]

Figure 01: Composition of Household Financial Assets[12]



[9] Pg 9, Table 3.1, Ibid
[10] Pg 10, Ibid
[11] Ibid
[12] Ibid

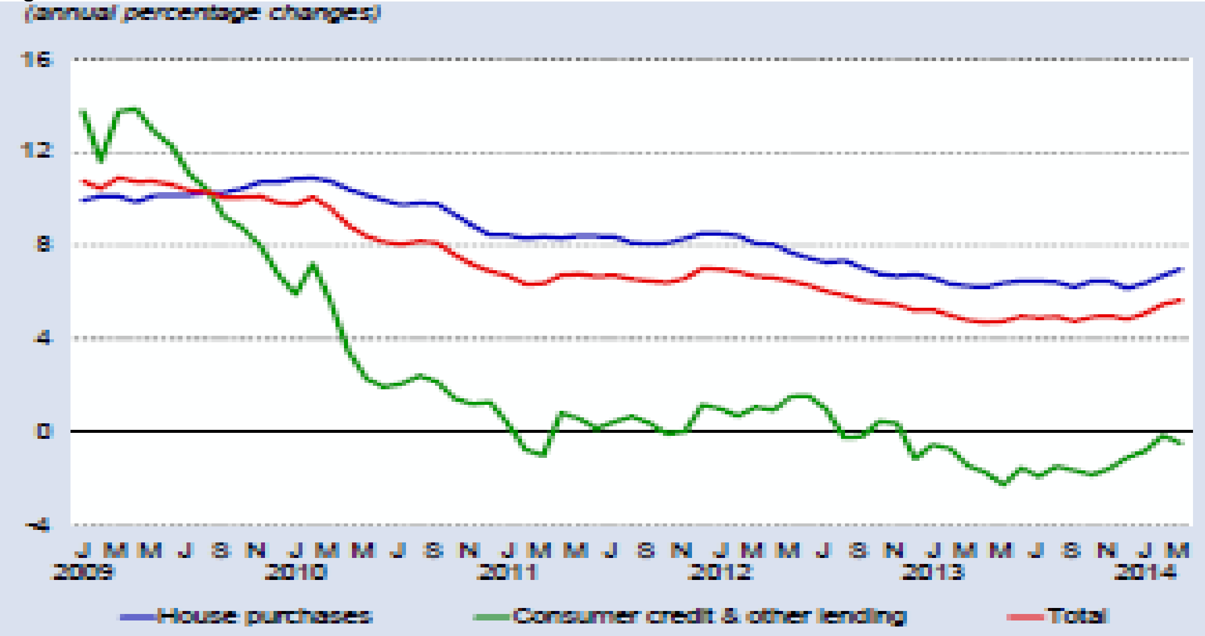
The Study estimated the overall median value of holdings of financial assets at €26,229. The median value of financial asset holdings, was found to vary with the educational attainment and work status of the reference person representing the household. For example, households whose reference person was an employee accounted for 36% of all households and owned financial assets with a median value of €29,769, while households whose reference person was self-employed persons representing 8% of all households, held financial assets with a median value of €68,856.[13] The median financial asset holdings for retired persons (27% of all households) stood at €28,906.[14]

Households with a primary level of education (23% of all households) owned financial assets with a median value of €17,015; those with a secondary level (62% of all households) held financial assets with a median value of €25,407, while those holding a university degree (15% of all households) owned financial assets with a median value of €54,029.[15]

02.2 Household Debts

Lending to households expanded at a faster rate, during the first quarter of 2014, with the annual growth rate rising to 5.6% in March from 4.8% in December. This was driven by loans for house purchases, which is the principal component of lending to households and which grew by 7.0% year-on-year.[16]

Figure 02: Loans to Households[17]



The Survey shows 34.1% of all households, had some type of domestic debt liability which averaged €35,814 per household. Almost 16% of households had an outstanding bank loan to finance the purchase of their main residence or other real estate property. Moreover, the average mortgage debt value of indebted households increased progressively with higher net wealth. 15.5% of home owning households used their main residence as collateral for the bank loans they obtained in connection with the purchase of their home.[18]

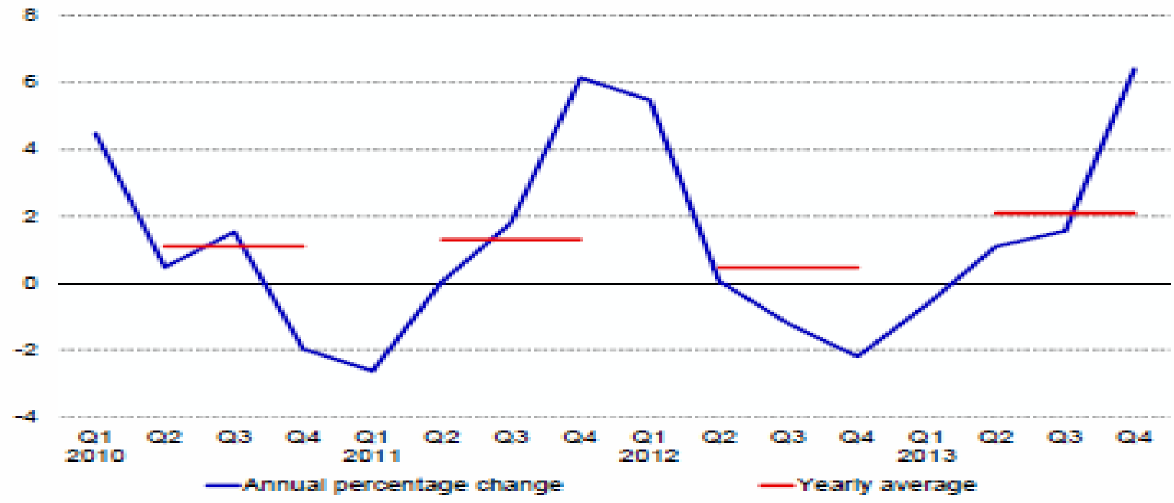
[13] Ibid
[14] Ibid
[15] Ibid
[16] Pg 61, Central Bank of Malta, Quarterly Review, 2013, Vol.46 No.4
[17] Pg 62, Ibid
[18] Pg 10, Caruana, K., and Pace, C., Household Finance and Consumption Survey in Malta: Main Results of 2010 Exercise, Central Bank of Malta, 2013

The majority of households financed the purchase of their homes through loans provided by banks. On average the initial amount borrowed by households stood at around €63,560 and the average repayment period was 26.5 years. The effective interest rate paid by households on their home loans was 4.1%, while the monthly debt repayment averaged €296. The average amount still owed by households to the banks stood at €44,003.[19]

02.3 Property Prices

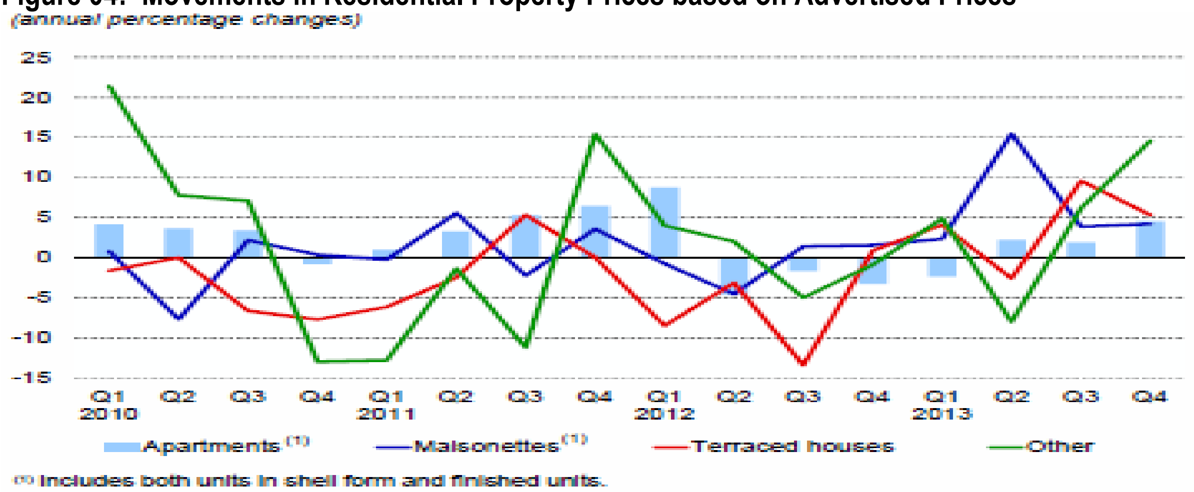
The Central Bank of Malta's property price index indicates that the property market suffered two successive slumps in recent years. The market bottomed at an approximate decrease of 2.25% and 2% in market prices in Q1 2011 and in Q4 2013 respectively. Throughout 2013, the property market rebounded and rose at an annual rate of 6.4% by the fourth quarter of 2013.

Figure 03: Movements in Residential Property Prices based on Advertised Prices[20]



The property price index shows that prices went up across all main sampled categories included in the index. Stronger annual rates of change were recorded in the prices of apartments, maisonettes and of property in the "other" category, which consists of town houses, houses of character and villas. Meanwhile, the annual rate of change of terraced house prices moderated in the quarter under review.

Figure 04: Movements in Residential Property Prices based on Advertised Prices[21]



[19] Pg 9, Ibid
[20] Pg 44, Central Bank of Malta, Quarterly Review, 2013, Vol.46 No.4
[21] Pg 45

The aforementioned Survey, estimated the median value of residences owned by households at €186,643 or €1,066 per square meter.[22] The average value of the main residence owned by the richest percentile households was estimated at €1,661 per square meter, while for the lowest 20% net wealth percentile this was estimated at €629 per square meter.[23]

02.4 Dwellings and Home Ownership

The 2011 census shows that there are 152,770 occupied dwellings – an increase of 13,592 and 33,291 dwellings on the 2005 and 1995 respective census base lines. Home ownership – freehold as well as ground rent –increased considerably in terms of number of dwellings on the 2005 base line by 12,183 dwellings on 11.4% on 2005. Proportionally, however, the total stock of occupied dwellings that is privately owned changed marginally by 1.3% – from 75.1% in 2005 to 76.4%. This constitutes a high percentage of home ownership and compares well with other MS, other than eastern European countries that were previously under the sphere of influence of the former Soviet Union – Romania, Lithuania, Bulgaria, etc. where own occupation rates are over 90%.

The Table below shows that the rental of property as residences, whilst still very low, more than doubled between 1995 and 2011. The increase in 2011 on 2005 is 2.1% and this indicates that there is the beginning of a marginal shift away home ownership to renting of property.

Table 03: Occupied Dwellings by Ownership[24]

	1995	%	2005	%	2011	%
Owned Freehold	81,242	68.0	76,689	55.1	92,281	60.4
Owned with ground rent			27,922	20.1	24,513	16.0
Rent furnished	30,824	25.8	24,383	17.5	22,351	14.6
Rented furnished	2,957	2.5	4,377	3.1	7,994	5.2
Held by emphyteusis			2,112	1.5	1,438	0.9
Used free of charge	4,407	3.7	3,695	2.7	4,193	2.7
Non-respondent	49	0	-		-	
	119,479	100	139,178	100	152,770	100

The largest categories of occupied dwellings are:

- Terraced houses / town houses constitute 34.7% of total stock. Of these, 86.1% are privately owned.
- Flats / apartments / penthouses constitute 29.4% of total stock. Of these, 62.0% are privately owned.
- Maisonettes / ground floor tenements constitute 28.9% of total stock. Of these, 77.2% are privately owned.

Of what can be termed to constitute high end property 93.3% of semi-detached dwellings are privately owned; 90.1% of fully detached dwellings; and 70.1% of farmhouses are privately owned.

[22] Pg 8, Caruana, K., and Pace, C., Household Finance and Consumption Survey in Malta: Main Results of 2010 Exercise, Central Bank of Malta, 2013
[23] Pg 9, Ibid
[24] Table 95, Census of Population and Housing 2011, Final Report, National Statistics Office, Malta, 2014

Table 04: Occupied Dwellings by Type of Property[25]

	Terraced house / Townhouse	Semi-detached	Fully detached house	Maisonette/ Ground floor tenement	Flat/ Apartment/ Penthouse	Semi-/Fully detached farmhouse	Other
Owned Freehold	38,007	4,012	2,107	25,536	21,727	687	205
Owned with ground rent	7,212	1,413	965	8,523	6,124	229	47
Rent furnished	5,104	153	128	6,890	9,542	223	311
Rented unfurnished	591	97	78	1,518	5,670	-	40
Held by emphyteusis	399	30	32	471	410	91	5
Used free of charge	1,206	107	73	1,207	1,446	76	78
Total	52,519	5,812	3,383	44,145	44,919	1,306	686

It is important to note that:

- 72.6 % and 20.3% of terraced houses / town houses are in a good state and in need of minor repairs respectively.
- 79.0% and 16.6% of flats / apartments / penthouses are in a good state and in need of minor repairs respectively.
- 73.0% and 20.1% of maisonettes / ground floor tenements are in a good state and in need of minor repairs respectively.

Table 05: Occupied Dwellings by Condition of Property[26]

	Total	Terraced house / Townhouse	Semi-detached	Fully detached house	Maisonette/ Ground floor tenement	Flat/ Apartment/ Penthouse	Semi-/Fully detached farmhouse	Other
In good state of repair	113,781	38,136	4,531	2,467	32,228	35,479	641	299
In need of minor repairs	29,364	10,664	1,046	712	8,876	7,466	405	195
In need of moderate repairs	6,857	2,671	187	155	2,156	1,465	154	**69**
In need of serious repairs	2,621	1,009	48	47	833	481	100	103
Dilapidated	147	39	-	2	52	28	6	20
	152,770	**52,519**	**5,812**	**3,383**	**44,145**	**44,919**	**1,306**	**686**

Of what can be termed to constitute high end property:

[25] Table 96, Ibid
[26] Table 90, Ibid

- 77.9% and 17.0%of semi detached dwellings are in a good state and in need of minor repairs respectively.
- 72.9% and 21.0% of fully detached dwellings are in a good state and in need of minor repairs respectively.
- 49.1% and 31.0% of farmhouses are in a good state and in need of minor repairs respectively.

Of the total dwellings that are in a good state of repair 80.5% are privately owned.

The Table below shows the occupied dwellings by age of occupant. The age cohort 66 to 85 years, occupies 36,175 (23.7% of the total stock) dwellings, of which 26,076 or 72.1% are privately owned. The generation aged 46 to 65 years occupies 64,804 (42.4% of the total stock) dwellings, of which 50,520 or 78.0% are privately owned. The generation aged 26 to 45 years occupies 46,494 (or 30.4%) dwellings, of which 37,183 or 79.2% are privately owned.

Table 06: Occupied Dwellings by Age[27]

Age	Total	Terraced house / Townhouse	Semi-detached	Fully detached house	Maisonette/ Ground floor tenement	Flat/ Apartment/ Penthouse	Semi-/Fully detached farmhouse	Other
<= 25	2,573	299	26	25	561	1,569	30	63
26-35	20,270	3,320	357	135	6,545	9,695	86	132
36-45	26,224	7,214	886	405	8,398	9,046	164	111
46-55	31,166	12,010	1,555	797	8,260	8,125	291	128
56-65	33,638	13,285	1,557	997	8,825	8,544	306	124
66-75	23,141	9,401	948	624	6,722	5,130	233	83
76-85	13,034	5,800	408	326	4,007	2,299	155	39
Over 85	2,724	1,190	75	74	827	511	41	6

[27] Table 94, Ibid

There are two legal forms of ERS in the UK: the sale of a home and conversion of capital into money - home revision (HR), or taking up a loan, secured against the home, which may be repaid out of a postponed sale or liquidation of the home - lifetime mortgage (LM).

A HR is an arrangement between a plan provider and a home owner, comprising of one or more instruments or agreements, in which a plan provider buys all or part of a qualifying interest in the home at a discount, in return for a lump sum payment or a regular income. The home owner retains the right to continue living in the property until the earlier of either his / her death or moving to another property. Under this agreement, the home owner no longer remains the owner of part or all of the property that is sold.

The plan provider either owns the property itself or finds an investor for the property. The lump sum generated from the sale of property depends on:

- The age of the owner/s.
- An actuarial assessment of life expectancy.
- The value of the property.

The lump sum is drawn in whole, or is invested into an annuity or some other type of investment, which provides the home owner with a regular income. In the case where either the home owner or the joint home owners moves to a nursing home or dies, the plan will terminate and the property is sold.

Research shows that, sale-based equity releasing products, however, only make up a small proportion of total schemes in the EU, either displacing the relatively small numbers of remaining private schemes, or they are in fact not strictly speaking ERS at all, since they lack the element of retirement provision.[28]

Definition of a 'Home Revision Plan' by the UK Financial Services Authority Handbook[29]

(In accordance with article 63B(3) of the Regulated Activities Order), an arrangement comprised in one or more instruments or agreements which meets the following conditions at the time it is entered into:

(a) The arrangement is one under which a person (the reversion provider) buys all or part of a qualifying interest in land from an individual or trustees (the reversion occupier);

(b) The reversion occupier (if he is an individual) or an individual who is a beneficiary of the trust (if the reversion occupier is a trustee), or a related person, is entitled under the arrangement to occupy at least 40% of the land in question as or in connection with a dwelling and intends to do so; and

(c) The arrangement specifies that the entitlement to occupy will end on the occurrence of one or more of:
  (i) A person in (b) becoming a resident of a care home;
  (ii) A person in (b) dying; or
  (iii) The end of a specified period of at least twenty years from the date the reversion occupier entered into the arrangement.

In this definition "related person" means:

(A) That person's spouse or civil partner;

[28] Pg 6, Reifner, U., Clerc-Renaud, S, et al, Study on Equity Release Schemes in the EU: Part I: General Report, Project No. MARKT/2007/23/H, Institut fur Finanzdienstleistungen e.V, Hamburg, 2009

[29] http://fshandbook.info/FS/html/handbook/Glossary/L

(B) A person (whether or not of the opposite sex) whose relationship with that person has the characteristics of the relationship between husband and wife; or

(C) That person's parent, brother, sister, child, grandparent or grandchild.

A LM allows the home owner to take out a mortgage loan secured on the property. The loan can be used to fund an annuity, and provide regular income (such as an annuity) or a lump sum payment. Such a financial product includes draw-downs which provide a regular income that is not linked to investments.

The value of the loan is based on the age of the owners, their life expectancy and the value of the property. Under a LM product, the ownership of the property remains with the home owner as it separates the ERS transaction from a property transaction in terms of the home. Technically, the difference lies in the time of the sale.

Definition of a 'Life Time Mortgage' by the UK Financial Services Authority Handbook[30]

A regulated mortgage contract under which:

(a Entry into the mortgage is restricted to older customers above a specified age; and

(b) The mortgage lender may or may not specify a mortgage term, but will not seek full repayment of the loan (including interest, if any, outstanding) until the occurrence of one or more of the following:

- (i) the death of the customer; or
- (ii) the customer leaves the mortgaged land to live elsewhere and has no reasonable prospect of returning (for example by moving into residential care); or
- (iii) the customer acquires another dwelling for use as his main residence; or
- (iv) the customer sells the mortgaged land; or
- (v) the mortgage lender exercises its legal right to take possession of the mortgaged land under the terms of the contract; and

(c) While the customer continues to occupy the mortgaged land as his main residence:

- (i) no installment repayments of the capital and no payment of interest on the capital (other than interest charged when all or part of the capital is repaid voluntarily by the customer), are due or capable of becoming due; or
- (ii) although interest payments may become due, no full or partial repayment of the capital is due or capable of becoming due; or
- (iii) although interest payments and partial repayment of the capital may become due, no full repayment of the capital is due or capable of becoming due.

While with an HR product, the transaction begins with the sale of the dwelling, the sale in LM occurs at the end of the transaction. Thus, the loan including interest is repaid when the property is sold either:

- On the event of the home owner's death; or
- If the home owner moves into long-term care.

[30] http://fshandbook.info/FS/html/handbook/Glossary/L

Some LM products allow the home owner to pay the interest on the loan, and the **principal** amount is paid when the property is sold. A LM may be paid off at any time, where-in charges may apply, with the ownership of the home remaining within the home owner. This enables heirs, should they so decide, to keep the home, as they redeem the mortgage, so that no transfer of the title in the property occurs at all.

The potential size of the market for LM is limited by demand, and the need for additional sustainable liquidity, homeownership with sufficient equity, and the fact that moving house is not the obvious option.

Box 01: Types of Equity Release Schemes[31]

Roll-up Mortgage	The scheme allows the owner of the home to take smaller sums over time and is also called 'a drawdown mortgage' as it allows for sums to be taken regularly or when required. Fixed or variable interest is added to the loan monthly or yearly. Interest is not paid until the home is sold. This could occur when the person dies or needs to go to enter into a care home. Interest is charged on the loan and also on all the interest added. If a single cash lump sum is chosen, the amount owed will grow quickly. If smaller sums are taken over time, the amount will grow at a slower rate.
Interest-only Mortgages	The loan is in a cash lump sum. Fixed or variable interest is paid on the loan each month. If the interest rate is variable and the pension or other source of income is fixed it may be more difficult to meet repayments when interest rates rise. The amount originally borrowed is repaid when the home is sold.
Fixed repayment Mortgage	Instead of a loan a cash lump sum is provided. Instead of being charged interest on the loan, the owner agrees to pay the lender a higher sum than borrowed when the home is sold. This higher the sum agreed at the outset - and the value will depend on age and life expectancy. The lender takes this higher sum in repayment for the mortgage, when the home is sold. When the owner dies, the lender may charge interest on this higher sum, from the date of death to when the mortgage is paid.
Home reversions	The sale proceeds for the home is in cash, which can be paid as a lump sum or in regular installments. The owner will get less than the full market value for the home. Typically, this would be between 20% and 60%, as the buyer cannot re-sell the property until the owner dies or moves out. The older the owner is when he / she starts the scheme, the higher is the percentage received for the home. The minimum age for such a scheme is usually higher than for a lifetime mortgage. The owner is normally provided with a lease giving him / her the right to carry on living in the home for the rest of his / her life or until such time he / she no longer requires it because he / she moves into a home for the elderly. Normally the ex-owner does not pay rent, but with some schemes one can pay a higher rent in return for more money from the sale. Once the scheme is initiated the buyer benefits from any rise in the value of the house.

[31] Equity Release Schemes: Raising money from your home, the Money Advice Service

The following are examples of how equity release schemes work.

Box 02: Worked Examples of Equity Release Schemes[32]

Life-time Mortgage

Interest only Mortgage

Mr. Zammit is 65 years old and is married. The home is valued at €200,000. They want to release €30,000 from the home. A lifetime mortgage with an interest rate of 5.99% is taken out.

The upfront costs total €1,445 - consisting of a valuation fee of €345, a solicitors' fee of €600 and a brokers' fee of €500. In addition, the lender charges an arrangement fee of €599 and a telegraphic transfer of €35; both of which are added to the loan balance. The loan, therefore, starts at €30,634. Mr. and Mrs. Zammit make no further payments, but each year interest is added to the total. The impact is the following.

Year	Balance at Start	Interest	Owed at the end of the Year
	€	5.99%	€
1	30,634.00	1,882.51	32,516.51
5	38,904.87	2,390.55	41,295.42
10	52,444.48	3,235.73	55,680.21
15	70,712.92	4,353.94	75,066.66

The effect of compound interest results in the debt growing very quickly making this an expensive way to borrow.

Roll-up Mortgage

Mr. and Mrs. Zammit borrow €30,000 but do not need access to the money all at once. In year 1, they take €3,000 to repair their roof. In year 2, they take €2,000 to visit their new grandchild in Brussels. In year 3, they take €3,500 to buy a replacement car. In years 4 and 5, they draw nothing.

At the end of year 5, they would have borrowed €8,500 out of the potential €30,000.

The charges remain the same, so they would still have to pay €1,445 in upfront fees and €634 would again be added to the initial €30,000.

Year	Balance at Start	Amount Borrowed	Interest	Owed at the end of the Year
	€		5.99%	€
1	3,634.00	0	217.68	3,851.68
2	3,851.68	2,000	350.52	6,202.19
3	6,202.19	3,500	581.16	10,283.35
4	10,283.35	0	615.97	10,899.33
5	10,899.33	0	652.87	11,552.20

Given that the amount of money actually borrowed is smaller, the interest has grown much more slowly.

Home Reversion Scheme

Mr. Zahra is 70 years old. The home is worth €200,000. The reversion company will not buy less than 30% and not more than 90% of the property.

The company offers Mr Zahra the following amounts:

Percentage Sold	Cash Released
%	€
90	89,975
70%	69,980
50	49,986
30	29,992

Mr Zahra decides to release 31% of the value of his home. This gives him €30,991. His costs total £1,590, made up of a valuation fee of €240, legal fees of €650 and a brokers' fee of €700.

Mr Zahra lives for another 15 years. By the time his house is sold, after his death, the value has increased to €350,000. The reversion company is entitled to 31% of the new valuation or €108,500. John's family receives the remaining 69% which is worth €241,500.

[32] Research into the Future Housing and Support Needs of Older People - Scoping Study: Assessment of the Potential of Equity Release for Older Owner Occupiers, Fiona Boyle Associates, Northern Ireland Housing Executive, October 2010

A study by the Institute fur Finanzdienstleistungen, on ERS, identifies the differences that exist between LM and HR. These are shown in the Table below.

Table 07: Differences between Loan Model and Sale Model Equity Release Schemes[33]

	Life time Mortgage	Home Reversion
Time of sale	End of contractual relationship	Beginning of contractual relationship
Owner of the property	Consumer	Provider
Maintenance of the property	Consumer	Provider (where not transferrable and transferred to the tenant)
Risk of negative equity	Possible	No risk
Profit from increased house prices	Consumer	Provider
Loss from fall in house prices	Consumer but potentially the provider if negative equity occurs and guarantee against this is promised	Provider only for total sale; Consumer and Provider for partial sale.
Repayment of principal	Possible in case of negative equity	None
Payments due	Occasional servicing of interest payments	Occasional rental payments
Provider	Banks and some other mortgage lenders	Insurance / other provider
Amount of equity released	Typically less than 100%	Typically 100%
Cultural Acceptance	Low in countries where a home is regarded as the most important asset	High in countries where tenancy and home ownership have similar status.

It is pertinent to mention, that most recently, in the UK, a new 'sale and lease back" market has taken hold. Such offerings are different to ERS, not just because of their lack of regulation, but because they confer no absolute security of tenure, and will require regular payment from policy holders in the form of a monthly rent. As opposed to the regulated equity release products that give consumers the right to live in their homes for life, sale and rent back arrangements involve a company buying an owner's home for significantly less than the market value, and then allowing that person to continue living in the property, but only by paying full market rent and often with only an assured short hold tenancy agreement.[34]

03.1 Regulation of Equity Release Schemes in the United Kingdom

Equity release products in the UK are, however, regulated by the Financial Services Authority (FSA) as well as through self-regulation by a Code of Conduct published by the industry body Safe Home Income Plans.

The regulatory regime introduced by the FSA consists of eleven "high-level" Conduct of Business principles, which apply to all financial transactions within the FSA's jurisdiction; detailed rules in the Mortgage Conduct of Business Sourcebook (MCOB) on matters such as advertising and promotions (MCOB 3), responsible lending (MCOB 11), and charges (MCOB 12) applicable to all regulated mortgage and home finance contracts; and specific rules, also in the MCOB, that adapt the FSA's rules on disclosure (MCOB 9) and advice (MCOB 8) to the particular characteristics and circumstances of loan and sale forms of equity release.[35]

[33] Pg 8, Ibid
[34] Pg 7, Reifner, U., Clerc-Renaud, S, et al, Study on Equity Release Schemes in the EU: Part I: General Report, Project No. MARKT/2007/23/H, Institut fur Finanzdienstleistungen e.V, Hamburg, 2009
[35] Financial Services Authority, Mortgage and Home Finance Conduct of Business Sourcebook (MCOB) is available at: http://fsahandbook.info/FSA/html/handbook/MCOB.

The FSA maintains a regular reporting system with regard to the equality release market complemented by site visits. Lifetime mortgages have been incorporated into the FSA's thematic review of the effectiveness of mortgage regulation. The FSA has taken compliance correction which included negotiated changes to the standard contract terms through its powers under the Unfair Terms in Consumer Contracts Regulations.[36]

The FSA sets out a general standard for communications by a financial firm, including that, advertisements and other financial promotions must conform to principles 6 and 7 of the FSA's Principles for Business, and as such must be "clear, fair and not misleading". This general standard is elaborated in MCOB 3, in the form of detailed rules on the conduct and content of written and non-written communications about qualifying credit (including lifetime mortgages) and home reversion plans, as well as the territorial scope of the FSA's rules.[37]

The first important document is the Initial Disclosure Document which describes the nature and scope of the services that the firm provides. While the equity release advising and selling standard is MCOB 8, this standard, incorporates the disclosure rules from MCOB 4, which apply to all regulated mortgage transactions. MCOB 4.4.2 clarifies that for transactions involving more than one firm, such as an intermediary and a lender, the Initial Disclosure Document should be provided by the firm that first makes contact with the consumer, normally the intermediary. Any other firm involved in the transaction "should take reasonable steps to establish that the customer has been provided with an initial disclosure document as required by MCOB 4.4.1".[38]

An "updated and suitably adapted illustration" must be provided as part of the offer documentation for the equity release contract. The purpose of this illustration is to enable the consumer "to check the features and price" before entering into the contract and to enable the consumer to compare the offer with the information received before making the application.[39]

The SHIP self-regulation body, seeks to ensure customer safety in the equity release market by requiring members to provide the following safeguards:

- A right to live in their homes until they either die or move into long-term care.
- A guarantee that they will never owe more than the value of their property, and therefore there will never be a debt left to their estate.
- In the event of a lifetime mortgage, the interest rate will either be fixed or capped so that they will know how much they owe at any one time and they will not have to worry about interest rates spiraling out of control.
- They can move from their main residence without financial penalty.
- They must take independent legal advice and their solicitor must sign the SHIP certificate to confirm complete client understanding.
- All applications must come from a specifically qualified adviser whom has followed a robust advice process, including the consideration of implications for the owner and the family.
- All members of SHIP agree to provide fair, simple and complete presentation of their plans.

03.2 Benefits and Risks for Home Owners

The advantages of entering into an equity release scheme is derived from the fact that an elderly person is able to release capital from the home to complement pension income and continue to live in his or

[36] Pg 12, Reifner, U., Clerc-Renaud, S, et al, Study on Equity Release Schemes in the EU: Part II: Country Reports, Project No. MARKT/2007/23/H, Institut fur Finanzdienstleistungen e.V, Hamburg, 2009
[3737] Pg 17, Ibid
[38] Pg 22, Ibid
[39] Pg 28, Ibid

her home until he or she dies or decides to enter into a retirement home. It is to be noted that in the UK, income released from home equity is tax free. Additionally, it provides an elderly owner of his or her home, to continue to live in the community, and the environment he or she is most comfortable in to the extent that this is possible. Possibly, unique to the market in the UK, is that an owner is able to leave a proportion of the equity totally protected, thereby ensuring that not all the potential inheritance is used up during later years.

The vulnerability of the customer base, means that this market must always be supervised as having a high risk of consumer detriment. Indeed risk management has increased significantly - in the UK as a result of the no negative equity guarantee. The risks include:[40]

- Advice: There exists the risk of inappropriate products being sold particularly in the event that financial advice to the home owner is not mandatory. The home owner may not have the sufficient level of knowledge to make the appropriate choices. As shown in the work examples an interest-only mortgage can grow into a considerable debt within a very short time.

- Entitlement to benefits: A home owner who enters into an ERS, may have his entitlement to State benefits negatively affected given that as a result of the income raised s/he may exceed the means criteria.

- Taxation: Depending how the legislative framework for ERS is designed the release of equity from a home may have a negative effective on the home owner's tax position. Changes in legislation could affect ERS models based on regular income payments: those payments may not be taxable at the time the ERS is established, but could become taxable as a result of fiscal changes at some point during the subsistence of the contract

- Inheritance: Taking an ERS implies that there is a reduction in the future wealth to be bequeathed to one's heirs.

- Valuation of the Property: A specific risk factor with regard to an HR ERS in the UK, in terms of consumer detriment is property valuation. Although the law concerning home reversions clearly states that the valuer is the agent of the consumer, there appears to have been a significant drift in actual practice as this is reported to be no longer the case.

- Credit and elderly people: There are barriers confronting elderly people in the credit market, in which ability to pay is still assessed on the basis of income from employment and the number of years over which the borrower will have sufficient income. If providers request additional security, elderly people most in need of additional income in old age may be excluded from the ERS market.

- Market behaviour: There has been a sharp drop in house prices in Malta, over the past years, which put to rest the myth that the Maltese property market is immune to negative equity. In the UK, the economic crisis resulted in providers lowering the payment for a home, which averages approximately 60%.

- Consumer is forced to move out: If a LM ERS is arranged, say, for only a five- or ten-year period, after which time, it can be renegotiated or recalled, external developments, such as changes in the property valuation, can lead to an unforeseen premature cancellation of the credit contract imposed on the consumer. The unexpected immediate repayment obligation would systematically lead to the consumer having to sell his / her home, in order to pay off the outstanding mortgage loan, if the amount due had accumulated over time or if the housing market had changed unfavourably.

- Risks to mobility and risks of health: LM ERS potentially hinder borrowers' mobility. In some schemes, the borrower is penalised by means of a redemption fee payable on early repayment of the loan. Early repayment fees are often charged when the house is sold, except where the

[40] Pp 77-85, Reifner, U., Clerc-Renaud, S, et al, Study on Equity Release Schemes in the EU: Part I: General Report, Project No. MARKT/2007/23/H, Institut fur Finanzdienstleistungen e.V, Hamburg, 2009

borrower has died or leaves the home to enter long-term residential care. Home owners may be inclined to stay in an inappropriate environment rather than leaving home for a period in order to obtain treatment or to convalesce.

- Liabilities in terms of property maintenance: While there is technically no risk of payment default by the consumer, default is possible in the form of failure to fulfill obligations under its terms and conditions. Many ERS have an obligation not to leave the property vacant for more than a certain amount of time in the course of a year. Others place a specific legal obligation onto the customer to carry out necessary maintenance of the property in a responsible manner.

- Poverty risks: Poverty risks may result from the products themselves where the products do not meet the needs of the consumers. Those risks may also result from choice of the wrong product due to aggressive marketing and/or little understanding of the products by consumers. Furthermore, poverty risks could be caused by unforeseeable changes in circumstances, after signing the contract, such as provider bankruptcy, changes in interest rates.

- Inflation: Price rises for goods and services, generally over the term of the ERS contract, may cause a decline in the purchasing power of the money received under the scheme. This is especially true for ERS models, where monthly payments do not allow for payment adjustments.

- Changes in interest rates in the future: the risk relating to changes in interest rates depends on whether a fixed interest rate or a variable interest rate has been agreed with the creditor. Poverty risks for the consumer arise where consumers bear the risk associated with fluctuating interest rates. The borrower will face considerable risk if he wishes to buy back the property, and the rise in interest rates causes him to pay back more than originally expected.

- Inducement into the contract: Poverty risks may also result from terms and conditions that provide for financial inducements, leading to contracts unsuited to the needs of the customer. Some offers provide for the payment of a bonus, in the event of contracting within a certain (short) period of time from the date of the ERS offer.

- Provider bankruptcy: Bankruptcy of the provider could give rise to poverty, especially in ERS models involving monthly payment, and where the provider has the benefit of the mortgage. The worst case for the customer would be losing ownership of the home, and the right to stay in the property, without having received any money in return. In the case of bankruptcy, the provider would stop making monthly payments.

- Longevity of the consumer: The lifespan of the customer may also become a poverty risk. Although normally the provider bears this risk, there are ERS models where the longevity risk is borne by the customer. A number of providers offer products in which the monthly payments terminate at a certain age.

A Regulated Equity Release Market for Malta

Chapter 04

The 2004 PWG in its final report had recommended that the financial services market, should offer a regulated property pension scheme, as a Third Pillar product. It had underlined that property should not be seen as a substitute source of retirement income to Second and Third Pillar pensions – but rather as a complement thereto. It emphasised that further research is carried out regarding the need or otherwise of a tailored regulatory regime for such plans, and other related areas such as inheritance law and taxation, and supporting educational campaign which are important, in order to build understanding and literacy.

The 2010 PWG, had recommended that the Ministry for Pensions and the Malta Financial Services Authority, should consider studying the introduction of a regulated home equity release market directed to allow a person to boost his or her retirement income, without the need to sell his or her property during their lifetime.

The following issues were raised during the consultation of the strategic review:

- Whether a specific legal framework would be required and whether amendment to the law of succession is required.
- The design of a regulatory framework that would ensure the proper conduct of business by entities providing such products as well as securing robust protection of consumers.
- The introduction of appropriate governance mechanisms to prevent concentrated ownership of property by a limited number of private sector operators.
- The risks and mitigation thereof of persons adopting home ownership products upon retirement.
- Inter-generational tensions and conflict between the desire to leave an inheritance and the need for money to live on in older age.
- The implication of equity release products in relation to taxation and succession duties.
- Not all private homes would interest financial services firms providing home equity products which would mean that such schemes would provide new forms of social injustice, given that certain persons who can enter into a home equity release product, will have a higher pension income in retirement than a private home owner who is not in a position to do so.

Not all members of PWG 2010, were comfortable with a recommendation for the setting up an ERS market in Malta. A minority argued that such an ERS market will result in the following issues:

(i) A danger that a high stock of property may end up concentrated in the hands of a small number of private sector players.

(ii) That whilst the local housing market has traditionally proven to be stable, it does not mean that Malta will not suffer declines in the prices of housing or for the matter that it may never suffer a negative equity collapse. Indeed this was experienced in the early 2010 as shown in this paper.

(iii) Increased investment in property which may create further pressures on a sector that is categorised by a high number of vacant property.

The fact is, however, that an 'informal' ERS market is actually in place today. It is known that owners of homes enter into agreement with private providers of residential home care for the elderly, where-in the home is exchange for a place within the private care institution. There is no legislation in place for ERS today and thus, consumers, have no protection.

Furthermore, the fact that there is no formal ERS market results in a state of play where the 'home' exchange is taking place with a very limited number of private care for the elderly providers. De facto, this is resulting in a concentration of homes with very few private operators.

A potential model that may be considered to counter the issue of property concentration is the creation of a Home Equity Bank. A Home Equity Bank would take the form of a public agency that is underwritten by the State whose primary function would be to enable people to release equity for their homes from it, in return of an income which is payable for life. A Home Equity Bank may result in the following[41]:

Older Person	
Advantages	**Disadvantages**
Older people who are asset rich and income poor, are able to convert part of their assets to income. This will allow them to have a more comfortable retirement and fewer financial worries.	If the income is not directly linked to house prices, then users may feel that they did not get a 'fair share', assuming they have given up a percentage of their home
Assuming that the income is inflation protected (either linked to inflation or house prices (though this could lead to a more volatile income)), the improvement will be durable.	
The asset income exchange can be priced with only an allowance for administration costs, hence giving higher income than if bought from a commercial provider.	
Individuals normally trust government financial institutions more than commercial firms and so should enjoy greater peace of mind.	
Unless the whole value of the home is used, users will still benefit from rising house prices.	
Government	
The Equity Bank will help reduce pensioner poverty and improve well-being and help people to remain in their homes for longer and keep them in better order.	If house prices go up a lot, there could be pressure to increase income, but not the other way around, in which case Government would be faced with difficult choices (again, only if a percentage of the home is given up).
It will help make a contribution to care costs when and if they are required, and help moderate growth in state funded social care.	If a person dies early there could be pressure on compensation to heirs (but again not the other way around). The scheme could be designed to avoid large financial loss but this would mean generating less income.
If house prices go up, this could be an additional source of profit for Government (but only if a percentage of the home and not a fixed sum is transferred into state ownership).	Heirs may contest that their elderly relation did not understand what they were doing, which underlines the necessity for good financial advice.
	There is an upfront cost and depending on the age offered there could take several years to break even.

[41] Mayhew, L., Smith, S., The UK Equity Bank - Towards Income Security in Old Age, City University London, 2014

Heirs	
Heirs would see a member of family with more income in old age and potentially take some financial pressure from their shoulders.	Heirs would lose some of their inheritance – this would be particularly distressing if a family member dies early unless there is protection built in for early death.
If family member has to go into care, the net cost of the equity release, will be lower than expected, due to it being more likely that the government will fund more of the care costs due to means testing.	

Private Sector Market	
If equity release becomes more popular as a result of the introduction of the Equity Bank, commercial providers might receive more business from those outside the qualifying criteria.	They would be up against a new competitor that can borrow money cheaper, has a different pricing mechanism and has a better 'brand' of trust so sales will be harder.
The Government may decide to franchise the product, in which case, commercial providers could compete with, as well as against, the Equity Bank.	

Malta has no regulated market for equity release products on that allows older people who are asset rich but income poor to liquidate their private home into income for retirement. Over the next decade, the number of older people, will increase substantially, so facilitating elderly persons to manage personal wealth more effectively rather than fall on the State to pay for day to day costs, assumes greater importance.

There is no doubt that establishing an ERS market is not a panacea. As this paper has showed, an ERS has risks and good governance through regulation, is mandatory.

Be that as it may, denying elder people who are asset rich but income poor from a regulated and formalised ERS market is not acceptable, particularly if participation in long term saving products remains low.

To kick-start the process, the Government should conduct a study of how large the informal ERS market is, and assess the possibility of the take-up of more formal arrangements. The Government should also study how to finance the setting up of the Home Equity Bank, either through EU Social funds or borrowing from multilateral institutions, such as the European Investment Fund. An alternative approach would be to get funding from the National Development Bank, mentioned in the Government's electoral manifesto. The scheme would be run by the Ministry for the Family and Social Solidarity. Private providers should be allowed to participate in this market, and there should be an appropriate market regulatory framework.