How Soon Is Now?

The time could be right for your organisation to enter into the equity release market.

By Shaun Parsley

It has long been thought that products that use the equity built up in-house to generate cash will move from being a niche solution to one which is considered by the masses. Figures released by the Equity Release Council show that consumer demand for Equity Release (ER) products hit an all-time high of £1.4 billion of new loans in 2014, and shows no sign of slowing down over the long term. This obviously catches the eye from a customer demand perspective, but is it really the next product or asset line for your business to enter?

Solvency 2 compatibility issues reducing

A key concern for those holding ER assets was their inadmissibility for qualification of the matching adjustment under Solvency II. The PRA has updated the market regarding their thinking around the treatment of equity release mortgages within certain vehicles under Solvency II. They have given clear guidance on their expectations of the standards of the structuring of the loans. This was a massively helpful move by the PRA, and lifts a cloud from the ER market. The regulator highlights the importance of thorough assessment of the quality of the loans and the requirement that the risk management framework is expanded to include this.

Asset quality & diversification

Diversification has always been a key focus for fund managers of financial institutions. ER loans are a recognised asset class and because of the increasing size of the ER market, the 'clip' size is increasing, thus making it a more attractive asset class to fund managers. A key moment was when the ER market breached £1 billion during 2013. The interest rates charged to the client have fallen recently, but in general they are between 5% and 6.5%[1]. The risk-adjusted returns for optimally priced and well underwritten loans can still be 200 basis points in excess of risk-free. If property and client underwriting are aligned to pricing, then the quality of asset will be high. Average Loan-to-value ratios are around 35%.

Conduct risk reducing?

Regulation of the ER market place has been an area of constant improvement since the 1990s. The FCA regulates the equity release advice marketplace and is ably supported by the Equity Release Council (ERC). Fiduciary requirements for solicitors involved in the loan process help to prevent misconduct. The ERC has always maintained a clear focus on simple products that emphasise the needs of the client.

Changing needs

The stated reasons for taking out an ER loan have changed drastically over the last 20 years. It has been estimated that up to 50% of loans are for debt consolidation or gifting to children to purchase a home. The financial demands on parents and grandparents are ever increasing and therefore the demand for ER to fund the family is likely to continue to increase. In addition to this, the acceptance of a mortgage 'for life' is increasing as those who have had mortgages for a large proportion of their lives increases.

[1] www.money.co.uk/mortgages/equity-release-mortgages.htm

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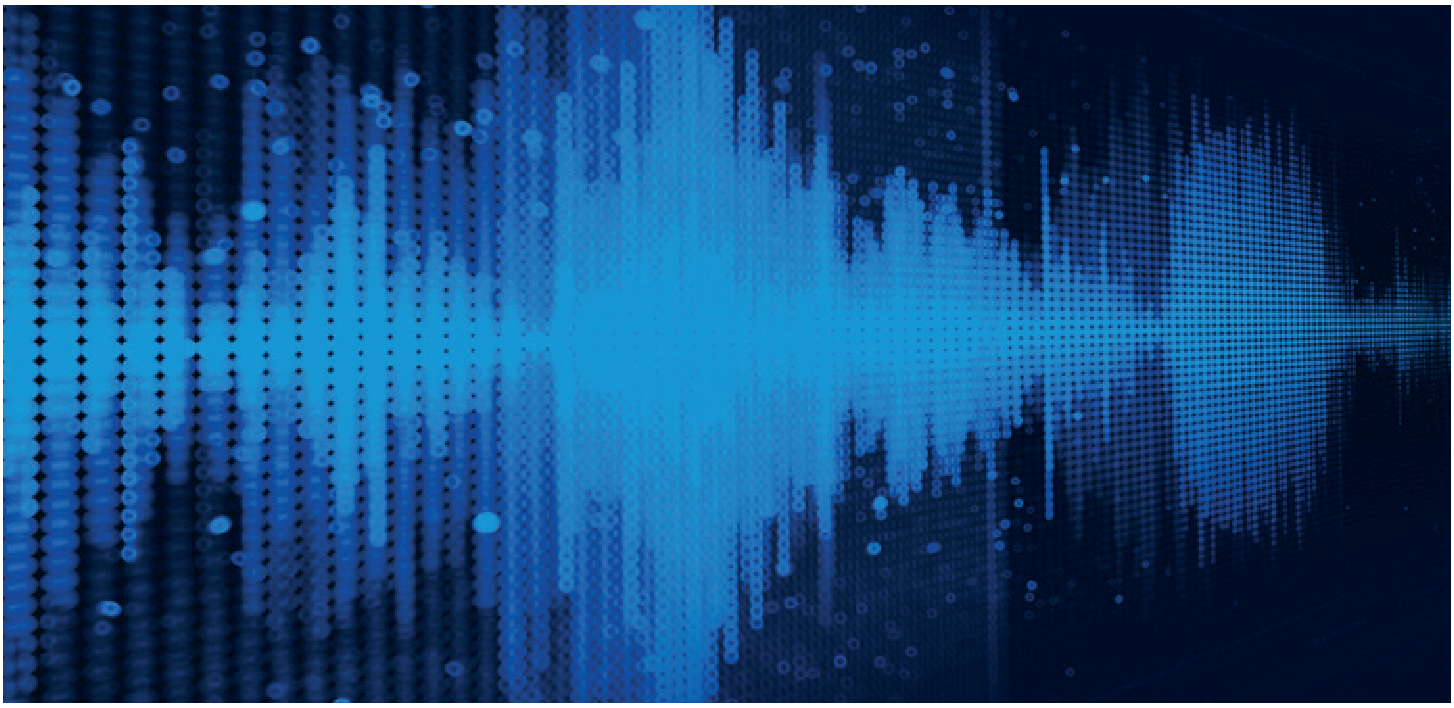

The changing advice landscape

Since the Budget speech of 2014, the options available to those planning their retirement have increased. It is likely that the discussion of how to plan for retirement will now encompass all assets – including the retiree's property. Knowledge of ER products is likely to reach a wider audience earlier in their lives, which will invariably lead to more people looking to release equity from their property assets.

Providers investing in technology and better pricing

We have seen rapid developments in all areas of electronic fulfilment for the provision of goods. Implementing paper-free processes can lead to a competitive advantage through significant cost savings. Crucially, electronic quoting can facilitate information-gathering about clients, helping providers understand the risks to which they will be exposed, and making it easier and faster to make a market leading offer. More client-specific risk pricing will give those providers embracing it a competitive advantage.

Proposition improvements

Over the last couple of years we have begun to see new products emerge that make the core ER products more flexible to the customer. Improvements have focused on making the product clearer in terms of interest and capital repayments. Further developments in most areas of the core offering will bring in new customers and expand the market further.

So is it for you?

This is a growing market that appears no longer constrained by the negatives that have haunted its past. The willingness to use the home as an asset to generate cash for a variety of needs is increasing. The regulatory environment is harbouring trust, and the quality of the client solutions available is improving. Your entry into the ER market is possible via a number of avenues, from entering into a loan funding arrangement all the way to establishing a standalone ER provider.

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To find out more about equity release development and how MBE can offer support, please call 01737 735563 or email info@mbe-intl.com.

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