



ADVISER GUIDE ON HOME EQUITY RELEASE LOANS

Introduction

These guidelines have been developed to assist advisers when advising on home equity release loans. They are not intended to provide detail about the features of a home equity release loan that should be taken into account, but rather the process and factors that should be considered in determining if a home equity release loan is the most appropriate solution for the customer.

Home equity release loans, often called reverse mortgages, have the potential to significantly improve the quality of life of older people with few assets other than the family home. Consumers of home equity release loans are often asset rich, but cash poor seniors who have limited opportunity to generate new capital and who have worked all of their lives to ensure that their main asset is debt free. Care therefore needs to be taken when advising a customer on home equity release loans to ensure suitability of any selected loan product for each customer's circumstances.

Key Reasons for Considering a Home Equity Release Loan

Many retirees do not want to leave their home, and home equity release loans are a way to fund one off or regular expenditure needs, maintaining or improving lifestyle, without the disruption and cost of moving. While downsizing has been the traditional means of unlocking equity, it results in a range of emotional issues (such as moving from the home and away from support networks) as well as cost issues (the cost of selling and buying can be between 5 and 10 per cent of the value of the house). In many cases, it will be preferable to remain in the home.

Common Uses

- To pay for one-off costs such as essential home maintenance, a replacement car, or a holiday or trip to visit and support family overseas
- To provide funds to meet emergency expenditure, such as unexpected healthcare costs
- To pay off high-interest loans, such as credit cards
- To improve the home. For example, refurbishing, upgrading kitchen facilities or altering the home to meet changing needs
- To provide funds for nursing or other home care
- To supplement other regular income to meet day to day expenses
- To assist family members in appropriate circumstances

Inappropriate Uses

- Re-investment into other medium or long-term investments, such as the share market, finance company term deposits or rental property
- To provide funds if the customer already has substantial liquid investments, the use of which may be more appropriate for their needs
- Helping family members in high risk ventures or where inappropriate pressure has been applied to provide funding



Regulations

In addition to standard consumer law, such as the Fair Trading Act, the primary legislation regulating home equity release loans is the Credit Contracts and Consumer Finance Act.

Recently enacted legislation that will also become relevant on implementation includes:

- The Financial Service Providers (Registration and Dispute Resolution) Act, and
- The Financial Advisers Act

The government through the Office for Senior Citizens has developed a voluntary Code of Practice for home equity release loans, expected to become a mandatory requirement at some future date. This Code can be viewed on the Office for Senior Citizens' website at www.osc.govt.nz

The government voluntary Code is supplemented by the self-regulatory SHERPA Code of Practice, mandatory for those loan providers who voluntarily elect to be members of SHERPA. This Code can be viewed on the SHERPA website at www.sherpa.org.nz

Both the government and SHERPA Codes require that the customer receive legal advice from an independent lawyer.

Key factors you should take into account when recommending home equity release loans

Given the nature of home equity release loans and the often vulnerable position customers are in, it is essential that a range of issues be considered with the customer before recommending a home equity release loan.

1. Does the customer understand how home equity release loans work?

It is vitally important that the customer fully appreciates the effects of compounding interest on the loan and the impact on remaining home equity. The customer should identify and understand the terms in the loan agreement that, if not met, could result in a loan default condition that may put the customer's ownership of the asset at risk.

One of the positive factors with home equity release loans has been the historical increase in value of house prices which has to a greater or lesser degree offset the effect of compounding interest. It is suggested that any projections in property values should be conservatively based.

A model such as Retirement Commission's Sorted Quick Reverse Mortgage Calculator should be made available to the customer to illustrate changes in equity over time for various loan sizes, interest rates and property growth rates. This calculator can be accessed online at www.sorted.co.nz



2. Has the customer considered all their alternatives?

There are a variety of options available to customers; some of which may be more appropriate than a home equity release loan, depending upon the customer's requirements or circumstances.

The appropriateness of a home equity release loan should be considered compared with alternative strategies, particularly with regard to the use of the funds.

Examples of alternatives include but are not limited to downsizing the family home or intrafamily funding, thus releasing the required funds.

Interfamily funding may be achieved by formal sale, a loan, or assistance with paying ongoing interest on a standard loan, but such interfamily arrangements should be formalised and the implications for estate planning documented and understood by those affected.

It should be noted that the costs of downsizing (both financial and personal) need to be taken into account, as well as any government benefit ramifications.

3. Have you discussed the customer's eligibility for state benefits and the effect equity release may have on them?

It is possible that any equity release may affect a customer's social security benefits. For example, if the proceeds are reinvested for a period or spent on assessable assets there may be an effect. In general, regular payments used as an income supplement will impact on entitlements subject to an income test. The customer should clearly understand these issues and consult with Work and Income (phone 0800 552 002) or obtain independent qualified advice.

4. Have you considered the customer's tax position in making a recommendation?

How funds released are invested before use, even short term, may impact on taxable income and tax levels.

5. Has the customer been advised to speak to their family and any other material beneficiaries of their Will?

The customer's family should not unduly pressure the decision on equity release. Conversely, the issue of family inheritance is often the cause of much friction and sometimes litigation. It may be appropriate that family members are made aware of the customer's proposal and the effect it may have on their inheritance. Advisers should encourage customers to discuss any proposed home equity release loan and the implications with family.



6. Has the customer been advised to consult an independent legal adviser?

The Property Law Section of the New Zealand Law Society has prepared guidelines for solicitors to follow in providing advice on home equity release loans. The provision of independent legal advice is a valuable means of ensuring that the interests of all parties associated with the transaction are protected, but particularly the interests of the customers. Most providers mandate independent legal advice for customers.

7. Have you discussed the customer's health and life expectancy and taken into account the effect of compounding interest and the changes in house values? Have you explained the impact this could have on their Will and estate planning?

Whilst health and life expectancy are uncertain issues, a customer's age and existing health should be taken into account. If your customer is young and in good health it may be preferable to consider other options in the short term. Releasing a substantial amount of equity when a customer is relatively young may limit their options and ability to draw further funds in the future.

8. Is the contract that you have recommended the most suitable home equity release loan plan for this customer, and have you advised that any other outstanding mortgage will need to be repaid prior to or as part of the new loan settlement?

In exercising care, skill and diligence in your advisory capacity, it is appropriate that you consider suitability of the solution proposed for the customer, and that you make them aware of the obligation to repay any other mortgage debt existing at the time the home equity release loan is drawn down.

9. Does the contract include the following protection features for the customer? (a) The right to live in the property for life? (b) The freedom to move to a suitable alternative property without financial penalties? (c) The amount owed will not be more than the net sale proceeds from the property?

Inclusion of these features in a home equity release loan provide a fundamental level of protection for a customer.

10. Have you advised that funds released should not be re-invested into any medium or long term investments?

It would generally be inappropriate to use the funds to re-invest in investments such as shares, finance company deposits or high risk family ventures depending on the customer's circumstances.



- 11.** Have you discussed the customer's needs and objectives, future plans and ongoing commitments including moving home? (This includes income requirements as well as property maintenance and insurance).

Due to the nature of home equity release loans and their potentially far reaching effects on that basic family asset, the home, it is important that they fulfil the customer's stated objectives. For example, if the customer's longer term plan is to use the equity in the home to fund entry into a retirement village, or to leave a certain value for family inheritance, it is important that the customer understands the impact that property value and interest rate changes will have on remaining equity and that the chosen home equity release loan product and the amount borrowed will together deliver a reasonable probability that there will be sufficient equity remaining to meet such objectives.

- 12.** Is the customer applying to release only the amount of equity required to meet their needs? Is the size of the loan taken appropriate to the customer's attitude to future risks?

Due to the impact of compounding interest it is important that customers borrow only as much as they need now to maintain the maximum amount of financial flexibility for unknown future needs that may arise. These requirements may include one-off costs or an amount required to supplement income.

- 13.** Has the customer put together a realistic expenditure budget plan for the funds released? This includes making use of drawdown facilities, if applicable.

Based on the best information available at the time, check that there is a match between the available funds and the customer's expectation of use.

- 14.** Have you established an appropriate record of the advice given and provided a copy to the customer, including the required disclosures?

To reduce the potential for misunderstanding and subsequent complaint, it is recommended that an appropriate record of the advice given be established, including coverage of the issues raised in this guide, and that a copy to be provided to the customer. Disclosures outlined as required under the Office for Senior Citizens Code of Practice include advice of fees, commissions or other payments that you may receive, any sole agency arrangements, any actual or potential conflict of interest that is relevant, and how the customer may access a complaints or dispute resolution process.

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Home Equity Release Loan Checklist for Advisers

No.	Check Point	Tick when Complete
1	Does the customer understand how home equity release loans work?	
2	Has the customer considered all their alternatives?	
3	Have you discussed the customer's eligibility for state benefits and the effect equity release may have on them?	
4	Have you considered the customer's tax position in making this recommendation?	
5	Has the customer been advised to speak to their family and any other material beneficiaries of their Will?	
6	Has the customer been advised to consult an independent legal adviser?	
7	Have you discussed the customer's health and life expectancy and taken into account the effect of compounding interest and the changes in house values? Have you explained the impact this could have on their Will and estate planning?	
8	Is the contract that you have recommended the most suitable home equity release loan plan for this customer, and have you advised that any other outstanding mortgage will need to be repaid prior to or as part of the new loan settlement?	
9	Does the contract include the following protection features for the consumer? (a) The right to live in the property for life? (b) The freedom to move to a suitable alternative property without financial penalties? (c) The amount owed will not be more than the net sale proceeds from the property?	
10	Have you advised that funds released should not be re-invested into any medium or long term investments?	
11	Have you discussed the customer's needs and objectives, future plans and ongoing commitments including moving home? (This includes income requirements as well as property maintenance and insurance).	
12	Is the customer applying to release only the amount of equity required to meet their needs? Is the size of the loan taken appropriate to the customer's attitude to future risks?	
13	Has the customer put together a realistic expenditure budget plan for the funds released? This includes making use of drawdown facilities, if applicable.	
14	Have you established an appropriate record of the advice given and provided a copy to the customer, including the required disclosures?	