Putting your mortgage into REVERSE – You get the money! They get the house

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Home equity conversion plans raise complex issues about the shape of the urban environment and the rights of older people.

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This article is based on research conducted at Lincoln, funded by the Australian Housing Research Council.

An innovative financial plan which is becoming increasing popular here and overseas promises to give cash to older people in return for housing equity. The concept is of interest and concern to lawyers and urban planners because of the consequences its widespread use may have for vulnerable older consumers, government policy and the character of the housing stock. The concept is known as home equity conversion (HEC). It is a financial process in which an older person (defined hereafter as a person aged 65+) converts some or all of the equity in their home to cash while retaining occupancy and security of tenure. There are two types of financial plans used for this purpose: sale plans and loan plans.

Loan plans encompass a lender who provides cash payments or income to an older consumer over a specified period in return for a mortgage over their property. Repayment of the principal and interest is deferred until the end of the period or the occurrence of a particular event, usually the consumer's death or the sale of the property. During this time the interest compounds. The amount eventually repaid by the consumer will depend on the interest rate charged, the length of the loan, the amount borrowed and the value of the property. As with other loans, responsibility for maintenance and rates remains with the consumer.

Sale plans involve a consumer selling their property to a purchaser in return for long-term or life tenancy. This is done in two ways. The property can be conveyed immediately with reservation of lease on title, or transfer of ownership can be deferred until the consumer dies or permanently vacates the property. In the latter case, providers have used vendor terms contracts to facilitate the transaction. Payment of sale proceeds to the consumer can be made in various forms – lump sum or a series of instalment payments paid outright, over a period or on the occurrence of a particular event, for example, the consumer's death or permanent vacation of the property. In some cases, where title has been transfered to the purchaser, the older tenant may be required to pay rent. Responsibility for rates and property maintenance differs between plans.

HEC plans originated in France under Napoleon where they were and still are known as *rentes viageres* – simple sale transactions arranged between vendors and purchasers with the assistance of the public notary. The concept's present wave of popularity began in America during the 1970s. Now, HEC plans are used in the United States, Great Britain, Japan and Canada. Home equity conversion was introduced to Australia in the mid 1970s (unsuccessfully), but only started to develop when Selstay Pty Ltd began marketing its sale plans in 1986. Since this time other companies have become involved in provision including Michael Devola and Associates in Victoria, Mair and Company in Western Australia and the Advance Bank, in co-operation with the Department of Social Security (DSS), nationally. The details of these plans are outlined below.

Advance Bank plans

The Advance Bank offers the only HEC loan plans in Australia. It has two loan plans, one which is partially financed by DSS and one which is solely financed by the bank. The latter is known as the Money For Living

Mortgage and has been available to older consumers aged 68 and over since 1985. A consumer can borrow up to 20% of their home's value and repayment of capital and interest can be deferred until their death, sale of the property or vacation of the property for a period greater than 12 months. After five years they may make application for further loans based on the home-'s increased value. This is limited to 20% of the increased value. The rate of interest charged on the loan is 1/2% above the housing loan rate. The consumer is also required to pay for the property valuation, legal expenses, stamp duty and the loan establishment fee. The latter is set at 2% of the amount borrowed or $600 whichever is greater.

As mentioned, the Advance Bank also offers a loan in co-operation with DSS. This is known as the Home Equity Conversion Loan and has been available since 1993. The loan funds are provided by the bank and DSS subsidises the interest rate and the establishment costs. The loan is available to older consumers aged 60 and over who are pension recipients. Those aged 60 to 74 can borrow a maximum of $5000 and those aged 75 and over can borrow up to $7500. The consumer can apply for further amounts annually. As with the Money for Living Mortgage, repayment of the loan is deferred until the consumer's death, sale of the property or vacation of the property for a period greater than 12 months. Unlike the Money for Living Mortgage the interest charged is set at the home loan rate. The loan also has a number of other special features not included in the Money for Living Mortgage. DSS requires and provides finance for consumers to obtain professional counselling before entering into the loan, and, together with the bank, guarantees that the consumer's equity will not fall below $20,000.

Other plans

The HEC plans offered by Selstay Pty Ltd (Sale Plans), Mair and Company (Sale and Security Asset Release Scheme), and Michael Devola and Associates (Life Tenancy Plan) are considered collectively as they have similar elements. Selstay Pty Ltd began marketing its plans in 1986, Mair and Company in 1989 and Michael Devola and Associates in 1984. All are available to older consumers aged 60 and over and involve the consumer selling their home (at current market value) to a purchaser found by the provider. All plans allow for either deferred or immediate settlement and ensure the continuation of the consumer's tenancy by title, contract or lease. The consumer's tenancy terminates on death or vacant possession of the property. The providers involved charge the normal real estate agent's commission on the sale of the property. Both Mair and Company and Michael Devola and Associates are, in fact, real estate agents.

Selstay Pty Ltd and Mair and Company offer plans which advance between 25% and 40% of the purchase price initially and the rest on vacant possession of the property whereas Michael Devola offers 20% of the purchase price with quarterly payments until the balance is paid. If any balance is owing on vacant possession it generally becomes payable within six months. All plans allow for a great deal of variation in determining responsibility for rates and property maintenance. In most cases this is left up to the parties to determine.

The Commonwealth Government appears to be actively committed to the promotion of home equity conversion amongst older people. This is evident from successive government pronouncements and, lately, government action. In 1989 Paul Keating indicated in his budget speech that pensioners who converted equity in their homes to cash would not be affected by the pension income test, and in 1992 Mr Dawkins in his budget speech stated that the Government would be releasing funds (around $10 million a year) to encourage HEC lending.[1] Last year this promise was fulfilled when DSS called for a tender from the financial industry to establish a subsidised HEC loan plan. The tender was won by the Advance Bank and has resulted in the plan discussed above. The rationale given by the Government for this involvement has been to encourage use and provision of HEC plans and provide assistance to older people who don't qualify for other HEC programs. So far the policy is working. Since the Home Equity Loan Plan was launched last year over 1809 loans have been made.[2]

Implication for allocation of housing resources

Given the Federal Government's financial support for home equity conversion, the question that needs to be asked is whether it is allocating scant housing resources fairly. The answer to this question is a difficult one.

Home equity conversion, potentially at least, can provide older people with a reasonable and humane lifestyle by giving them cash to ameliorate poverty in retirement. There is no doubt that older people are impoverished as a group. Despite the fact that most older people in Australia own their own homes (81% in 1988 were owner purchasers), they are income poor.[3] In 1988, two-thirds received the pension as their main form of income and only 10% were in receipt of superannuation.[4] Further, various qualitative studies have found that many older people have trouble purchasing necessaries such as food and clothing.[5]

The argument against government allocating resources to older homeowners through HEC plans is that it is using public moneys to augment private wealth. This is not only a morally questionable role for government but is also unfair to those in greater need. Despite financial distress among older homeowners they are generally better off than older people living in the private and public rental sectors who pay most of their income on housing costs. The 1988 ABS Housing Survey found that 29% of single private tenants paid over half their pension on rent while 37% paid between 30% and 49%.[6] In view of this extreme poverty, it is hard to justify government subsidies to older *homeowners* as older *tenants* are obviously the more disadvantaged of the two groups. Having said this, however, government may be able to justify subsidies longer term if the savings it derives from encouraging older people to use HEC plans in order to maintain them at home, at their own expense, frees up moneys which could be used to assist those in the rental sectors.

The use of housing stock

The use of HEC plans not only has implications for welfare policy but also for the character of the housing stock. On the positive side such plans can be used to improve the condition of the housing stock as older people who have accessed cash may be likely to use it to maintain their homes. This is supported to some extent by existing research. In 1984 it was calculated that older pensioners paid an average of 21% of their income on rates and house repairs,[7] and research examining potential consumer take up of HEC plans found that most older people interviewed would use them for home maintenance and repairs.[8] As well as physically improving the housing stock, HEC plans, in the form of sale plans, could be used by public housing authorities to spot purchase housing at reduced expense and so add to the diversity and location of public housing. HEC sale plans could also be used by younger people who can no longer afford to buy into the housing market by enabling them to purchase existing housing on more generous terms rather than adding to

urban sprawl by building further afield.

Conversely it could be asserted that the use of HEC plans will detract from the housing stock because they keep people in their homes who would otherwise move out and so add to urban sprawl and under-occupancy rates. This is a very real threat as the impact of HEC is compounded by government programs which assist people to age in their existing accommodation such as the Home and Community Care Program which delivers in-home domiciliary care. It should be noted, however, that the positive and negative scenarios outlined are largely dependent on the cost and availability of housing. If prices fell and a large supply of housing came onto the market HEC plans would no longer be socially or financially viable.

Immediate legal consequences

Of more immediate concern than the policy implications of HEC plans are the potential legal consequences of using them. The plans are marketed to older people who are not usually in a position to redress any major financial loss suffered by them. It is not edifying, therefore, to find that the plans are unregulated. They are not sufficiently covered by existing consumer legislation and the Standing Committee of Consumer Affairs Ministers has recently taken them off its regulatory agenda. The case for regulation is strong. There is a paucity of information about home equity conversion available among professionals and consumers because the market is in its infancy. This can lead to uninformed and potentially dangerous investment decisions and to a certain degree of institutionalised unfairness in that HEC providers have greater bargaining power and are therefore in a position to introduce unfair terms and conditions into contracts.

Of most concern to consumers and their advisers is the potential for provider default. This can occur due to the insolvency of the HEC provider, or fraud. In both instances the consumer may have to become involved in lengthy and costly court action to recover their money. In the event of insolvency the consumer would have to line up with other creditors to obtain any amounts owing and, in the extreme, the consumer's home may become the asset of the defaulting company; claimed by creditors in compensation for their losses. This would be possible under a HEC mortgage where the contract gave the provider an opportunity to vary terms or foreclose on tenuous grounds. In a sale plan it would be possible where the consumer's tenancy was not adequately protected by lease. In cases of fraud, consumers of loan plans stand to lose income but consumers of sale plans may be far more disadvantaged as it may be possible with certain plans to sell the consumer's interest to a third party. If this happens, the consumer's only course of action would be to sue the original provider who in the meantime may have disappeared.

There are further consumer concerns that need to be considered in relation to the structure of HEC plans. HEC loans are sensitive to market fluctuations. The compounding of capital and interest can lead to fast equity depletion especially if interest rates rise and property values fall. It is conceivable in these circumstances that the loan may exceed the value of the consumer's home and that the provider may seek satisfaction from the consumer's other assets or may (if allowed by contract) foreclose on the consumer to avoid further loss. Also of concern to the consumer is the effect of government income rules which can reduce HEC proceeds and the fixed nature of most income received from HEC plans which can lose much of their value due to inflation.

The need for consumer protection is real. Over the past five years two plans have been withdrawn from the Australian market: D.F. Johnson Maxi Life Property Trust, a privately funded property trust involving HEC sale plans and the NSW Department of Housing's Home Update Loan, a housing maintenance loan. The official reason given for the failure of these plans was that the providers involved had changed their investment policy, but one suspects it was also because the plans were not financially viable. Fortunately no consumers in the Australian HEC market have been adversely affected. Overseas, however, the situation has been vastly worse. In the United Kingdom, a HEC bond investment scheme which relied on consumers investing moneys in bonds to provide income and meet loan interest failed because it was dependent on bond and property prices rising. When markets collapsed in the late 1980s causing bond income to fall, many consumers fell into debt as they could not meet loan repayments. Age Concern, a consumer advocacy organisation, believes that over 10,000 people were affected by this disaster. Some of them have had to sell their homes to meet their debts while others are staying on at the mercy of HEC providers.[9]

In some senses the entrance of government-sponsored HEC plans will obviate some need for concern about consumer protection. As a matter of policy, though, regulation of HEC plans should not depend on government goodwill. In a recent publication for the Commonwealth Government I suggest a regime of regulation for HEC plans which should offer consumers an adequate level of protection.[10] For regulation to be worthwhile it should encompass security of tenure and adequacy of income.

In relation to both requirements it is recommended that:

- all costs associated with a HEC plan be disclosed to the consumer;
- the consumer be required to obtain independent counselling before entering a HEC contract concerning their security of tenure and the adequacy of HEC income for their lifestyle including the potential impact of inflation and DSS and tax treatment;
- any default in payment by the provider result in extinguishment of rights under the HEC contract;
- a guarantee of security of tenure be given to the consumer which is subject to the provider's rights in restricted circumstances, for example, destruction of the property;
- security of tenure is protected by a registered interest if title has passed to the provider;
- debts accrued in HEC loans be limited to the value of the consumer's home and, in the event of all equity being exhausted, the consumer cannot be evicted.

Conclusion

I believe HEC plans are potentially of great benefit to older people who require cash to improve their quality of life in retirement but are probably not the best way for government to distribute housing assistance to older people. Government needs to consider whether it should be promoting the use of HEC plans or whether this is best left to the private market. In the event of increased consumer takeup, long-term use of HEC plans will affect the character of the housing stock. At this stage it is difficult to determine what effect this will have as such will depend on the future cost and availability of housing. While policy issues are open to conjecture, the need for regulation is not. HEC plans are being used in Australia now and require regulation now. It is important for government to treat this matter as a priority as, firstly, older people are less likely to use plans in the absence of protection, and, secondly, given the Government's support and promotion of HEC, it has a duty to protect the vulnerable older consumers whom it encourages to enter the market.

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