EQUITY RELEASE

Keeping it in the family

Equity release is a great way of passing money on to the next generation and particularly attractive now due to tax allowance freezes and low interest rates – but be sure to do your homework

Charles Calkin
Financial planner, James Hambro & Partners

The March budget offered a glimpse of what is to come as the chancellor tries to balance the books. It was a budget of tax allowance freezes. Once the economy recovers we might expect more direct demands on wealth.

Not surprisingly, some older savers are considering how they might start passing money on to the next generation beforehand.

Under current potentially exempt transfer (PET) rules, you can give away as much as you like without triggering inheritance tax (IHT) – as long as there are no strings attached to the gift and you live for seven years afterwards. Passing excess wealth on now can therefore start the PET clock ticking.

It can be hard to give away substantial amounts of money if your assets are tied up in the home in which you live, as is often the case. House prices have outstripped earnings and inflation in the past 20 years. There are now 369 local authority districts in England and Wales – mostly in London – where the average price paid for a property last year was over £1m (in Westminster it was £5.34m).

If your investments lie in assets such as equities, which are outside an ISA or pension tax wrapper, you are likely to trigger capital gains tax (CGT) on disposal or transfer. For clients in these circumstances, equity release may offer a solution.

When equity release originally emerged the industry was less regulated. Those offering advice today must have specialist qualifications and follow strict rules. Last year, £3.89bn was lent through these schemes, often known as 'lifetime mortgages'.

Later-life care

Of course, equity release is useful, not only for those wishing to give money to younger loved ones but may help those wanting to carry out renovations, consolidate debts or fund later-life care. If, as a couple, one of you requires care and you cannot afford it out of your normal income and savings – or if you want to resist drawing down pension assets because of their IHT exemption – equity release may give you the money you need for the quality of care you really want.

How equity release works

Equity release is simple in principle. You effectively take out a loan against the equity in your house and you can do what you like with this money. For those looking at IHT planning, you might give the cash – or a proportion of it – to your loved ones.

Interest is charged on the loan but is generally rolled up, avoiding the cashflow servicing cost. This does mean there is a compounding effect, however. The loan is transferable if you downsize, assuming there is sufficient equity remaining. It is repaid when you no longer need the property.

All plans that meet Equity Release Council standards guarantee borrowers will never owe more than the value of the property, even if there is a housing market crash. And borrowers are guaranteed tenure for life or until they move into long-term care.

As a consequence – and to safeguard their own interests – lenders will consider only older homeowners (aged 55+) and how much you can borrow will depend on your age and value of the property.

Equity release is particularly attractive at the moment because interest rates are at an all-time low. By the end of last year you could get fixed-rate deals as low as 2.3%. This is a better rate than many people are getting on a mortgage – at 2.3% it will take you 30 years for the debt to double. So it may be helpful if you want to help children or grandchildren get on the property ladder and do some IHT planning at the same time.

I should add that the current fixed-rate deals are so attractive that those who signed up to more expensive earlier agreements may find it worthwhile to renegotiate terms. Do check if the current lender will levy an Early Redemption Penalty.

The broker we work with advised a couple recently who had set up a £250,000 equity release facility five years ago at 6.78%. He arranged to refinance at 2.5%. The difference is a saving of £140,000 over nine years. The revised rate of 2.5% is fixed for life.

Choosing a reputable broker is important – there are still some hard-sell businesses out there, so check what people say about them online.

Paying back the debt on death

On death, the executors of your estate will generally have a grace period of six to 12 months to sell your property and settle the outstanding loan. In terms of IHT, the outstanding loan is considered a debt against the estate. So if your estate is worth £3m but the equity release lender is owed £1m, for example, the value of your net estate falls to £2m.

A couple in this scenario who had taken out equity release might find only £1m of their estate is liable for IHT, which is a tax charge of £400,000. Had they not taken out equity release the estate would be worth £3m. The final bill for them would be a punitive £940,000.

That is because for every £2 an estate is worth over £2m, £1 is knocked off the residence nil-rate band. That can reduce a couple's IHT allowances from £1m to just £650,000.

Those who use equity release to save them having to liquidate assets liable for CGT benefit because, on their death, any CGT liability is washed out. The assets are simply rolled into the estate and valued for IHT purposes.

> **The best gift you can make to your loved ones is not to be a burden on them. Whatever you do, never jeopardise your financial independence**

Take advice

There is a lot to be said for affluent people cascading their wealth down the generations before they die. It helps to avoid IHT but it is also more likely to benefit children and grandchildren earlier in their lives – when they most need it.

However, never give more than you can afford. Remember, the best gift you can make to your loved ones is not to be a burden on them. Whatever you do, you should not jeopardise your financial independence – even if that means paying tax.

And if you are considering using equity release, ensure your family knows. It can be a horrible shock on death to find that there is a debt against the house, particularly if you have children or grandchildren expecting to inherit when you die.

There may be simpler ways to mitigate the threat of IHT – by distributing wealth more evenly between partners, for instance, and running down savings outside your pension pot first. With specialist advice, though, equity release can be a useful tool – and at current interest rates it is one my clients are finding increasingly attractive.