

## Asset Rich Income Poor - What Can You Do?

Let us suppose that you own your own home worth \$355,000 which is mortgage free and that you are in receipt only of the National Superannuation. You can find sufficient to meet basic outgoings but repairs and maintenance are becoming a worry and you look like having to cancel your medical insurance but don't know how you will pay for health care and prescription drugs.

Reverse annuity mortgages have been popular in the United States for some while and in recent times several products have come onto the New Zealand market, although they are not entirely new to New Zealand. In the past they have been viewed with some scepticism due to the seemingly high costs and interest rates. Some of the more modern products are easier to understand and give greater flexibility and safeguards. Nevertheless there could be pitfalls and each product needs to be considered carefully and compared with others on offer, as well as matching the product to your own needs.

The mortgages come in different forms and bear different names. One such name is "Equity Release Mortgages".

Each scheme has its own characteristic but the basic fundamentals are as follows:

1. The mortgages allow borrowers over a certain age, usually 60 or 65, without an income stream, to access the equity in their houses.
2. Applicants can apply for a loan of between pre-determined percentages (depending on the lender) of the current market value of their home.
3. The loan amount can increase every year past the commencement date - the older the customer and the greater the value in the home, the more money can be borrowed.
4. Monies received under the mortgage are tax free and can often be obtained either in a lump sum or by way of a monthly annuity.
5. As the amount borrowed increases so the equity in the home will reduce, even allowing for reasonable inflation.
6. The amount owing may not be repayable until the last surviving borrower either moves from the home permanently or passes away.
7. Some of the products on the market are non recourse (no access or borrow personally), so the amount owed can never exceed the value of the borrower's equity in the property, meaning the borrower can never be in default provided they maintain the property in a reasonable condition and meet all their insurance and rates obligations.
8. Each product has an establishment fee. Most fees are added to the loan amount, along with interest and paid on maturing. There may also be a reinsurance levy.
9. Interest rates vary. Some are fixed and some are anchored at a percentage above the New Zealand Bank Bill Rate ("BBR") and are reset at periodic intervals in accordance with changes up or down to the BBR.
10. A valuation will be required at the outset. Some lenders pay this fee and add it into the amount of the loan.
11. Products vary in respect of the rights to repay the loan at any time prior to maturity. Some may allow early repayment subject to payment of a penalty.
12. No change of ownership is required to the property as the loan is secured by a mortgage. If the borrower sells the property and repurchases the loan can be transferred to another property.
13. There are no monthly payments due by the borrower.

These mortgages are not for everyone. The most important aspect is the matter of inheritance. After taking out a reverse annuity mortgage there will be a consequent reduction in the size of the borrower's estate which will continue to reduce as the years go by. The mortgages are most suited to those who are asset rich but income poor, and want to enjoy life a bit more.

By way of example we set out below the position for an individual aged 73 with a property value of \$355,000, with no initial capital sum but desires payment of a monthly annuity of \$365. The interest rate is 11% and the term of the mortgage is set at the life expectancy, or when the client moves out of and/or sells the security property, whichever event first occurs.

Year	Estimated Owing \$	Premium	Estimated Propety \$	Value	Estimated Remaining \$	Equity
2	17,810		369,342		351,532	
4	35,441		384,263		348,822	
6	56,004		399,788		343,783,	
8	78,753		415,939		337,186	
10	107,337		432,743		325,406	
12	142,000		450,226		308,226	
14	184,708		468,415		283,707	
16	237,945		487,339		249,394	
18	302,922		507,027		204,106	
20	383,535		527,577		143,977	
21	430,345		538,062		107,717	

The above table assumes that the lender has paid all the fees and charges associated with the policy on the borrower's behalf and has added them to the balance of the mortgage - the security property has increased at a rate of 2% per annum and no repayments have been made during the term of the mortgage.

The borrower's requirements need to be considered on a case by case basis. The interest rate may be open to negotiation based on the risk associated with each application. It is recommended that you consult your legal advisor prior to making any application for one of these mortgages