Bridging the gap:

Developments in later life lending to an ageing population

July 2018

Executive summary

Later life mortgage lending has been the focus of increased attention recently. With a growing customer base of older borrowers, product innovation and regulatory changes that support lending to this age group, it seems the importance of this customer segment is set to continue to grow.

- **UK population is ageing but homeowners are ageing more rapidly.** Britain's population of 65 plus year olds increased by 28% in the twenty years to 2016, rising from 9.2 million to 11.8 million. But over the same period, the number of 65 plus year old homeowners rose from 4.0 million to 6.0 million, a 52% gain. Over the next twenty years, the population aged 65 and over is set to rise more rapidly, reaching 17.1 million by 2036, a 44% increase on 2016.

- **Over 55 year olds now hold 69% of housing equity.** Total homeowner equity in England reached £2.6 trillion in 2016, of which £1.8 trillion belonged to households with a homeowner aged 55 years old or over – a figure forecast to double by 2036.

- **Lending to older homeowners is increasing.** With people entering owner-occupation and climbing the housing ladder later in life and more working past traditional retirement ages, lending to older homeowners is increasing. The amount of mortgage debt held by 65 year olds and above is estimated to have reached £43 billion in 2012-14. The mortgage debt of this age group is projected to nearly double by 2030.

- **Lifetime mortgage lending has grown by 29%pa since 2014.** With more people reaching retirement with inadequate pension income and large housing wealth, demand for equity release and in particular lifetime mortgages is rising sharply. New lifetime mortgage lending jumped from £1.5 billion in 2014 to £3.2 billion in 2017.

- **Divide between mainstream and lifetime mortgage products is softening.** In March 2018, the FCA created the regulatory category of 'retirement interest only mortgage' (RIO mortgage), where older borrowers do not face a fixed mortgage term and where affordability is assessed on an interest only basis. With many lifetime mortgage providers now offering borrowers the option to pay interest, the traditional distinction between lifetime and conventional mortgages is diminishing.

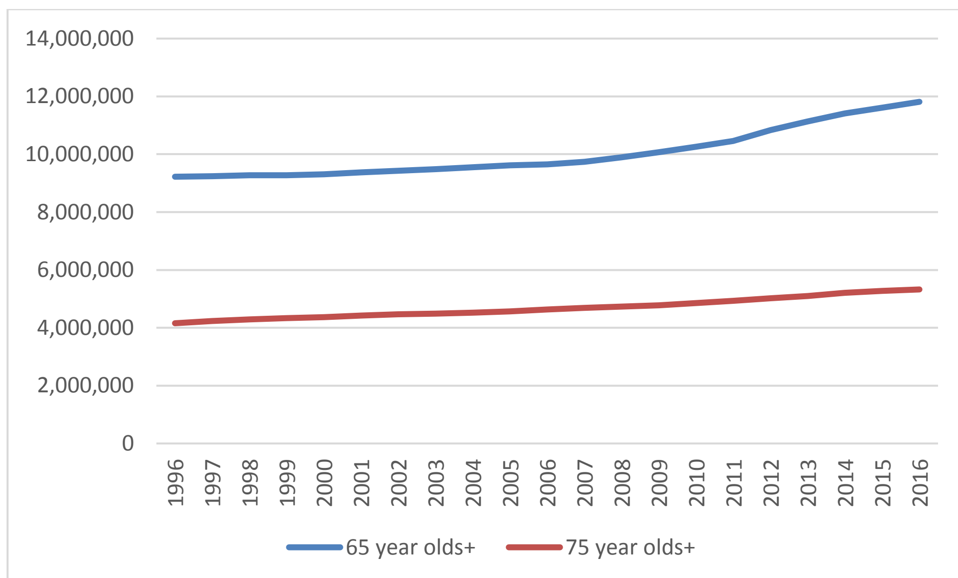
- **Need for retirees to take a holistic view of their finances.** Since pension freedom in 2015, over 55 year olds have had unprecedented access to their pension assets. Logically, this should encourage retirees to consider how best to use all their assets to meet their financial objectives. Much more work needs to be done on signposting consumers to appropriate sources of advice.

1. Britain's aging population of homeowners

1.1 Rising power of the aged homeowner

A number of factors have led to an increased focus on older borrowers in the mortgage market. Firstly, the UK population profile has been changing, with an increasing proportion of the population aged over 65. In 1996, there were 9.2 million people aged 65 and above (15.9% of the total population) and 4.2 million aged 75 and above (7.1% of the population). By 2016 this had grown to 11.8 million aged 65 and above (17.8% of the population) and 5.3 million aged 75 and above (8.1% of the population) - see Chart 1. Over this 20 year period both the population aged 65 and above and those aged 75 and above rose by 28%.

Chart 1 – UK population 65 years old and above and 75 years old and above



Source: ONS

Second, while the population as a whole has been ageing, the population of homeowners has been ageing at an even faster rate. Table 1 shows the number of owner-occupiers aged 65 and 75 and above relative to the total population of homeowners. Over the same 20 year period the number of homeowners aged 65 and above rose 52% while the number aged 75 and above rose 69%, against only a 9% rise in the total number of owner-occupiers.

Table 1 – Homeowners by age group

	1996	2006	2016
65 and over	3,957,000	4,665,000	6,009,000
75 and over	1,673,000	2,234,000	2,821,000
All homeowners	15,968,000	17,688,000	17,404,000
65 and over % of total	24.8%	26.4%	34.5%
75 and over % of total	10.5%	12.6%	16.2%

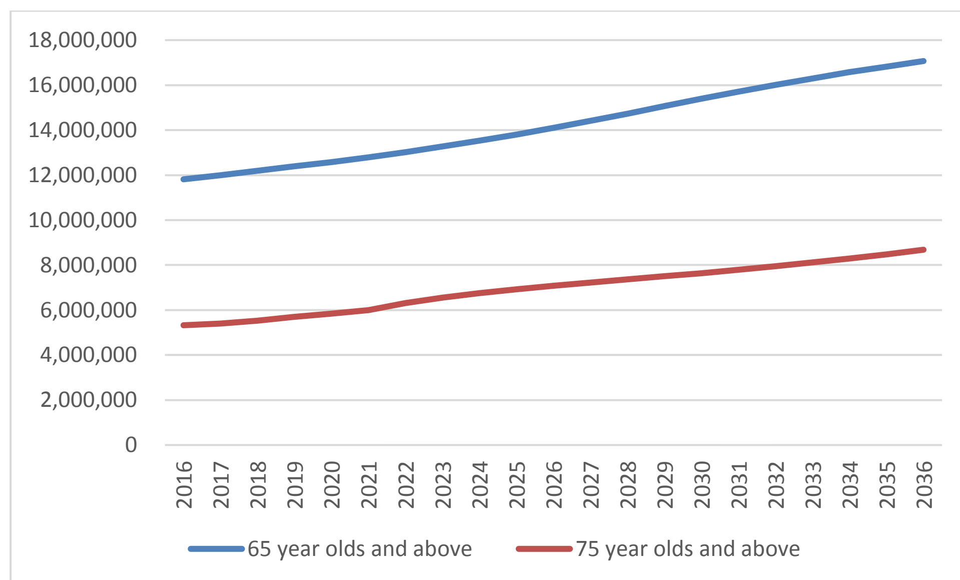
Source: House of Commons Library

Not only do the elderly constitute an increasing proportion of total homeowners but the amount of housing equity they hold has been increasing faster than that of other age groups, leading to a growing concentration of equity amongst older homeowners. One estimate suggests that total homeowner equity in England reached £2.6 trillion in 2016, of which £1.8 trillion (69%) belonged to households with a homeowner aged 55 years old or over[1].

1.2 Projected future rise of the older homeowner

The trends of an ageing population and rising housing equity amongst older homeowners are set to continue. Indeed, as Chart 2 illustrates the growth of those aged 65 and above is expected to accelerate markedly with the ONS projecting that the population of 65 year olds and above will reach 17.1 million by 2036, a rise of 44% on 2016 and the population aged 75 and above will reach 8.7 million, a rise of 63%.

Chart 2 – Projected rise in UK's older population



Source: ONS

The £1.8 trillion of housing equity held by 55 year olds and above in England is forecast to double by 2036. And it is not only the level of housing wealth that is forecast to rise. Experts also project a sharp rise in mortgage debt amongst older homeowners. The amount of mortgage debt held by over 65s is projected to increase by 95% by 2030[2].

The factors outlined above not only explain why later life lending has become a greater focus for the mortgage industry but also suggest that later life lending is set to play a significantly greater role going forward.

1 Equity release rebooted: the future of housing equity as retirement income – Equity Release Council April 2017

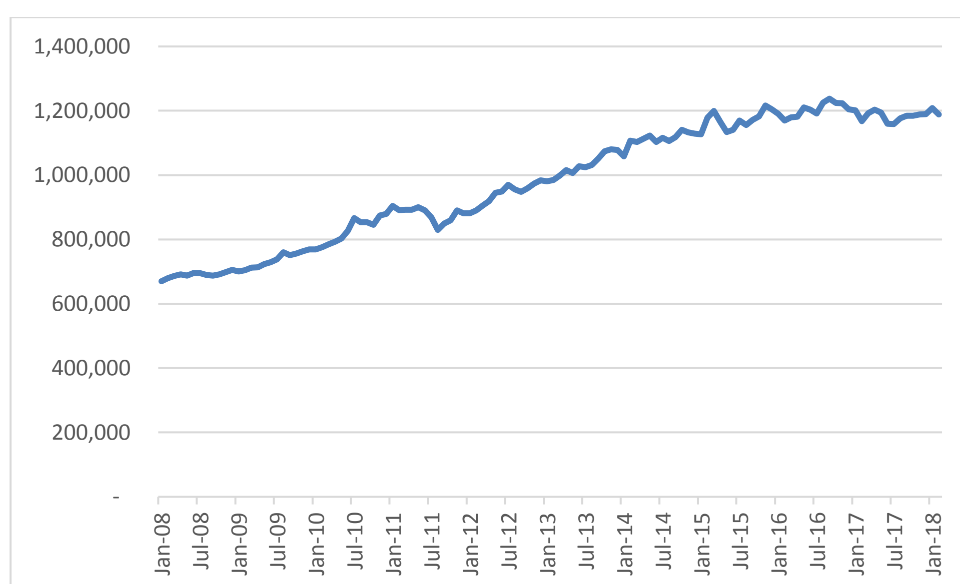
2 Lengthening the ladder - The future of mortgage borrowing in older age Ben Franklin, Cesira Urzì Brancati and Dean Hochlaf ILC-UK, supported by the BSA

2. Lending into retirement and lending in retirement

2.1 Society's changing attitudes to retirement

Expectations around retirement have changed a great deal in recent years. The Equality Act 2010 sought to remove the default retirement ages that most employers had in place (typically 60 or 65). Since then over 65 year olds have been the fastest growing part of the workforce with 1.2 million in work in February 2018 (over 10% of this age group), up from 830,000 in 2010 according to ONS data (see Chart 3).

Chart 3 – Number of 65 year olds and over employed in UK (thousands)



Source: ONS

Lenders have accommodated this changing pattern of work: the most common approach that lenders now take is to ask an applicant at what age they plan to retire but to sense check this or set a backstop age at which they assume all borrowers will have retired (most commonly 70 years of age). This is helpful for borrowers who plan to work beyond a traditional retirement age, as recognition of later retirement can underpin mortgage affordability.

However, this approach does create additional risks for lenders as a borrower's retirement plans can change. So a loan that was expected to be repaid within the extended working life of a borrower and therefore did not include an assessment of income in retirement, could in fact extend into retirement. Where such a borrower decides to retire before their mortgage term ends they should talk to their lender if they are concerned that the loan might become unaffordable.

2.2 Lending into retirement

A typical pattern of mortgage borrowing in previous generations saw people entering owner-occupation in their twenties, moving up the housing ladder in their thirties and forties and having their mortgage paid off by their retirement at 60 or 65. This pattern is already in retreat with an estimated 1.42 million borrowers aged 35 to 64 (6.4%) not on course to repay their mortgage before entering retirement given the current term of their loan[3]. However, even this understates the scale of change as many within this group are still climbing the property ladder and will need to extend their mortgage term on future home moves.

A number of factors have spurred this shift. People are entering owner-occupation later in life and also making subsequent moves up the housing ladder later, in part due to stretched housing affordability. And crucially, since the introduction of the MMR borrowers have found it much more difficult to borrow on an interest only basis and so to keep monthly payments as affordable as possible borrowers are opting to take mortgage with longer terms instead, as discussed in Section 5.3 below.

There are also a considerable number of borrowers who took out interest only mortgages and do not have an adequate repayment strategy. The FCA estimates that over 40,000 interest only mortgages are due to mature in households with borrowers aged 65 and over every year between 2017 and 2032[4]. Many of these borrowers are going to need to extend the term of their loan if they are going to remain in their homes. For some extending the mortgage term further into retirement may be a viable option and recent regulatory changes should provide more options (see Section 2.3. below).

2.3 Lending in retirement

Lending in retirement is quite a different proposition for a lender than lending into retirement, although the closer a working borrower is to retirement the more similar the two become. And while many borrowers are now choosing loans that extend into retirement (as stated in 2.2 above) relatively few borrowers seek new mortgage loans in retirement, making this a specialist market.

Lenders typically have a maximum age at which mortgages must be repaid which can lead to quite short loan terms for borrowers who are already retired. This makes repayment conditions particularly important and there are now four repayment options for retired borrowers: lifetime mortgages are addressed in Section 3 below, the others are:

Capital repayment

Retired borrowers can take out a conventional capital repayment mortgage. However, monthly payments will be high if the loan must be repaid over a shortened period. For example, a 65 year old borrowing from a lender with a maximum age of 75 would need

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3 Lengthening the ladder - The future of mortgage borrowing in older age ILC-UK, BSA
4 See Ageing Population and Financial Services - FCA Occasional Paper 31

to be able to afford payments on a 10 year term. As a result, these loans are usually made to borrowers with high pension incomes looking to make a sizeable capital outlay such as buying a second home. Now that many lenders have lengthened the maximum age at maturity, however, borrowers are finding more choices that allow them to stretch these terms, even up to 25 years.

Interest only

Some lenders will advance loans to retired borrowers on an interest only basis with a fixed term, cutting the monthly outlay against a capital repayment loan, but only where there is a clear strategy to repay the capital as a lump sum on maturity. This can be helpful for borrowers who want additional capital now and have assets which they plan to sell, such as a holiday home or buy-to-let property they wish to keep for a few more years. Some lenders accept sale of the borrower's residence as a suitable repayment strategy but only where there is sufficient equity for the homeowner to downsize to a cheaper property.

Retirement interest only mortgage (RIO mortgage)

In its Quarterly consultation paper[5] the FCA created a new definition of 'retirement interest only mortgage' (RIO mortgage), which came into effect in March 2018. Rather than having a fixed term like conventional interest only loans this category has repayment terms akin to those of lifetime mortgages so the loan can extend until death or permanent move into long term care. But the FCA will no longer regulate these loans as a form of lifetime mortgage in recognition of the borrower's contractual commitment to maintain interest payments (see Section 4.2 for more detail). The Bath and Vernon Building Societies as well as Hodge Lifetime already offer RIO mortgages and it is believed that a number of other lenders have plans to introduce them.

Concerns with lending in retirement

Although ill health or death can afflict people of any age, the risk obviously rises with age. Lenders need to be sensitive to the risk that a borrower may find a mortgage unaffordable if a partner dies, where for example pension income is reduced or stopped. Lenders also have to be alert to the risk of ill health and in particular the mental capacity of the borrower.

Conditions such as Alzheimer's and dementia are more common amongst the elderly and these conditions can impair a borrower's ability to look after their affairs. Care costs are also a factor as these can quickly consume a borrower's net wealth where for example a spouse requires residential care. Because of these factors it should not be expected that older borrowers will be eligible for the same range of loans that are available to working age borrowers and lenders need to balance the desire to meet demand from older borrowers with the need to limit the financial risks that these borrowers face.

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5 FCA CP17/32

2.4 Assessing mortgage affordability in retirement

For the lender, one crucial aspect of both lending into retirement and lending in retirement is how to assess income in retirement. Earned income has traditionally been the bedrock of mortgage affordability calculations. Other forms of income, such as buy-to-let profits, dividends or pension income, have not always carried the same weight.

FCA rules provide a clear differentiation based on whether the borrower is close to retirement (see Section 5.1 for more detail):

- Where they are many years from retiring, the lender should ask for evidence that they have a pension in place.

- For a borrower who is closer to retiring, the lender should make a more robust assessment of the borrower's expected pension income by looking at their pension statement.

In practice, where a borrower is more than 10 years away from expected retirement, most lenders will not require an assessment of projected retirement income. But where a borrower is nearer to retiring, most lenders will assess expected retirement income based on the projections contained in the borrower's latest pension statement. This should provide a suitably conservative estimate of future pension income as it will be based only on the pension benefits already accrued whether it is a defined benefit (DB) or defined contribution (DC) pension.

However, in DC schemes projected pension incomes have been depressed in recent years by low annuity rates. Since the 2015 'pension freedom' changes retirees are no longer bound to convert their pension pot into an annuity (guaranteeing an income for life) but rather are free to withdraw funds from the pot as they see fit. With annuities seen as poor value for money by many, pension 'drawdown' has become a valid option but how should a lender assess the implications for affordability?

In practice few lenders have acknowledged the ability to meet mortgage payments from pension drawdown but at least one lender does recognize this enhanced flexibility by allowing projected annual pension income to be calculated as 4% of the value of the borrower's pension pot. And a similar approach can be applied to other investments. However, concerns with conduct risk may prevent lenders taking a more flexible approach which recognizes DC pension holders' ability to use drawdown to pay mortgage interest and debt.

It should also be remembered that pension income can be more secure than earned income. The state pension is one obvious example and retirees on final salary pension schemes (DB schemes) rank at the top of claims on their former employer's pension scheme assets and in the unlikely event that a scheme is unable to pay current

pensions the Pension Protection Fund pays 100% of the retiree's pension without a cap[6]. And where individuals have purchased an annuity (most commonly with a DB pension pot) this annuity is underwritten by the Financial Services Compensation Scheme (FSCS) in full.

2.5 Buy-to-let in retirement

There are an estimated 1.75 million landlords in Britain according to data from HMRC. On average they are significantly older than the general population and many have bought rental property specifically as a source of pension income. In recognition of this, many lenders extend mortgages on buy-to-let properties with older maximum age limits or no age limits. The sensitivity around these loans is lessened because the repayment of the loan from sale of the property does not involve the borrower having to downsize and the income from the property supports mortgage payments.

However, buy-to-let lending to older borrowers does still come with some age related concerns. The loss of mental capacity or ill health can challenge a borrower's ability to manage a buy-to-let loan and property. So lenders must satisfy themselves that there is not an undue risk that a buy-to-let will prove too burdensome to the borrower. In the event that a borrower does become unable to manage their buy-to-let property lenders do have the option of appointing an LPA Receiver of Rent to manage it on their behalf, which does provide the lender with some additional comfort.

6 Members who have not yet retired receive 90% of their contractual pension income currently capped at £35,000.

3. Lifetime mortgages

3.1 Reasons for the rise of lifetime mortgages

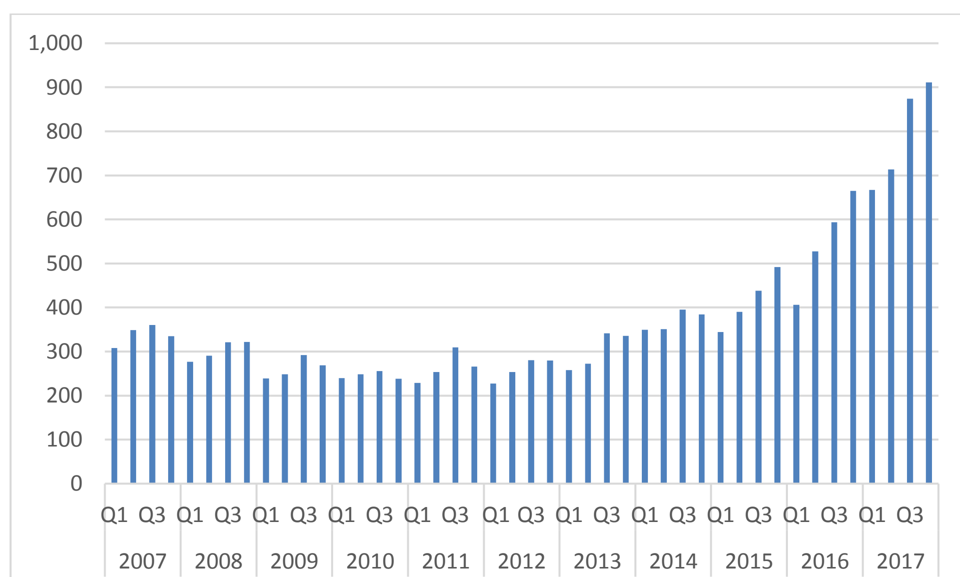
Older UK homeowners have been able to release equity from their homes for many decades using one of two types of product:

- **Home reversion plans.** The homeowner sells all or part of their property in return for a lump sum or stream of income. The homeowner retains the right to live in the property under a lifetime tenancy.

- **Lifetime mortgages.** A loan is made to the homeowner either as a single advance or to be drawn down in stages. Interest is rolled up until the house is sold on death or the owner is no longer able to remain living in their home. The homeowner retains ownership of the property and all providers who are members of the Equity Release Council – the trade body representing the equity release industry - provide a no negative equity guarantee which ensures that the debt will never exceed the value of the property.

Despite the potential benefits of equity release it is estimated that only some 1% of older homeowners have taken out one of these products. Psychological barriers seem to play a significant part with many older homeowners feeling that, having spent a lifetime accumulating housing equity by paying off their mortgage, it is a failing to then have to borrow again.

Chart 4 – Lifetime mortgage lending per quarter (£ millions)



Source: FCA

But the landscape is now changing with lifetime mortgage lending showing much higher growth rates in recent years (see Chart 4). This may reflect changing attitudes to debt amongst older homeowners or perhaps the fact that people are now better informed about the product and its safeguards. It may partly reflect more people using

lifetime mortgages to pass money onto children or grandchildren or to pay off more expensive debts. But we believe that it also reflects a series of underlying changes that are set to continue to drive a high rate of growth:

- The widespread switch from DB to DC pensions since the 1990s is starting to show through in the population retiring now. Typically, DC pensions produce much lower incomes than DB pensions, meaning that the latest generation of retirees includes an increasing number of people facing disappointing pension income.

- The 2015 pension freedom changes have made it easier for retirees to draw funds from their pension. But it has also made it more advantageous from a tax perspective for people to retain funds in their pension, as in contrast to housing assets, pension assets fall outside the retiree's estate for inheritance tax purposes.

- Increased competition amongst providers has reduced interest rates on lifetime mortgages. In 2012, average lifetime mortgage rates were 5.92% but this had fallen to a new low of 3.94% in 2017[7]. As most products are fixed rate for the full duration of the loan, new customers are locking into these lower rates for good.

- A steady stream of borrowers are now reaching retirement with interest only mortgages without other assets to cover the debt. As stated in Section 2.2 above, the FCA estimates that 40,000 interest only mortgages are due to mature in households with borrowers aged 65 and over every year between 2017 and 2032. A significant proportion of these borrowers may look to equity release in order to remain living in their family homes.

- New product features have become available which has broadened the range of people who find lifetime mortgages an attractive option, while the no negative equity guarantee provides the reassurance that debts can never exceed the value of the home.

3.2 Product flexibility

Improvements in product features are a particularly important factor, as they have successfully addressed some of the most common concerns that held retirees back from taking out lifetime mortgages in the past. The range of product features available in today's market include[8]:

- **Partial repayments** – allows the borrower to make repayments of capital at a time of their choice, typically up to 10% of the initial loan per year, with no

7 Source: Key Retirement
8 Source: Equity Release Council, Equity Release Market Report – Spring 2018 edition

early repayment charge (ERC). This helps customers to reduce the build-up of interest or even reduce the loan balance over time.

- **Drawdown facilities** – these allow borrowers to withdraw money in stages rather than taking a single lump sum. Interest is only applied when the funds are withdrawn, keeping costs down.

- **Inheritance guarantee** – borrowers can choose to ring-fence a fixed percentage of the value of their home to leave as an inheritance regardless of the total interest accrued on the loan.

- **Fixed ERC** – ERCs set at a fixed percentage of the initial loan amount over the early period of the loan. Typically, the ERC will decrease on a sliding scale. Once the fixed period has ended the customer can repay the loan in full without penalty.

- **Downsizing option** – allows customers to downsize to a smaller property and repay the loan, either voluntarily or if the new property does not fit the provider's criteria. Typically there is a qualifying period of five years before this feature applies.

- **Sheltered/age restricted accommodation** – some plans can be secured against sheltered or age restricted properties, subject to the provider's specific criteria at the time, and generally with a lower maximum LTV reflecting the more limited market for aged restricted accommodation.

- **Enhanced lifetime mortgages** – some providers offer high LTV loans to those with lower than average life expectancies.

- **Variable rate interest** – while most lifetime mortgages offer fixed rates for the duration of the loan to provide long term certainty, some providers do offer a variable rate option, which Equity Release Council standards ensure is capped to protect consumers against rate rises.

- **Interest payments** – allows for either full or partial interest repayments to be made each month, which either stops or reduces the interest being rolled up on the loan. There is no risk of repossession if payments are missed as customers can stop monthly interest payments and revert to interest roll-up at any time. Typically, once the borrower has stopped making interest payments they cannot revert back to making them.

Second home and buy-to-let lifetime mortgages

Another product innovation has been the second home or buy-to-let lifetime mortgage. As mainstream lenders have also recognized, older buy-to-let investors represent a sizeable marketplace. For those that have already paid off a buy-to-let

mortgage or have a modest LTV, a lifetime buy-to-let mortgage could be a way to increase their available cash or pass on funds to children to manage inheritance tax.

3.3 Issues impacting retirees' financial choices

Advice

By allowing people to access their pension capital, the 2015 pension freedom changes have made it possible for retirees to consider how best to meet their financial objectives taking into account all of their assets. Traditional thinking, which tends to see pensions exclusively for providing an income in retirement and a family home as an asset to be passed on to children, will not always produce the best outcomes.

However, financial advice for retirees is generally found in silos – pension advisers will explain how a customer can maximise the benefits of their pension while equity release advisers will explain how the customer might use their home as a source of income or capital. It would be helpful if retirees had more tools to help them understand their options better. Much more work needs to be done on signposting consumers to appropriate sources of advice.

Similarly when RIO mortgage products become available, where brokers advise on either RIO mortgages or lifetime mortgages, there will be a risk that the customer will not get a good overview of which product is most suitable for their needs. This points to the need for brokers who can advise on both RIO mortgage and lifetime mortgage products and effective signposting and referral arrangements between those who do not advise on both product types.

Lack of downsizing options

Another factor that may have increased lifetime mortgage sales but is a concern to many housing professionals and politicians is the difficulty many older homeowners have finding suitable property to downsize to. Research from Legal & General[9] has found that only 7,000 age-specific properties were delivered in 2017, making it the most under-supplied part of the housing market. The report includes a survey of 'last time buyers' who had thought about downsizing in the previous five years but didn't. 49% said it was because there were no suitable properties on offer, while a further 29% stated that the properties that were suitable were too costly.

9 Last Time Buyers – Legal & General April 2018

4. Bridging the gap between conventional and lifetime mortgages

4.1 Product innovation breaking down the lifetime and conventional mortgage distinction

Traditionally, lifetime mortgages have occupied a separate space in the mortgage market. They have been seen as a tool for older people who want to raise funds, typically against an unencumbered home where the mortgage had been paid off over the owner's working life. Now product innovation is softening the distinction between lifetime and conventional mortgages giving older homeowners greater flexibility to control the roll-up of interest whilst providing solutions for borrowers who have not been able to pay off their mortgage during their working lives.

4.2 Retirement interest only mortgage (RIO mortgage)

In March 2018 the FCA finalised rule changes creating the new category of RIO mortgage, where there is no fixed term and the sale of the property on the death of the borrower or their move to a care home is an acceptable repayment strategy. Affordability can be assessed on an interest only basis and the FCA has also removed a requirement that lenders assess the borrower on their ability to downsize to a cheaper property.

RIO mortgages, which are already being offered by the Bath and Vernon Building Societies and Hodge Lifetime, will be most appropriate for older homeowners who can afford the interest payments but cannot afford or do not want to make additional regular capital repayments. They could be a lifeline for borrowers entering retirement with significant mortgage debts as some may not qualify for lifetime mortgages because their LTVs are above the maximum for their age/status.

In addition, a RIO mortgage is likely to have a lower interest rate than a lifetime mortgage once there is more competition in the market. This is partly because of the lack of yield on lifetime mortgages and the need to factor in protections like a guaranteed fixed rate of interest for an unspecified period of time and the no negative equity guarantee. The type of interest rates on offer is also likely to differ from those seen in the lifetime mortgage market, with more shorter term fixed and possibly variable rate loans available.

4.3 Lifetime mortgage with an interest only option

Lifetime mortgage providers have also introduced interest only payment as an option under a lifetime mortgage contract. For example, the L&G optional payment lifetime mortgage allows the borrower to make monthly payments covering part or all of the interest but they can stop making these payments at any time, from which point interest will roll up.

The flexibility that these loans offer, allowing the borrower to switch to interest roll-up at any time, is a potential advantage over the RIO mortgage but necessarily places a greater constraint on the maximum LTVs lenders can offer: as the borrower has the option to revert to interest roll-up at any time, lenders must assess the maximum LTV much as they would with other lifetime mortgages.

But there are also mortgage products that marry features of lifetime mortgages and RIO mortgages because they have a mandated period when interest must be paid followed by the option to move to rolling up interest after a set date. For example, the Hodge Lifetime Retirement Mortgage initially requires monthly interest payments. But when the youngest borrower reaches 80, or after the fifth anniversary of taking out the loan (if later), the borrower(s) can choose to stop paying interest and move to roll-up. This potentially allows for a higher initial LTV than would be available on a conventional lifetime mortgage.

4.4 Further developments

Retirement borrowing as tax planning

In the post pension freedom era, with retirees having access to all their assets including their pension, there could be a wider range of customers who find these new mortgage products attractive. With pensions outside the inheritance tax net and withdrawals subject to income tax (beyond the 25% tax free allowance), borrowing against your home to reduce pension withdrawals or to pass money on to children can be an efficient way to reduce tax. For those who wish to manage tax liabilities but do not want to see interest rolling up on their home, interest only options are a potential solution.

Lifetime remortgaging

The substantial fall in interest rates seen on lifetime mortgages over recent years has started to spur the development of a lifetime remortgaging market. For customers who took their mortgage out over the last few years, the savings in interest charged from switching to a new loan could outweigh any ERCs they may incur. For those who are now out of their ERC period switching loan is likely to provide savings.

Remortgage from lifetime to RIO mortgage and vice versa

When the RIO mortgage market develops it is entirely possible that a similar remortgage market will emerge whereby borrowers could find it advantageous to switch from a lifetime mortgage to a RIO mortgage and vice versa. This could include customers who have lifetime mortgages but have found themselves able to afford to make interest payments at today's modest interest rates. Alternatively, some future RIO mortgage customers might want to switch to a lifetime mortgage to provide the option of rolling interest up.

The move toward staggered payment of lifetime mortgage advances

While many homeowners want a lump sum to spend on a project such as home improvements, many others are borrowing to enhance their general lifestyle. For these borrowers the drawdown option is of benefit as interest is only charged once the funds are drawn, but a regular monthly or quarterly payment could be still more attractive. For the customer such a regular payment would feel like an income but would not be subject to income tax.

One lender offered such a product before the financial crisis with a fixed rate of interest available on future payments, giving the borrower certainty in regard to cost. It is unclear whether providers would be willing to provide such a product in the future, as it would commit them to making payments to the borrower well into the future at a rate fixed today but the increased availability of loans with staged payments does go some way to meeting demand for such a product. Another approach by which borrowers could draw regular sums would be with an offset mortgage, where the retired borrower would have in effect a credit line available to use against the value of their home.

5. Impact of regulation

5.1 MMR and mortgage affordability in retirement

The regulatory environment that has been in place since the MMR was introduced in 2014 has affected the way lenders assess mortgage applicants, and in particular the way they assess affordability. MCOB 11.6.15 states:

"If the term of a regulated mortgage contract or home purchase plan would extend beyond the date on which the customer expects to retire (or, where that date is not known, the state pension age), a firm should take a prudent and proportionate approach to assessing the customer's income beyond that date."

"The degree of scrutiny to be adopted may vary according to the period of time remaining to retirement when the assessment is made. The closer the customer is to retiring, the more robust the evidence of the level of income in retirement should be. For example, where retirement is many years in the future, it may be sufficient merely to confirm the existence of some pension provision for the customer by requesting evidence such as a pension statement; where the customer is close to retirement, the more robust steps may involve considering expected pension income from a pension statement."

While these rules offer some clarity to lenders where a loan is being advanced many years before expected retirement (albeit without defining how many years), there is less certainty where the borrower is nearer to retirement. This led lenders generally to take a cautious approach to such cases in the early years after the MMR was introduced.

Predicting future retirement income is not always straightforward (see Section 2.4 for a fuller discussion of assessing affordability in retirement). Without FCA guidance on how lenders should account for the risk that pension income might disappoint, most lenders felt the need to take a conservative approach. Predicting post-retirement expenditure is also difficult which again encouraged many lenders to take a conservative approach. This frustrated some older borrowers who found it difficult to borrow despite having plenty of housing equity and exemplary payment track records.

For borrowers aged over 40, lenders' concerns about affordability after retirement meant that the loan term was often shortened to ensure that the loan did not extend into expected retirement. The combination of loan terms of less than 25 years and the requirement that loans were taken on a capital repayment basis pushed up monthly payments for borrowers. This in turn heightened affordability constraints, restricting the amount these customers could borrow.

5.2 FCA seeks to reassure lenders on later life lending

In recognition of concerns that creditworthy older borrowers were finding it increasingly difficult to raise a mortgage the FCA has sought to reassure lenders about

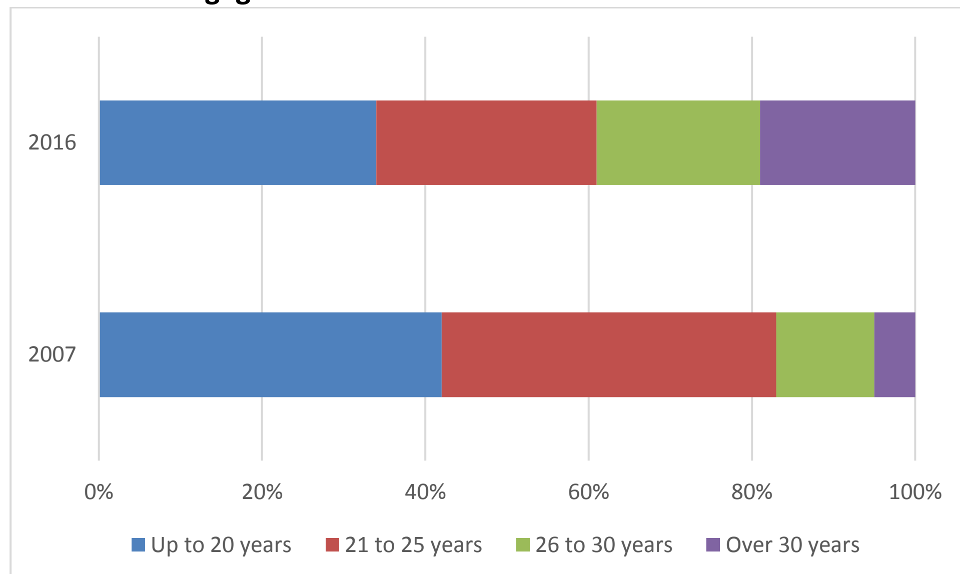
the intended meaning of MCOB 11.6.15. In March 2015 Linda Woodall, FCA director of mortgages and consumer lending, gave a speech urging lenders to take “a proportionate and common sense approach” to lending to older borrowers and in September 2017 the FCA published Ageing Population and Financial Services (Occasional Paper 31). This stated that: “The FCA Mortgage Conduct of Business (‘MCOB’) rules do not prohibit, or put restrictions on firms lending to older consumers. Product and service innovation to assist older consumers is likely to benefit both consumers and firms.”

In response, many lenders have relaxed restrictions, extending the age to which they will lend and accepting cases where the loan could extent into retirement. But concerns remain that if customers find themselves unable to pay their mortgage after retirement, the regulator could revisit the rulebook and conclude that the lender who facilitated a loan that met the customer’s needs was, with the benefit of hindsight, acting imprudently. It is still not entirely clear that recent FCA guidance indemnifies lenders against such a potential charge.

5.3 Implications of restricting mainstream interest only mortgages

While in the early post-MMR period many older borrowers were finding that the term of their mortgage was being restricted to less than 25 years to avoid it extending into retirement, the tightened rules on interest only meant that demand for longer mortgage terms was rising, as borrowers sought to keep the monthly payment on their capital repayment mortgage as low as possible. Ironically, this increased the number of people seeking to borrow into retirement.

Chart 5 – Mortgage term bands in 2007 and 2016



Source: FCA

With lenders responding to the FCA’s more accommodating statements on later life lending, more borrowers have been able to extend mortgage terms (see Chart 5) and borrow into expected retirement. FCA data shows that for loans made in 2016, 44% of borrowers moving home and 22% of first time buyers will be aged over 65 when

the mortgage matures. The most common age on maturity for loans made in 2016 is 66.

Thus regulation itself has been a key factor increasing the number of customers borrowing into retirement. However, had interest only mortgages remained as widely available as they were in the pre-MMR period it could be argued that although mortgage terms might be shorter, there would be more borrowers carrying more debt into retirement. Nonetheless, with the wider product choices available today borrowers who are carrying mortgage debt into older age have a range of options that should provide the flexibility for most to remain in their homes if they wish to, even where repayment of the outstanding debt is not affordable.

6. Conclusion

6.1 A broad later life lending proposition is crucial

With over a third of homeowners now aged 65 and above, it is unsurprising that later life lending is becoming an increasingly important part of lenders' businesses and a focus for product innovation.

And, with regulatory change creating the RIO mortgages earlier this year and new product features added in the lifetime mortgage market, it could be argued that older borrowers have never had such a wide range of product choices than are becoming available to them now.

This is just as well, as the need for more flexible finance options amongst older borrowers has also increased, driven by the uncertainty many retirees now face given the shift to DC pensions and the changes brought about by pension freedom.

Many homeowners will save more over their working lives through capital repayments on their mortgage than they will on pension contributions. So it is only sensible that the reservoir of savings people build up in their homes is available to them in retirement.

6.2 Consumers need joined-up advice to avoid disjointed journeys

Perhaps the largest question is how older borrowers are assisted in making choices about later life funding and the potential role that the increasing range of home finance and lending products can play, depending on their needs and stage of life.

Considerable work was put in by HM Treasury, the FCA and the advice industry to produce the Financial Advice Market Review[10] of 2016, and the FCA has since continued to explore the current and desired state of play via the Ageing Population project. Government's new single financial guidance and claims body is due to open by the end of the year, combining the Money Advice Service, The Pensions Advisory Service and Pension Wise into a single reference point for consumers.

These initiatives are set up to help move things further in the right direction, and it is vital that the pace of development gets up to speed with the wave of later life lending innovation in the residential and lifetime mortgage markets. Bridging the gap between silos means that guidance and advice needs to reflect the range of options as part of a broader assessment of later life financial planning. On a practical level, this may require increased partnerships and referral arrangements between advisers who specialise in complementary areas.

In the meantime, intermediaries will need to assess their knowledge of later life lending products to ensure they can adequately inform and advise their older clients.

10 Financial Advice Market Review Final Report – Financial Conduct Authority, March 2016

Many new variations of mortgages have entered the market recently and brokers need to be sure that they can adequately signpost or advise clients towards the best possible outcome.

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About IMLA

The Intermediary Mortgage Lenders Association (IMLA) is the trade association that represents mortgage lenders who lend to UK consumers and businesses via the broker channel. Its membership unites 39 banks, building societies and specialist lenders, including 16 of the top 20 UK mortgage lenders responsible for almost £180bn of annual lending.

IMLA provides a unique, democratic forum where intermediary lenders can work together with industry, regulators and government on initiatives to support a stable and inclusive mortgage market.

Originally founded in 1988, IMLA has close working relationships with key stakeholders including the Association of Mortgage Intermediaries (AMI), UK Finance and the Financial Conduct Authority (FCA).

Visit www.imla.org.uk to view the full list of IMLA members and associate members and learn more about IMLA's work.

About the author

Rob Thomas is a Director of Research at Instinctif Partners. He previously served as an economist at the Bank of England (1989-1994), a high profile analyst at the investment bank UBS (1994-2001) and as senior policy adviser to the Council of Mortgage Lenders (2005-12). He was also the project originator and manager at the European Mortgage Finance Agency project (2001-05) and created the blueprint for the government's NewBuy mortgage scheme.