Wealth managers and equity release

Delivering holistic financial advice

Introduction

Pension freedoms have transformed the way advisers and their clients are using their pension funds during retirement. Pensions can now be used to provide one-off cash sums, regular income payments and to leave an inheritance.

For many people, the option to leave what is left in their pension pot to their family (see pensions/death benefit section) is a very attractive option and opens up a number of retirement planning opportunities by using all available assets, including savings, investments and property.

However, many advisers are not taking property assets into consideration when providing retirement advice, including wealth managers who are uniquely placed to complement their investment expertise with a better understanding of how housing wealth could be used as part of retirement planning.

This guide explains how equity release and property assets could be used to achieve better retirement solutions and outcomes for clients.

Holistic retirement planning

For many people, the pattern of retirement has changed. It is no longer a single event but the start of a journey through the various stages of retirement. This means advisers must have the knowledge and skills to give more complex advice during the different life stages. This is called 'holistic retirement planning' and involves taking account of all available assets when planning the best way to meet income and other retirement objectives. These assets include:

Pensions – normally provides the backbone of retirement income but advantageous death benefits mean they can also be used to transfer wealth through the generations

Savings & investments – can provide a 'rainy-day fund' and be used to fund discretionary spending as well as for inheritance planning

Property – can be used alongside pensions and investments to release capital and income when required

Therefore, advisers must be able to advise not only on pensions and investments, but later life financial planning including: IHT, Wills and Lasting Power of Attorney (LPA). A good adviser/holistic financial planner must also have the skills to take property and equity release into consideration when giving retirement planning advice.

Why property and equity release is important

For most people, their largest financial asset is their home so it makes sense to take this into account when planning for retirement, especially in later life.

Although there may be an understandable emotional attachment to the family home which cannot be underestimated, there are important advantages in considering equity release. These include:

Providing additional tax-free income

A way to transfer wealth to children and grandchildren

Reducing IHT liabilities

There are a wide range of equity release plans available so it is easier and more cost effective to release capital from residential properties than ever before.

Key Partnerships does not provide advice on tax planning and our equity release advisers do not give tax advice.Equity release is not the right solution for everybody. If your client is using equity release as part of a wider estate planning strategy, an individual should always refer to a qualified tax specialist prior to considering equity release to ensure it is tailored to their individual circumstances. Tax treatment depends on individual circumstances and could vary on location within the United Kingdom.

Equity release and retirement planning

Conventional wisdom dictated that many people converted their pensions into cash and income at retirement and supplemented this with income from savings and investments during retirement. In the past, equity release was used to provide additional cash or income in later life when other assets had been spent. But now savvy advisers and their clients are re-thinking their approach to retirement because three things have happened:

Growing numbers of older people are helping the younger generation onto the property ladder

Pension freedoms mean that pension pots can be left to the family without any IHT liability

IHT is affecting an increasing proportion of older people due to rising property prices

Equity release can be used to release money for capital expenditure, gifts and early inheritance for the younger generation and as a result it could also reduce IHT liabilities.

Pension death benefits

After death, most money purchase pensions (including SIPPs) allow the remaining pension to be transferred to a pension in the name of the chosen beneficiaries. The beneficiaries can normally choose to take the pension fund as a lump sum, as income (e.g. annuity or pension drawdown) or leave it invested in the pension.

If the retiree dies before age 75, all payments (cash or income) will be tax free, but if death occurs after age 75, any cash or income will be taxed at the beneficiary's marginal rate of tax.

There is normally no IHT payable on pension death benefits.

When should equity release be considered?

There are a number of ways equity release can be used in retirement planning including:

Providing additional cash or income for clients who are 'cash poor but asset rich'

Gifting money to children or grandchildren

High net worth clients who want to reduce their IHT liabilities

Cash poor but asset rich

It is not uncommon to find elderly clients with a substantial property asset, modest pension provision but low levels of personal savings.

Whilst they may enjoy a comfortable lifestyle, they may need cash to fund additional discretionary or unexpected expenditure, such as overseas travel to visit family and friends, home improvements or even care costs.

In these situations there is a strong case for using equity release to provide the required cash and income.

Gifting money to children

Most parents and grandparents want to help their children and grandchildren get on in life, whether it is help funding education costs or getting on to the housing ladder. However, most people don't have the readily available cash and do not want to give away the money they have saved for their own retirement.

In the right circumstances, equity release can be used to help the younger generation get on in life.

Reducing IHT liabilities

IHT is often described as a 'voluntary tax' because there are a number of simple ways to reduce it.

Those with complex financial situations who need sophisticated IHT planning advice, should consult a specialist financial / tax adviser who will explain the various ways of reducing IHT. This might involve setting up a trust, using life assurance policies or investing in assets which do not attract IHT.

However, those with relatively straightforward financial circumstances, for example, where their main asset is the family home, equity release can provide an easy to understand and uncomplicated way to reduce future IHT liabilities.

An equity release plan reduces the value of the estate which in turn could reduce IHT liabilities, for example, if the value of the joint estate is over £1 million.

Case Study

Geoff and Mary are both 78 years of age and in reasonable health. According to the Office for National Statistics, their life expectancy is about 10 to 11 years. They are in good financial shape with a substantial property on the south coast, a self-invested personal pension (SIPP) and an investment portfolio. Both the SIPP and share portfolio are managed by a well-known wealth manager.

Personal details

Ages:	**78**
Health:	**Reasonable**
Children:	**4**
Life expectancy:	**Geoff 88 / Mary 89**

Assets

House:	**£ 1,250,000**
Pension:	**£ 500,000**
Investments:	**£ 250,000**

Their objectives are to have sufficient income to maintain their lifestyle, a rainy-day fund in case of an emergency and to leave as much money to their children as possible, which means keeping any IHT liability to a minimum. More specifically, they need £25,000 of income (gross) in addition to their state pension and want to give £100,000 to each of their four children.

Their financial adviser, in association with their wealth manager, made the following recommendations:

Income – The £25,000 per annum gross could be taken by way of pension drawdown. This would be 5% of the pension fund and although it exceeds the '4% rule', this level of income should be sustainable given their age and chosen investment strategy.

Gifts to children – They don't have sufficient savings to pay this and in any case they want to keep a readily available rainy-day fund. Therefore, £400,000 will be released through equity release.

Minimising IHT – If Geoff and Mary didn't arrange an equity release plan when they were 78 and they both died 7 years later (age 85), their estate would be faced with an IHT bill of nearly £294,343.

However, if they gifted the £400,000 raised by equity release to their children and survived seven years, the IHT liability would have reduced by nearly 70% to £97,563 if we assume – as in Scenario 2 – that the value of their property had increased by 2.5% each year.

If their property had not increased in value (Scenario 3) they would be faced with an IHT bill of £3,220. However, it should be remembered that, as with Scenario 2, the four children would have had the benefit of the £100,000 lump sum given to each of them seven years earlier, plus any growth they might have achieved over that period, depending on where and how that money was invested.

	Scenario 1 **No Equity Release & 2.5% property growth**	Scenario 2 **Equity Release & 2.5% property growth**	Scenario 3 **Equity Release but no property growth**
Age in seven years time	85	85	85
House[1]	£1,485,857	£1,485,857	£1,250,000
Equity Release[2]		-£491,950	-£491,950
Investments	£250,000	£250,000	£250,000
Total assets	£1,735,857	£1,243,907	£1,008,050
Less IHT allowance[3]	-£1,000,000	-£1,000,000	-£1,000,000
Net estate for IHT	£735,857	£243,907	£8,050
IHT at 40%	£294,343	£97,563	£3,220
Net inheritance value[4]	£1,441,514	£1,546,344	£1,404,830

Notes and assumptions:

[1] House valued at £1,250,000 at outset. [2] £400,000 mortgage with inteterst at 3% rolled up for 7 years. [3] Nil-rate band = £325,000 + Residence Nil-Rate Band = £175,000 x2 (Mr & Mrs). [4] Value of the house and investments, net of IHT payable, plus equity release.

Pension pot is not included as it will fall outside IHT and allowances and tax rates remained unchanged.

*This is for illustrative purposes only, tax treatment depends on individual circumstances and is subject to change. For this reason, you should seek the advice of a tax specialist before proceeding if IHT mitigation is the primary goal.

Equity release – the basics

The most popular type of equity release is a lifetime mortgage. Unlike conventional mortgages, there are typically no requirements to make monthly repayments and equity release plans do not have a fixed term.

The client retains full ownership of their property and the interest on the loan can be paid each month or rolled up.

The outstanding loan and any rolled up interest is repaid after their death or if they sell the property and move in to long term care. If they move to another home, they could port the scheme.

There is normally a drawdown option where cash can be taken in a series of lump sums rather than all at once with a lifetime mortgage. Client's may get a higher loan to value if they have reduced life expectancy, or a reduced rate of interest.

Although it may be tempting to get some extra cash, it is important that clients don't take equity release too early in their retirement. The average age for equity release is 67 and anyone taking equity release in early retirement must watch out for the effect of compound interest.

This is a specialised area of financial services, and expert financial advice should always be sought before taking out equity release.

IHT the basics

IHT is payable on an estate valued over £325,000 (nil rate band). This allowance can be transferred to the surviving spouse so a married couple can leave £650,000 free of IHT.

In addition, a Residence Nil Rate Band (RNRB) effectively increases the nil rate band by another £175,000* (2020/2021 tax year), which can also be passed to a surviving spouse.

This means the total IHT threshold for a married couple will be £1,000,000 from April 2020. This is 2 x £325K + 2 x £175K.

*** RNRB is reduced if the overall value of the estate exceeds £2 million.**

Start referring today

It only takes a few minutes to register and make an equity release referral, just visit **www.keypartnerships.co.uk**
Or contact us:

refer@keypartnerships.co.uk **0800 138 1663**

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