Knight Frank Finance

# Later Life Finance.

## The new normal for wealthy homeowners? Q1 2021

Equity Release is becoming a mainstay on the menu of financial advisors as the wealthy seek to redistribute funds to the young while managing their potential inheritance tax exposure.

## Market update

The motivations, attitudes and worries of global ultra-high-net-worth individuals (UHNWIs), those worth at least $30m+, are often hard to know.

Famously private, few know what they are thinking beyond their family, friends and perhaps their private bankers.

That's why Knight Frank conducted a survey for their flagship publication The Wealth Report, of more than 600 private bankers, wealth advisors and family offices across 50 countries and territories, representing combined wealth of more than US$3.3 trillion.

The responses reveal how the wealthy think about finances during their latter years, particularly inheritance. Respondents cite the prospect of passing on wealth as both a concern – almost a third say they worry how they will transfer wealth to the next generation - and a source of motivation (24%), illustrating the degree to which leaving a legacy is so important.

### Product innovation

The Wealth Report's findings have big implications for the evolving world of later life finance. They build on evidence that the sweeping regulatory change and product innovation we've seen in recent years have moved Equity Release products from a last resort for those struggling with their finances to a mainstay on the menus of financial advisors and individuals seeking to make shrewd estate planning decisions.

**Some 52% of the UK's ultra-high-net-worth individuals view tax planning as central to their wealth management strategy in 2021.**

Tax planning is likely to be one of the biggest factors driving the growth of later life finance in the coming year and beyond. Some 42% of respondents globally said tax will be one of their key issues when it comes to managing wealth during the year ahead, rising to 52% in the UK. This is to be expected: low rates and huge fiscal stimulus have fuelled asset prices, swelling the population of high-net-worth individuals. Policymakers globally have signalled their willingness to target the wealthy in order to pay for the crisis.

Using a Lifetime Mortgage to gift wealth to the next generation can be a way to address all these issues. As we outline in more detail later in this report, the transfer itself is tax free at the time the gift is made. It then falls outside of the estate for Inheritance Tax purposes after seven years and creates a debt, reducing the taxable estate further.

### Drivers of growth

The pandemic has accelerated other drivers of growth. While the pandemic has created new high-net-worth individuals, it has also placed significant pressure on the young. The number of recent graduates out of work has doubled to one in eight since the onset of the crisis. More than half of job losses in the two months to February were among 18-24 year olds.

Older family members have stepped in to help, often opting for Equity Release products. Research by Legal & General suggests five million parents expect to offer additional financial support to younger family members due to Covid-19, providing loved ones with an extra £1.9 billion.

That's in addition to the financial support they already provide. Over a third (39%) of young adults, around 3.3 million people, receive regular financial support from their older family members and depend on it to cover their monthly outgoings. Almost a third say they use financial gifts to save for big ticket items like housing.

All of this is attracting new entrants to the market. Royal London purchased a 30% stake in equity release company Responsible Group last month after predicting later life lending "will become a core part of financial planning". Scottish Widows entered the market during the summer of 2020.

### Rates on the rise

Rock bottom rates, another factor driving growth, are beginning to

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climb. In recent weeks, all Lifetime Mortgage providers have increased rates; a likely sign of things to come.

Unlike normal mortgages, Lifetime Mortgages are fixed for life, and rates move in tandem with long-term Gilt yields, which in turn reflect the future health of the economy. The first quarter economic contraction is likely to be far shallower than economists expected only a few months ago and the Bank of England predicts the economy will roar back to life from the second quarter onwards.

Market leading Lifetime Mortgage rates are currently just above 2.5%, and could hit 3.5% before Christmas, so it's worth speaking to a qualified expert now to explore the competitive options available this year.

## At a glance

**28%**
Of UHNWIs cite wealth transfer to the next generation as a key source of worry

**52%**
Of UK UHNWIs say tax will be one of the top three issues dictating wealth management strategy this year

**59%**
Of job losses during January and February were among 18-24 year olds

**5m**
parents expect to offer additional financial support to younger family members due to Covid-19

**£1.9bn**
Additional financial support expected from parents seeking to help younger family members

**£1.6bn**
Property wealth unlocked by new and returning Equity Release customers in Q4 2020

Sources: Knight Frank, ONS, L&G, Equity Release Council

## Need to know

### The case for borrowing in retirement

The reasons for borrowing into retirement vary, but for most homeowners their property is their most valuable asset, and turning this into liquid funds can have its advantages. The most common reasons we see at Knight Frank Finance are:

- **Making gifts to family, perhaps to help them purchase property**
- **As part of Inheritance Tax planning**
- **Paying off an interest only mortgage, or restructuring other debts**
- **Home and garden improvements**
- **Topping up or replacing income, perhaps as part of retirement planning**

### How do Lifetime Mortgages work?

Unlike a normal mortgage, this has no fixed term. Instead the loan runs until the borrower(s) pass away or have to move out permanently into care. At that point the property is sold and the mortgage repaid. Interest is charged in the same way as any other mortgage, but with a Lifetime Mortgage the borrower can choose to let it roll up on top of the loan, pay some or all of it each month, or make ad hoc repayments. The amount an applicant is able to borrow is based on their age and the value of their property.

### How does Equity Release fit with Inheritance Tax (IHT) Planning?

All UK residents can pass on assets up to the Nil-Rate Band (NRB) (currently £325,000) without any Inheritance Tax. Property owners can also make use of the Residence Nil-Rate Band (RNRB) (currently £175,000). On top of these Nil-Rate Bands there are reliefs and exemptions that, with careful planning, can be used to further reduce your Inheritance Tax bill. Certain Trust structures can also form part of a wider plan.

If the value of an estate exceeds £2 million, for example, the owner's Residence Nil-Rate Band (RNRB) will reduce. Raising a debt against a borrower's property could bring their estate back to this level, thereby maximising the RNRB. Equity Release can also turn illiquid assets into liquid funds for use in other IHT planning tools. Most of us expect to wait until death before passing on wealth to our beneficiaries through our wills. However, it can be more tax-efficient for IHT purposes to gift money while you are still alive.

### How it works in practice: a simple IHT scenario

*Mrs Brown, aged 80, became a widow this year. She has two sons, who are her only beneficiaries. Her home is valued at £1.7 million and she has other assets worth £100,000. The following are two scenarios if Mrs Brown passes away in 10 years.*

#### 1 – Do nothing

Assuming there is some conservative growth in the value of her property and other assets over the 10 years, Mrs Brown's estate is now worth £2 million. She inherited her husband's Nil-Rate Bands which means £1 million can be deducted from the estate*, leaving a taxable estate of £1 million.

The current IHT tax rate is 40%, and the chancellor's recent messages suggest this is unlikely to change for some time, so her sons will pay £400,000 in tax on Mrs Brown's estate, leaving them with the remaining £1,600,000, or £800,000 each, in 10 years' time.

#### 2 – Raise a Lifetime Mortgage now for £800,000 and gift £400,000 to each son.

Mrs Brown takes a Lifetime Mortgage on the property that forms most of her £2 million estate. She chooses to let the interest roll up, enabling the Nil-Rate Bands to be deducted from the estate.

If we assume interest has rolled up at approx' 3%, which is achievable for an 80 year old borrowing at 50% LTV in today's Equity Release market, the mortgage will be £1,075,000. This reduces the taxable estate to zero, the IHT liability to zero, and the two sons inherit the remaining £925,000, or £462,500 each in 10 years, plus the £400,000 they each receive today.

Not only has the Lifetime Mortgage reduced the IHT bill to zero, it has allowed the sons to benefit from £800,000 of 'early' inheritance, which over 10 years using the same conservative growth rates, could be worth £975,000.

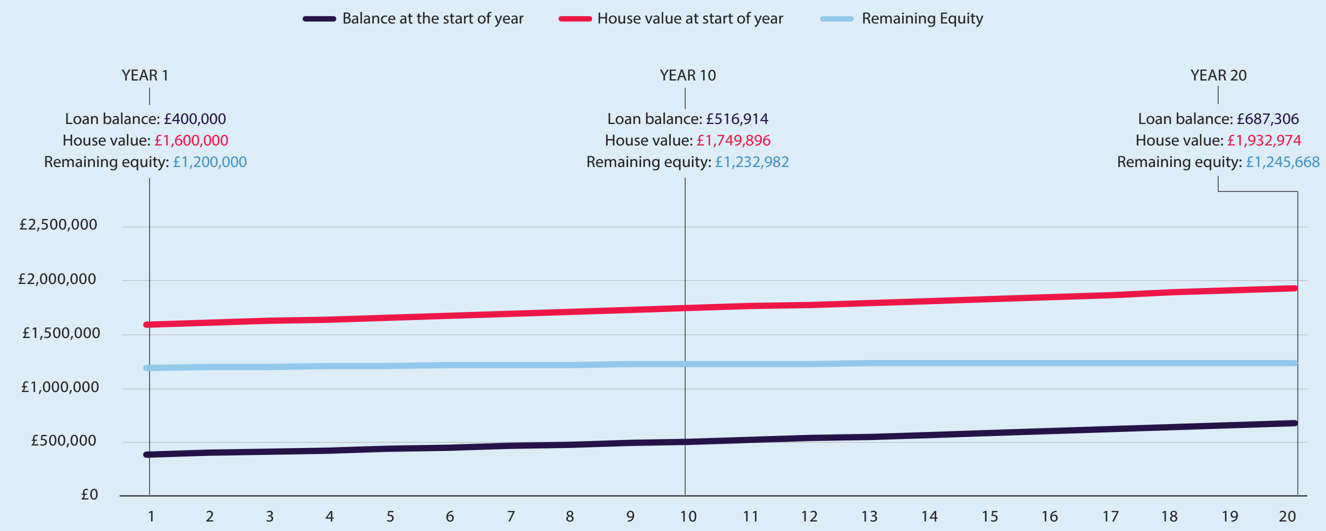
**Market leading Lifetime Mortgage rates, currently at 2.5%, could hit 3.5% by Christmas.**

*The individual Nil-Rate Band is currently £325,000. The Residential Nil-Rate Band is £175,000. When added together for two people this gives a total of £1 million.

## How a Lifetime Mortgage works

Mr Smith takes a £400,000 loan against his £1.6 million home

*Loan interest rate: 2.89%. Scenario assumes annual house price growth of 1%*




Source: Knight Frank Finance

# Meet the team

Knight Frank Finance is a whole-of-market mortgage broker, able to support clients at all levels of the market. Our Later Life Finance team are all qualified in the field of Equity Release and experienced advisors specifically for clients over the age of 55. The team also specialise in high net worth Equity Release lending, regularly securing and managing loans of over £1,000,000. We have extensive experience of advising clients with complex financial circumstances, involving Inheritance Tax and estate planning.

The team is led by David Forsdyke, who has over 15 years' experience in the Equity Release market. In 2009 he joined the regulator (the Financial Conduct Authority) and became regarded as a subject matter expert. Since then David has held senior positions in the industry, including two years as a member of the Equity Release Council Standards Board, before joining Knight Frank Finance in 2019. He continues to support the Council's work as a member of both their Risk Committee and their Expert Working Group. David's experience and expertise is widely recognised, and he is often asked for comment by the industry press.

**David Forsdyke**
+44 1483 947 764
+44 7970 034 250
david.forsdyke@knightfrankfinance.com

**Laura Rodriguez**
+44 1483 947 761
+44 7970 251 526
laura.rodriguez@knightfrankfinance.com

**Andrew Metcalf**
+44 1483 617 913
+44 7971 014 765
andrew.metcalf@knightfrankfinance.com

**John Flexer**
+44 1483 617 914
+44 7583 129 349
john.flexer@knightfrankfinance.com

**Roshan Percy**
+44 1483 963 880
+44 7866 067 289
roshan.percy@knightfrankfinance.com