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Home Equity Release: An alternative product and its pricing

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Background

- What will happen to asset values when the boomers retire?
- What about the "housing asset"?
  - Many prefer to age in place
  - What can be done about low take-up on home equity release (HER) loans?

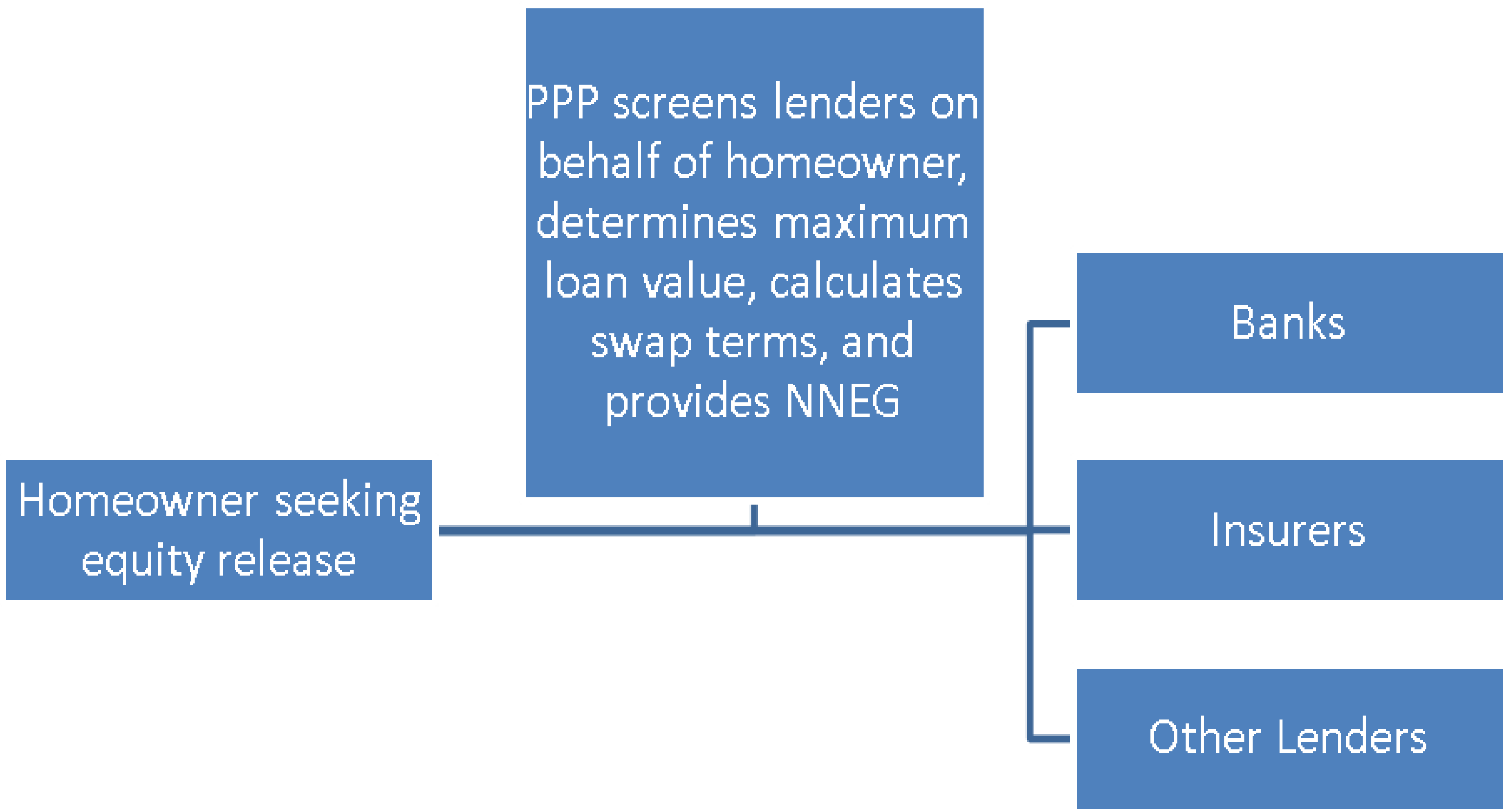
Today's Presentation

- Our past work with respect to HER
- An alternative product
- Original aspects in this paper
- Some pricing results
- Other items included in the paper
- Further research

Our Past Work with respect to HER

- HER bundles features that are not the specialty of any financial institution
  - Collateralized loan with an increasing balance and no regular payments
  - No Negative Equity Guarantee (NNEG)
- HER could serve a special need for those requiring "care"
- Difficult to get a consistent data set

Role of Public Private Partnership in Arranging Home Equity Loans



An Alternative Product

- Loan is floating rate based on a Regional House Price Index
- Plus a fixed charge for NNEG, administration and profit
- Including a requirement for borrowers to maintain the home
- Could be advanced in a lump sum or installments

Original Aspects in this Paper

- 20 years' data on repeat sales' returns for 3 postal codes in Kent
- Apply the methodology described in Gourieroux and Lu (2014) "Long-term care and longevity"
- Generalize model to be used for non LTC loans at higher ages

Some Pricing Results
Healthy Couple Age 65

- Using a 3.2% annual fixed charge
- Discount rate of 4.5% per annum

➢ Breakeven NNEG charge is less than 0.8 % per annum for a lump sum loan

➢ Less than 0.2% per annum for a loan in 10 installments

Other Items Included in the Paper

- Analyses for different discount rates – 1.5% and 7.5% - NNEG cost higher for lower rates
- Varying the reason for loan discontinuation
- Assuming the couple requires the loan for “care” needs

Further Research

- Extend the analysis on repeat sales' returns to all of England
- Apply the method of Gourieroux and Lu to English mortality data using the insights of CMI
- Consider the implications of age and reasons for exit on product pricing
- Explore the market's interest in the "unbundled" features
- Determine the "right" fixed charge

Conclusion

- HER products serve consumer and social needs
- Current pricing leads to low take-up
- Unbundled approach provides more precise pricing
- Restricting loan to those with “care” needs may further enhance design
- Challenge to access a consistent data set