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Releasing equity assets to finance retirement

For people who are asset-rich and cash-poor, there are a few ways to monetise their real estate assets to provide a major retirement income resource. BY KWONG KOON SHING

AS ageing populations evolve into a global problem, innovative retirement financing approaches become increasingly imperative in many countries, including Singapore. For many asset-rich-cash-poor retirees, real estate forms a large portion of their total assets and becomes major retirement income resource.

Two well-known equity release products, a debt-type Reverse Mortgage (RM) plan and a sell-type Home Reversion (HR) plan, entitle a homeowner to release property assets to cash, with the guarantee to live there for life.

In a reverse mortgage plan, a homeowner remains the owner of the property for life and it is not necessary to repay any principal and interest on the loan during the term of mortgage. After the death of the homeowner, if the sale proceeds from the property exceeds the outstanding loan balance, the surplus is returned to the estate of the owner. On the other hand, any shortfall in the proceeds is borne by an insurance arrangement.

HOME REVERSION PLAN

In a home reversion plan, a homeowner sells a portion of the home equity for a lump sum payment upfront while retaining the home title and the right to live in the home until death. The homeowner shares a contractual portion of the future home sale proceeds with the product provider in exchange for receiving an immediate lump-sum payment and the right to live in his home for life.

RM has been developed as the most popular equity release product in many countries, such as Australia, Canada, Demark, the UK, Korea, Japan and Hong Kong. HR is only available in some countries, such as Australia and the UK.

In the less well-known Lease Buyback Scheme (LBS), which is a unique equity release plan available only in Singapore, a homeowner sells the tail-end of the property leased to the government for a cash lump sum (subject to CPF retirement fund arrangement), with the right to stay in the property until the expiry of the front-end lease, without the guarantee of lifetime occupation.

As existing equity release plans are relatively complex and opaque, most consumers may not be able to understand their costs and benefits or to make meaningful comparisons. As a result, equity release markets are relatively small and under-developed in most countries.

To increase the supply of equity release products to boost demand, we propose a new product called the Hybrid Equity Release (HER) plan (see Kwong, Tse and Chay, 2020). The HER plan allows a homeowner to sell a portion of the property at a discounted price while he/she obtains the right to stay there for a guaranteed period or for life, whichever is longer.

For example, consider a male Singaporean homeowner, aged 65, who wants to fund his retirement with a guaranteed 10-year staying under HER by selling 70 per cent of his house value. Based on our HER actuarial pricing models, house price estimate (say S$450,000) and Singapore mortality statistics, the HER provider can determine the 10-year rental cost (S$92,000) and the deferred lifetime staying insurance cost (S$30,000).

Therefore, the market value of sold property portion S$270,000 (ie S$450,000 x 70 per cent) covers three benefits: guaranteed 10-year staying benefit, a lifetime staying benefit and the cash proceeds of S$148,000 (= S$270,000 - S$92,000 - S$30,000), which is equivalent to 54.8 per cent of the sold property portion value.

In general, the amount of cash proceeds is smaller for a longer guaranteed staying period and/or lower mortality rate according to our HER pricing models. Under the HER, the homeowner has the flexibility to sell any remaining property portion to raise additional funds if necessary. The HER pricing models should be certified by qualified actuaries yearly and be available online for public scrutiny.

Compared with the debt-type RM, which incurs high uncertain debt-interest cost and non-recourse insurance costs (to cover the risk of accumulated debt amount more than the current property value), the HER involves a very affordable and certain lifetime staying insurance cost.

In contrast to the HR, the HER includes an option of choosing a guaranteed staying period. This guarantee not only provides a homeowner's family the right of staying in the house for a fixed period regardless of the survival of the homeowner, but also reduces the lifetime staying insurance cost when compared with the HR.

Unlike the rigid LBS features of selling the whole house and without lifetime staying benefit, the HER allows the homeowner to sell a proportion of the house to generate cash proceeds with the guarantee of lifetime staying. By not selling the whole house under the HER, the homeowner has financial flexibility to release just a particular portion of property to meet his/her own financial needs, and still enjoy possible appreciation of the property value.

This selling option is especially important and valuable to homeowners with large house values because they are not forced to release all equity value in one shot.

SECURITISATION

To diversify overall funding risks, the HER plan provider can invite government and private investors through securitisation to fund the product if the public and private properties are involved, respectively. If the homeowner does not want to sell the property on an open market, the plan provider can act as a facilitator to arrange an individual transaction with direct funding from the homeowner's immediate relatives.

Launching the HER plan in any particular market will be a complicated and challenging process for ensuring consumer confidences and significant market demand. Besides appropriate property pricing, rental yield and mortality models required in the HER plan, there are several extraneous factors which might affect the success of the plan, such as government commitment, administrative cost control, product promotion and education, as well as political and social stability.

It is important for policymakers or plan providers to coordinate all available resources and consider all factors when designing a plan that would suit individual needs and sustain long-term product development. Our novel equity release proposal provides the first step to move in this direction.

The writer is professor of statistics (education) at Singapore Management University and director of its actuarial science programme.

Reference: Kwong, Koon-Shing, Tse, Yiu-Kuen & Chay, Junxing (2020). 'A hybrid equity release plan for retirement financing.' Asia-Pacific Journal of Risk and Insurance. DOI: https://doi.org/10.1515/apjri-2019-0028