

# Lending into retirement

Interim report

November 2015

 Building Societies  
Association

## What we do

We fulfil two key roles. We provide our members, all 44 building societies and two credit unions, with information to help them run their businesses. We also represent their interests to audiences including regulators, the Government and Parliament, the Bank of England, the media and the general public.

Our members have total assets of over £330 billion, and account for approximately 20% of both UK mortgage and savings balances. It's estimated that more than a third of the UK population has a financial service relationship with a building society.

# Foreword



Dick Jenkins  
Chair of the BSA

It seems obvious to say that the population of the UK is ageing. Together with other factors as diverse as new pension freedoms; high house prices and even the age that couples are having children, our world is becoming more complex. Society is changing and the way that the mortgage market works must adapt, as must the way that later life is funded.

In 2014 there were 11.6 million people over the age of 65. Twenty years on this figure is, at a conservative estimate, projected to rise to 17.3 million. Amongst this group will be a substantial number of borrowers who are today's first-time buyers – already one in four people borrowing beyond the age of 65 is a first time buyer.

Looking at the statistics in a different way, lending to borrowers who will be over the age of 65 when they repay their mortgage accounted for 35% of total lending at the end of 2014. These 'successes' are counterbalanced by regular press stories about individuals in their early 40's who report that they can't borrow with a term that makes the loan they need affordable.

The assertion that the over 40's can't get a mortgage following the changes to mortgage regulation is overstated, but there are challenges. Largely because of insufficient housing supply, house prices have more than doubled in the past 20 years. As a consequence, first-time buyer deposits have multiplied by five to almost £50,000. The average age of first time buyers is also unsurprisingly on the up as is the number of borrowers looking for a term of 30 years or more.

So before even getting to the huge topic of funding later life, we already have a potent mix. This interim report, which is the result of work across a broad range of building societies, is the start of what will be a process; getting to grips with different risks, reviewing maximum age policies; better empowering consumers with clear information and yes innovating too.

Through the BSA we are now engaging with many interested parties including the Council of Mortgage Lenders, charities and consumer groups, parliamentarians, regulators and more. Whilst building societies may tend to be more flexible already, it is only by working together that solutions, and they will need to be many and varied, will be found.

# Introduction

Life expectancy is increasing by five hours a day, according to the social research charity Nesta<sup>1</sup>. Living longer and healthier lives is good news for us all.

However, the phenomenon of an ageing population also presents new challenges in healthcare, lifestyle, housing and financial services. These are challenges that the financial services industry, and mortgage lenders in particular cannot shirk. The lending community must ensure that people can continue to access the services they need with appropriate consumer protection.

Affordability pressures across all housing tenures and other factors such as student loans, other unsecured debt and changes to family lives continue to push the age of first-time buyers upwards. They face not only the prospect of buying later but, for many, borrowing longer is an increasing necessity. Clearly the provision of mortgage finance is not the sole answer to wider issues in the housing market, but a concerted effort is now needed from all with an interest in ensuring that older borrowers are properly served by the mortgage market into the future.

This interim report sets out some of the measures the BSA believes are needed to meet the inevitable growth in demand for borrowing both into, and in, retirement.

Building societies have led the way in lending to a wide spectrum of borrowers and believe that the time is right to review their lending policies, to examine how advice is provided and to work closely with other industries – such as insurers and pension providers – and broader stakeholders to enable them to respond appropriately to changing demographics. The customer must be at the heart of all of these measures. The BSA also believes it is right that others, including the Government and the regulators, play their part and consider further measures to support older borrowers.

## The role of building societies

For over 200 years building societies have been helping their members to fulfil the fundamental ambition to own their home – from providing mortgages for first-time buyers to assisting members in retirement.

Building societies exist to serve the changing needs of their members through the different stages of life. At present they serve people's retirement needs primarily through comprehensive support for members' savings. Yet more can and should be done to support housing needs through a more inclusive approach to mortgage lending.

It is no secret that the UK, like the rest of Europe, has an ageing population. Combined with changes to working lives and ever-increasing house prices, a significant increase in demand for lending to older borrowers seems inevitable in the coming years. More people may also want or need to unlock their housing equity – as the 'Bank of Mum and Dad', helping children onto the housing ladder, to make adaptations to their home, or to fund social care.

Many lenders are already preparing for how they will meet rising demand in a responsible way. Given the diversity of borrowers, the range of needs that lending will be expected to support, differing levels of financial capability, and a range of assets and income streams to consider it is likely this will continue to be an area needing case by case consideration. It could be envisaged that a range of niche solutions from a

number of lenders large and small will emerge in order to service that demand. In this environment advice remains key.

This type of lending is natural territory for building societies. That is why, as a sector, they have come together to discuss the opportunities to serve the needs of their members, and to face up to the challenges.

## Why now?

With the introduction of the new mortgage regulations in 2014 we saw the culmination of many years of work by the Financial Conduct Authority (FCA) and its predecessor to fundamentally overhaul the way that mortgage applications are assessed.

There were fears that these measures could systematically lock older borrowers out of the mortgage market. In reality these fears have not materialised. Figures show that at the end of 2014 lending to borrowers who will be older than 65 when they repay their mortgage accounted for 35% of total lending<sup>2</sup>. Yet there is still more to be done to meet rising demand into the future.

Importantly these fears ignited a debate about whether the mortgage market really works for older borrowers. Rising house prices and changing demographics mean that people are buying homes later in life and are also likely to need to borrow for longer. Financial services must adapt to the changing needs of an ageing population. This is a debate which the industry must lead in the search for answers to the question 'what does really good look like'.

## A changing society

The population is ageing rapidly, but people are also looking to extend their working lives:

- According to the Office for National Statistics (ONS) projections, almost a quarter of the population will be aged 65 and over by 2034<sup>3</sup>
- A poll on people's attitudes to working found that nearly half of respondents want to continue working between the ages of 65-70<sup>4</sup>.
- In 2011 the Government abolished the default retirement age.
- Research also suggests that 39% of 65-70 year olds do not want to retire in the conventional manner but would prefer a period of part-time work before fully retiring.<sup>5</sup> Retirement is increasingly becoming a process, rather than an event.

Although an older borrower can secure a mortgage based solely on their retirement income, supplementing this with an income stream from employment may improve the prospects of the loan passing affordability tests with some lenders.

Across age groups a range of social and economic pressures also appear to be driving a need to buy homes later in life. Consider that 42% of marriages end in divorce, according to statistics from 2012<sup>6</sup> this means many people may need a mortgage to start over again.

For younger people a combination of debt levels, the cost of living and the undersupply of housing could delay that

first step onto the housing ladder for many:

- The total value of outstanding student loan debt is estimated to reach £100 billion by 2016-17. It is projected that by the mid-2030s this figure will stand at £0.5 trillion<sup>7</sup>. Clearly with such high levels of outstanding debt, many graduates will choose, or need, to wait before taking on mortgage debt.
- Since 1996 the number of 20 to 34 year-olds living with their parents has increased by a quarter, from 2.68 to 3.35 million<sup>8</sup>.

## The mortgage market must adapt

There are signs already that mortgages are being adapted to the challenges posed by the housing market squeeze:

- Borrowers facing affordability pressures are looking to borrow for longer. In 2014 the average first-time buyer borrowing more than 4.5 times their income sought to repay the loan over more than 30 years<sup>9</sup>.
- Figures show that around one in four people today who will borrow beyond the age of 65 is a first-time buyer<sup>10</sup>.

- BSA research shows that around half of 25-34 year olds thought they would need a mortgage lasting into retirement.
- Equity release lending in the first half of 2015 exceeded £710m – the largest amount on record<sup>11</sup>. This signals growing demand from older age groups, which is currently being served primarily by the specialist equity release market.

Case study  
Cambridge Building Society

### Bank of Mum and Dad

Cambridge Building Society agreed to lend £110,000 to one borrower over ten years against an unencumbered buy-to-let property. The borrower wanted to raise money to help his son onto the housing ladder. The loan-to-value is 28%. He has sufficient capital to cover the rest of the price of his son's home.

The borrower and his wife own a manufacturing company, which has shown a track record of good profits over the last 5 years. The borrower is 71 and oversees the running of the business but is not involved in running it day-to-day. He has an unencumbered main residence and another buy-to-let property but anticipates the business will make enough income to repay the mortgage.

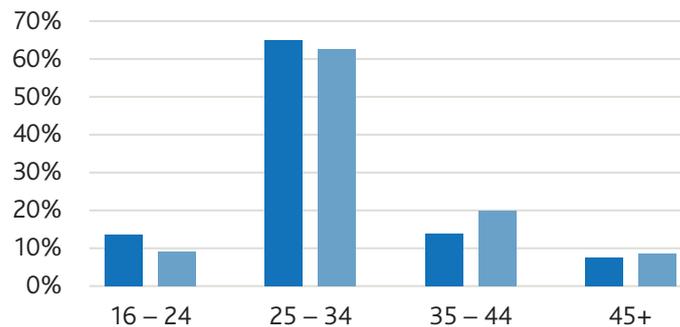
## The housing market

Trends in the housing market make borrowing into older age a necessity for many:

- The average age of an unassisted first-time buyer hit 31 in 2014<sup>12</sup>.
- Real house prices have more than doubled in 20 years<sup>13</sup> from an average of £88,944 in Q3 1995 to £195,733 in Q3 2015<sup>14</sup>. Since the late 1990s, average first-time buyer deposits have increased around five times from £10,000 to almost £50,000<sup>15</sup>.
- In the decade between 2003 and 2013/14 owner-occupation in England declined from 71% to 63% whereas private rental has steadily increased. This suggests significant pent up demand for home ownership, meaning many people will be older when they finally move from renting to owning<sup>16</sup>.

■ 2003/2004  
■ 2013/2014

## Change in age for first-time buyers



Source: English Housing Survey Household Report, 2015

Case study  
Vernon Building Society

### Renting to buying

Vernon Building Society agreed to lend to a married couple, both aged 70, who were renting in Poole for around £1200 per month. The couple previously lived in Spain but sold their property and returned to the UK with around £100,000 of capital. In order to buy a home they needed a mortgage of around £80,000.

The Vernon lent the couple the £80,000 on an interest-only Retirement Mortgage. The interest is paid from the couple's pension income and the capital will be recovered from the sale of the property on death or if they move into alternative accommodation. One feature of the Vernon's product is that the borrowers will receive a discounted rate for registering a Lasting Power of Attorney as a mitigant against the risk of cognitive decline.

The couple's mortgage interest payments are affordable from monthly income and will be substantially lower each month than their rental outgoings (which had been eating into their savings). When informed that the Vernon could help, one of the borrowers remarked that they had been suffering sleepless nights thinking about their financial situation and that a depression had been lifted.

As the chart above shows, the proportion of younger first-time buyers decreased in the decade between 2003/04 and 2013/14. This was met by an increase of 6% in the 35-44 age bracket and an increase of almost 1% of first-time buyers older than 45.

Clearly it is imperative that we address the housing crisis. It is encouraging that both the new Government and the Opposition have made this a political priority. However reversing these trends will not be quick. Consequently the mortgage market will, in the short-term, need to adapt to an environment in which more and more borrowers will be in their late thirties and forties when they take their first steps onto the housing ladder.

*'For younger generations, renting privately is now the norm and many will only become home owners quite late in their adult lives'<sup>17</sup>*

PwC UK Economic Outlook, July 2015

However it is equally clear that finance cannot treat the underlying structural causes of these housing trends. If anything, increasing the supply of credit risks exacerbating house price inflation unless there is a corresponding boost in housebuilding. Without wider policy changes there is a risk that increasing the supply of credit to older borrowers could contribute to the very issues we are trying to address.

### The silver-haired housing revolution

While it is beyond the scope of this interim report, lending to older borrowers is often linked in policy debates to the issues of 'right-sizing' and 'last-time buyers'. We support the clear case for developing new homes designed to meet the needs of older people. Many older people may want to move from homes which are too large to maintain, difficult to heat, or no longer appropriate for their mobility needs. However Legal & General research found that despite 32% considering this in the last 5 years only 7% of homeowners over 55 had actually moved to a smaller property. The BSA believes that the Government should carry out further research to understand the barriers preventing older people who wish to move from doing so.

It is very pleasing that in the first six months of 2015 the number of homes designed and built specifically for older people exceeded the total for the whole of last year by over 400<sup>18</sup>. This follows the news from March 2015 that planning guidance has been amended to encourage local councils 'to take better account of the needs of their older residents when planning new homes in their area'<sup>19</sup>.

The BSA welcomes these moves. We will aim to ensure that access to mortgage finance does not pose a barrier for any credit-worthy older person or 'last-time buyer' seeking to right-size. While many older homeowners have sufficient housing equity to buy a new home, some may require a small mortgage; perhaps to move from a semi- into a detached property, or closer to family and friends in an area with higher house prices.

**'We need more homes, more facilities, mixed communities, not just elderly people in retirement villages – that is not what they all want, they want to be near the 3Fs – friends, family and facilities'**

Legal & General<sup>20</sup>

Mortgage lending decisions are a two-stage process. Much of this report focuses on the first stage – whether the borrower can afford the loan. However the second stage is just as important – whether the property they want to buy constitutes acceptable security for the lender.

A number of developers appear to be shifting their business models to develop more retirement homes, accessible homes and others aimed at older consumers<sup>21</sup>.

While this shift is certainly welcome, the market for these types of homes is relatively small and untested at present. In particular there are likely to be issues around valuations, leasehold conditions and restrictive covenants that need to be worked out. We will seek to work with developers and surveyors to ensure that specially designed retirement homes and accessible homes constitute acceptable security for lenders, so that lending and underwriting policy can move in tandem with the market.

#### **Action 1** **A range of housing options for right-sizers and last-time buyers**

For people at the 'top of the ladder' moving house should feel like an aspiration not a chore. Research suggests that many more older people consider moving than actually do so. Further research is needed to better understand what prevents them, as well as the types of housing right sizers and last-time buyers aspire to own.

The discussion should not be limited to retirement homes and bungalows. Further work is needed to make self-build a realistic option, and to make shared ownership attractive.

The BSA will work with developers and other stakeholders to ensure that mortgage finance enables people to right-size if they desire to do so.

Some 'last-time buyers' may prefer to be 'last-time builders'. Self and custom build could be an attractive option for wealthier customers looking to develop the right home for their older age. The vast majority of lenders in the self-build market are building societies and we support the Government's focus on this area<sup>23</sup>.

We must also explore a range of tenures. While the Government provides some support for Older People's Shared Ownership, more should be done to make shared ownership a mainstream choice. This could provide an attractive option for buyers with enough equity to buy a share in their house of choice, rather than the whole.

Case study  
Loughborough Building Society

### **Right-sizing**

Loughborough Building Society recently agreed a mortgage enabling joint borrowers to right-size to a smaller property. The couple wanted to purchase a new property while retaining their current home to let out for retirement income. They needed £200,000 to buy their new home. Aged 66 and 67 and both retired, the couple receive a combined income of over £60,000 from state and occupational pensions. The Loughborough agreed to lend the money over a term of 14 years on a capital and interest basis.

# What do we mean by an ‘older borrower’?

Lending to older borrowers can capture a range of scenarios; from a first-time buyer in their 40s looking to borrow for thirty years, to retirees wanting to gift some housing wealth to their children. The diversity of borrowers’ needs means a range of policy solutions are required.

At the most rudimentary level, lending to older borrowers can be broken down into two relatively distinct types of lending:

- **Lending into retirement** lending to borrowers who will still be repaying their mortgage after they have reached normal retirement age or have retired from work at some point in the future
- **Lending in retirement** lending to borrowers seeking mortgage finance when already in retirement or semi-retirement

Throughout this report ‘in retirement’ refers to the age at which a borrower begins to draw their pension. While there is no longer a default retirement age, many people still begin to draw their pension at 65. There are a range of underwriting approaches across building societies. Some take retirement as the state pension age, others will accept a borrower retiring later, if reasonable. Some underwrite solely on pension income, others take a broader view of affordability.

However the broad categories of into and in retirement clearly encompass a large spectrum of customers with different needs. This section provides further granularity, first within age groups then through income and assets. The aim is to illustrate the different policy and risk considerations across the spectrum. Crucially, these are dynamic categories which customers move between at different stages of life.

## Action 2

### Rationalise policy on the treatment of older borrower’s housing wealth

An older borrower’s decision on whether to take out a mortgage or leverage their housing wealth can be affected by a broad range of factors. Yet policy responsibilities are spread across a variety of Government departments, including:

- Mortgage policy: HM Treasury
- Housing policy: DCLG
- Pensions and benefits: DWP
- Tax treatment: HMRC
- Social care: Department of Health

Coordination is needed across Government departments to ensure that, for the borrower, all of these elements of policy are transparent, rational and consistent.

Case study  
Bath Building Society

## Lending into retirement for self-build

Bath Building Society recently agreed to lend £1m to a married couple aged 74 and 68 years old via an interest-only mortgage. They currently own a 400 year-old manor house in 11 acres but wanted to down-size and build their own eco-friendly home. Their plan is to split the title on the land into two once the home has been built. They will live in the new home and sell the £2.5m manor house to repay the mortgage, which has been taken on a five year term. The couple will landscape the land in between the two properties and plant trees for privacy, as well as have separate driveways.

The borrowers have a combined income in excess of £200,000 and their monthly mortgage payments will be over £3,000 a month. Whilst waiting to sell the house they have lived in for 26 years, they could rent it out for £3,000 a week.

The Society agreed to lend the money and the couple were thrilled to finally be able to realise their dream of building their own eco-home. The design will fit in with its surroundings; the landscape and the Mendip Hills. The lady is an interior designer and says she cannot wait to get started!

# Age

## 30s-40s

The first category consists of borrowers in their late 30s and early 40s, some first-time buyers, with mortgage terms lasting into retirement. They are clearly decades away from the Age UK definition of 'older' as 65<sup>24</sup>, but will likely still be repaying their mortgage when they reach that age.

Given that Defined Benefit (DB) pension schemes are increasingly rare for this age group, most borrowing into retirement will likely be based on income from a Defined Contribution (DC) pension scheme. Lenders rely on the borrower accumulating sufficient pension wealth through their working life to be able to service the mortgage in retirement.

Underwriting a DC pension pot, therefore, holds risks. The borrower could cease pension contributions, lose their job, or their pension investments could perform poorly. Any of these factors could yield a smaller pension pot than anticipated. For lenders to make a lending decision based on a pension income projected 25-30 years into the future, is clearly difficult.

The FCA is clear: making an incorrect projection will not attract regulatory sanctions. It is enough simply to confirm that the borrower has a pension plan in place. Yet for lenders this is still a significant risk. It is only amplified by the April 2015 pension freedoms meaning that some borrowers might draw down a substantial proportion of their pension pots in future other than to pay off the mortgage.

## 50s-60s

An increasing number of people could re-enter the mortgage market in their 50s or 60s due to life events such as divorce. Others may be looking to remortgage and extend their term into retirement or be 'empty nesters' needing a mortgage to right-size. As these borrowers are relatively close to pension age, lenders are required to make a more robust assessment of their projected pension income.

Prior to April 2015 many lenders would rely on annuity projections in order to underwrite this pension income. However, the pension freedoms mean it is no longer necessary to buy an annuity, enabling many more people over 55 to draw sums from their pension.

Many equity release products also become available to people over the age of 55. Others become available at 60. These are lower limits, however. It is often recommended that borrowers should wait as long as possible before releasing equity as a lifetime mortgage with interest roll-up could become very expensive for the borrower if they live for many decades, due to the compound interest effect. However members of the Equity Release Council operate a 'no negative equity guarantee', meaning that the amount of debt will, at least, be capped at the value of the home<sup>25</sup>.

## 65+

Borrowers in this category fit the Age UK definition of 'older'. Those who have bought an annuity, or are on a DB scheme, will receive a stable and regular income— making underwriting the mortgage relatively straightforward on the face of things.

However for this age group the lender must consider the increased risk of mortality and/or the risk that the borrower(s) could require social care over the term of the mortgage. Care costs may absorb a large part of their retirement income, and even their assets, and could leave the borrower unable to cover mortgage repayments. With the Government's cap on care costs being delayed until 2020<sup>26</sup> this will continue to be a substantial risk, one with potentially significant reputational consequences.

Borrowing on a traditional mortgage over a long period of time is likely to be difficult for these borrowers, as many lenders operate a maximum age limit of 75 and some set their limits even lower. While being 'older' is in no way an inherent indication of a particular borrower's capacity or vulnerability, lenders need to give consideration to conduct risks when deciding whether to lend to borrowers in this age group.

Equity release may become a more appealing option to some of the borrowers in this age group who, as outlined, could find it difficult to secure traditional mortgage finance.

# Income and assets

It is also possible to define four broad categories of customer by income and equity.

High Income. Low Equity	Low Income. Low Equity
<p>Likely to be working age first-time buyers</p> <p>Contributing to a DC pension or on a DB scheme</p> <p>Largely served by the traditional mortgage market</p> <p>However a high loan-to-value mortgage is needed which may be challenging for borrowers in their 50s and 60s</p>	<p>Unlikely to pass affordability tests under the new regulatory framework</p> <p>Some borrowers may have an outstanding interest-only mortgage</p> <p>Borrowers may need Government support</p>
High Income. High Equity	Low Income. High Equity
<p>Equity built up through decades of mortgage repayments</p> <p>Likely to still be in work potentially towards the end of their career. Some borrowers already receiving a good pension may be included</p> <p>Borrowers may want to release equity, e.g for home improvement or to help children with their housing needs</p> <p>Served either by remortgaging or equity release</p>	<p>Many borrowers will be retired and now 'asset-rich, income-poor'</p> <p>Unlikely to pass affordability tests for a traditional mortgage</p> <p>Some borrowers will choose to use equity release to draw on asset wealth</p>

## What does lending into retirement mean in practice?

Traditionally a mortgage was designed to provide the borrower with the means to buy their home, to be repaid over the borrower’s working life. The majority of people would expect to pay off their mortgage before reaching retirement.

However, today many lenders will agree to lend to a borrower who plans to carry some of this mortgage debt into retirement. With pensions paying a stable, regular income in the form of an annuity under a DC scheme or based on the pensioner’s final salary under a DB scheme, mortgages can continue to be affordable after the borrower retires from work.

Mortgage regulation requires lenders to take a 'prudent and proportionate approach' when assessing whether to lend to a borrower beyond their retirement age<sup>27</sup>. That assessment will change depending on how many years away from retirement the borrower is:

- Where they are many years from retiring, the lender should ask for evidence that the borrower has 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.

## Case study

### Mansfield Building Society

## Second homes, debt consolidation and home improvement

Mansfield Building Society (MBS) offers a specialist 'Older Lives' mortgage product with the purpose of providing mortgage finance to customers into retirement and to those who are already retired at the point of application. This bespoke product is designed to meet individual customer needs with the flexibility to allow the mortgage term to extend up to the age of 80. It permits a term of up to 30 years. However, MBS has found that a number of customers apply for their mortgage advance over a shorter period of time.

One locally based couple, aged 71 and 67, sought mortgage finance for £150,000 over a 5 year term. The loan-to-value ratio was low at 35%. The couple applied for a mortgage to buy a second home closer to their

place of work and to allow them to spend quality time with their family. Their future plan was to use the second home as their main residence. MBS carried out a robust affordability check to ensure that they were able to manage the cost of running both properties whilst also meeting their monthly mortgage commitments. One borrower was in receipt of a private pension and directors' remuneration, the other borrower received both a private pension and an annual employed salary. The Society's responsible lending approach found that the borrowers' income was more than sufficient to cover the mortgage advance even at a stress-tested rate.

Another scenario involved a single borrower requiring a mortgage over a term of 20 years. The borrower was 60 years of age at the time of application and requested a remortgage for £70,000 with a loan-to-value of 25%. After the repayment of the current mortgage the remaining funds were to be used to consolidate some unsecured debts and to carry out home improvements. MBS assessed both the borrower's employed income and expected income into retirement and calculated that affordability would improve, together with the borrower's financial circumstances and standard of living, once all sources of pension income were drawn and the unsecured debt consolidated.

For borrowers who are close to retirement, lenders may assess the affordability of the mortgage on the lower of the borrower's working income or expected income in retirement. This is to ensure that the repayments remain affordable if the borrower's income reduces upon retirement.

Since the Mortgage Market Review the affordability calculation must also take expenditure into account, to try to ensure as far as possible that the borrower will not suffer financial difficulty.

The logic of the new mortgage regulations should therefore not preclude lending into retirement. As the FCA stressed in a speech in March 2015:

“...we expect lenders to consider whether [the borrower is] likely to be able to afford the mortgage if it extends into their retirement, based on what the lender knows when they are assessing the application. But we recognise this is not an exact science.”<sup>28</sup>

However it is important that regulation continues to be reviewed to ensure it does not adversely affect certain groups of customers in the future. Regulation should facilitate innovation in markets not stifle it – and there are a number of opportunities on the horizon to review its effect.

The regulatory framework can also drive other changes or ancillary effects. For example, figures from the Mortgage Advice Bureau suggest that the number of borrowers seeking a mortgage term of 30 years or more has increased from 8% to 21% in a year<sup>29</sup>.

The affordability tests implemented after the MMR are likely to be a factor in this. As this test effectively sets how much of the mortgage the borrower can afford to repay each month, many borrowers will choose to stretch the length of the term in order to meet affordability. Clearly this increases the chance that the later years of the mortgage term will last beyond the borrower's retirement age.

It is therefore important to ensure that regulation continues to be reviewed with the aim of achieving the best possible outcomes for borrowers. In particular there may be areas of the regulatory framework which create unintended consequences, or stifle innovation and competition, and we welcome the FCA's intention to open that debate<sup>30</sup>.

### Action 3 Regulation that encourages innovation but keeps consumer protection at heart

We welcome the collaborative and open nature in which the FCA has approached the BSA's lending into retirement project.

Clearly consumer protection is the fundamental purpose of conduct regulation, but there are a number of upcoming opportunities to review how competition and innovation is fostered, through:

- The joint HM Treasury and FCA Financial Advice Market Review
- The review of Competition in the mortgage sector

We will work with these Reviews to ensure that the needs of older borrowers are fully considered.

# Lending close to or in retirement is not always riskier – just different

It is not inherently riskier to lend to a borrower who is close to or in retirement, but the risks a lender has to consider are different. The risks of lending into retirement are also largely different to those involved in lending to a borrower who is close to or in retirement.

As part of the process of looking at the issues of lending into older age, building societies have discussed the potential risks at length. Although the risk can never be fully taken out of mortgage lending, building societies are committed to doing what they can to understand the risks and prepare for them accordingly. Going forward we intend to concentrate on how to mitigate or remove as many of them as possible.

## Action 4 Clear information empowers consumers

There is a wealth of consumer information guiding first-time buyers through the mortgage process. The mortgage market does not become less confusing with age so building societies want to empower consumers with clear information about what is on offer in older age.

The BSA will publish a consumer guide aimed at older borrowers, including information on:

- Maximum age policies
- Inheritance
- Pension freedoms
- Powers of Attorney
- Equity release

# Health, capacity and longevity

We know that, while people are living longer and healthier lives, age exacerbates a number of risks, such as:

- The likelihood of developing conditions such as Alzheimer's and dementia increases with age<sup>31</sup>. A borrower developing such a condition could become financially vulnerable.
- Unknowns surrounding care costs. The cap on costs under the Care Act 2014 will now not be implemented until 2020<sup>32</sup> meaning that individuals needing social care in old age could be called upon to contribute a significant proportion of their assets.
- Potential affordability issues if the mortgage has joint borrowers and one dies. This can clearly happen at any age, but the risk increases as the borrowers get older.

While such issues should not preclude a borrower from being able to access mortgage finance, they are issues which lenders must take seriously. Not only is this important in order to protect the lender, but crucially it seeks to ensure that borrowers do not suffer financial hardship during difficult times.

In recent months the FCA has rightly placed the protection of vulnerable customers high up the regulatory agenda. We should not presume that any particular borrower is more likely to suffer vulnerability merely as a result of their age, but lenders must ensure they have a proper strategy in place to help anyone who experiences difficulty with keeping up their repayments due to vulnerability.

## Underwriting DC pension pots and the pension freedoms

As outlined earlier in this report, uncertainty around a borrower's future pension pot when they are decades away from retirement poses risks for the lender. In the past lending into retirement tended to be dealt with by customer disclosure. The introduction of the new mortgage regulations changed this completely.

The introduction of the pension freedoms in April 2015 could also have a significant effect potentially increasing the risk of lending to borrowers close to or in retirement. It is still too early to fully quantify the effects of the pension freedoms but figures show that in the three months to June 2015 savers took £2.5bn<sup>33</sup> out of their pensions. As lenders rely on the borrower receiving a stable income from their pension pot to underwrite a mortgage into retirement, these changes inevitably create new unknowns. In theory a borrower can now take a lump sum or drawdown out of their pot from the age of 55, potentially leaving them with a pot which is too small to service their mortgage.

This scenario has been compared by commentators to a working age borrower losing their job or overspending. The implication is that lending into retirement is no riskier than lending to someone of working age with job insecurity. In some ways this is true. However, with a working age borrower the lender can often manage any arrears by, for example, agreeing

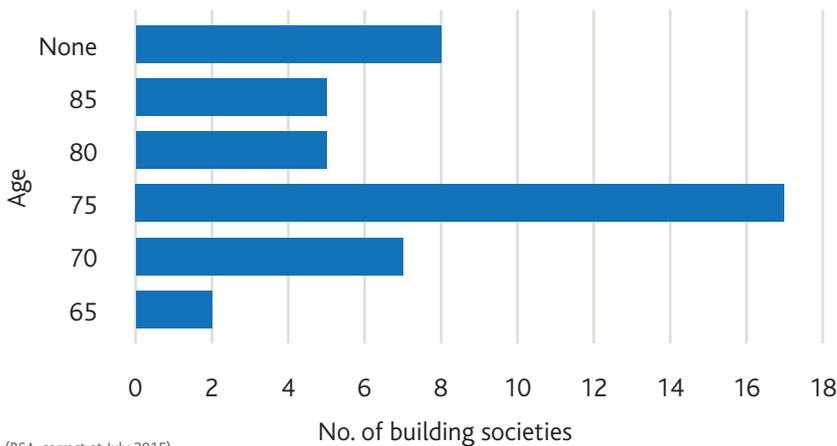
a plan for arrears to be repaid when they return to work. In comparison it is far more difficult for a borrower nearing retirement to replenish their pension pot, or for someone in retirement to find new income streams.

There is, therefore, a need for the mortgage industry to work closely with the Government, the regulators and the pension industry to understand the impact of these changes in far more detail. While clearly creating a number of new risks, there may also be new opportunities. The fact that there has been a great deal of disruption in the DC annuities market inevitably brings with it opportunities for innovative lenders to carve out new niche markets.

## Annuities and DB pensions

The risks are different again when considering someone who is already drawing an annuity or DB pension. Such borrowers will be in receipt of a stable pension income, making such cases look like responsible and prudent lending. The main challenges are around lending to joint borrowers and ensuring that if one borrower dies that enough of their pension income will be transferred to the other to meet repayments.

## Building Society maximum ages



(BSA, correct at July 2015)

### Action 5

**Building societies will work with insurers to develop policies that enable lenders to mitigate risks relating to lending to older borrowers**

Lending to older borrowers is not always riskier – just different. The BSA has initiated discussions with insurers to understand how we can better work together to meet the challenges of an ageing population.

We will continue to work with the insurance industry to understand how together, we can mitigate age-related risks. Indemnity insurance could help some borrowers, while others might feel safer knowing that they are covered if they need social care.

Industry solutions are preferable where possible but there may be areas of the market where a lead from Government would be helpful.

### Action 6

**Building societies will review maximum age policies**

For many lenders having a maximum age policy in place is a way of ensuring they are lending responsibly.

However, building societies are committed to ensuring that their maximum age policies are set at the appropriate level to balance consumer protection with access to finance, and will keep their policies under review.

## Why some lenders have a maximum age at maturity

Most lenders set a maximum age by which a borrower must pay off their mortgage. These apply whether the borrower is of working age or in retirement, though some lenders might have specialist retirement products. Mortgage lenders develop these policies to ensure they are lending responsibly and the mortgage is not likely to lead to the borrower suffering financial difficulty.

Each lender's approach is different, as their policies are based on their own risk appetite, skills, expertise and experience of the market. Maximum age policies may therefore vary from lender to lender. The important thing is that the policy should be set following an appropriate assessment of the risk, both for the borrower and the lender.

Building societies tend to be more flexible with their maximum age policies than the wider mortgage market. Many of the largest banks place significant restraints on lending into retirement, whereas a number of building societies will lend up to age 80 or 85 compared to the wider market, where a limit of 75 is more the norm.

A few building societies do not have a maximum age limit at all, meaning they can offer older borrowers a service for their specific need subject to affordability and security.

Other lenders have adopted a systems-based approach to lending which enables them to lend at a large scale and serve more customers, treating them consistently and often with cheaper rates. However for borrowers with more complex circumstances, a more tailored approach to underwriting is often needed. As many building societies continue to underwrite manually they can often take the time to understand such complex circumstances.

## The wider financial services landscape

Developments in lending to older borrowers do not, of course, exist in a vacuum. Underlined recently by the introduction of pension freedoms is the fact that older people often have a complex web of income streams, savings, pensions, benefits, housing and other assets. While the pension changes have enhanced consumer choice, they have also added to this complexity.

People now also need to understand what effect borrowing into retirement will have on any future plans to take a lump sum from their pension. This is just one scenario among many which borrowers will have to consider when deciding how to maximise the use of their assets.

As Age UK remarks, just in terms of changes to pension policy in recent years, we have seen:

**‘The ending of a default retirement age, the continual rise of state pension age, the introduction of the single tier pension and changes to pensions allowing many people to take their pension as a lump sum rather than an income.’**

Age UK 2015, *Never too late*

Even though the mortgage market has been largely advised since 2014, mortgage advisors understandably have a singular focus and are not able to offer the holistic advice many older people need when deciding on such trade-offs and are planning for their retirement.

It is also clear that there will be an increasing demand for guidance and advice which takes a holistic view of financial planning into and in retirement including traditional mortgages, pensions, equity release, life insurance, and other assets to give customers a broad picture of their options.

We welcome HM Treasury and the FCA’s Financial Advice Market Review (FAMR) and note that retirement planning is an area of particular focus in the Call for Input. We welcome the Equity Release Council’s call for housing wealth to be considered alongside pensions and investments, for example through Pension Wise information, and will support moves across the financial services sector to rationalise the advice framework.

### Action 7 Developing a holistic view of financial planning in retirement

Building societies recognise that there is an opportunity to leverage the trust in their brands to provide holistic financial support for older borrowers.

Many already provide significant support to older borrowers and have an appetite to do more.

Support could range from:

- Training branch staff to understand the needs of older customers;
- Providing clear consumer information and signposting;
- Having an ‘older person’s champion’ at a senior management level ensuring that policies and systems take full account of older borrowers;
- Providing mortgage staff with introductory training in pensions, equity release, and other areas of retirement planning;
- Through to developing a full accreditation for mortgage advisers and underwriters, for example through the Society of Later Life Advisers (SOLLA).

**Action 8****The BSA is forming a cross-industry alliance with other bodies focused on the needs of older consumers**

A cross-industry alliance, including representatives from Government and the regulators, should meet regularly to discuss changes in the financial services landscape where older people are affected. This includes changes in Government policy, regulations, demand and market conditions.

The aim for the alliance will be to create an environment in which product development and innovation can take place in a more holistic fashion, encouraging markets where products are developed to meet the needs of older consumers.

## The customer journey. What does really good look like?

Consider for a moment what a mortgage market designed to suit the needs of an older borrower might look like if designed from a blank page. The customer journey might look something like this.

### Capital and interest mortgage

- › Working age borrower
- › Borrower builds up housing equity through monthly repayments

### Interest only

- › Income likely to fall in retirement
- › Borrower may wish to pay interest, but not the capital for cost of living reasons

### Lifetime mortgage

- › Borrower wants to draw an income from housing equity
- › Housing equity could fund social care, making adaptations to the home or support retirement income
- › Outstanding capital paid on death or entering full-time care

A mortgage market designed in this way would mirror the changes taking place in the pensions landscape. Work is going on in that market to smooth the transition between the 'accumulation' phase when pension savings are built up through contributions to 'decumulation' – when the pension is drawn down.

A mortgage product following this logic would, in a similar fashion, enable a borrower to transition easily between the phases of accumulating and decumulating housing equity. A borrower would take out a traditional mortgage to purchase their first house then maybe move or remortgage, while making capital repayments over their working life.

Through these repayments the borrower would build up housing equity. As we know that a person's income often begins to fall away in retirement, they might wish to switch to an interest-only mortgage in order to reduce their outgoings whilst maintaining the security of tenure that comes with home ownership.

Further into retirement, when drawing an income from assets becomes more important, the borrower might be able to switch to a lifetime mortgage, or other equity release product, by leveraging the value in their home. This income might then be used to support their pension, to finance house adaptations and for social care.

Research also suggests that attitudes towards inheritance are changing.<sup>35</sup> Increasingly people plan to prioritise their needs in retirement and enjoy their equity in life – for holidays or other big-ticket items – rather than being careful with their money just to pass it on.

A mortgage product with flexible triggers built into it would be able to respond to the customer's changing needs and wants as they move through the different stages of life.

While we set out some of the current barriers to this model in the following pages, it is nonetheless important to keep this flexible customer journey in mind.

Case study  
Scottish Building Society

## Right-sizing

Scottish Building Society (SBS) offers a Lifetime Mortgage, on an interest-only basis, for borrowers aged 65 and over and resident in Scotland. As the borrower(s) is required to pay the interest, affordability checks are carried out on their pension and any other income to ensure they can afford the monthly payments.

The capital is recovered following the sale of the property if they move into long-term care or from the borrower's estate on death. This amount does not

increase because of the borrower paying the interest each month. The maximum amount SBS will lend under this product is £300,000 at a maximum loan-to-value of 35%.

SBS agreed to lend £65,000 to a married couple, aged 65 and 66 and both retired, at a loan-to-value of 33%. The mortgage was assessed for affordability both jointly and solely. It was found to be affordable even if the higher earner were to predecease the other borrower, as they would be transferred a

proportion of their spouse's pension.

Before SBS took up their case the couple had been on an interest-only mortgage with another lender, with the term due to come to an end in eight years' time. Their endowment policy had performed poorly and they could not foresee any way of making up the gap. The couple found it difficult to find another lender willing to offer a mortgage after age 65 so otherwise faced having to sell their home within the next few years.

## The gap between traditional and lifetime mortgages

Building societies primarily lend in the traditional mortgage space. For that reason the main focus of this interim report is on traditional mortgage lending into and in retirement. However a full consideration of lending in the retirement space must also include the role of equity release. This consists of two main types of product: lifetime mortgages and home reversion plans.

This section focuses primarily on lifetime mortgages. It is widely acknowledged in the industry that the traditional mortgage market should be brought closer to products in the lifetime space.

In March the FCA asked the question:

‘...given changing demographics, is the traditional mortgage the right product or do new products need to be designed to bridge the gap between a traditional mortgage and a Lifetime Mortgage?’<sup>36</sup>

The BSA does not wish to second guess what kinds of products will emerge to meet customer needs. As things stand, though, we can envisage a number of areas of complexity that may impact the delivery of new products in between the poles of the traditional mortgage and lifetime mortgage:

- **The regulatory framework** governing lifetime mortgages is very different. The advice process for a lifetime mortgage is also different, often involving legal advice. There are also different prudential regulations to take into account. This gap is likely to get bigger after the European Mortgage Credit Directive is implemented in March 2016, as lifetime mortgages are excluded,
- Secondly, **Funding**. For lifetime mortgages where the interest is rolled up until death or the borrower goes into long-term care the market is particularly specialised, consisting largely of pension providers. For this reason, and also because of the very different risks, lifetime mortgages tend to be priced at a higher rate than traditional mortgages.
- **Customer demand**. Consumer demand is unknown currently, so lenders will have to develop products without confirmation of the level of demand. This is likely to result in an iterative process as the market develops and matures overtime.

- The accounting treatment of providing a **no negative equity guarantee** is very complex and could be challenging for mainstream lenders.

For these reasons there would need to be a concerted drive across the financial services industry as well as the regulators if these markets are to be made more cohesive.

Currently the fact that these markets operate very separately may generate confusion for customers who may have repaid a mortgage over most of their adult life and yet find that there is a much larger step up to releasing equity than they expected. While consumer protection must clearly remain at the heart of regulation, we must consider whether regulation keeps these markets artificially separate and whether, ultimately, it is in the interests of really good customer outcomes.

### Action 9 A mortgage which adapts to the different stages of a person's life

It is clear that if housing equity is truly going to be seen as a flexible asset which can be accumulated over a borrower's working life and decumulated in retirement then this will require a concerted drive across the industry traditional lenders, equity release lenders, and the regulators.

We welcome the FCA's willingness to open these discussions and intention to look at this area.

# Conclusion

There is no question that the mortgage market must adapt to the needs of an ageing population.

This report has sought to analyse some of the factors that will continue to drive an increasing demand for mortgages lasting into retirement over the next decade and beyond.

This is only the start of the conversation and the policy actions set out in this paper will evolve along with regulation, product development and the market. Building societies have the desire to be at the heart of that evolution and to do what is needed to serve the needs of older borrowers.

# Summary of actions

## Action 1 A range of housing options for right-sizers and last-time buyers

For people at the 'top of the ladder' moving house should feel like an aspiration not a chore. Research suggests that many more older people consider moving than actually do so. Further research is needed to better understand what prevents them, as well as the types of housing right sizers and last-time buyers aspire to own.

The discussion should not be limited to retirement homes and bungalows. Further work is needed to make self-build a realistic option, and to make shared ownership attractive.

The BSA will work with developers and other stakeholders to ensure that mortgage finance enables people to right-size if they desire to do so.

## Action 2 Rationalise policy on the treatment of older borrower's housing wealth

An older borrower's decision on whether to take out a mortgage or leverage their housing wealth can be affected by a broad range of factors. Yet policy responsibilities are spread across a variety of Government departments, including:

- Mortgage policy: HM Treasury
- Housing policy: DCLG
- Pensions and benefits: DWP
- Tax treatment: HMRC
- Social care: Department of Health

Coordination is needed across Government departments to ensure that, for the borrower, all of these elements of policy are transparent, rational and consistent.

## Action 3 Regulation that encourages innovation but keeps consumer protection at heart

We welcome the collaborative and open nature in which the FCA has approached the BSA's lending into retirement project.

Clearly consumer protection is the fundamental purpose of regulation, but there are a number of upcoming opportunities to review how competition and innovation is fostered, through:

- The joint HM Treasury and FCA Financial Advice Market Review
- The review of Competition in the mortgage sector

We will work with these Reviews to ensure that the needs of older borrowers are fully considered.

## Action 4 Clear information empowers consumers

There is a wealth of consumer information guiding first-time buyers through the mortgage process. The mortgage market does not become less confusing with age so building societies want to empower consumers with clear information about what is on offer in older age.

The BSA will publish a consumer guide aimed at older borrowers, including information on:

- Maximum age policies
- Inheritance
- Pension freedoms
- Powers of Attorney
- Equity release

**Action 5**  
**Building societies will work with insurers to develop policies that enable lenders to mitigate risks relating to lending to older borrowers**

Lending to older borrowers is not always riskier just different. The BSA has initiated discussions with insurers to understand how we can better work together to meet the challenges of an ageing population.

We will continue to work with the insurance industry to understand how together we can mitigate age-related risks. Indemnity insurance could help some borrowers, while others might feel safer knowing that they are covered if they need social care.

Industry solutions are preferable where possible but there may be areas of the market where a lead from Government would be helpful.

**Action 6**  
**Building societies will review maximum age policies**

For many lenders having a maximum age policy in place is a way of ensuring they are lending responsibly.

However building societies are committed to ensuring that their maximum age policies are set at the appropriate level to balance consumer protection with access to finance, and will keep their policies under review.

**Action 7**  
**Developing a holistic view of financial planning in retirement**

Building societies recognise that there is an opportunity to leverage the trust in their brands to provide holistic financial support for older borrowers.

Many already provide significant support to older borrowers and have an appetite to do more.

Support could range from:

- Training branch staff to understand the needs of older customers;
- Providing clear consumer information and signposting;
- Having an 'older person's champion' at a senior management level ensuring that policies and systems take full account of older borrowers;
- Providing mortgage staff with introductory training in pensions, equity release, and other areas of retirement planning;
- Through to developing a full accreditation for mortgage advisers and underwriters, for example through the Society of Later Life Advisers (SOLLA).

**Action 8**  
**The BSA is forming a cross-industry alliance with other bodies focused on the needs of older consumers**

A cross-industry alliance, including representatives from Government and the regulators, should meet regularly to discuss changes in the financial services landscape where older people are affected. This includes changes in Government policy, regulations, demand and market conditions.

The aim for the alliance will be to create an environment in which product development and innovation can take place in a more holistic fashion, encouraging markets where products are developed to meet the needs of older consumers.

**Action 9**  
**A mortgage which adapts to the different stages of a person's life**

It is clear that if housing equity is truly going to be seen as a flexible asset which can be accumulated over a borrower's working life and decumulated in retirement then this will require a concerted drive across the industry traditional lenders, equity release lenders, and the regulators.

We welcome the FCA's willingness to open these discussions and intention to look at this area.

# Members of the Lending to Older Borrowers working group

1. Bath Building Society
2. Beverley Building Society
3. Buckinghamshire Building Society
4. Cambridge Building Society
5. Chorley Building Society
6. Coventry Building Society
7. Darlington Building Society
8. Ecology Building Society
9. Furness Building Society
10. Hinckley & Rugby Building Society
11. Holmesdale Building Society
12. Leeds Building Society
13. Loughborough Building Society
14. Mansfield Building Society
15. Market Harborough Building Society
16. Marsden Building Society

17. The Melton Building Society
18. Monmouthshire Building Society
19. Nationwide Building Society
20. Newbury Building Society
21. Newcastle Building Society
22. No1 CopperPot Credit Union
23. Nottingham Building Society
24. Principality Building Society
25. Saffron Building Society
26. Scottish Building Society
27. Tipton & Coseley Building Society
28. Vernon Building Society
29. West Bromwich Building Society
30. Yorkshire Building Society

# References

1. 'Five hours a day: systemic innovation for an ageing population', Nesta, 2013
2. FCA Product Sales Data, Q4 2014
3. 'Overview of the UK Population', ONS, 25 June 2015
4. 'A New Vision for Older Workers: Retain, Retrain, Recruit', Dr Ros Altmann CBE, 2015,
5. Ibid.
6. 'What percentage of marriages end in divorce?', ONS, 09 February 2013
7. Student Loan Statistics, House of Commons Library, 05 October 2015
8. 'Large increase in 20 to 34-year-olds living with parents since 1996', ONS, 21 January 2014
9. 'Counting the cost: What is the annual cost of housing in the UK?', Savills, Residential Property Focus Q3 2014
10. FCA Product Sales Data, Q4 2014
11. 'Equity release lending surges to all-time high in Q2 following pension freedoms', Equity Release Council, July 2015
12. 'New CML data shows nearly half of first-time buyers didn't use "bank of mum and dad"', CML, 5 March 2015
13. Using the Nationwide House Price Index adjusted for inflation, Q3 2015
14. Ibid.
15. UK Economic Outlook, PwC, July 2015, p. 19
16. English Housing Survey Headline Report 2013/14, DCLG, 25 February 2015
17. See footnote 15
18. NHBC reports growth of homes for the elderly', NHBC, Q2 2015
19. 'Better homes and bungalows for Britain's older people', Brandon Lewis MP, Housing Minister, DCLG, 21 March 2015
20. Steve Goodall, Legal and General Surveying Services at the Mortgage Finance Gazette 'Housing and lending for the last time buyer' roundtable, 14 October 2015
21. For examples, see Sir Michael Lyons, Redrow board member's comments Ibid. or the article on 'Barratt Homes targets downsizing baby boomers' by Kate Allen in the Financial Times, 3 November 2014
22. 22 out of 25 lenders are building societies according to 'Self Build Mortgages and Deals' on [www.homebuilding.co.uk](http://www.homebuilding.co.uk)
23. The Self-build and Custom Housebuilding Act 2015, House of Commons Library, 15 June 2015
24. 'Later Life in the United Kingdom' factsheet, Age UK, October 2015
25. See the SHIP Standards, Equity Release Council
26. 'Delay in the implementation of the cap on care costs', Department of Health, 17 July 2015
27. Mortgages Conduct of Business sourcebook, rule MCOB 11.6.14 and guidance in MCOB 11.6.15(2)
28. 'The Evolution of the Mortgage Market', speech by Linda Woodall, FCA Director of life insurance and financial advice, Mortgage Finance Gazette conference, 11 March 2015
29. 'Number of 30-year mortgages taken out increases', Mortgage Advice Bureau, 18 August 2015
30. See footnote 28
31. 'Dementia and cognitive decline: A review of the evidence', Age UK Research, 2014
32. See footnote 26
33. 'Payments made to savers since the pension reforms reach nearly £2.5 billion', Association of British Insurers, 2 September 2015
34. The exceptions to this are execution-only transactions, business loans, and those carried out by mortgage professionals and high net-worth individuals
35. JRF, Attitudes to inheritance in Britain 2005
36. See footnote 28





York House  
23 Kingsway  
London WC2B 6UJ  
020 7520 5900  
@BSABuildingSocs

[www.bsa.org.uk](http://www.bsa.org.uk)