ADVERTORIAL

WHAT DO RISING INTEREST RATES MEAN FOR HOME EQUITY RELEASE BORROWERS?

Over the past few years we have lived through a cycle of increasing interest rates, and it remains uncertain when this trend will be halted, let alone be reversed. The purpose of this article is to explore the consequences of rising interest rates for people who have taken out home equity release loans.

The basic idea behind home equity release loans is that older homeowners offer their properties as security for loans. Because they continue to own these properties, borrowers have continued rights of residence, and benefit from future appreciation in the value of their properties. Loans are calculated based on the value of the property and the age of the borrower, larger loans being offered to older homeowners with more valuable properties. A 75 year old, for example, would qualify for a loan of up to 20% of the value of his or her property. What makes these loans different is that they do not need to be repaid each month, not even the interest, hence the attractiveness of the concept to people who are considered "asset rich but cash poor", and therefore wish to extract some of the equity that is tied up in their homes.

Nic Craig, Managing Director of Seniors' Finance, South Africa's first home equity release loan provider, gave us his views on this topical question. Craig says that, generally speaking, rising interest rates mean that the interest component of the debt that will ultimately be repaid by the borrower is higher than it would have been before such increases. While his response is obvious, Craig believes that the ultimate impact differs according to whether the borrower has a home equity release loan or a more conventional form of debt.

Conventional loans are typically serviced on a monthly basis until the capital and the interest on it are completely repaid to the lender. Rising interest rates therefore lead either to an increase in the monthly instalments that are required to repay the loan or to an extension of the term of the loan, which means that borrowers repay the same amount each month, but over a longer period. The impact of rising interest rates is very different for home equity release borrowers, primarily because their loans are not repaid each month. Rising interest rates therefore have no impact on the monthly cashflows of the borrower, as they do not make monthly repayments, no matter how interest rates fluctuate.

Craig concedes that the amount that will ultimately be repaid by the borrower's estate once the borrower has passed away will be more than what it would have been in the absence of interest rate increases. But interest rate changes are cyclical. One would be hard pressed to find an economy anywhere in the world where interest rate changes are a one-way bet. Interest rates always go through "cycles of ups and downs". Craig also points out that home equity release loans are long-term contracts; hence they are often referred to as "lifetime loans". Rising interest rates in the short term should not be the focus of borrowers. Longer-term average interest rates will be far more important, and will almost certainly include periods when interest rates rise, but also periods when they fall.

Craig believes that home equity release customers should not consider the accumulating balance of their loans in isolation, especially in an increasing interest rate environment. Borrowers are consciously spending some of the equity in their properties when they apply for their loans, and should therefore expect less than 100% of the sale proceeds to be available to their heirs or beneficiaries after they have passed away and the loan has been repaid. Borrowers must look at the change in value of their properties in relation to their outstanding loan balances over the duration of the loan. While the future is impossible to predict, if over the long term property prices keep pace with the interest rate applicable to home equity release loans, the net position for the borrower when the loan is ultimately repaid will be exactly the same as the net position when the loan was first taken out.

So, while rising interest rates are generally bad news for consumers, one might argue that the effect of rising interest rates for home equity release customers is far less dramatic than it might be for borrowers who are exposed to more conventional forms of debt.

Nic Craig

If you would like to find out more about Seniors' Finance or their SAHERPA-accredited home equity release product called SF HELP, please call 0860 736 467 / 0860 SENIOR, or visit www.seniorsfinance.co.za.

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