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RESEARCH REPORT

Factors influencing the supply of Home Equity Release Products in the United Kingdom

Masters in Business Administration

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ABSTRACT

Home Equity Release Products ("ERPs") are innovative financial products that enable elderly, retired people to use their unencumbered houses as a source of income/funding whilst they continue to reside in them. ERPs are typically non-recourse loans and the client is not required to service the loan or to repay the capital. The loan and outstanding amounts are normally settled through the sale of the property, either on death or when the client voluntarily vacates. This research is an exploration of the demand and supply issues which affect the suppliers of ERPs (both internationally and locally). Interviews were held with established suppliers in the United Kingdom (where the market is more advanced) as well as with a handful of financial services companies in South Africa.

The ERP industry has grown slowly over the last decade. Factors such as increased life expectancy, decreased savings rates and changing attitudes towards debt are just some of the driving forces of demand. However, the growth of the ERP industry has consistently fallen short of analysts' predictions, highlighting some of the difficulties facing the market - not least of which, is to be accepted by both the market and government as a mainstream option for the elderly who are often asset-rich but income-poor. There are a number of impediments to market growth that are explored in detail within this research.

In terms of the market for ERPs in South Africa, it was found that there should be demand for such products as South Africa is facing similar macro-trends as the United Kingdom and other developed economies. However, South African firms face unique challenges. It appears likely that demand would probably be limited, at this stage, to certain wealth groupings. The higher interest rate environment would also have to be carefully managed and would most likely result in lower loan to values (LTVs). Based on the findings of the interviews, a number of recommendations were made to the local firms.

Declaration

I hereby declare that this research report is my own work and effort. Professor John Luiz, my supervisor, provided some much appreciated guidance. Where other sources have been used they have been acknowledged.

Signature: ……

Gareth Craig Stobie

Date:……..

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1 Purpose of the study

The purpose of this research is to analyse the factors influencing the market for ERPs from the perspective of suppliers in the United Kingdom and to examine its relevance for South African firms.

1.1 Introduction

In many developed countries Home Equity Release Products (ERPs) have been promoted as a means of accessing equity locked up in a residence, particularly after the holder of the property has retired (Gibler and Reed, 2003). Research shows that debt-free property forms the major part of most elderly people's net assets (Caplin, 2000; Australian Securities and Investments Commission, 2005; Actuarial Profession, 2005). However, despite this wealth of property ownership, many elderly people do not have sufficient income to meet their retirement needs, leading to the catch phrase "Asset Rich, Income Poor" (Australian Securities and Investments Commission, 2005; Terry and Gibson, 2006). ERPs have been developed to address this dilemma and are designed to provide elderly people with income whilst using the equity they have in their homes as security.

The Home Equity Release industry is supported by the concept of the life cycle hypothesis (Williams and Kao, 1997) that, amongst other issues, deals wiith dis-saving after retirement. Demographic and economic trends also seem to support the development of the ERP industry. Factors that support the increased consumption and liquidation of assets in retirement include the boom in house prices midway through the last decade that left many elderly people with a windfall gain in their property asset (although this has now, to some extent, been eroded due to the financial crisis of 2008), lower savings rates and pension contributions, increased life expectancy and the general trend of retirees desiring a more active life style in retirement

The ERP industry (which is still relatively small) is, however, plagued by teething problems and complexities. There are both demand and supply constraints hampering the growth of

the industry. The impediments to demand include a suspicion of the market and its size, fears of indebtness, the costs involved and the bequest motive. Suppliers and potential suppliers face similar issues and, in addition, are also faced with risks such as longevity of the client, interest rates and property price movements, not to mention softer concerns such as possible moral hazards that would emerge should the structure go wrong.

The ERP industry is inextricably linked to the traditional mortgage market industry. In its simplest form the ERP industry involves the inverse of a traditional mortgage arrangement. Within both industries, property is used as security against the advancement of funding.

This research explores those issues influencing the demand and supply of ERPs from the perspective of the suppliers of such products in the United Kingdom. The ERP industry is still in its infancy in South Africa. By conducting an up-to-date analysis of the current issues affecting the industry in the United Kingdom, valuable insights should be gained for the South African market. The analysis will involve interviews with actual companies offering ERPs and the research will primarily focus on qualitative issues.

The basic structure of this paper is as follows:

- An introduction to the concept of Home Equity Release, as well as details on the current demand and target markets. This is based on available literature.
- Setting the South African context. This is based on available literature.
- A real world analysis of factors influencing the demand and supply of ERPs. This is based on a literature review as well as interviews with suppliers in the United Kingdom.
- Drawing lessons for South African firms.

1.2 Context of the study

Rajagopalan (2002) says that developing countries face growing aging populations. He says that this is due to improved health and greater life expectancy (but also due to the possibility of a lower fertility rate). These countries are faced with budgetary constraints in terms of sustaining old-age income and social schemes. He argues that government's inability to provide such schemes at the level required, combined with the quality of life that elderly people are now looking for, will fuel a massive demand for financial products tailored to the elderly. These would need to be safe and may involve systematic liquidation of assets to finance consumption, managing longevity and inflation risks and imparting liquidity to illiquid assets. ERPs are well positioned to provide this (Rajagopalan, 2002).

Fisher-French (2006) points out that South Africa is in a similar predicament – 'It is estimated that only 6% of South Africans will be able to retire in comfort, accessing the equity built up in a home without having to sell will be a welcome relief for many retirees, although probably not so welcome by their heirs'. The ERP market in South Africa is still in its infancy with only one active member currently registered with South African Home Equity Release Protection Association (SAHERPA). SAHERPA itself was only recently established in mid-2007. Seniors Finance and Nedbank are to date the only two providers of ERPs within South Africa. Developed countries such as the United Kingdom, United States, Australia and New Zealand have been making use of such products for a longer period of time. In looking at these developed markets and analysing their trends, valuable insights can be gained that will be of use in the further development of such an industry in South Africa.

This research was conducted under the cloud of a severe global economic downturn during 2008 and early 2009. Amongst other factors, residential property financing arrangements contributed significantly towards this downturn. It is expected that these market conditions will have an impact on the ERP industry, particularly as the ERP industry

is linked to the traditional mortgage market. Notwithstanding this, the issues facing the suppliers of ERPs are unique. ERPs differ significantly from traditional mortgages in terms of their structure, term, LTV ratios and consumer profile, and as such, should be assessed in isolation. Reference will be made to the current conditions when appropriate.

1.3 Problem statement

Main problem:

Identify the factors influencing the demand and supply of ERPs in the United Kingdom and examine its relevance for South Africa.

Sub-problems:

1. Identify the key drivers of demand for ERPs.

2. Identify the factors hindering demand for ERPs.

3. Assess factors influencing the supply of ERPs.

4. Examine the viability of, and scope for, ERPs in the South African market.

1.4 Significance of the study

ERPs provide a means for elderly homeowners to access their home equity while still continuing to live in their homes. This could be an effective means of improving the economic plight of many elderly people, especially if this group has no other way to access its home equity (Bartel et al, 1980). Despite the potential benefits, consumer interest has been relatively modest to date. Estimates of the potential market for this product have varied widely, but these estimates are generally much larger than current volumes (Fratantoni, 1999).

The Equity Release market in South Africa is still in its infancy. By analysing the factors that influence demand and supply of ERPs in developed countries and by learning from the experiences of the suppliers questioned, informed decisions can be made going forward. This research builds on previous analysis relating to the ERP industry in other developed economies. The paper will provide real world and up-to-date insights on issues affecting suppliers.

This study will be of particular interest to new and current financial services providers who have entered the South African market, or are looking to do so, as they will invariably face similar demand and supply issues to those that occurred in more developed countries.

1.5 Delimitations

- The population has been narrowed to those suppliers operating in the United Kingdom and to those who are members of Safe Home Income Plans.
- There are many variations of ERPs, all with slightly different nuances and pricing structures. The most note-worthy is the difference between mortgage loan-based products and reversion products but, for the purposes of this research, all will be treated as one homogonous product (unless specifically differentiated).

1.6 Assumptions

- It is assumed that most of the suppliers would have performed independent research into their markets and thus, by meeting with different suppliers, one will be able to aggregate their experiences.
- It is assumed that people within the higher tiers of management will be experts in the field and will have strategic insights into the market.
- The suppliers listed on SHIP make up the majority of the reputable suppliers within the United Kingdom.

2 Literature Review

2.1 The Concept of Home Equity Release

Equity Release Products (ERPs) generally relate to either a Reverse Mortgage Product or a Home Reversion Scheme (Terry and Gibson, 2006). For the purposee of this research both will be treated as one homogenous product. Both types of products are described below.

A Reverse Mortgage can be defined as follows: the consumer borrows money against the equity in his or her home and the principal and interest is not repaid until the home is sold, usually when the consumer dies or voluntarily vacates the home (Australian Securities and Investments Commission, 2005). Reverse Mortgages are designed for elderly homeowners to access their home equity while continuing to live in their homes (Bartel et al, 1980, Gibler and Reed, 2003). Most often, a reverse mortgage is described as an annuity to the homeowner for the length of time that she remains in the house (Kutty 1996).

Mayer and Simons (1994) draw comparisons with normal mortgages: A reverse mortgage allows the elderly homeowner to borrow against the equity accumulated in the home, without moving or being forced to sell the house. Unlike a conventional mortgage where the homeowner makes periodic payments to the lender, a reverse mortgage provides payments from the lender to the homeowner. The loan is repaid with interest when the borrower sells the house, moves permanently, or dies. Reverse mortgages are usually available only to borrowers aged 62 or older.

The main advantage of a reverse mortgage over other means of tapping home equity lies in its repayment schedule. In contrast to conventional second mortgages or home-equity lines of credit, a reverse mortgage does not require the homeowner to make payments of interest and principal during the term of the loan. Since the elderly homeowner may need

to tap home equity precisely because his/her income is insufficient to cover living expenses, it is likely that he or she would not have the income to make payments on a second mortgage or a home-equity line of credit (Mayer and Simons, 1994).

The amount of money that can be borrowed via a reverse mortgage generally depends on the borrowers' age and the value of the home. Typically, the older the borrower and the greater the home value, the more funds can be made available via loan advances (Redfoot et al, 2007).

A typical mortgage culminating in a reverse mortgage is described below and is presented in Figure 1.

1) A conventional housing loan is commenced that requires the security of a lien over the house via a mortgage;
2) Over time, the household equity increases - this is due to both the value of the property increasing and the outstanding loan decreasing;
3) Complete home ownership is often achieved in the middle to late years of the working life when the mortgage has been completely repaid;
4) Retirement commences and regular cash flows cease. The retiree has to rely on savings from earlier years. A reverse mortgage can commence. The bank advances new funding to the retiree. The retiree may stay in his/her home and is not required to service the new funding;
5) Equity that is in the house is returned to the owner (via loan funding) either as a once off amount or over a period of time. This will result in the equity decreasing over time (Gibler and Reed, 2003);
6) The funding is repaid to the bank when the house is sold, usually on death or on voluntary vacation.

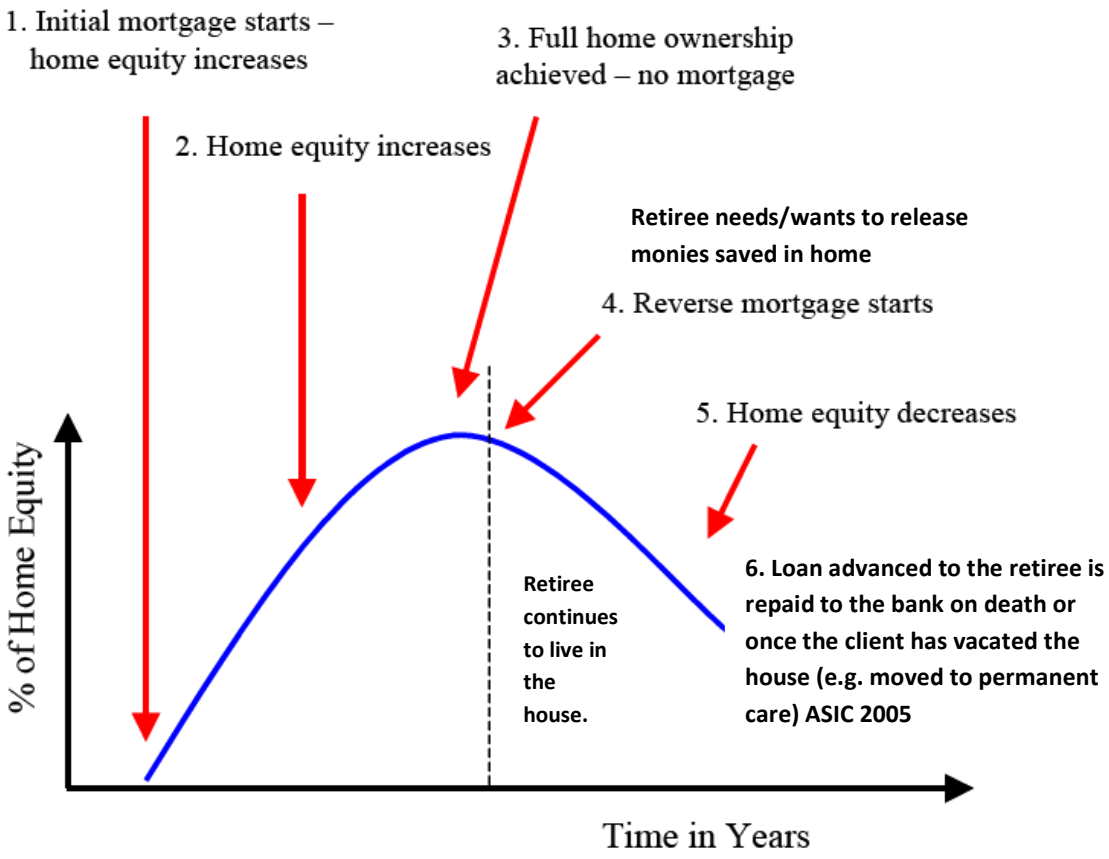

Figure 1: Home Equity over time using an ERP

(Source: Gibler and Reed, 2003)

Home Reversion Schemes are the other main form of ERP. The consumer sells part or all of his/her home to a reversion company. The home is sold for less than its market price (typically between 35% and 60%), but the consumer can remain on the property until he/she dies or voluntarily vacates the home. There are at least two types of home reversion schemes – a sale and lease model, and a sale and mortgage model (Australian Securities and Investments Commission, 2005).

In this research, ERPs are generally treated as one homogenous product. However, there are complications attached to this as the different types of products have had different levels of support. For example, Fratantoni (1999) dedicated research to the take up of

different types of Reverse Mortgages, concluding that the line of credit plan enjoys the most support as opposed to the monthly payments. Mayer and Simons (1994) also comment on this, stating that whilst the potential market for reverse mortgages is typically evaluated on changes to monthly income, holders may prefer lump sums or irregular draw downs.

Most ERPs come with a "No negative equity" guarantee. This guarantee ensures that possession of a property subject to an equity release deal will never be sought, even if the growth of the property value falls well short of expectations (Terry and Gibson, 2006). In other words, if the value of the loan (capital and interest) surpasses the market value of the property, the right of the client to occupy that property is not prejudiced. Reverse mortgages are typically "non-recourse" loans, which means that the borrower's debt is limited by the value of the home. Borrowers must however, continue to maintain the home, pay their property taxes, and keep the home insured.

2.2 Current practice in developed economies

When assessing the factors influencing demand and supply of ERPs it is important to gauge the current, historical and forecast demand for ERPs. When analysing the demand, one is also able to define the target market(s). Demand will naturally differ between countries where the size and structure, as well as the stage of development, of the ERP industry will vary. Forecast demand is difficult to estimate due to potential future changes in consumer attitudes to ERPs, house prices, interest rates and a number of other factors driving (or hindering) demand. These are elaborated on later.

2.2.1 Demand in the United Kingdom

The Actuarial Profession (2005) has tracked demand in the United Kingdom through the 1990s and early 2000's as presented in Table 1. From its low point of £23,7 million (new business in 1993), the ERP market recovered steadily through the 1990s, primarily through

growth in the reversion market. The introduction of the first roll-up mortgage scheme by Norwich Union in November 1998 saw the first real impetus for the mortgage market and it is now the mortgage market that dominates (Actuarial Profession, 2005).

Table 1: The value of new business between 1998 and 2003

(Source: Actuarial Profession, 2005)

Value of new business (£m)						
	1998	1999	2000	2001	2002	2003
Mortgage Sales	6.3	84.7	297.4	359.2	651.1	1032
Reversion Sales	121	155.4	226.8	213	200.8	129.4
Total	127.3	240.1	524.2	572.2	851.9	1161.4

Since 2003 the market has continued to grow and the UK Equity Release Market Monitor report for 2007 (Key Retirement Solutions, 2008) highlighted the following:

- The total amount released in 2007 was approx £1.4 billion (up 15% year-on-year)
- The total number of loans increased by 9% (30,088 vs. 27,700)

The figure below shows the geographical spread and the year-on-year increase in the ERP market in the United Kingdom during 2007.

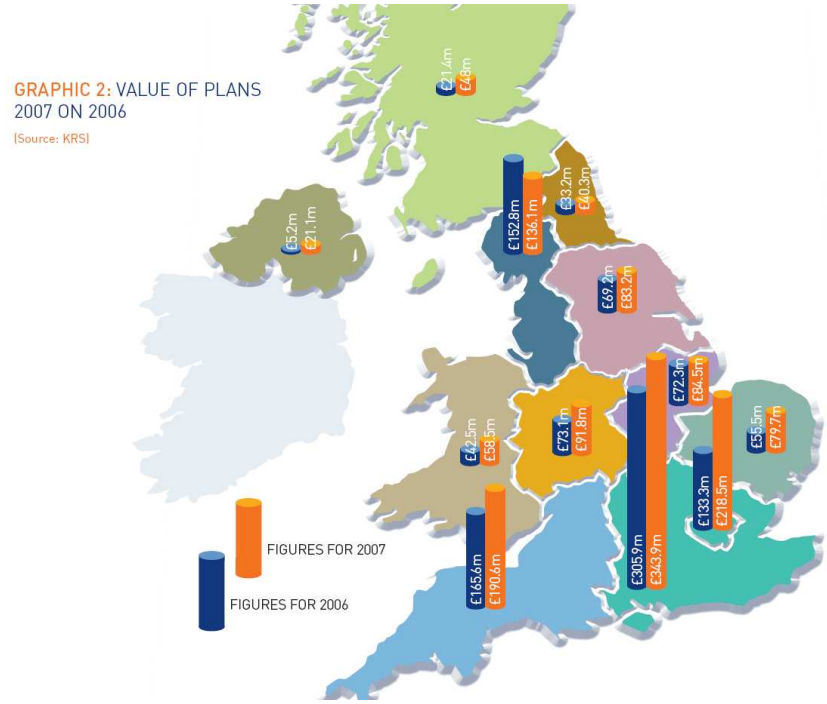

Figure 2: Value of plans across the UK

(Source: Key Retirement Solutions, 2008)

Apart from the earlier mentioned trend of moving away from reversion to mortgage sales, the Key Retirement Solutions Report also claims that more recently "draw down plans", an offshoot of mortgage plans, are becoming more popular than the life-time mortgages as they are more flexible and there are possible savings in interest. Home reversions, which the Actuarial Profession showed to be declining, are now only 5.7% of the market. The Key Retirement Solutions report also cites that the average age of the user is decreasing from 69.6 years of age in 2006 to 68.4 years of age in 2007 (Actuarial Profession, 2005; Key Retirement Solutions, 2008). The main use for the funds was found to be home improvements (58%) and paying off existing debt (40%). Lastly, the report suggests that uncertainty, in terms of house prices and the global credit crunch, may slow the market (Key Retirement Solutions, 2008).

In a more recent report by Key Retirement Solutions (2009), published shortly after the research interviews were conducted, the predictions of the prior year were confirmed. The volatility in world markets and the banking crisis of 2008 did impact on the ERP market. The total number of plans written during 2008 decreased by 14% and the total amount released was down to £1.18 billion. Notwithstanding this, the report remained upbeat, noting that the decline in the ERP industry was not nearly as severe as in other sectors of the mortgage industry.

In terms of forecast demand, the Actuarial Profession (2005) has attempted to forecast future demand in the United Kingdom by defining the various users and then projecting the demand using a Bottom-Up and a Top-Down approach. These two approaches are essentially the reverse of each other and consider the same factors with which to filter the population. The flow chart below, Figure 3, takes the whole population and filters it down to the potential market for ERPs. The diagram starts with the total population and then filters out those who do not own a house outright, then those with > £60,000 equity, then those who have more than £60,000 equity but who have insufficient income, and finally those who are prepared to forgo leaving an inheritance. Through this process, the market (of 60 – 65 year olds) is cut down from approx 4.2million potential users to only 30 thousand (Deloitte, 2002).

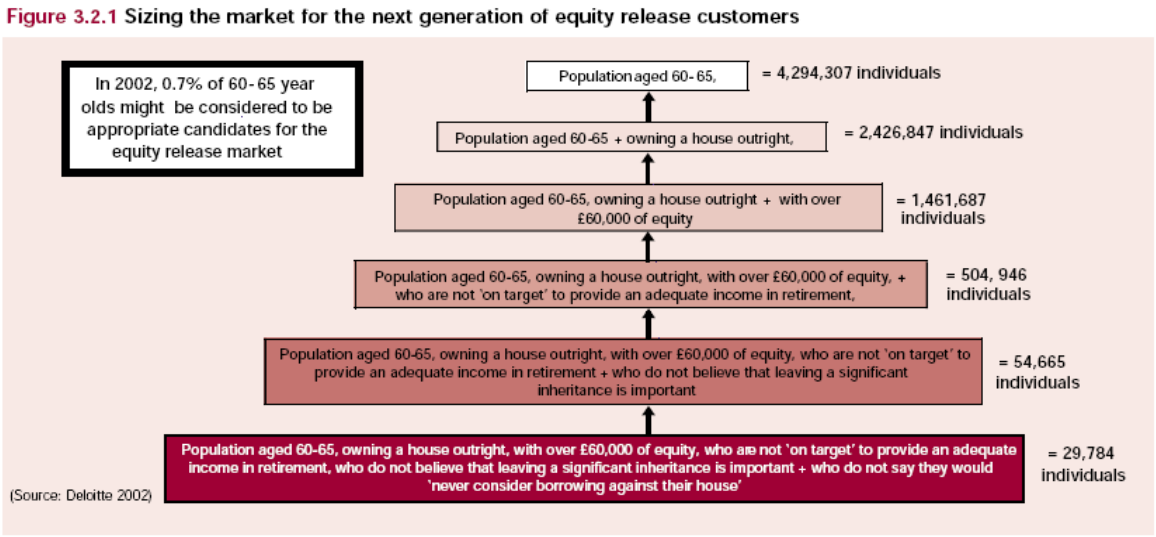

Figure 3: The Bottom-Up approach to forecasting demand for ERPs

(Source: Deloitte, 2002)

In assessing the potential market size, one must consider not only those customers who might have a need for ERPs but also whether the individuals have the means to qualify for equity release i.e. sufficient sums of equity. The client must have an appetite for equity release that is driven primarily by attitudes towards taking on debt, to spending potential inheritance and the existence of a die-broke mentality. Groups with little financial experience and those averse to using advisors may find accessing the ERP market difficult (Deloitte, 2002).

Finkel et al (1994) affirmed that the household most likely to want and to benefit from a reverse mortgage is an older, low income, single person who wants to stay in his or her house for life, has substantial amount of equity in the house and lives in a time of appreciating house values.

Customer groupings have been created within the ERP market by existing providers (Deloitte, 2002). Criteria used to determine customer segmentation include: wealth status of the individual, income status of the individual and primary drivers for equity release:

Lifestyle - to enhance own life (and property);

Survival – to meet basic financial needs / pay bills;

Altruistic – to be able make financial gifts to family and friends;

2.2.2 Demand in Australia and the United States

The Australian market has also shown signs of growth. 'Whilst remaining only a tiny fraction of total consumer lending, the reverse mortgage sector has grown significantly in the 12 months to March 2005, growing from $468 million to $770 million, with 8,899 new loans provided. A recent industry report estimates that the potential opportunity market for reverse mortgages could increase to $112 - $15 billion by 2010 (Australian Securities and Investments Commission, 2005). In a follow up report in 2007, the Australian Securities and Investments Commission (2007) put the market at $1.8 billion consisting of over 31,000 reverse mortgages.

There are approximately 350,000 homes that make use of ERPs in the United States, approximately 1% of the 30.8 million households with a member older than the age of 62. The Federal Housing Administration expects the value of loans advanced to increase to approximately US$25 billion by 2015 - this is graphed in the figure following (Redfoot et al, 2007).

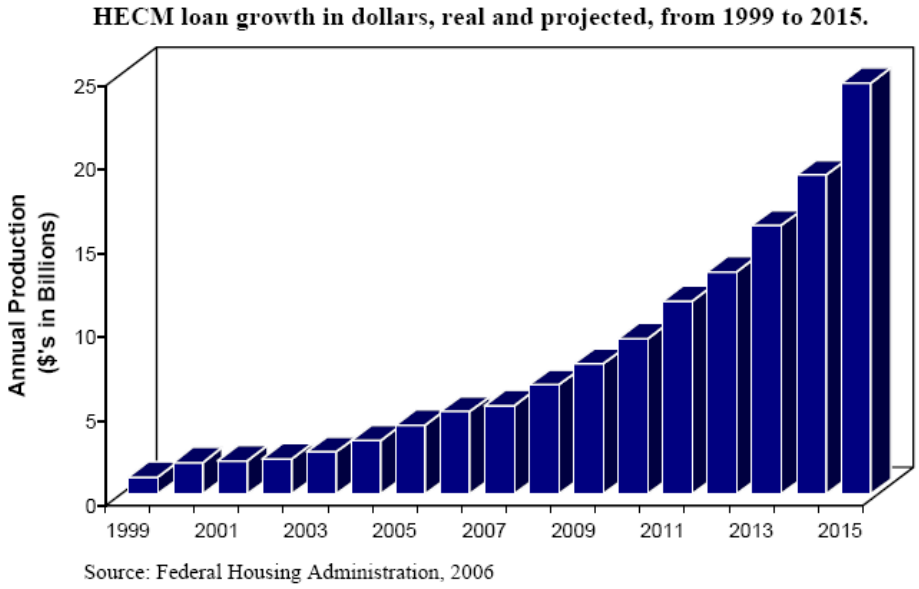

Figure 4: Anticipated Reverse Mortgage Loan Growth in the United States

(Source: Redfoot et al, 2007)

2.3 Factors driving demand for ERPs

This section examines some of the key drivers for ERPs.

2.3.1 Housing wealth as a driving factor

One of the key driving forces in the development of the ERP market is the very high percentage of wealth that elderly people have tied up in property (Gardner, 2003). Home equity is the major type of wealth held by most elderly people, and according to the 1989 survey of consumer finances, more than 80% of retired households own their own homes (Williams and Kao, 1997).

Mitchell and Piggott (2004) claim that in most developed countries enormous wealth is held in residential property. They argue that from the perspective of strategic asset allocation, an owner-occupied dwelling is illiquid and undiversified. They also state that

elderly households have lower incomes and yet, on average, possess greater housing wealth. Mitchell and Piggott's comments are backed up by the below figure that looks at Japanese housing data, clearly showing the trend of growing housing wealth and a similarly declining income.

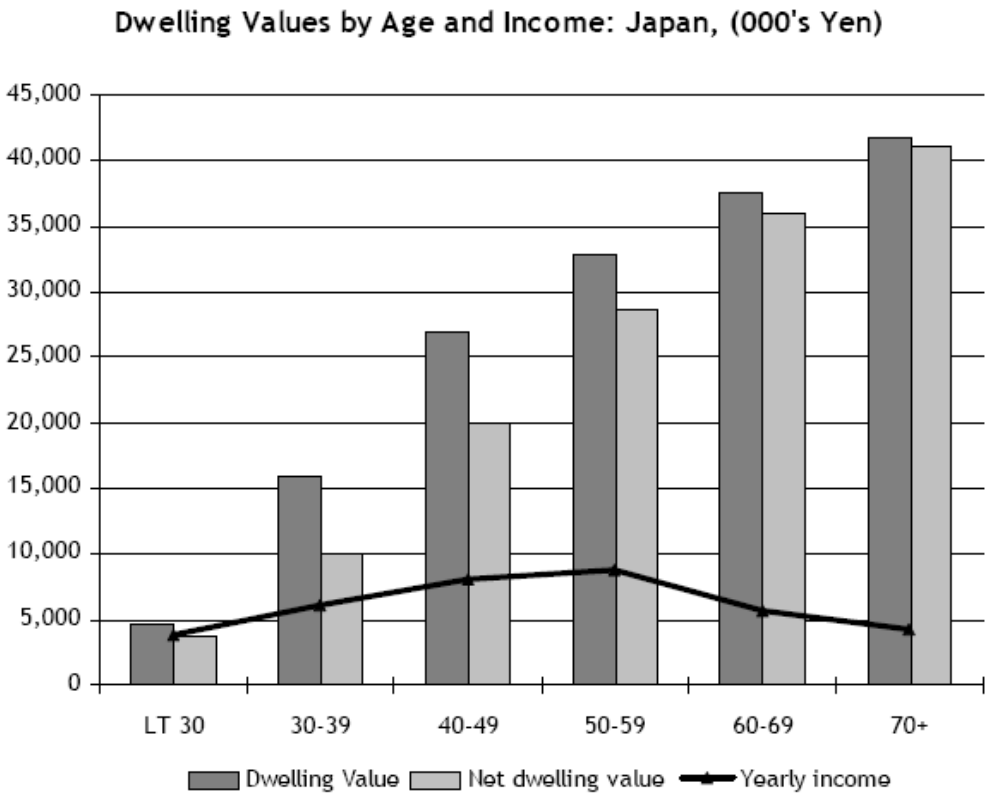

Figure 5: Average housing equity and income by age

(Source: Mitchell and Piggott, 2004)

Findings in New Zealand show a similar trend: 'Home ownership rates increase with the age of occupiers and by retirement the majority of people live in mortgage-free homes. The most common form of significant wealth-holding in New Zealand is home ownership' (Davey, 2005).

Sodha (2005) found that the number of pensioners who will be 'income poor' but relatively 'housing-rich' is set to grow over the next 10-15 years. Of those aged 50 plus, who were yet to retire, 15.6% were projected to have an accumulated state and private pension wealth of less than £160,000 on retirement and owned gross housing equity worth £100,000. This is the amount required to secure a modest but adequate retirement income.

In summing up the situation, the Actuarial Profession (2005) points out the following for the UK market: 75% of the population have inadequate retirement income and 70% of the retired population are homeowners. Assuming that the 25% with adequate income are home-owners, this means that 45% of the current retired population, or 4.3 million people, are home-owners but do not have sufficient income.

2.3.2 Increased life expectancy

Improved health in the population results in both increased life expectancy and the ability to maintain an active lifestyle into retirement, both with associated costs (Actuarial Profession, 2005). From the table below, it is apparent that life expectancy in the UK is expected to grow over the coming decades. During the last century, life expectancy grew by over 60%. Table 2, below, shows the increase in life expectancy from 1841 to the projected forecast in 2020. Whilst this trend is likely to slow, growth is still expected (Actuarial Profession, 2005).

Table 2: Increase in life expectancy

(Source: Actuarial Profession, 2005)

	Expectation of life at Birth	
	Male	Female
1841	40	42
1900	49	52
2000	76	80
2020	79	83

Increased life expectancy leads to an aging population. This trend exists in other developed countries with New Zealand expecting to have 25.5% of its population in the age group 65 years plus versus a current 11.7% (Davey, 2005).

When looking at financial innovation for an aging world, Mitchell et al (2006) point out the reality of an aging population is an important issue. Aging populations come about through people living longer and through younger people having fewer children. Reverse mortgages were introduced as one of the key innovations for an aging society.

2.3.3 Poor retirement planning and saving trends

Mitchell and Moore (1997), state that retirees will bear a larger responsibility for ensuring their own well-being in retirement. They cite Gohale's research that notes the national shift from defined benefit to defined contribution in private pension plans. Despite this, household saving rates in the United States have dropped from over 10% in the 1950s to around 3% in the first half of the 1990s. 'This discouraging pattern raises serious concerns about Americans' ability to maintain consumption levels in old age'(Mitchell and Moore, 1997). Mitchell and Moore (1997) also cite another study that concluded that United

States households were saving at only one-third the rate needed to fund a comfortable retirement. In a later paper by Mitchell and Moore (1998), they conclude that the median American on the verge of retirement has accumulated insufficient wealth to support a comfortable retirement. They also found that Americans have little other retirement wealth under their control besides company pension plans.

Figure 6 presents the trend (across various developed countries) of a decline in household savings rates from the late 1970s onwards.

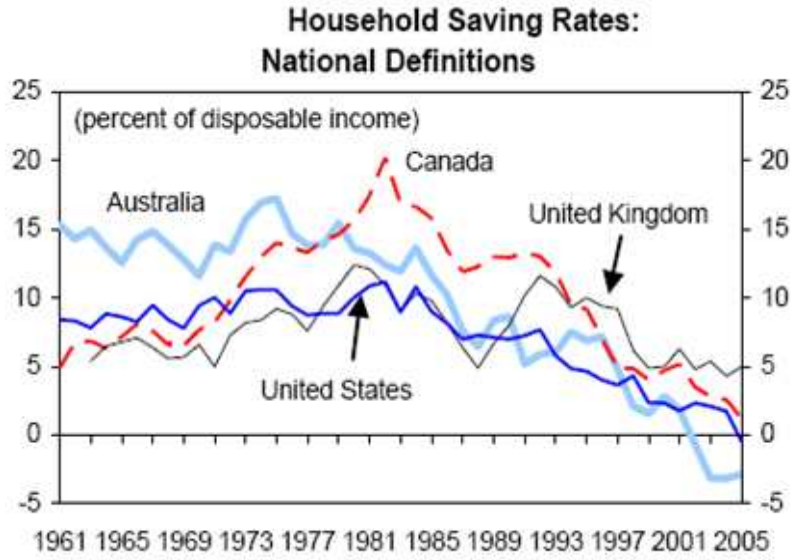

Figure 6: Household Saving Rates

(Source: Klyuev and Mills, 2006)

2.3.4 State and employer support decreasing

Due to an increasing dependency ratio in the United Kingdom, government policy has been formulated to reduce the proportion of the pension provision that is provided by the public sector. Current government policy is to reverse the 60:40 ratio between public and

private sector by 2050. This decrease in government spend coincides with a likely increase in the percentage of the population over 65 (between 16% and 26%) (Actuarial Profession, 2005).

Davey (1998) found that in many countries comparable to New Zealand, the state is seeking to reduce its level of support for older people in the face of increasing aging populations. This means that greater responsibility for supporting retired people will shift to retirees themselves and their families. There is also evidence to suggest that whilst state pension support is decreasing, so too is employer support. It was found that employers' contributions to occupational schemes decreased from an average of 11.1% to 5.1% in the United Kingdom (Actuarial Profession, 2005).

2.3.5 Property price boom

Ward (2004) notes that the property boom in New Zealand (which has arguably been an international phenomenon) has meant that many older people are living in houses that have increased in value, while their incomes have advanced at a much slower rate.

> New Zealand super-annuation, which is the major source of income for many and the sole source for some, barely keeps pace with inflation while the return from bank deposits and similar forms of investments which are commonly owned by older people has fallen with the era of low interest rates. The phrase asset rich, income poor has seldom been more appropriately applied than to elderly people living in large debt free homes on incomes little beyond NZ super. This situation has brought about renewed interest in financial plans for releasing equity and augmenting incomes (Ward, 2004).

The housing boom that Ward comments on has since slowed dramatically, due to the financial and banking crisis of late 2007 / 2008. Notwithstanding this, significant value still remains in the residential property market.

2.3.6 Low interest rates

Lower interest rates will support demand for ERPs as they make the products cheaper to use, with less interest being accrued against the amounts draw down on (Davey and Wilton, 2006). The underlying property asset is likely to appreciate more in a lower interest rate environment as debt becomes cheaper, thereby pushing up demand for housing (Tsatsaronis and Zhu, 2004). Interest earned on other retirement savings is also likely to have declined.

2.3.7 The life cycle hypothesis

'According to the life cycle hypothesis of savings and consumption, one would predict that individuals would pay down debts and build savings in their working years, then divest those savings to support consumption in their older years' (Redfoot et al, 2007). This concept of consuming ones savings seems to support the concept of a reverse mortgage. 'Reverse mortgages would be attractive to elderly homeowners if they become less risk averse and more economically rational, they need to understand the great opportunity cost of not utilising their housing assets' (Kao and Williams, 1997).

Skinner (1993) explains the concept of the life cycle hypothesis in an environment where there is a perfect reverse mortgage market and where there are no moving costs i.e. changing the size of one's house is easy.

> The conventional life cycle model implies an active reduction of housing equity at retirement, either by way of moving to a rental unit or by reverse mortgage arrangements. That is, if housing prices rise while people are young, life cycle homeowners save less for retirement in other forms. To finance retirement consumption, they cash out the now increased housing wealth. No rational life cycle homeowner dies with any housing equity remaining (Skinner, 1993).

Skinner's (1993) paper suggests that a $1 increase in housing wealth reduces saving by 1 - 2 cents. The paper also suggests that the lifecycle scenario suggested above is normally not followed and that retirees only use the housing equity in cases of adverse economic events such as bad health or serious financial loss. Bernheim (1987) points out that testing the life cycle hypothesis is problematic due to the uncertainty of life spans.

In Hurd's (1990) findings, he supports the life cycle hypothesis. Based on the Retirement History Survey, he notes that consumption declines as households age. He questions that if the bequest motive for saving is an important determinant of consumption, the consumption paths of parents and non-parents should differ, but no systematic difference between their consumption paths is found.

Danzinger et al (1983) found that whilst consumption may decline (as mentioned above), savings generally increase in retirement. They hypothesised that this may be due to many older people entering retirement but finding that their savings were insufficient to meet their future consumption needs.

2.3.8 Tax consequences

There are two tax benefits in making use of ERPs. Firstly, the draw-downs on the loan are not taxable income but loans. Secondly, the estate is reduced towards death which will lower the ultimate estate duty payable (D'Alton, 2006; Fisher-French, 2006).

2.3.9 Health needs

Chen (2003) claims that the need for spendable cash among retirees is likely to increase, as more and more individuals in the baby boom generation face the risk of requiring long term care in the next several decades. Chen states that converting home equity would seem to be a means of satisfying several desires. It can augment the income needed for

health and long term care, or other needs or desires in later life. It can enable older adults to stay in their homes, providing substance to the often-repeated ideal of “aging in place”. It elevates the role of personal savings as part of retirement security, and it gives meaning to the principle of sel- reliance (Chen, 2003; St John, 2005).

2.3.10 Changing attitudes

In forecasting the demand for ERPs, one needs to look at whether some of the current deterrents such as attitudes towards debt and inheritance are likely to change in the foreseeable future. Masnick et al (2006) states that whilst ERPs are not very popular among elderly homeowners today, their use may increase amongst the next generation that already has a different perspective on tapping into home equity, and accordingly we could see greater use of ERPs for cash strapped households.

The AHURI survey found that whilst most retirees expected to leave assets to their estate, a significant, younger, minority expected to use up all their assets while alive (about one fifth of males and one third of females). The survey found that 35% of those aged 50 - 59 expected to use up all their assets while alive, as did 33% of those aged between 60 and 69. By comparison, only 18% of those aged 70 - 79 and 11% of those aged over 80 expected to do so. This suggests that there may be a growing willingness to access home equity by some future retirees (Dolan et al, 2005).

The report produced by Deloitte in 2002 seems to show a strong change in attitude towards inheritance (Deloitte, 2002). Figure 7 below shows the percentage break down of expectations towards inheritance. Only 35% of the survey expected a cash inheritance.

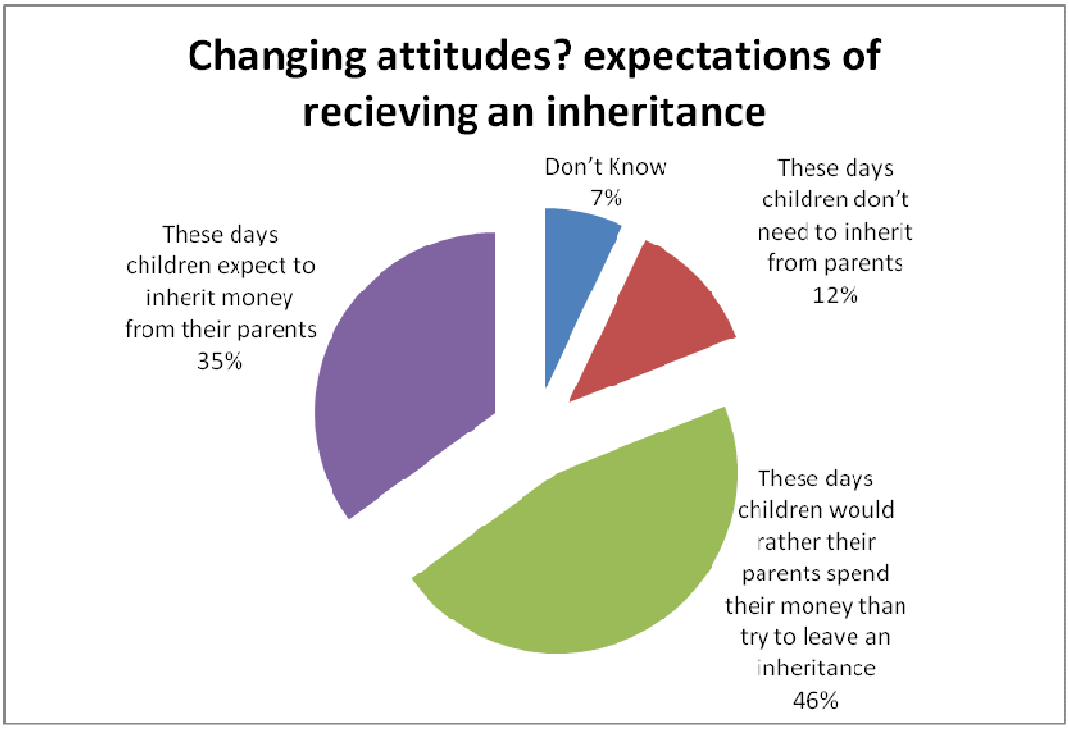

Figure 7: Changing attitudes? Expectations of recieving an inheritance (Source: Deloitte, 2002)

Commenting on barriers to growth in the industry, Gardner states that changes in consumer attitudes both with regards to inheritance and how property itself is viewed (as a financial solution) is likely to break down such barriers (Gardner, 2003). 'There is little sign of older consumers scrimping in order to leave an inheritance to their children. Increasingly retired groups would prefer to distribute their wealth whilst they are still alive' (Gardner, 2003). There is also the belief that younger generations are more used to debt and are used to managing it as part of their everyday financial planning.

Davey (2005) claims that the next generation of older people will have different attitudes. They will be more financially aware and attuned to managing debt, and they will also have lower expectations of welfare support.

Proposition 1:

The factors driving demand for ERPs are:

- Increased housing wealth (supported by increased property prices and lower interest rates) has lead to a demand for products that will unlock value.
- Increased life expectancy has meant that there is a longer period needed to sustain income in retirement.
- Poor retirement planning and savings trends mean that retirees are not as well prepared for a long retirement.
- There is an opportunity cost of not spending one's assets before death (life cycle hypothesis).
- State and employer retirement support is decreasing, leaving more up to the individual.
- ERPs are tax efficient.
- ERPs are useful in affording health care.
- There are changing attitudes towards debt and inheritance.

2.4 Factors hindering demand

There has been much debate over the economic potential of the reverse mortgage market. Even the most pessimistic assessment would suggest that this market should be larger than it is by order of magnitude (Caplin, 2000).

Venti and Wise (1989) are critical of the industry. They claim that elderly people simply do not want to reduce equity in their homes. They argue that if elderly people wanted to reduce the equity they would move and that the costs involved in moving are not to blame. They assert that those who do move are equally likely to experience an increase or decrease in housing equity. In a later paper, they also find that the median elderly homeowner, even in the lowest third of the income distribution, would only have a small

percentage increase in income from a reverse mortgage. They claim that the reverse mortgage market is limited to single persons who are very old (Venti and Wise, 1989, 1990). When analysing the housing decisions of the older homeowner, Vanderhart (1994) found that demographic factors play a much more important role than financial factors in housing decisions. He claimed that reverse mortgages would not play a large role in enabling the elderly to stay at home.

This section identifies and explores those issues that are said to be negatively impacting demand.

2.4.1 Lack of confidence in the market

The strongest argument against the importance of the ERP market is the relatively low demand for existing products, i.e. if the market was important, surely it would be here already? (Caplin, 2000). Older people are wary of schemes that entail risks to what is possibly their only asset. The Actuarial Profession claims that there is wide suspicion of ERPs including concern over value for money, fear of indebtness, attitudes to inheritance, misgivings about the future direction of government policies and high administrative costs (Actuarial Profession, 2005).

The Actuarial Profession (2005) also claims that the lack of consistent regulation and the lack of participation in the market by the big brands (particularly the banks) are contributing factors. 'There is a low awareness and understanding of ERPs. The products are also perceived in the market as being a distress purchase (rather than a life style purchase)' (Actuarial Profession, 2005). Terry and Gibson (2006) agree that the absence of the mainstream financial institutions is hampering demand.

2.4.2 Fear of indebtedness

Davey (2005) argues that current older generations in Australia, New Zealand and similar countries, are traditionally financially conservative and risk adverse. However, there is an understanding of how mortgages work as the potential user would have made use of a mortgage at some stage during his/her life. The use of ERPs may come with an element of stigma (it may signal dire financial circumstances). Conversely, one could argue that the younger generations are used to dealing with debt as part of everyday money management (Davey, 2005).

The Joseph Rown Tree Foundation Report groups the various inhibitions that consumers may have into three sectors (Terry and Gibson, 2006):

1) Those that are generally concerned about any form of finance
- Practicalities of actually spending the money (organising care, managing building contractors etc.)
- Attitudes to spending and inheritance
2) Those concerned with debt
- Reluctance to incur debt of any kind
- Reluctance to take on housing debt, feeling that they have spent a lifetime paying off a mortgage loan so as to be debt free in their retirement
3) Those specific to financing by Equity Release
- Lack of trust in the product
- Value for money
- The formidable process: ASIC agrees that the process of equity release is formidable as consumers are required to consider both investment and borrowing issues at the same time with respect to a single product (Australian Securities and Investments Commission, 2005).

2.4.3 Poor historic experiences (especially in the 1980s)

Poor product design and poor marketing during the 1980s resulted in public mistrust and poor publicity for the industry overall. 'Undoubtedly, the unfortunate experiences of the 1980s style home income plans have bred mistrust of the market. Research has shown that the current perception of equity release among consumers still has some distance to travel before it is perceived as a wholly credible market' (Gardner, 2003).

2.4.4 The rainy day approach

Many older people strongly believe in preserving their assets for some emergency in the future. The contemplation of future health problems often underpins this attitude that is linked to the last resort theory. Others accept that their rainy day has come or that there is something to be said for enhancing standards of living while they are alive (Davey, 2005).

2.4.5 Expectations and suspicions of government

Expectations of government support for retired people have been fostered by decades of welfare state provision. Older people have often seen it as their right as citizens to receive income and services at the tax-payers' expense, especially given their own contributions over a working lifetime. This makes them reluctant to draw down on their own housing assets (Davey, 2005).

2.4.6 Inheritance

Attitudes surrounding inheritance are central to the debate on whether housing wealth could or should be used to supplement income in old age. Many authors agree that

attitudes to inheritance or bequests are very important with regards to ERPs (Caplin, 2000; Mitchell and Piggott, 2003; Gardner, 2003). Caplin argues that two of the strongest reasons for avoiding the market may be a desire to move from a current home and a powerful bequest motive (Caplin, 2000). 'There are the intergenerational tensions and conflict between the desire to leave inheritance and the need for money to live on in older age' (Australian Securities and Investments Commission, 2005).

Davey (1998) grapples with the various social and economic purposes that inheritance serves:

- It formalises and symbolises family lines
- It keeps significant or important property within the family e.g. land, furniture, jewellery and art works
- It is the final act of parents "providing for their children"; and
- It gives younger people assets to enhance their own lives.

However, inheritance has also been seen to perpetuate inequalities in society leading to the advent of policies such as estate duty (Davey, 1998).

2.4.7 Lower value properties

There is a paradox that will always challenge the ERP market: those homeowners on the lowest incomes are likely to live in the lowest value properties and their properties are most likely to have fallen into disrepair. So those in the greatest need of equity release may find that their property does not meet the underwriting criteria for schemes offered by commercial organisations. Furthermore, they may find that any income or capital they raise through an ERP affects their entitlement to means-tested state benefits (Actuarial Profession, 2005).

2.4.8 Means-tested benefits

For older home owners entitled to means-tested benefits, Equity Release deals can be very unattractive, because they may lose substantial amounts of entitlement by entering into such a deal (Terry and Gibson, 2006). Financial advisors further complicate the problem as they are used to dealing with clients whose income and capital puts them well beyond the scope of benefits and thus, they lack experience in dealing with the complexities of benefits (Terry and Gibson, 2006). In the United Kingdom around 9% of retired individuals potentially in a position to release housing wealth face disincentives to do so from the benefits system (Sodha, 2005).

2.4.9 Costs

ASIC states that the costs cannot always be assessed upfront with ease. They involve a number of elements in varying proportions, including initial and ongoing fees, interest charges, rental or license costs and capital gain or equity foregone (Australian Securities and Investments Commission, 2005). William and Kao (1997) claim that the small increase in income that would result from reverse mortgages (4-10%) may not be worth the transactional cost.

2.4.10 Movements in property prices and interest rates

Reverse mortgages can be an expensive way to generate cash income, especially in periods of high interest rates. In a reverse mortgage, a borrower is borrowing his or her own money (equity) and for this privilege is paying out a substantial amount of interest and loan charges. People living alone, especially the very old with lower incomes, may benefit the most in percentage gains in reverse mortgages. Unfortunately, many in this low-income group are living in low-valued homes with low appreciation potential because

of declining neighbourhoods. As a result, financial institutions do not consider them attractive options for reverse mortgages (Williams and Kao, 1997).

2.4.11 Alternatives to Equity Release Products

Davey has tabled alternative options available to the elderly who are asset- rich, income-poor and that may compete with ERPs.

Housing Wealth Options				
MOBILSE		**PRESERVE**		
SALE	INTENSIFY USE	EQUITY CONVERSION	FOR A RAINY DAY	INHERITANCE
Trade down	Share	Mortgage	Residential or Community Care	
Rent	Convert	Home Reversion	Assistance to family	
Share	Build on	Reverse Mortgage	Emergency use	
	Sub-divide	Other options		

Table 3: Housing Wealth Options

(Source: Davey, 2005)

Proposition 2:

The factors hindering demand include:

- Lack of confidence in the market
- Fear of indebtedness
- Poor historic experiences of ERPs
- Unwillingness to spend housing wealth in case of some unforeseen financial disaster
- Retirees expect government to support them in retirement
- People want to leave assets to the next generation (the bequest motive)
- Lower value properties and higher interest rates may mean less home equity to utilise
- Home owners do not want to jeopardise other benefits such as means tested support
- ERPs are perceived to be expensive
- The alternatives to ERPs may be more attractive.

2.5 Factors influencing supply

This section primarily deals with the risks and challenges facing suppliers. Many of the factors hindering demand for ERPS (analysed under sub-problem two) may also be the negative forces affecting the supply side of the industry (Davey, 2005). For instance, a concern for demand would be that the loan and interest amount on an ERP might be greater than the equity in the house, leaving the owner with no further housing wealth. Likewise, this would result in the lender having no further security.

Rajagopalan (2002) claims that the basic source of risk facing suppliers is the unique problem of predicting accumulated future loan balances under a reverse mortgage at the time of origination. A reverse mortgage is a 'rising debt' instrument. Since reverse

mortgages are non-recourse loans, even if the collateral property appreciates in value, it might still be lower than the loan balance at the time of disposal of the property.

In assessing the risks, the Actuarial Profession has tabled some of them along with possible hedging strategies in Table 4 below.

Financial Risks on Roll-up Mortgages			
Risk	**Impac**	**Issue**	**Mitigation**
Mortality	M	Provider takes annual margin over cost of funds. Heavier mortality will shorten the term of the mortgage, reducing the period for which the margin is earned. Lighter mortality will increase the company's exposure to negative equity.	Redemption profile insurance or Securitisation
Long term care entry	L	Same as mortality, but lower incidence rate means lower exposure.	Redemption profile insurance or Securitisation
Miscellaneous home exits (e.g. move in with family)	L	Same as mortality, but lower incidence rate means lower exposure	Redemption profile Insurance or Securitisation
Remortgaging	H	Same issue as mortality, but likely to occur very early in contract life when origination costs won't have been covered. May result in significant losses on hedged interest rates as most likely to arise in volume when long-term interest rates have fallen.	Redemption profile insurance or Securitisation and/or Product design
Interest rates	H	Loan generates fixed rate of interest that may fall behind (floating rate) cost of funds.	Interest rate swap or Securitisation or Raise fixed rate funds
House price exposure	H	Impacts of "no negative equity guarantee". May be significant in protracted period of stagnant or very low house price growth.	Insurance or Securitisation or House price swaps
Expense Risks	L	Expenses may exceed allowances in product loadings, or business volumes may not reach critical mass.	Outsourcing

Table 4: Financial Risks on Roll-up Mortgages

(Source: Actuarial Profession, 2005)

This section identifies and explores those issues that are said to be influencing supply.

2.5.1 The image of home equity release

There is always a suspicion surrounding new financial products and providers may be wary of offering a new product whose image is not wholly positive. Problems experienced in the United Kingdom during the 1980s with poorly structured and poorly sold products have left a poor legacy (Davey, 2005). 'Due to the cost of the schemes, the roll up of interest and loan which limits future options available to the elderly, ERPs are sometimes accused of ripping off the aged or throwing them out of their home. No financial firm wishes their products to be labelled as exploitive nor do they want to be seen, even in theory, as evicting vulnerable elderly people from their homes' (Davey, 2005).

Insurance companies and banks tend to take a conservative view of the risks involved and may also believe that ERPs are complicated and expensive to put together compared with the expected business volumes.. Davey claims that public debate and government involvement is likely to be key in a market increase (Davey, 2005).

2.5.2 Marketing and other transaction costs

The marketing of ERPs demands a considerable investment of time and effort. Working with older clients makes the process even more difficult as additional explanations and reassurances are necessary. Broker commission is relatively unattractive. In some instances, social worker skills are perhaps more appropriate than sales (Davey, 2005). Terry and Gibson (2006) agree that providers need to recoup not only high marketing costs but other transactional costs as well.

> Despite the large numbers of elderly homeowners who could potentially benefit from a reverse mortgage, few financial institutions have shown

interest in offering the product. Older consumers tend to be more financially conservative than the general population, and one difficulty is the high cost of borrower counselling and the slow process of educating them about the properties of a complex financial product (Mayer and Simons, 1994).

Case and Schnare (1994,) when evaluating the HECM Reverse Mortgage Program, noted that it took some lenders as long as 18 months to close their first reverse mortgage. They point out that lenders need to develop staff capabilities, documentation and loan processing procedures specific to the product.

Despite this, Case and Schnare did point out that firms that entered the reverse mortgage market viewed the products as: innovative, low risk and profitable in the long run. It was also found that firms were pleased to be servicing the interests of the older community.

2.5.3 Long-term commitment of funds

Insufficient return for the supplier is mentioned as a supply problem (Terry and Gibson, 2006). There can be a very long time period before the provider receives any return (usually when the property is sold because the homeowner has died or has moved into permanent care). There is also difficulty in fixing the funding rate as the period is uncertain. The supplier has a perception that the return has a relatively large margin of adverse risk, which cannot be readily hedged. However, Terry and Gibson (2006) state that there is no indication that the scale on which commercial equity release deals are currently offered is constrained by the difficulty of financing them.

Davey (2005) points out that the payment of annuities or lump sums is a major drain on the cash resources of the lender. This may present serious liquidity problems depending on cash flows, the range of other assets held and the likely maturity dates of the portfolio (which are hard to predict). Providers should therefore have diversified streams of cash flows so as to hedge this complication. ‘Securitization through intermediaries is now fairly standard, turning borrowings into bonds, but this requires financial soundness and

favourable ratings in the market' (Davey, 2005). In reverse mortgage loans where the borrower draws down on his loan through a credit line, there is a risk of sudden withdrawals (Rajagopalan, 2002).

2.5.4 Longevity risk

The longevity of clients or when they decide to sell their homes is what dictates the payback of capital. Lenders need to protect themselves against the worst-case scenario – that the borrower or spouse will remain in permanent occupancy longer than anticipated and that the loan balance will exceed the equity. It is possible for lenders to take a loss in cases where no-negative equity guarantees, security of tenure and/or life annuities are involved (Chinloy and Megbolube, 1994; Mitchell and Piggott, 2003; Davey, 2005).

Rajagopalan (2002) points out that the lender gets hit in two ways: annuity payments have to be made for a longer period; and the eventual value realised might decline. He does point out however, that the risk is usually diversifiable by having a large pool of such borrowers (some in good health, others in poor health etc). Rajagopalan also indicates that the very supply of home equity release products may be the cause for better life expectancy as users can afford better medical treatment, health care, diets etc. The longevity issue also has reporting complications for the lender, as both the interest and any shared appreciation component added to the loan balance are taxable as current income, even though there is no cash inflow (Rajagopalan, 2002).

Edward and Szymanoski (1994) note that longevity risk is diversifiable by pooling sufficiently large numbers of loans. Lenders are able to utilize mortality tables and other information to come up with reasonably accurate predictions of future loan terminations.

2.5.5 Property price risk

The ERP market relies (to some degree) on increasing house prices that will preserve the security of the service provider. Despite historical upward trends, there is no guarantee that house prices will increase and even less certainty that any growth will be at a steady state (Mitchell and Piggott, 2003; Davey, 2005). Rajagopalan found that this risk is potentially diversifiable by geographical diversification and non-stationary time series (Rajagopalan, 2002). Edward and Szymanoski (1994) also comment on geographical diversification but point out that the risk to national economic recession is not diversifiable. Mitchell and Piggott (2003) also cite that developed property price indexes are essential in making forecasts. Countries with more developed house price indexes will thus be at an advantage.

2.5.6 Interest rate risk

Given that the typical reverse mortgage borrower is elderly and is looking for predictable sources of income / liquidity, reverse mortgage loans promise a fixed monthly payment / lump sum / credit line entitlement. However, for the lender, this is a long-term commitment with significant interest rate risks. While fixing the above, the lender has to account for a risk premium and thus can offer only a conservative deal to the borrower. This interest rate risk is not fully diversifiable within the reverse mortgage portfolio. Most of the reverse mortgage loans accumulate interest on a floating rate basis to minimize interest rate risks to the lender. However, since there are no actual periodic interest payments from the borrower, these can be realized only at the time of disposal of the house, if at all (Rajagopalan, 2002).

In research conducted by Boehm and Ehrhardt (1994) they concluded that fixed rate reverse mortgages had very high interest rate risk relative to other fixed rate securities. They claimed that unless financial institutions measure the risk inherent in reverse

mortgages correctly and hedge it appropriately, they are likely to experience unexpected volatility.

2.5.7 Regulation and government policy

Davey (2005) cites the complications of having many regulatory bodies (with different regimes and systems of governance) governing ERPs. Davey does go on to say, however, that the industry is not perceived to be over-regulated. The creation of bodies such as SHIP in the United Kingdom is seen to be a positive move (SAHERPA is South Africa's equivalent of SHIP).

According to Davey (2005) there are three government policy issues that need to be considered, namely:

- The tax treatment of equity release schemes with regards to estate planning and the nature of the annuity income
- Super-annuation policy and policies relating to the funding of residential and other health care
- General government support and potential subsidies to equity release suppliers (this could also be in the form of guarantees).

2.5.8 Moral hazards

There are two moral hazards that impact suppliers:

1) The homeowner may become ill or incapable of maintaining the property. Some contracts provide for foreclosure under such conditions but this seems to be impractical and is sure to result in litigation and bad publicity for the supplier. The same holds true for non-maintenance of rates and taxes on the property (Caplin, 2000).

2) The homeowner, realising that the debt accrued on the house has surpassed the equity, may be more inclined to stay in the property at the lenders expense. At this point the homeowner will also have no incentive to maintain the house so as to preserve or enhance market value (Caplin, 2000; Rajagopalan, 2002)

In the research done by Davidoff and Welke (2004), they concluded that reverse mortgages have enabled longer stays at home, but that the kind of people who want to cash out their housing wealth have turned first to reverse mortgages and relatively soon thereafter to the disposal of the entire asset.

Advantageous selection has lead to very few losses paid out by insurers for insufficient collateral. Davidoff and Welke (2004) also argue that to reduce the upfront fee and increase the interest (as opposed to the opposite pricing structure) will less incentivise people to stay in their houses for longer time periods. They do note the possible catch in doing this however, in that reducing the upfront fee may encourage the type of users who have long-term intentions to stay where they are.

Schiller and Weiss (2000) recommend that suppliers consider incentives to improve home values and to negotiate good sale prices. They caution suppliers that moral hazards may take many years to develop and that competitive pressures for achieving volumes in future may increase this risk.

2.5.9 Major supply shocks

The suppliers of ERP products are likely to be affected by macro issues facing the banking and financial services sectors. The recent and ongoing Sub-prime crisis is an example of such an issue and is particularly relevant as it is linked to mortgage back lending. The Sub-prime crisis will have an effect on mortgage back securitizations that is a source of funding for ERP suppliers (Rose, 2008).

Proposition 3:

Factors influencing the supply of products include:

- The image of ERPs
- Marketing and other transaction costs
- The long-term commitment of funds
- Financial risks including term (longevity risk), property price risk and interest rate risk
- Regulation and government policy
- Possible moral hazards which suppliers may face
- Major supply shocks (such as the Sub-prime crisis)

2.6 The South African context

There has been little research done on the potential market for ERPs in South Africa. However, as noted earlier in this paper, the market is beginning to take shape. Seniors Finance and Nedbank have both entered the market but take up has been slow. In drawing lessons from the United Kingdom, it is necessary to assess the environment and contextualise the setting in South Africa.

2.6.1 Economic and social environment in South Africa

The economic and social characteristics of South Africa will naturally shape the ERP industry locally. This section provides some basic background on the country's economy and some of the macro trends present.

The economic and social environment in South Africa is complex and diverse. South Africa is considered an upper middle-income economy by the World Bank and has an average income per capita of $ 5,360 US (Clarke et al, 2006). South Africa is a middle-income emerging market with a rich supply of natural resources. It has advanced financial, legal,

communications, energy, and transport sectors. The Johannesburg Stock Exchange is the 17th largest in the world. The infrastructure is able to support the efficient distribution of goods to major urban centres throughout the region. As with many emerging economies, growth has been robust since 2004. Despite the recent slow-down, South Africa has reaped the benefits of macro-economic stability and a global commodities boom. On the down side, unemployment remains high at 24.3%. Daunting economic problems remain from the apartheid era - especially poverty, lack of economic empowerment among the disadvantaged groups, and a shortage of public transportation. The South African Reserve Bank and Financial Ministry are fiscally conservative but pragmatic, focusing on controlling inflation, maintaining a budget surplus, and using state-owned enterprises to deliver basic services to low-income areas as a means to increase job growth and household income (Central Intelligence Agency, 2008).

South Africa has a poor Gini coefficient of 0.59 with 64.8% of total earnings earned by the richest 20% of the population and 2.9% of total earnings earned by the poorest 20% of the population (Clarke et al, 2006).

The South Africa Reserve Bank aims to maintain an inflation rate of between 3% – 6%. Similar to many developing economies, South Africa has an above average inflation rate. The interest rate environment in South Africa is higher than the United Kingdom. As at October 2008, South Africa had a current prime-lending rate of 15.5% (Standard Bank, 2008), whilst the United Kingdom had interest rates closer to 6%.

In line with the other developed countries that make use of ERPs, South Africa has also experienced a decreasing trend in household savings rate as illustrated in Figure 8.

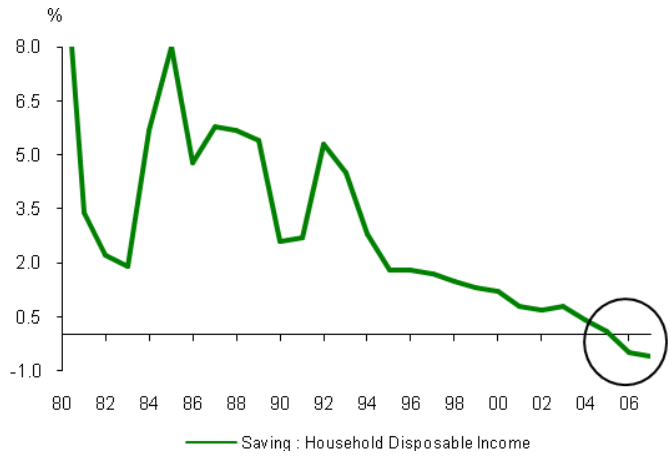

Figure 8: Savings trend in South Africa

(Source: South African Reserve Bank 2008)

2.6.2 Life expectancy, aging and home ownership amongst the elderly

Life expectancy at birth in South Africa is approximately 50.3 years of age for males and 53.9 years of age for females. This low life expectancy is possibly due to the high prevalence of HIV and the high percentage of people living below the poverty line (50%)(Statistics South Africa, 2008).

Kinsella and Ferreira (1997) looked at the aging trends in South Africa, and notwithstanding the low life expectancy stated above, the South Africa population of 60 plus years was found to be growing. In 1997 the percentage of population over 60 years of age was 6.8% and this is expected to grow to 8.6% by 2010 and 10.8% by 2025.

The majority of South Africans surveyed owned their own home (or it was owned by their spouse). Nine out of ten rural blacks owned their homes. In the urban setting, 62% of elderly whites resided in homes owned by themselves or their spouses, while 72% of elderly Asians resided in dwellings owned by someone else (presumably a child) in the household (Kinsella and Ferreira, 1997).

Commenting on black home ownership, Lightstone Risk Management (2008) states that in 2007 36% of all property owners registered with the deeds office were black. This marks an increase of 63.4% from 1997 when the figure stood at 22%. A high proportion of the entrants were not typical buyers in a normal open market, but people who got transfer of duties on 99-year lease types.

2.6.3 Estimation of potential users of ERPs in South Africa in 2010

The table below is an attempt to estimate the potential market for ERPs in South Africa in 2010. This table is a summary of Appendix 3. The methodology used is similar to Figure 3 above that took the total United Kingdom population of between 60 and 65 years of age and whittled it down to the potential market for ERPs. South Africa has a population of approximately 49 million people (Central Intelligence Agency, 2008). Of a total population older than 60 years of age (5.61 million), it is estimated that there are approximately 91,000 people who may be in a position to take up ERPs. As a percentage, this equates to approximately 1.7%.

Sizing the market for equity release in South Africa: 2010	
South Africa: Total Population 2008	48,5 million
Population older than 60 (Projected 2010)	5,61 million
Population older than 60 who own their own home	4,62 million
Population older than 60 who own their own home and who have in excess of R550k worth of equity	498,000
Population older than 60 who own their own home, who have in excess of R550k worth of equity and who do not have sufficient income	169,000
Population older than 60 who own their own home, who have in excess of R550k worth of equity, who do not have sufficient income and who do not want to leave an inheritance	91,000

Table 5: Sizing the potential market in 2010

(Summary of Appendix 3)

When describing the market in South Africa, Nic Craig (a founder member of SAHERPA) splits the market into three (Masie, 2008):

- Needs-based users (most of the market share in SA)
- Wants-based users (who want to enhance their quality of life by travelling and so on)
- And the smarter money-based users (who might, for example use a home equity release loan to lower their estate duties)

2.6.4 Brief overview of the traditional mortgage market in South Africa

A mortgage is defined as follows: 'A Mortgage is a lien on a property/house that secures a loan and is paid in instalments over a set period of time. The Mortgage secures your

promise that you'll repay the money you've borrowed to buy your home' (Freddie Mac, 2008).

South Africa's mortgage market has its roots in the Building Society concept inherited from the British settlers in the mid-19th century. Building societies were/are essentially friendly societies created to support their members' efforts to procure houses. Post the so-called De Kock Commission in the mid- 1980s, new legislation forced building societies to compete with banks on an equal footing and many became banks or were merged with banks. For instance, the United Building Society was the biggest building society in South Africa and formed a major part of the formation of Amalgamated Banks of South Africa (ABSA). By the mid 1990s, no building societies remained in South Africa (Luus, 2003). Banks are by far the most important providers of mortgage finance. In June 2003 mortgage loans accounted for 32% of total loans advanced by banks, amounting to R289 billion (Luus, 2003). By December 2007 this number had increased to R783 billion (SARB, 2008).

2.6.5 Housing market

In South Africa, property ownership rates highly in the national consciousness. For most working South Africans, their house and retirement provision account for the bulk of the wealth they have accumulated throughout their working lives (Luus, 2003). The residential property market in South Africa comprises of approximately seven million formal dwellings. There is no formal data, but the value of the residential property market in 2002 was estimated at roughly R750bn. The government has succeeded in building nearly 1.5million low-cost housing units during the period 1994 – 2003 (Luus, 2003). The higher end of the market (houses > 80m2) has also experienced a significant increase in activity over the past few years. The table below shows the breakdown of housing between rural and urban, as well as between the formal and informal/traditional sectors.



Table 6: Housing in South Africa

(Source: Luus 2003)

2.6.6 House price fluctuations

House prices have fluctuated significantly over the last decade and the major boom between 2002 and 2006 has led to greatly enhanced values of residential property. This large increase in house prices (as well as the recent decline) is important when setting the context of this study.



Figure 9: South African house price growth index

(Source: Standard Bank 2008)

The above figure shows the increased growth in house prices from 2002 to 2006. In 2004 and 2005 house prices were increasing by as much as 35% per annum.

2.6.7 Conclusion

There are both similarities and differences between the South African market for ERPs and the market in the United Kingdom.

Factors in common which may drive demand for ERPs include:

- Decreasing savings rate
- Increasing % of population over 60 (despite a low life expectancy)
- Home ownership is considered to be important to South Africans i.e. a high % of the elderly own their own homes
- Until recently, South Africa has also experienced a boom in house prices
- Well developed traditional mortgage market (>R783 billion)
- Increasing home ownership amongst black people (specific to South Africa and important in looking at future trends).

Factors that do not support an ERP market in South Africa include:

- A higher interest rate environment (to some extent this is offset by a higher inflation rate and one should perhaps look at real interest rates)
- Complex distribution of wealth (poor Gini co-efficient and political legacy that has distributed wealth along racial lines)
- Small home-owning middle class.

Given the contextual setting in South Africa, what lessons can be drawn from the experiences of suppliers of ERPs in the United Kingdom? What are the implications for South African firms? These questions are examined towards the end of this study.

2.7 Propositions and research questions

The propositions and research questions arising from the literature review are as follows:

Proposition 1:

The factors driving demand for ERPs are:

- Increased Housing Wealth (supported by increased property prices and lower interest rates) has lead to a demand for products that will unlock value;
- Increased life expectancy has meant that there is a longer period that income is needed to be sustained in retirement;
- Poor retirement planning and savings trends mean that retirees are not as well prepared for a long retirement;
- State and employer support is decreasing, meaning that more is left up to the individual;
- There is an opportunity cost in not spending ones' assets before death (life cycle hypothesis);
- ERPs are tax efficient;
- ERPs are useful in affording health care;
- There are changing attitudes towards debt and inheritance.

Proposition 2:

The factors hindering demand include:

- Suspicion of the market size and the lack of participation by the bigger banks;
- Fear of indebtedness;
- Poor past experiences of ERPs;
- Unwillingness to spend housing wealth in case of some unforeseen financial disaster;
- Retirees expect government to support them in retirement;

- People want to leave assets to the next generation (the bequest motive);
- Lower value properties and higher interest rates may mean less home equity to utilise;
- Home owners do not want to jeopardise other benefits such as means-tested support;
- ERPs are perceived to be expensive;
- The alternatives to ERPs may be more attractive.

Proposition 3:

Factors influencing the supply of products include:

- The image of ERPs;
- Marketing and other transaction costs;
- The long-term commitment of funds;
- Financial risks including term (longevity risk), property price risk and interest rate risk;
- Regulation and government policy;
- Possible moral hazards that suppliers may face (e.g. eviction);
- Major supply shocks (such as the Sub-prime crisis).

Given the contextual setting in South Africa discussed above' this study seeks to draw from the experiences of suppliers of ERPs in the United Kingdom and examines the implications for South Africa.

3. Research methodology

In this exploratory research the methodology will be qualitative and word based in nature. The research will be in the form of a collective case study and will involve in-depth interviews with key personnel of financial services providers (suppliers) of ERPs in the United Kingdom. The suppliers will all be members of SHIP. Themes and issues emerging from these interviews will also be discussed with other general mortgage providers (both in the United Kingdom and South Africa) who have not, as yet, entered the market.

3.1 Paradigm

3.1.1 Defining qualitative research

Creswell (1998) defines qualitative research as 'an inquiry process of understanding based on distinct methodological traditions of inquiry that explore a social or human problem. The researcher builds a complex, holistic picture, analyses words, reports detailed views of informants, and conducts the study in a natural setting'. Leedy and Ormond (2001) claim that all qualitative approaches have two qualities in common: they focus on phenomena that occur in the real world and they study the phenomena in all their complexity. Straus and Corbin (1998) define qualitative research in terms of what it is not: 'By the term qualitative research we mean any type of research that produces findings not arrived at by statistical procedures or other means of quantification'. In a quantitative enquiry one looks to control the variables, however, in a qualitative enquiry the variables are not controlled because it is exactly this freedom and natural development of action and representation that we wish to capture (Henning, Van Rensburg and Smit, 2007).

3.1.2 Why qualitative research is appropriate

The propositions set out within the sub-problems require a qualitative approach. The propositions have characteristics that are consistent with the nature of qualitative research (as described in 3.1.1 above). These consistencies are listed below:

- Complexity – The propositions are complex as they are contextual, subjective, and involve social issues such as attitudes towards inheritance, care for the ageing, government policy on pension plans etc.
- Word Based – Data to be collected will be mostly word based
- Real World Setting – The interviewees will be selected from within the industry and will have a "hands on" / "front line" perspective of the issues. The interviewees will be current employees of financial service providers within the United Kingdom.
- Not quantitative – The data to be collected will not be quantitative and results will not be derived through statistical means.
- Variables will not be controlled – The questions posed to the interviewees will be open ended. Answers will be unguided and uncontrolled.
- Questions will focus on the "hows and whys" of the factors influencing demand and supply.

A collective case study approach is suitable as the ERP industry is still relatively unknown and poorly understood, especially in the South African context where the products are only now being introduced. A complete view of the industry is needed, as well as a deep understanding of some of the issues facing the participants. A qualitative study is appropriate given the type of issues facing the industry.

3.2 Methodological Approach

The research will take the form of in-depth interviews with key personnel of the financial services providers (suppliers).

Population Description:

Financial Services Providers in the United Kingdom who have entered the Equity Release market and have products available to the public.

The UK suppliers were selected as, based on existing litereature, the UK market appears the most developed. The UK market also has a number of different suppliers. The total amount of Equity Release funding released in 2007 in UK was approx £1.4 billion and the total number of plans taken out in 2007 was 30,088 (Key Retirement Solutions, 2008).

Sample:

Members of the Safe Home Income Plans organisation (SHIP). SHIP currently has 20 members registered. SHIP is the main industry body regulating the Home Equity Release market in the United Kingdom (Safe Home Income Plans, 2008).

Sampling Method:

All 20 members will be approached. However, due to possible unavailability, unwillingness to be interviewed or other logistical constraints, the goal will be to meet with between 8 and 10 of the 20 member companies.

List of SHIP Members: Please see Appendix 2 attached.

3.3 Procedure for collecting data / instrument to be used

A collective case study will be conducted consisting of in-depth interviews with identified financial service providers in the UK. Telephonic and written communication will be used in order to establish the correct people at the organisation, arrange a meeting and provide them with sufficient background as to the nature of the study and the proposed agenda

for the meeting. A letter or email will be sent giving background to the meeting and listing the themes to be discussed.

The context of the questions will be framed so that the interviewee can understand and relate to the questions. Such background information is not intended to guide the answer but merely to provide a setting. Questions will be focused on the "hows and whys" of the industry through the eyes of the supplier. Collection of statistical and numerical data will help in illustrating a point but, as a whole, the research will remain qualitative.

The interview will be conducted in a semi-formal manner. Insights and thoughts on the industry that fall outside the guided interview schedule will not be discouraged.

The table set out in Appendix 1 lists 11 questions (and sub questions) relating to the propositions and the various issues raised within the literature review. Many of the questions apply to more than one proposition - for instance, a factor impeding demand for ERPs might also be the same factor that is hindering the supply of ERPs, and accordingly such factors are dealt with together under one question (with possibly more than one sub question). The context is set for each question based on the literature review. The questions are intended to be open-ended and the answers word based.

3.4 Analysis Method

The interviews (data) will be analysed using content analysis as well as other qualitative methods. Lewis and Ritchie (2003) define content analysis as 'analysis in which both content and context of documents are analysed: themes are identified, with the researcher focusing on the way the theme is treated or presented and the frequency of its occurrence. The analysis is then linked to "outside variables" such as the gender and role of the contributor'. Emphasis will be on themes emerging from the interviews and questions. The content analysis will be both conceptual and relational in nature (as these are the two general categories of content analysis). Creswell states that when analysing

data in a case study, one should be as descriptive as possible and should look to establish patterns in the data as well as to develop naturalistic generalisations (generalisations that people can learn from either for themselves or for application to a population of cases) (Creswell,1998).

Accordingly, the data to be collected will be analysed in order to add depth to the factors listed under the propositions. The analysis will be as descriptive as possible and will try to establish patterns in terms of frequency of its occurrence and the link to uncontrolled variables. The data will be analysed with the South African context in mind, generalisations will be drawn that will be useful to a South African firm looking to enter the industry, or to one that has already done so.

3.5 Validity and Reliability

Olshansky (1987) states that validity and reliability in qualitative research relate to credibility and trustworthiness. Credibility means to ensure that the theoretical framework generated is understood and is based on the data from the study. Trustworthiness is the extent to which one can believe in the research findings (Olshansky, 1987).

3.5.1 Validity

According to Golafshani (2003), validity encompasses attributes such as trust worthiness, rigor and quality.

> Validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are. In other words, does the research instrument allow you to hit "the bull's eye" of your research object? Researchers generally determine validity by asking a series

of questions, and will often look for the answers in the research of others (Golafshani, 2003).

Ratcliff (1995) gives the following pointers in order to ensure validity:

- Divergence from initial expectations - see personal notes kept from the beginning to see how the data has pushed you from initial assumptions.

- Convergence with other sources of data, using various kinds of triangulations and comparisons with the literature.
- Extensive quotations-from field notes, transcripts of interviews, and other notes.
- Other research data-such as archival data, recordings (video or audio).
- Independent checks/multiple researchers - more than one person involved in the research of those studied; team research approach or other sources of verification.
- Member check - where you go back to those researched, at the completion of the study, and asks them if you are accurate or need correction/elaboration on constructs, hypotheses, etc. Some take this to the point of the researcher and those researched working together in the planning, conducting, and analysis of results (Ratcliff, 1995).

3.5.2 Reliability

Although the term 'Reliability' is a concept used for testing or evaluating quantitative research, the idea is most often used in all kinds of research. If we see the idea of testing as a way of information elicitation then the most important test of any qualitative study is its quality. A good qualitative study can help us "understand a situation that would otherwise be enigmatic or confusing" (Golafshani, 2003).

In an effort to try and achieve reliability, Ratcliff (1995) encourages multiple viewings/ listening of data by the same person or different people.

This research will attempt to achieve validity and reliability by adhering to the guidelines set out above. Accurate accounts of the interviews will be achieved by taking written notes and by using audio recordings. Quotes will be taken from the audio-tapes and from written notes. As a group of firms are being used in the collective case study, one is able to compare their responses and look for convergences, divergences, agreement and contradictions.

Email and telephonic correspondence will be used post the interviews, when further clarity on an issue is required.

Achieving Triangulation:

Triangulation is typically a test for improving the validity and reliability of research or evaluation of findings (Golafshani, 2003). Triangulation is used to control bias and establish valid propositions. Triangulation in qualitative research may lead to exceptions that will then modify the theories and prove fruitful (Golafshani, 2003).

Testing in the United Kingdom:

It is proposed that the results of the first round of interviews are tested via an interview with the industry body SHIP. The inclusion of a party such this will have the following benefits:

- Remove some of the bias a supplier may have towards the ERP industry.
- SHIP will be able to comment on the issues facing suppliers even though they are not a supplier themselves.
- SHIP is a pivotal body in the industry and thus interacts with suppliers, customers, regulatory bodies and the press.

- Broad knowledge of the general issues facing mortgage financiers in the United Kingdom.
- General independence and impartiality.

Testing in South Africa:

The benefits of meeting with local firms are similar to those benefits listed above. In order to understand the contextual setting in South Africa and the development of the ERP market to date, the following companies and representatives are proposed:

1. Mr John Loos, a leading property economist from First National Bank
2. Ms Samantha Kruger, Standard Bank Home Loans
3. Mr Dave Claase, Stone Castle Trust Company (consultants to Nedbank)

4 Presentation of themes and issues emerging from the research results

4.1 Introduction

There were 12 interviews conducted in total. Of the 20 SHIP members, representatives from 8 firms were interviewed (representing 40% of the total population). An interview was conducted with the industry body SHIP. The remaining interviews were with local South African firms.

Themes and issues emerging from the United Kingdom interviews appear below and covered the following broad topics:

- The target market
- Attitudes towards debt and inheritance
- Housing wealth and savings trends
- The role of government
- Interest rates and house prices
- Reputation of the industry, and the presence of the big brands
- Cost of ERPs
- Moral hazards
- Supply constraints
- Health

Within these topics, propositions 1 to 3 are dealt with in detail below.

4.2 Target Market

Discussions relating to the target market uncovered a number of issues pertaining to the driving forces of demand. These are set out below.

4.2.1 Debt consolidation

The use of ERPs to pay off, or consolidate, debt was a common (4/8) theme arising from the interviews. The poor economic environment has highlighted the need to pay down debt as families may have over extended themselves or simply want to be ultra-conservative. Debt consolidation recurred as a theme when discussing attitudes towards debt.

4.2.2 Helping the younger generations (in particular the grand children)

According to some of the interviewees, ERPs are a way for the older generation to help the following generations. Two common examples used were education and helping the younger generations get onto the property ladder.

4.2.3 Altruistic reasons

Altruistic intentions are a growing element of the market. It was found that increasingly people are giving the money away to beneficiaries such as family (see above) or to charities and other philanthropic causes.

4.2.4 Economic cycles

Many of the interviewees (4/9) commented that the economic cycle would have an impact on what ERPs are used for. In buoyant economic conditions, the products were used for home improvements, cars, holidays etc, but more recently the products have been used to pay down debt (see 4.2.1 above) and to help younger generations with their

debt / expenses . It was also mentioned that in a weaker economic environment less part time / casual work is available for the older generations.

4.2.5 Investment

The amounts released from ERPs are sometimes used to make other investments such as purchasing annuities or capitalising on market opportunities.

4.2.6 Loan size and product design

Suppliers commented on product design when looking at the end use for ERPs. The needs-based users were said to be smaller in terms of the amounts they wanted whilst the lifestyle-users drew larger amounts and wanted expensive goods.

4.3 Attitudes towards debt and inheritance

All of the UK firms agreed that attitudes were changing, albeit that the degree of change depended on the clients' age groups and particular circumstances.

There were mixed views on whether attitudes towards inheritance had changed. Whilst there were some views (2) that inheritance remains important, others believed that the next generation were older and more financially independent than previous generations. Interviewees said that there was a realisation that inheritance is not an automatic right and accordingly there was a growing culture of "help your self". Others believed that the big change in attitude is still to come.

In terms of heirs, there were again mixed views as to how they viewed inheritance and ERPs. Whilst some heirs may encourage their parents to use these products, others were more selfish. Thus, ERP providers encourage family discussions around the products.

In terms of debt, many (4/9) claimed that the generations entering retirement were already used to debt, using it for homes, cars, holidays etc. A couple of the interviewees referred to the fact that the first credit cards were introduced to the British market in 1965 and that it was this generation of debt users who were now entering retirement.

In terms of attitudes towards debt, a number of the interviewees (4/9) mentioned that ERPs are a way of settling or consolidating debt. This implies two things:

a) The user of the ERP was previously in debt and not adverse to it;
b) They are prepared to settle debt with another debt instrument (that does not require servicing or repayment).

One in three users of ERP were said to be using the product to replace debt.

4.4 Housing wealth and savings trends

All of the interviewees agreed that the recent housing boom and poor savings trends were driving forces of demand. Commenting on the poor savings trends, a number (5/9) pointed out that increasingly people are carrying debt into retirement which, in turn, creates an opportunity for the ERP industry (see 4.3 above). Some of the factors behind people entering retirement with debt include:

- Mortgage design that has discouraged people from paying off debt e.g. interest only loans and 30 year loans;
- People entering the property ladder at a later age (average age is now 33);
- People tending to move up the ladder, taking on more debt.

Notwithstanding this trend of people entering retirement with debt, the amount of housing wealth amongst the older generation is described as significant.

4.5 The Role of Government

All the interviewees commented on the ERP regulation by the Financial Services Authority ("FSA"). There was general consensus that the regulation has helped in developing the market and was good for the industry. The FSA regulation has helped increase public confidence and offers protection from unprincipled brokers. In 2007, the FSA brought the reversion products into the fold, pleasing those reversion product providers who had previously felt that they were competing on an unequal playing field.

In terms of general government support and interaction, most (6/9) of the suppliers believed that a firmer stance was required by government. There was frustration that government had not taken a view on, or fully endorsed, the ERP industry. Interviewees felt that some of the reasons why government had not taken a firmer line were:

1. The problems in the 1980s resulted in politicians being wary of any reputational risk, tending to avoid it;
2. There is a lack of understanding by government.

Despite the call for a firmer stance, there does seem to be the view that government tacitly supports the industry, realising that this is a way for individuals to help themselves. Government is starting to appreciate that ERPs may provide a solution to the funding gap problem that it currently faces. Some interviewees referred to the fact that that whenever an issue arises prejudicing ERPs, government appears to support the industry.

There was wide spread (4/9) comment on the fact that the funding gap is becoming an increasing problem for government, with more and more people moving into costly care homes. The time frame that government has to fund is also growing as longevity

increases. Some interviewees described the funding gap as unsustainable and commented that there are currently more people retired than working. Government is expected to support those in need – with long-term economic implications.

Most of the interviewees (5) were critical of the complications that means-tested benefits present, and felt that more engagement with government was required in order to reach a compromise with regards to means-tested benefits.

Customers (with the help of their advisors) are encouraged to take any means-test benefits forgone into account, prior to taking out the product. Suppliers felt that product design also needed to take means-tested benefits into account.

Mortgage Interest Relief at Source ("MIRAS"), a tax incentive scheme introduced in the 1980s, was identified in two of the interviews as being a typical example of how government could lend support to the ERP industry. MIRAS allowed for tax relief on interest mortgage payments and encouraged people to buy property.

Two of the interviewees pointed out that government is already making indirect use of ERP. If someone goes into long-term care, government uses their house to pay for it - this essentially replicates an ERP product.

All of the interviewees concurred that ERPs are efficient from a tax perspective, as the capital amounts advanced are not treated as taxable income. ERPs' role in bringing down inheritance tax was also noted. However, it was generally felt that the avoidance of inheritance tax was a secondary benefit and was seldom the main reason for using the product.

4.6 Interest rates and house prices

There was disagreement as to whether a change in the interest rate environment affected demand for ERPs. Some argued that as long as the ERP rates were in line with traditional mortgages, clients were tolerant. Three of the interviewees said that ERPs were not interest rate sensitive.

By contrast, other interviewees claimed that people did select plans based on interest rates and, accordingly, higher interest rates would deter demand. One interview stated that the reverse mortgage market only took off in a lower interest rate environment.

It was noted that changes to the interest rates would affect the roll up of debt. In terms of the FSA rules, clients are shown the roll up of debt. Thus, if interest rates are higher the roll up of debt is higher - which could discourage clients. ERP products are offered on a fixed rate basis so as to provide users with certainty.

Views were again mixed as to whether changes in the house price environment affected demand. One interviewee commented that the timing depended less on the market environment but more on when the client wanted or needed to release the equity. However, another interviewee said that the volatile housing environment created uncertainty that impacted negatively on the market. It was found that volatile house price movements are also problematic with regards to the long lead times involved in concluding ERP transactions. Some interviewees, on the other hand, did not believe that the house price environment was a significant factor.

In terms of the “real” interest rate impact on ERPs, it was noted that in the past, in the United Kingdom, property prices have increased at a rate greater than or equal to the cost of interest (especially over the last ten years). However, the fact that house price growth is not guaranteed means that reliance on real interest rates is problematic. Firms in the United Kingdom work off an approximate house price inflation of 4%, and a deferential of less than 2.5%.

4.7 Reputation of the industry and the presence of the big brands

All but one of the interviewees said that they would welcome the entry of the bigger brands, and all believed that the entry of the bigger brands would be a boost to the credibility of the market as a whole. Some commented that there needed to be a belief that the product is mainstream and that, for instance, the client's neighbour might also have bought into it. It was noted that bigger brands would create greater awareness about the offering and would spend far more on marketing, and that this would probably result in positive spin offs for the smaller firms. Some pointed out that certain bigger brands such as Prudential and Norwich Union (both members of SHIP) had already entered the market. In addition, it was also noted that some bigger brands have partnered with smaller brands, thereby quietly entering the market.

Reasons given for the lack of big brand presence included:

- Lack of IFAs selling the product;
- Big brands have other priorities to attend to;
- Market not big enough;

A number (4) of the interviewees discussed the poor product design of the 1980s and attributed many of the current reputational issues to those particular recurring problems. Examples were given of journalists who loved digging up past stories of poor product design and inappropriate selling, even though the industry is currently far better regulated and the suppliers far more prudent.

Despite the poor press (that still recurs), the industry has worked hard on improving its reputation, and it was claimed that the industry's reputation has never been better. There was consensus that even further education and communication is needed. It was found that the FSA regulation and the creation of SHIP had helped the industry and were important from a reputational point of view.

4.8 Cost of ERPs

4.8.1 Users' perspective

Most (6/8) of the suppliers raised the cost vs. benefit argument - in other words, is the amount drawn worth the cost involved? This was then balanced against the use of the funds. Does the client see value in raising the money? What are the funds going to be used for? The upfront cost to the client is approximately £1,000 - not usually more than a standard mortgage. Costs are generally added to the loan outstanding, meaning that the client never really pays the cost.

Interviewees commented that the increasing competition and product flexibility is good for the consumer. It emerged that competition is starting to lower the costs involved, for instance many of the lenders have waived costs such as up-front property valuations. Suppliers tend to regard costs as a differentiator. One interviewee pointed out that there could be a social responsibility aspect to lowering costs.

4.8.2 Suppliers' perspective

Most of the suppliers (6/8) used IFAs to sell and distribute their products. Thus, the selling and marketing cost is a variable one that is easier to manage. The management of fixed costs was said to be of importance. Interviewees said that smaller firms had been able to carve a niche for themselves.

It was noted that suppliers who were already mortgage providers were able to more easily handle the costs involved. Non-mortgage lenders face greater set up and system costs. Some of the firms that offered ERPs amongst many other lending products were unsure of their profitability on a stand-alone basis. They were of the opinion that their firm needs to take a long-term view when offering the product, implying that if the market grows to its' possible potential, they want to be well positioned to capitalise.

4.9 Moral Hazards

Moral Hazards relate to situations wherein the supplier is forced into an ethical dilemma relating to their rights under the ERP contract. The typical example relates to the maintenance of the property and/or the paying of rates and taxes. If the elderly person fails to comply with the contract and maintain the home to the required standard, it is unlikely that the supplier will exercise his/her right under contract (EG to harshly penalise the elderly user).

Suppliers (5/8) mostly dismissed moral hazards as being problematic, although some admitted that they had not been in the market long enough for any such issues to have happened. One firm said that maintenance issues were a problem for them and that they had been quite benevolent in dealing with them. It was noted that reversion companies are more likely to face this dilemma.

Most of the interviewees stressed the importance of regular spot checks and the fact that the lending firms are contractually protected. Most said that they would deal with any potential problems possibly by conducting the repairs themselves and then adding the resulting costs to the loan outstanding. There was a feeling that the risk to the overall portfolio did not warrant excessive risk mitigation processes. It was noted that taking out an ERP did not automatically render anyone less house-proud.

Credit scoring and previous credit management was offered by two of the firms as an indicator as to whether the person was likely to neglect a home. Larger firms also commented that it was difficult to monitor whether any moral hazards were developing when ERPs only formed a small part of their overall business.

4.10 Supply constraints

Discussions around supply constraints centred on the suppliers' ability to attract funding as well as on the types of instruments used for funding. All of the firms said that they had adequate funding.

Half of the firms commented specifically on how well the ERP industry had withstood the economic crisis of 2008. They stressed the difference between the low LTVs in the ERP industry verse the normal mortgage market. As ERPs require no servicing, suppliers are not taking a risk on the owners' ability to service debt.

A number of different funding mechanisms are being used across the firms, ranging from debt and life insurance funding to listed equity. Surprisingly there was no reliance on securitisation. It was noted that equity funding is useful as equity funders typically do not need regular cash flows on their investment. Private and public equity is used by some of the firms for this reason. The types of firms that have entered the market vary - there is a combination of banks, insurance companies, building societies and public / private companies.

It was noted that ERPs provide a natural hedge for the life insurance industry and that the life insurers are a source of funding for the ERP industry. Simply explained, life insurance companies receive monthly premiums and pay out on death, whilst the ERP industry generally pays out monthly and collects on death. It was also pointed out that the cost of this funding is likely to have an inverse relationship to the cost of normal debt funding.

4.11 Health

Impaired health ERP products emerged as a common offering (4/8) amongst the providers' suites of ERP products. Impaired health products essentially allow for higher LTVs if the life expectancy of the user is impaired in some way (e.g. diabetes, cancer etc).

This is advantageous for these unfortunate few who no doubt face greater living and medical expenses.

A number (3) of the suppliers said that health issues were a driving force for demand, but not bad health per se. The interviewees said that people wanted to use the money now whilst they were still fit and healthy.

In terms of healthcare, it was found that older generations do want more private healthcare. However, there has been no formal tie up with health insurance companies or the like. Private health care was said to be expensive and ERPs provide a way to fund this expense. Interviewees noted that statistically health care ranks far down in terms of the end uses for ERP.

4.12 South Africa

Themes and issues emerging from the South African interviews are set out below and covered the following broad topics:

- The target market
- Debt in South Africa
- The South African government, legislation and regulation
- Systemic risks
- Interest rate environment
- Socio demographics
- Costs in South Africa and issues facing suppliers
- Moral hazards
- Health

4.12.1 Target Market in South Africa

As previously stated, ERPs have been offered by Nedbank Limited and Seniors Finance. The current market size in South Africa is still small. All the South African interviewees agreed that there would be a take up within the South African market, though there was debate as to the magnitude of that take up. It was suggested that the take up would be limited to small wealthgroupings (to be elaborated on later). In terms of a boom in housing wealth and decline in savings trends, local trends were found to be similar to those of overseas. The target market in South Africa was described in a similar way to the United Kingdom's market and was broken into three types of users:

- The asset-rich but cash poor;
- The aspirational user;
- The sophisticated tax planner.

In terms of the take up so far in South Africa, it was found that there are many different reasons for use and, as in the United Kingdom, making generalisations is difficult. When illustrating this point, one of the interviewees gave the following examples:

- Some of the users were encouraged to use the product by their children who had immigrated to Australia and were familiar with the product there. Presumably the children were also less interested in the property asset now that they lived abroad.
- The take up of the product by the typically staid Afrikaans community was positive.

One of the interviewees noted that South Africa has less of a social net than developed countries which should support ERP. For example, state provided means tested benefits in South Africa are comparatively lower than in the United Kingdom, meaning that a greater responsibility is left to the individual.

4.12.2 Debt in South Africa

According to the interviewees, South Africa is a credit market with poor saving levels. Many people live off credit and are consumption driven. South Africans were described as having a "Keeping up with the Jones" psyche wherein younger generations are happy to take on debt for consumption purposes.

4.12.3 The South African Government, legislation and regulation

After consultation by one of the interviewees with a number of the regulatory bodies, including the South African Reserve Bank, the Department of Trade and Industry and the Financial Services Board, there was clarification that the product is regarded as a loan and therefore is governed by the National Credit Act ("NCA"). All the regulatory bodies were reasonably satisfied with the product being offered in South Africa.

The NCA was implemented in June 2007. The Act aims to protect consumers by regulating the country's credit-granting practices. Ideally, the Act will provide a credit environment that is transparent, fair and responsible. Some of the aims of the act include:

- Non-discriminatory practices when dealing with different users;
- Comprehensibility of terms, fees, costs, interest rates etc;
- The client is given responsible lending options;
- Loans are extended at reasonable interest rates.

It was found that ERPs do not contravene the NCA in any way as the lender does not have to pay anything back and can never be in default (there are no serviceability issues). It was also confirmed that the "In Duplum" law relating to the compounding of interest is not relevant as the law only comes into effect in a default scenario. Users of ERPs can never default due to the no-negative equity guarantee. It was found that in the early stages of the Nedbank project, the "In Duplum" rule was a major consideration and culminated in

the ERP being structured over a 5-year renewable term. This ensured that the interest to capital ratio was not compromised.

A benefit to firms in South Africa is that South Africa is joining the ERP industry at a late stage of the international learning curve so there is now the ability to model the local industry on the best practices from abroad. For instance, the local South African industry body, SAHERPA, has been modelled on SHIP as well as the Australian equivalent.

It was noted that in terms of regulating the industry, the task is made easier for the South African government in that only larger companies "with deep pockets" are able to enter the industry due to the very nature of the funding.

In terms of general government support for the product, it was felt by one of the interviewees that socialist agendas within government would support it.

Regarding tax efficiency, South Africa was found to be the same as the United Kingdom.

4.12.4 Systemic risks associated with ERPs

One of the South African firms raised a concern relating to the systemic risks associated with the ERP market. It was argued that the debt ultimately needed to be paid by somebody and that this type of product could eventually lead to an asset collapse. It was felt that banks needed to look at income as opposed to asset values (asset values are not always assured). It was noted that even income has its cycles, however such cycles are not as volatile as asset values. It was argued that one needs to look at what the risks are to the financial system, especially in countries with large elderly populations where broad take up of the product is foreseeable.

When considering the safeguard that lower LTVs offer, it was felt that this provided some protection to the lender. However, it was noted that LTVs tend to creep upwards during

the good times. Human behaviour and banking practices change over cycles and banks would have to model the ERPs very conservatively.

The use of ERPs was also likened to people who often spend lump sum pension pay-outs rather than re-investing. A concern was raised that ERPs may discourage saving in the long run.

4.12.5 The interest rate environment

Commenting on the higher interest rate environment in South Africa, some of the United Kingdom suppliers (4) said that the higher interest rates would be prohibiting and would increase the risks to the lender. The higher interest rate environment would mean low LTVs and this would restrict servicing to only the older age groups. It was noted, however, that it depended on the firms' knowledge of the local housing environment and house price inflation within South Africa.

South African firms said that nominal house price inflation is higher in South Africa. However, the real cost of borrowing is likely to be more expensive locally as South Africa has a more conservative interest rate policy. South African firms agreed that the higher interest rates would result in lower LTVs. It was felt that the real interest rate argument would not hold much sway with the banks' credit departments.

In terms of Nedbank's involvement in the industry, it stopped new business due to the high interest rate environment. It was noted that ERPs are prime plus lending and Nedbank's offering involved a 5 year fixed rate loan of prime + 1.95%. A rate of 15% + 1.95% would mean that the loan would double approximately every four years. When considering house price inflation, it was noted that there are decreasing levels of certainty into the future and that the likelihood of house price growth could not be guaranteed.

Other discount factors, aside from interest rates that need to be modelled, included: Disposal costs, Capital Gains Tax and estate duties.

4.12.6 Socio demographic issues

There are a number of socio-demographic issues that emerged from the local interviews and that were likely to impact on the development of the ERP industry in South Africa:

1) The distribution of housing wealth, by value, remains skewed towards to the white minority population. It appeared that there were no black users of the Nedbank product and commentators felt that at this stage the product was most suited to the more affluent white user. The white population makes up approx 16% of the total population over 60 years of age in South Africa, and it was noted that older black people generally do not have large amounts of equity, relying on family support.
2) Families differ both culturally and structurally in South Africa. Within lower income groups, emphasis is placed on the passing down of property from generation to generation. With multiple generations live together. South Africa was described as being a communalistic and group-orientated society.
3) The emerging black middle class: It was noted that as the black middle class lacks an historical build up of housing wealth, uncertainty exists around the future development of this emerging class and what its long-term attitudes towards housing wealth, debt and inheritance will be.
4) Poor financial literacy: Financial literacy is very low in South Africa. ERPs, as a concept is generally more complicated than most other lending products.

The issues above were found to have the following likely effects on the ERP market:

Presently the size of the potential market is mostly limited to the white minority grouping that does have an historical build up of housing wealth.

ERPs present a risk to the current inter-generational build up of wealth. This poses an ethical issue for suppliers. One interviewee put forward the question: “Is it ethical to offer the elderly debt that will, in turn, deny the next generation an asset?”

In terms of reputational risk, it was noted that difficulties already exist with lending to the lower income groups on normal mortgages, as evictions can become very difficult when there are multiple generations living together. From a reputation perspective, banks cannot be seen to be discriminating and cannot have a “red lining” policy that would be viewed as discriminatory. Although, on a purely risk weighted basis, banks do vary their lending from townships to upmarket residential areas, the issue remains problematic.

4.12.7 Cost in South Africa and issues facing suppliers

From the client’s perspective:

There was mixed feedback in terms of how costs were likely to affect the client. On the one hand, it was felt that cost would not be an issue as clients are protected by the NCA. It was noted that Seniors Finance has managed to reduce the upfront cost to less than R5,000 which is significantly lower than the £1,000 average in the United Kingdom. On the other hand, one interviewee still felt that the products would be expensive in relation to the amounts advanced, especially considering that LTVs would have to be lower in South Africa due to higher interest rates.

From the supplier’s perspective:

Feedback was also mixed regarding the cost and profitability issues facing suppliers. Some felt that as the products were niche, the banks would be able to charge higher margins and that the roll up of interest over the term would be attractive. However, it was also believed that operational costs would be higher due to the “high touch” nature of the sales process. There is a long process of teaching, negotiating and thinking involved when dealing with the client, as well as interaction with lawyers, families, advisors etc. It was found that at this stage, South African firms are not able to rely on the IFA market to the

extent that the United Kingdom firms are able to. However, it was felt that the IFA market would take to the product over time, as there were a number of spin offs for the advisor, including the option of reinvesting the monies that were released.

Funding costs for the suppliers were said to be an issue and Life Houses were proposed as being an efficient source of funding. ERPs were described as a "book matching asset" for the life insurance industry.

4.12.8 Absence of South Africa's big banks

South Africa is unique in that one of its big four retail banks was the first to enter the market. Some of the reasons given for the absence of the other bigger brands were as follows:

- Big brands think that the market is too small, with one interviewee remarking that even overseas the market is only 1% of total mortgages;
- One interviewee noted that due to the financial crisis of 2008 and the recent increase in bad debts in the South African market, the local banks are in a defensive mode and are not looking at new products;
- The larger banks operate with substantial IT systems with new product development being slow;
- Local South African banks are regarded as being conservative.

4.12.9 Moral hazards

There were mixed views on whether moral hazards are likely to affect suppliers. The point was made that houses and plots in South Africa tend to be larger than in the United Kingdom and thus require more maintenance - increasing the possibility of the house falling into disrepair. One interviewee commented that the suppliers might have to

discount normal house price inflation, taking into account that the occupants are older and thus less likely to modernise or add significantly to the properties' marketability. Simultaneously, it was noted that South Africans respect their homes and are house-proud.

4.12.10 Health

It was proposed that ERPs may be an efficient way to fund health care during old age. Commentators believed that this was an important consideration especially in South Africa as the public health care system is not as advanced as the United Kingdom's. It was noted that private health care funding is as a significant burden for many elderly South Africans.

5 Application of Research Results to the Propositions

5.1 Proposition 1: Factors driving demand for ERPs

- Increased housing wealth (supported by increased property prices and lower interest rates) has led to a demand for products that will unlock value: Interviewees were unanimous that the increase in housing wealth has driven demand for ERPs and despite an increasing trend of people entering retirement with debt, the potential market is still described as significant.

- Increased life expectancy has meant that there is a longer period in which people need to sustain their income: All agreed with this factor.

- Poor retirement planning and savings trends mean that generally retirees are not well prepared for a long retirement: All agreed with this factor.

- Decreasing state and employer support has meant that more is left up to the individual: This particular issue was raised by only one of the interviewees who concurred that more is left up to the individual. She cited a shift in pension fund policy resulting in individuals having to actively opt out of private pension plans. It was hoped that this shift would encourage individuals to save.

- There is an opportunity cost of not spending ones' assets before death (life cycle hypothesis): Whilst the terms "life cycle hypothesis" and "opportunity cost" were not used specifically, the SHIP members spoke of treating the home as its own asset class. It was noted that when one looks at portfolio planning the home is an asset class. Thus, if one were to treat it as an asset class, one would be more economically rational regarding its use.

- ERPs are tax efficient: All the interviewees concurred with this factor although they felt that the benefits to estate planning were only a secondary consideration and not a primary driver of demand.

- ERPs are useful in affording health care: Due to the well-established national health care system in the United Kingdom, health does not rank very high up in terms of the end use for ERPs. However, there was a recognition that increasingly older people are looking towards private health care. Some interviewees pointed out that good health rather than poor health was a driving factor for demand as the client was healthy now and wanted to enjoy life whilst still healthy.

- There are changing attitudes towards debt and inheritance: There were mixed views on whether attitudes towards inheritance had changed. There was, however, more widespread consensus that attitudes towards debt had changed. Interviewees cited the number of users who use ERPs to replace debt.

Other themes/driving factors emerging from the interviews were:

- Debt consolidation in retirement is a common use for ERPs;

- Financial assistance for younger generations (children and grand children);

- Altruistic reasons (e.g. gifts to charity or family);

- Factors driving demand for ERPs will differ in different economic cycles;

- ERPs are often used to free up cash for other investment (e.g. Annuities);

- Demand will differ depending on loan design.

5.2 Proposition 2: Factors hindering demand for ERPs

- Suspicion of the market size and the lack of participation by the bigger banks: Most encouraged the entry of the bigger brands claiming that it would boost the industry's credibility. It was felt that it is important that the products are regarded as mainstream. Some bigger brands, such as Prudential and Norwich Union, have entered the market.

- Fear of indebtedness: There was wide spread consensus that attitudes towards debt had changed and that generations now entering retirement were more accustomed to using debt.

- Poor historic experiences of ERPs: Legacy issues relating to the 1980s and earlier products are still adversely impacting on the industry.

Some of the initiatives that are being taken to improve the image include:

  - The industry body SHIP;
  - Constant communication to the market and the press;
  - FSA regulation.

- Unwillingness to spend housing wealth in case of some unforeseen financial disaster: Interviewees did not raise this particular issue as a factor possibly hindering demand.

- Retirees expect government to support them in retirement: Many of the interviewees discussed the pressures facing the United Kingdom government in terms of funding the needs of retirees. It was felt that government might turn to ERPs as a solution. Government has used ERPs indirectly by using peoples' houses to pay for ongoing state-funded medical care.

- People want to leave assets to the next generation (the bequest motive): There was mixed feedback as to the role the bequest motive still plays.

- Lower value properties and higher interest rates may mean less home equity to utilise: There were mixed views on whether the house price environment or the interest rate environment had a direct impact on demand. The roll up of interest in a higher interest rate environment was highlighted as an issue for both the user and the lender. Whilst the real interest rate argument was put forward, commentators were careful to point out that house price growth cannot be guaranteed.

- Home-owners do not want to jeopardise other benefits such as means tested support: Most of the suppliers were critical of the complications arising with regards to means tested benefits, and they felt that government should make exemptions for ERP use.

- ERPs perceived to be expensive: Cost was only seen to be a problem if the amount advanced was not significant enough to warrant the upfront costs. Most of the suppliers felt that it all depended on what the money was actually used for ie: was the benefit worth the cost? ERPs are not more expensive than standard mortgages and the increasing competition is contributing to lowering costs.

- The alternatives to ERPs may be more attractive: Suppliers did not discuss these in much detail but did say that users were encouraged to speak to their families and to fully consider the other alternatives available to them. This principle is ingrained in the ethos of SHIP.

5.3 Proposition 3: Factors influencing supply of ERPs

- The image of ERP: Despite public suspicion of the market and the legacy issues relating to the poor advice and product design of the 1980s, many of the firms were up beat about the impact SHIP and the FSA regulations had made.

- Marketing and other transaction costs: Most of the suppliers made use of independent financial advisors (IFAs) to sell their products. Therefore the distribution is not a fixed cost; rather a variable one. Small firms were seen to able to carve a niche. System and IT costs were seen to be onerous although these were of less significance if the firm was already a mortgage lender.

- The long-term commitment of funds: All of the firms said they had adequate funding. A number of different funding mechanisms are being used across the firms, ranging from debt and life insurance funding to listed equity. Surprisingly, there was no reliance on securitisation.

- Financial risks including term (longevity risk), property price risk and interest rate risk: Longevity risk is generally outsourced to the Life Insurance industry. Suppliers tend to take a conservative view on house price inflation. The real cost of borrowing in the United Kingdom has been neutral over the last ten years. Interest rate risk is largely mitigated by the use of fixed interest rates.

- Regulation and government policy: FSA regulation has supported the development of the market. Although government may tacitly support the industry, most of the firms were disappointed that government had not fully endorsed it. Firms felt it necessary to engage with government with regards the treatment of means tested benefits. It was suggested that tax schemes such as MIRAS be used to encourage ERP use. ERPs were found to be tax efficient.

- Possible moral hazards that suppliers may face (e.g. eviction): Moral hazards were not seen to be a problem. Suppliers said that risk was generally mitigated by: regular spot checks, ad hoc maintenance and the credit scoring of clients.

- Major supply shocks (such as the Sub-prime crisis): Half of the firms commented specifically on how the ERP industry had withstood the economic crisis of 2008. They stressed the difference between the low LTVs in the ERP industry verse the normal mortgage market.

5.4 The implications of the research results for South Africa

A summary of the contextual setting in South Africa has been set out in section 2.6. There are both similarities and differences between the South African environment for ERPs and the environment in the United Kingdom. Most noteworthy are the differences in the socio-demographic environment and the interest rate environment.

- Socio-Demographic Issues

Due to South Africa's political legacies, housing wealth is still largely distributed along racial lines with the white population owning the lion's share. Families within South Africa also vary in their structure and complexity. In some homes, for example, a number of generations may live together under one roof.

These issues present a number of problems for the ERP industry in South Africa:

1. The percentage of the elderly population who are able to take up ERPs is small and limited mostly to the white population. There were no black users of the Nedbank offering and it was felt by one commentator that the product would probably be best suited to the affluent white community;

2. If the housing wealth was greater in the previously disadvantaged communities, family structures and cultural diversity could present additional barriers to demand (that are not common in the United Kingdom). Furthermore, if the products were to be used by the elderly generations in those households, the question would arise as to how the bank would deal with the younger generations also living in that home when the loan came to maturity;

3. From a reputational risk perspective the banks would have to ensure that they were not seen to be discriminatory.

It was felt that that the development of the emerging black middle class would need to be monitored – both from a wealth accumulation aspect and from a cultural perspective.

- Interest Rate Environment

The United Kingdom interviewees believed that South Africa's higher interest rate environment would be problematic. They said that it would result in the loan escalating very quickly and this in turn would increase the risk to the lender. The higher interest rate environment would mean low LTVs and firms would be restricted to servicing only the older age groups. Knowledge of the local housing environment and house price inflation was deemed important and should decrease the aforesaid risk.

It was noted that while house price inflation should be higher in South Africa, the real cost of borrowing was still likely to be more expensive due to the generally more conservative interest rate policy. Although South Africa is likely to have higher house price inflation, banks seem reluctant to take confidence from this.

Notwithstanding the socio-demographic and interest rate issues set out above, when looking at the elderly segment of the population in South Africa with housing wealth, commentary on this market and its drivers were similar to those of the United Kingdom.

Research outcomes that support the growth of the industry in South Africa are as follows:

- Attitudes towards debt: South Africa was described as a credit market. Consumption debt (although frowned on by government) is high.

- Reputational risk: South Africa has no legacy issues regarding poor product design that was a negative driving force in the United Kingdom market. Starting with a clean slate should therefore be advantageous.

- Big bank entry: The fact that Nedbank (one of the big four retail banks in South Africa) was one of the first to enter the market is encouraging. However, the reality that it is no longer offering new products is worrying.

- International learning curve: South Africa is joining the ERP industry relatively late in its life cycle. Suppliers in South Africa are able to learn from the mistakes and best practices of overseas firms.

- Housing wealth and savings trends: The interviewees confirmed that savings trends and housing wealth patterns have tracked those in countries like the United Kingdom.

- Government regulation: There are currently no regulatory or government obstructions to industry growth. The product is clearly regulated by the NCA. It was felt that the socialist factions within government would support the development of a product such as ERP.

- Health care: South Africa differs to the United Kingdom that has an established national health care framework. More is left up to the individual and ERPs may be a solution to funding private health care.

- Lack of relevant social nets: Like the health care point made above, South Africa's social nets are generally designed for the lower-income groups. Middle-income home-owners do not benefit from these to the same extent that their first world counterparts might ie: more is again left up the individual.

Research outcomes that do not support industry growth in South Africa:

The socio-demographic and interest rates issues have already been dealt with.

- Cost: The LTVs are likely to be lower in South Africa due to the higher interest rate environment. Thus the fixed costs involved in taking out the product are more problematic (ie: the cost as a percentage of the amount advanced would be higher). The point was made that as the product is niche, banks are likely to charge more. The IFA market is not yet geared up for ERP products and thus the firms would have to take on a lot of the sales process. This process was described, in turn, as "high touch" and costly.

- Moral hazards: There were mixed views as to whether moral hazards would be a problem in South Africa. Whilst the plots / homes are relatively large and thus more likely to fall into disrepair, South Africans are described as notably house-proud.

- Systemic risk: Although not a problem unique to South Africa, there was concern with the concept of lending against an asset rather than against an income stream. Going forward, banks may be more inclined to favour the latter.

6 Conclusion

6.1 Introduction

A real world, qualitative analysis of the market for ERPs in the United Kingdom was conducted. Of the United Kingdom SHIP members, 40% was interviewed as well as SHIP itself. Interviews were also conducted with South African firms in an effort to relate the United Kingdom findings back to the South African market.

6.2 Summary of main findings

The interviewees generally concurred with the propositions emerging from the literature review, although there were some notable additions and exceptions. When analysing the factors driving demand (Proposition 1), a number of new driving forces came to light, such as debt consolidation, financial assistance to other family members and the altruistic motive. Given the poor macro-economic environment during 2008, the interviewees also pointed out that demand will differ depending on the economic cycle, citing a move away from purchases such as cars or holiday homes to the settling of debt or other more conservative uses. Suppliers said that they were able to tailor their products to different types of end users thereby creating their own market. Good health was seen as a driving force as opposed to poor health (and the expenses associated with this). Whilst there was widespread consensus that attitudes to debt had changed, there were mixed opinions as to the change in attitudes towards inheritance. Many of the interviewees commented on the difficulty of generalising in the ERP industry.

In terms of Proposition 2, the suppliers welcomed the idea of the bigger brands entering the market, noting that Prudential and Norwich Union have already done so. There was consensus that the products needed to become more mainstream. The legacy issues relating to poor product design and selling in the 1980s was still found to be negatively

impacting the market. However, consistent public relations together with the creation of SHIP and the FSA regulation, is improving perceptions of the market. Firms are eager for the government to take a firmer position on the industry. The interviewees felt that more engagement was required with government on matters such as means tested benefits. MIRAS was put forward as a typical way in which government could incentivise people to use ERPs. Changes in the property prices and interest rates were not seen to be major drivers of, or deterrents to, demand.

When discussing supply issues (Proposition 3), firms were generally confident of their ability to raise finance and continue supplying the market, notwithstanding the liquidity crisis of 2008. Firms tended to vary in the manner in which they raised finance. Life Insurance funding emerged as a good source of finance; securitisation was noticeable in its absence. Firms favoured the use of IFAs as a variable cost to market and distribute their products. There was the opinion that smaller firms are able to carve a niche in the market.

In terms of South Africa, the target market is similar to that of the United Kingdom's. The market size, however, is limited by the socio-demographic environment and by the fact that the majority of housing wealth is still held by a small minority. Despite high house price inflation in South Africa, the higher interest rate environment is also problematic with the loan rolling up more quickly and posing a greater risk to the lender. Other potential problems with the South African market are the costs involved in taking out a product relative to the lower LTVs. The larger, more onerous, size of properties in South Africa, mean that the possibility of houses falling into disrepair is greater. The possible systemic risks resulting from ERPs were also highlighted. Factors that were found to be favourable for industry growth in South Africa were the fact that, South Africa was described as a debt market and has a well developed traditional mortgage market. House prices have boomed as they have done abroad. There is clarity in terms of the regulation. South Africa's late entrance to the ERP industry was seen as advantageous as the country can easily apply best practice and avoid mistakes made earlier by other countries. ERPs may be a solution for elderly South Africans trying to afford private health care.

6.3 Recommendations

This research serves two functions. Its primary use is to provide an up-to-date and real-world analysis of those issues facing suppliers of ERPs. Of particular interest are those factors facing current or future suppliers in South Africa. The interviews with the United Kingdom and South African firms provided insight into and, in some instances, solutions to the issues raised. Secondly, it explores the scope for, and viability of, ERPs as an answer to the funding of older population in South Africa.

Looking firstly at the scope for, and the viability of, ERPs in South Africa there were significant challenges facing both of them:

In terms of scope it was found that due to the demographic distribution of housing wealth in the country, the product was mostly suited to the minority (16%) white grouping that owned the major share of historical housing wealth in South Africa.

This threatens the ERP model in South Africa in a number of ways:

1) It reduces the potential market size significantly.
2) It places considerable reputational risk on the lender who may be viewed as being discriminatory.

Recommendations:

1) Whilst the South African market size is whittled down significantly, there may still be sufficient numbers that have a need for ERP products for a supplier still to be profitable. Appendix 3 suggests that there are in the region of 90,000 potential users. United Kingdom interviewees commented that smaller firms were able to carve a niche, thus there may still be room for the industry to grow in South Africa

albeit on a smaller basis. Suppliers would need to carefully manage the reputational risk.

2) Whilst wealth distribution patterns currently point to a limited grouping within South Africa, one does not know how the economy and its people are going to change over time. For example, South Africa is currently experiencing a rapid growth in black middle-class wealth creation. Whilst cultural barriers may still exist, it is unclear as to what the future wealth patterns of the country are going to look like. Innovation in the ERP, housing and financial markets over time may mean that people with less equity in their homes are able to access ERPs.

3) South Africa is not immune from some of the macro issues that are said to be driving the demand for ERPs. For instance, increased life expectancy and decreasing savings trends are both serious issues in relation to retirement funding. Thus these macro issues may force the growth of the ERP industry in South Africa.

With regards to the viability of the products in South Africa, the higher interest rate environment emerged as a major stumbling block. Higher interest rates threaten ERPs in a number of ways, namely:

1) The roll up of interest means that the lender has to decrease the amount advanced.
2) The lender faces additional risks in terms of the no negative equity guarantee.
3) The user is discouraged when shown the impact of the compounding interest.

Recommendations:

Whilst the suppliers cast a dim view on the ability to factor in property inflation against the cost of interest, it is perhaps unfair to discount such an argument. The figure below reflects property price inflation in South Africa against the cost of

borrowing (assuming that borrowing is done at prime). The average over the last 40 years in South Africa was approximately 2.5%. United Kingdom firms commented that they generally work on 2.5% or less. Thus South Africa is not that different to the United Kingdom in this regard.

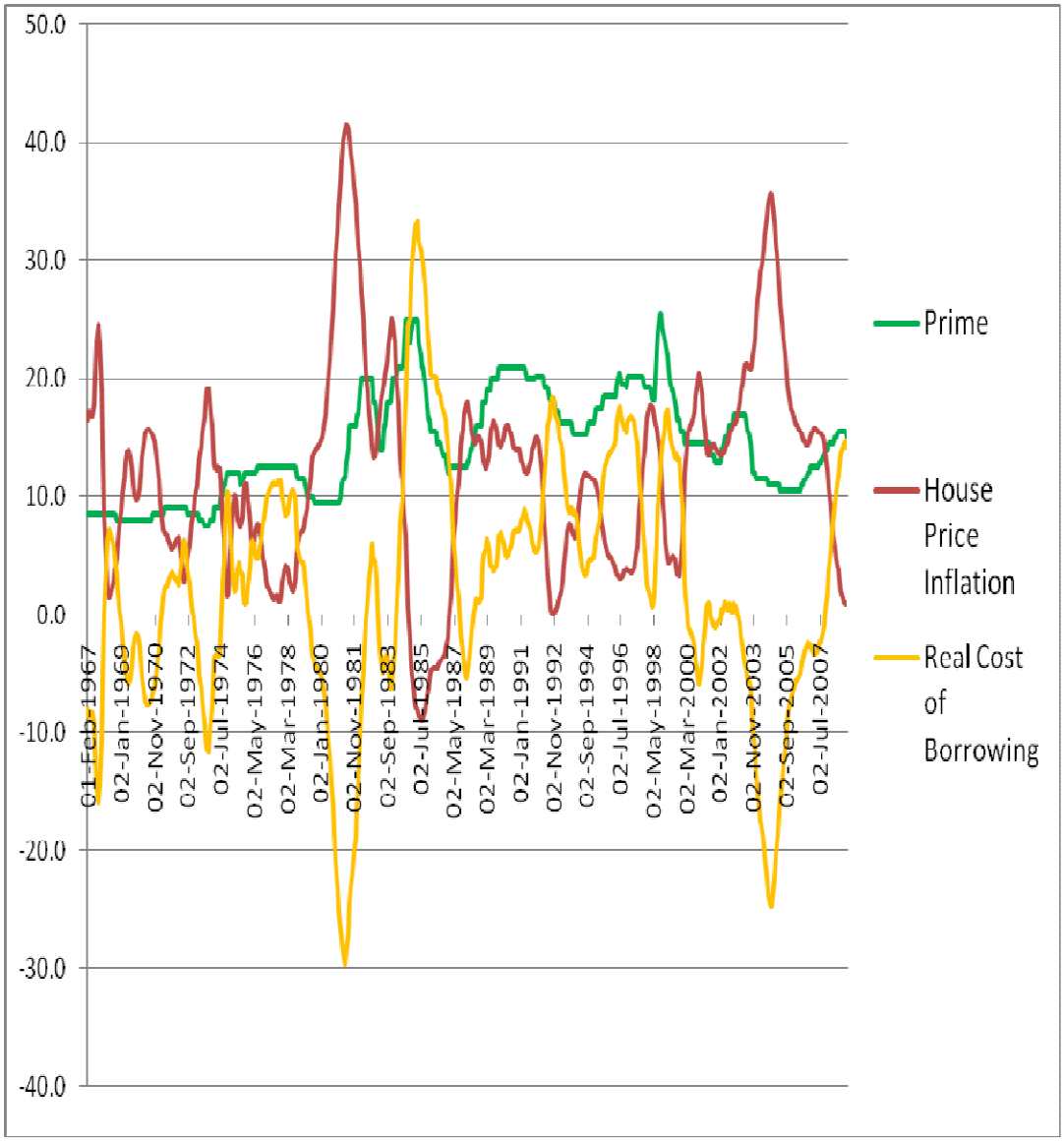

Figure 10: Real house price inflation in South Africa (1967 – 2008)

(Source: ABSA, 2009)

If the supplier is to take a view on property price inflation then, as pointed out by some of the interviewees, the supplier needs to have a robust understanding of the local residential property environment as well as robust data on which to rely.

Other key recommendations for South African firms that emerged from the research:

1) ERP as a debt consolidation tool in retirement

The growing trend of people entering retirement with debt is an opportunity for ERP providers. As ERPs require no further servicing, they become a useful tool for paying down debt. Without ERPs, individuals would have to use other resources to settle their debt. This would put further strain on their other retirement savings.

It was suggested in one of the interviews that mortgage funding could evolve to automatically allow for ERP to take place at the end of a conventional mortgage cycle. This would be particularly advantageous from a cost point of view as a number of legal and administrative costs would be nullified (for example the bond registration cost).

2) Product Design

Based on the trends witnessed in the United Kingdom, it is recommended that South African firms concentrate on the reverse mortgage products (in particular the "line of credit" product) as opposed to reversion products. Reverse mortgages made up approximately 90% of the market in the United Kingdom. Interviewees said that reverse mortgage products were more popular for the following reasons:

- They are easier to understand
- The client retains the upside in the property
- They avoid the emotional element of "selling"

3) ERP could be viewed as an asset class in its self.

Conventional retirement planning does not include the home as an asset class. Retirement planners will generally look at other asset classes such as equities, bonds, annuities and cash. Suppliers of ERPs should promote a change in mindset relating to this. The home should be viewed as an important asset and ERPs as useful tool to liquidate this asset. If ERPs were to form part of mainstream retirement planning, it would be advantageous for the industry.

4) ERPs could be promoted as a tool to fund health care in retirement

Private health care is a costly "grudge" purchase for many South Africans. ERPs could be used as a tool to fund health care either directly or through health care insurance products. Formal partnerships with medical aid funds may prove advantageous. Suppliers in South Africa should also consider offering "impaired health" products such as are available in the United Kingdom.

5) Firms should concentrate on their public relations efforts

Firms in the United Kingdom seem to be "turning the tide" with regards to the public perception of ERP. Successes in the United Kingdom relate to: regulation by their Financial Services Board, constant communication with the market/press and, lastly, their industry body that encompasses a strict code of conduct.

South Africa has gotten off to a good start in this regard and has already launched its industry body, SAHERPA, which also has a strict code of conduct. ERPs are regulated in South Africa by the National Credit Act.

Firms should communicate as much as possible with the market to ensure that their products are understood. ERPs should not be promoted for consumption purposes as this would almost certainly be frowned upon by the regulators.

6) Cost management

The upfront costs are an important consideration for the user of ERP especially in the South African context where the LTVs are likely to be lower. Reasonable efforts should be made to try and reduce these costs, such as having in-house legal teams attend to any legal costs and the waiving of valuation fees. Product design should also cater for the roll up of upfront costs into the loan.

In terms of the ongoing selling costs of the product, South African firms should look to educate / train the IFA market so that they are able to sell and advise on ERP use. United Kingdom firms were able to distribute their ERPs through the broker community. This helped them manage their costs efficiently as brokers only got commission when successful and the selling cost became a variable cost for the supplier.

7) Life Insurance Funding is an efficient source of funding

Life insurance funding emerged as an efficient source of funding for suppliers. It is recommended that South African firms engage with the life insurance industry in this regard.

8) Relationship with government and other regulatory bodies

It is recommended that firms engage with government and other regulatory bodies so as to ensure that policy going forward takes ERPs into account.

9) Managing the risks faced by suppliers

Many of the risks faced by suppliers are manageable either by way of diversification or by outsourcing to other firms who understand that particular risk better (e.g. the longevity risk can be outsourced to a life insurer).

10) Managing moral hazards

As houses are generally larger in South Africa there is a heightened risk that they might fall into disrepair. The following risk mitigation procedures should be introduced:

- Credit and character profiling of the client. (IE has the client had a good track record in terms credit management?)
- Systems and procedures to ensure regular spot checking of the properties as well as maintenance teams to perform ad hoc improvements

6.4 Suggestions for further study

Suggestions for further study include:

1 Given the wealth distribution complexities in South Africa, further analysis into the potential market size for ERPs would be beneficial;
2 Analysis into hedging and funding strategies for South African firms taking note of the higher interest rate environment;
3 Analysis of what systemic or sustainability risks the development of the ERP industry poses.

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Appendix 1

Guided Interview Schedule

Number (theme)	**Context / Question:**	**Proposition**
Question 1 (Target Market? / Different Users?)	**Context:** The market for equity release products seems to differ between those users who are looking to advance their lifestyle verse those users who need the product as a core source of income ("needs" based user verse "wants" based user) (Masie 2008). The factors driving or hindering demand may differ between these two types of users. Question: How would you define your target market? What drives their demand and why? How does your business model differ (if at all) when supplying and marketing to these different users?	**Propositions 1,2 and 3**
Question 2 (Attitude towards Inheritance and Debt?)	Context: One of the factors that is said to be driving demand is a change of attitude towards debt and inheritance (Deloitte 2002). Question: Have the suppliers experienced a change in the attitudes of their market? If so, how have attitudes changed? Are suppliers actively promoting a change of attitude?	**Propositions: 1, 2 and 3**
Question 3 (Housing Wealth and Savings Rates)	**Context:** The development of the Home Equity Release Industry is that there is large percentage of elderly people who are said to be asset rich but income poor (this is one of the key drivers of demand for equity release products) (Dolan et al 2005) another trend which is said to be driving demand is the poor savings rate IE people are not saving enough for retirement (Klyuev & Mills, 2006). Question: Would you agree with these factors?	**Proposition: 1**

Question 4 (The States Role?)	Context: Legislation, Regulation and the role of the State is a common theme when researching ERPs. On the one hand Governments decreasing support of pension plans is said to be a driving force for the development of ERPs (Equity Release Working Group 2005) on the other hand concerns about not being able to qualify for "means tested" state pension programmes are also said to be a detracting force of demand (Terry and Gibson 2006). Government subsidies are also said to be important in the development of the market (Davey 2005). Not to mention the various tax benefits that affect users (IE income is tax-free and the products are often useful in estate planning (D'Alton, Fisher-French 2006). Question: How has the State engaged with and affected the ERP industry to date? How do you think the State should involve itself in the development of this industry? How important is the state's role?	**Propositions 1,2 and 3**
Question 5 (Interest Rates and House Prices? – Emerging Markets?)	Context: Lower interest rates (Davey and Wilton 2006) and rising house prices (Ward 2004) are said to drive demand. South Africa has relatively high interest rates. Question: How dependent is the market on low interest rates and rising house prices? How important are real interest rates?	**Propositions: 1 and 2**
Question 6 (Reputation?)	**Context:** Davey notes that the image of the ERP industry is not wholly positive (Davey, The Prospects and Potential for Home Equity Release in New Zealand , 2005). Question: How do suppliers deal with the suspicion that exists in the market place including the question as to why the market isn't already bigger? How important is the presence (or lack thereof) of the bigger financial service providers?	**Propositions: 2 and 3**
Question 7 (Costs?)	**Context:** Costs are said to be a prohibiting force with regards to both demand and supply (Terry & Gibson, 2006; Australian Securities & Investments Commission, 2005) Question: How problematic are the costs involved? How are suppliers dealing with these costs?	**Propositions: 2 and 3**

Question 8 (Moral Hazard?)	**Context:** Suppliers are said to face moral hazards such as: • Home owners who become ill and are unable to service rates and taxes as well as maintain the house • Once the debt advanced is greater than the value of the property the incentive to have the house kept up decreases (Caplin, 2000). Question: How do suppliers manage these and other moral hazards? How do suppliers generally strike the balance on many of the moral and ethical issues facing the industry?	**Proposition 3**
Question 9 (Supply Constraints and Shocks?)	**Context:** A factor prohibiting supply is said to be the long-term commitment of funding (Terry and Gibson 2006) as well as major supply shocks such as the Subprime Crisis. Question: Has your firm found the long-term funding problematic? How are equity release products generally funded? How do you think these products will be funded in the future? How is the Subprime Crisis likely to affect supply constraints?	**Proposition 3**
Question 10 (Health Considerations)	**Context:** Health expenditure is a major consideration for retired people. The ability to access housing wealth to pay for such needs is seen as a driving force for demand (Chen, 2003) but also as a factor impeding demand, as people would rather keep the asset unencumbered so that they can meet unforeseen expenses (Australian Securities & Investments Commission, 2005). Question: Have you found that on balance, health considerations are positive or negative driving forces of demand? What are the current and likely future trends with regards to ERPs and the health care and health insurance industries?	**Propositions 1, 2**
Question 11	Are there any other factors influencing either the demand or supply of products that you believe may be important? Other Insights or trends?	**All**

APPENDIX 2

List of SHIP Member Companies

Bridge Water Equity Release Ltd	Citygate, St James Boulevard, Newcastle upon Tyne NE1 4JE Tel: 0808 100 1065 Website: www.bridgewaterequityrelease.co.uk
Bristol and West Mortgages	Bristol and West Mortgages, One Temple Back East, Temple Quay, Bristol BS1 6DX Intermediary Enquiry Line: 0117 943 2288* Consumer Enquiry Line: 0845 300 8000* Website: www.bristolandwest4brokers.co.uk
Coventry Building Society	PO Box 9, High Street. Coventry CV1 5QN Telephone 0845 7665522 Website www.thecoventry.co.uk

Hodge Equity Release 	Hodge Equity Release 30 Windsor Place, Cardiff CF10 3UR Freephone: 0800 731 4076 Website: www.HodgeEquityRelease.com
Home and Capital 	Home and Capital 31 Goldington Road, Bedford MK4O 3LH Freephone: 0800 253657 Website: www.homecapital.co.uk Email: enquiries@homecapital.co.uk
In Retirement Services 	In Retirement Services 2 Alexandra Gate, Pengam Green, Cardiff, CF24 2SA Telephone: 0800 70 75 80 Website: www.inretirementservices.co.uk

Just Retirement Limited 	Just Retirement Limited Vale House, Roebuck Close, Bancroft Road, Reigate, Surrey, RH2 7RU Tel: 01737 233296 Fax: 0845 301 2287 Website: www.justretirement.com
LV = 	LV= Tilehouse Street, Hitchin, Herts SG5 2DX 0870 609 0616 Website: www.LV.com
More 2 Life 	more 2 life PO Box 1168, Preston, PR2 0GB Tel: 08454 150 150 Fax: 08451 260 060 email: info@more2life.co.uk website: www.more2life.co.uk
Mortgage Express 	Mortgage Express Endeavour House, 1 Lyonsdown Road, New Barnet, Herts EN5 1HU Freecall: 0500 0500 20 www.mortgage-express.co.uk

National Counties Building Society	National Counties Building Society Church Street, Epsom, Surrey KT17 4NL Tel: 01372 744155 (Mortgage Centre) Email: mortgage.centre@ncbs.co.uk Website: www.ncbs.co.uk
New Life Mortgages Ltd	New Life Mortgages Limited Registered Office : Warwick House, 737 Warwick Road, Solihull, West Midlands, B91 3DG Telephone : 0121 712 3800 Fax: 0121 712 3859 Website: www.newlifemortgages.co.uk Email: enquiries@newlifemortgages.co.uk
Northern Rock plc	Northern Rock plc Registered Office: Northern Rock House, Gosforth, Newcastle upon Tyne NE3 4PL Tel: 0845 60 50 500 Website: www.northernrock.com
Norwich Union	Norwich Union Equity Release Ltd PO Box 520, Surrey Street, Norwich, NR1 3NG Tel: 0845 302 0111

	Website: www.norwichunion.com/equityrelease
Partnership Home Loans 	Partnership Home Loans 2nd Floor, Regent House, 1-3 Queensway, Redhill, Surrey, RH1 1QT General Enquiries: 0845 108 0582 www.partnershiphomeloans.co.uk
Prudential 	Prudential Prudential Lifetime Mortgage, Stirling FK9 4UE Freephone: 0800 316 9959* Website: www.pru.co.uk *Or talk to your Financial Adviser*
Retirement Plus Ltd 	Retirement Plus Ltd Prince Frederick House, 37 Maddox Street, London W1S 2PP Tel: 0845 850 8510 Website: www.retirement-plus.co.uk
Standard Life Bank	Standard Life Bank Freestyle® Lifetime Mortgage 20 Brandon Street Edinburgh EH3 5PP Tel: 0845 609 0254*

	Website: www.freestylemortgages.com
StoneHaven 	Stonehaven 83 Victoria Street, London SW1H 0HW Intermediary enquiries: Tel: 0203 008 5500 or e-mail: support@stonehaven-uk.com Customer enquiries: Tel: 0203 008 8976 Website: www.stonehaven-uk.com

Appendix 3

EXCEL INSERT

Appendix 4

United Kingdom Interview Schedule

Interviews:

1) Alan Bannister, Head of Marketing, Retirement Plus Ltd

   1 December 2008

   Introduction: Retirement Plus is a Milton Homes company that specialises in providing equity release products. Retirement Plus arranges and administers the Property Plan. The Property Plan is a type of Home Reversion Plan and Home Reversion Plans are regulated by the FSA. Both companies are authorised and regulated by the FSA.

2) Michelle Cutler, Category Manager - Equity Release, Just Retirement Ltd

   2 December 2008

   Introduction: Just Retirement is a specialist life assurance group in England and Wales (incorporated in England) focusing on the provision of financial services to those at or in retirement. Just Retirement currently writes enhanced annuities and equity release plans.

3) Dean Mirfin, Business Development Director, Key Retirement Solutions

   3 December 2008

   Introduction: Key Retirement Solutions was established in 1998 with the aim of helping retired homeowners to boost their retirement income by releasing cash from their homes. Since then it has grown to become the UK's leading national independent financial adviser firm specialising in equity release. It is often the first and only point of call for retired homeowners, businesses and journalists when looking for advice and information on the equity release market.

4) Nigel Hare-Scott, Home & Capital

3 December 2008

Introduction: Home & Capital was privately owned until October 2006, when it became part of the equity release activities of Sovereign Reversions plc. Sovereign was established in 1992 to invest in home reversion plans and is listed on the London Stock Exchange's AIM. Home & Capital is a founder member of Safe Home Income Plans (SHIP), the body established in 1991 to set standards of consumer protection for the equity release industry. Through SHIP they have been active in bringing about the regulation of home reversions by the Financial Services Authority (FSA), effective April 2007.

5) Bob Stanworth, Senior Product Manager, Bristol & West

4 December 2008

Introduction: Bristol & West Mortgages is a company within the Bank of Ireland

6) Jon King, Managing Director, Julian Hodge Bank

4 December 2008

Introduction: Hodge Lifetime is the trading name of Julian Hodge Bank Limited and Hodge Life Assurance Company Limited. Hodge introduced the very first equity release plans in 1965 and is the longest established equity release provider in the UK.

7) Andrea Rozario, Director General, Safe Home Income Plans

5 December 2008

Introduction: Safe Home Income Plans (SHIP) is a company supported by the leading providers of home income and equity release plans. It was launched in 1991 and is dedicated entirely to the protection of plan-holders and promotion of safe home income and equity release plans.

All participating companies are pledged to observe the SHIP Code of Practice set out here. Members display the SHIP logo in their brochures and other printed material as a guarantee to their customers.

8) Alan Kimber, Business Development Manager, Saffron Building Society

5 December 2008

Introduction: Saffron is a regional building society. They have a network of 12 branches serving the communities of Cambridgeshire, Essex, Hertfordshire, Suffolk and London as well as many agencies in the region.

9) Michael Philps, Equity Release Manager, Coventary Building Society

9 December 2008 [Telephone Interview]

Introduction: Coventry Building Society was established in 1984 and is now the fourth largest building society in the UK, serving well over 1 million customers.

South African Interview Schedule

Interviews:

10) John Loos, Property Economist, First National Bank

27th January 2009

Introduction: First National Bank is a division of First Rand Limited and is a major retail bank in South Africa.

11) Samantha Kruger, Head Product Manager – Home Loans, Standard Bank

29th January 2009

Introduction: The Standard Bank Group is one of the big four full-service South African banks.

12) Dave Claase, Managing Director, Stone Castle Trust Company

2nd February 2009

Introduction: "Stone Castle Trust Company, a 100% South African company, was formed in May 2005 with the purpose of "designing, developing and managing specialist financial products and services that deliver best solutions to clearly defined markets. These products and services are the intelligent and unique integration of the financial and insurance disciplines inherent in the intellectual capital of StoneCastle".

"StoneCastle was the first South African company to develop a complete equity release solution and we enabled Nedbank to launch South Africa's first credible, bank-supported Reverse Mortgage product. The development, pilot and launch of this product has positioned us as the first-choice for supplying a turn-key Equity Release solution".

Appendix 5

List of Abbreviations:

ERP :	Equity Release Product
FSA:	Financial Services Authority
FSB:	Financial Services Board
LTV :	Loan to Value ratio
MIRAS:	Mortgage Interest Relief at Source
NCA:	National Credit Act
SAHERPA:	South Africa Home Equity Release Protection Association
SHIP:	Safe Home Income Plans