2016 STAR RATINGS REPORT

Reverse Mortgage

Reverse Mortgage

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Foreword

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The results are in: CANSTAR's 2016 Reverse Mortgage Star Ratings research report is a great example of what's on offer in Australia when it comes to home equity retirement solutions.

Industry leaders Deloitte and SEQUAL have found that reverse mortgages are regaining popularity, with 40,000 reverse mortgages in Australia in 2015, amounting to $3.6 billion worth of loans. The average loan for a reverse mortgage is currently $92,000 in size and is held by a 75-year-old Australian.

Reverse mortgages are one way older Australians can access extra income during their retirement to supplement their income from superannuation or the Age Pension. Research by the Productivity Commission in 2015 showed Australians want to grow older in their own homes rather than moving into residential aged care – and a reverse mortgage can be one way to afford aged care in your own home.

Who is the average reverse mortgage holder?

- The average reverse mortgage holder is 75 years old (Productivity Commission, 2015), and the bulk of borrowers (48%) are aged 70-79 years old (Deloitte, 2015).
- Most reverse mortgages are held by couples (47%), followed by single females (36%) (Deloitte, 2015).
- The average outstanding loan size is $92,000 (Productivity Commission, 2015). The average amount borrowed is consistent across ages 65-80, with those over 80 borrowing slightly more.
- NSW has both the most outstanding loans (37%) and the most settlements (34%) in Australia, followed by Victoria (21%) and then Queensland (19%) (Deloitte, 2013).
- 71% of outstanding loans and 85% of loan settlements are in our country's capital cities (Deloitte, 2015).
- 94% of reverse mortgages are taken out as a lump sum, and 6% are taken out as an income stream. These figures have been stable since 2008 (Deloitte, 2013).

This year, CANSTAR researched and rated 10 reverse mortgages currently on offer from 7 lenders in Australia. Read on to find which products provide outstanding value for retired Australians needing to access their home equity.

Reverse Mortgages May Be Regaining Popularity

Reverse mortgages declined in popularity during the GFC, but the Productivity Commission's [2015 report] into ageing has put them back in the spotlight.

According to Deloitte and SEQUAL's 2015 report, there are 40,000 reverse mortgages on issue in Australia, amounting to $3.6 billion worth of loans. The average loan size for a reverse mortgage is $92,000, which shows an increase from $86,000 in 2013 and $84,000 in 2012.

Reverse mortgages were first made available in Australia in the early 1990s, with the Advance Bank (now St. George Bank) leading the way. By 2006, more than 20 banks, credit unions, and non-bank lenders were offering reverse mortgages, and because of the large number of providers, brokers were used for 50% of reverse mortgages.

But the GFC took a hit out of the capital markets that mortgage lenders relied on, and CANSTAR ceased rating reverse mortgages in 2008. Now, in a growing market, we are pleased to present the renewal of this ratings series this year.

Reverse mortgages can help older Australians achieve a "modest" retirement

As we recently reported, according to the government's Productivity Commission report Housing Decisions of Older Australians (2015), many older Australians could be accessing their home equity to improve their retirement lifestyle, but aren't. Older Australians prefer to focus on saving their pension, even though 40% are actually spending less than the "modest" standard of retirement of paying for daily living needs and basic activities.

Of the many pensioners who are currently not achieving a modest standard of retirement, 96% could use their home equity to reach a modest standard for the rest of their lives, without ever going into negative equity. What's more, they wouldn't lose their pension, as Deloitte reports that a reverse mortgage has very little, if any, impact on pension entitlements.

Pensioners typically only draw down a mere 2.5% of their wealth per year until they pass away, according to a longitudinal analysis of Centrelink records up to 2015 (Productivity Commission, 2015). Seniors usually access this wealth through savings, investments, and selling assets.

When would you use a reverse mortgage?

The Productivity Commission's 2015 report found that the number one reason for accessing a reverse mortgage was to be able to afford aged care or other healthcare costs. This is largely so that people could grow older in their own home.
Deloitte's 2013 report found a similar result, and the main reasons why older Australians chose to utilise a reverse mortgage then included the following:

- Regular income source: 1 in 2
- Debt repayment: 1 in 3
- Home improvement: 1 in 7

Features
of a Reverse Mortgage

To be eligible for CANSTAR's research ratings, a reverse mortgage home loan product must meet the following criteria:

- Available to new customers for new loans, not just existing customers.
- Available for an LVR of 15% or greater.
- Disbursements can be received at once as a lump sum.
- Not a bridging loan, construction only loan or reverting loan.

CANSTAR rates the following cost-related and other features of a reverse mortgage.

Interest rate

The vast majority of reverse mortgages offer a variable interest rate for borrowers. The number of fixed interest rates in reverse mortgages has remained small since 2009.

Terms of the loan

- **Lending terms**: What is the minimum loan amount? What are the valuation details?
- **Protected equity**: What specific equity amount is protected from the lender (LVR)? Is there an additional option for protecting a specific equity amount?
- **Security requirements:** What types of securities can be used for collateral?
- **Specific conditions:** Can the property be rented out? What is the default rate?
- **Committed funding:** Is there guaranteed future funding for instalment payments?

Product functionality

- **Offset facility:** Is a mortgage offset account available?
- **Redraw facility:** Is a redraw facility available?
- **Additional repayments:** Is there flexibility to make additional repayments?
- **Split facility:** Is there the ability to have different interest types and fees for a split loan?
- **Portability:** Can a loan be transferred from one house to another if you move house?
- **Top-up facility:** Is there the ability to top-up the loan?

Default

- **Definition of default:** What events may cause default?
- **Action after default:** What specific action is taken by lenders if the borrower is in default?

Fees

- **Loan fees:** What fees are charged?

Application and approval

- **Loan application and approval:** How easy is the loan application and approval process?

How Do Reverse Mortgages Work?

A reverse mortgage is a type of Equity Release Product (ERP). Equity release products come in two forms – credit products and debt-free products – and a reverse mortgage is a credit product.

Who owns your home?

In a reverse mortgage, you own your house but the bank can lend you money in a lump sum or income stream using the bank as security, up to a small portion of the house's value.

You remain the legal owner of your house at all times, and legal requirements exist to protect your rights so that you can never owe the bank more than a certain portion of your house's value. This is known as **negative equity protection**. Interest does compound though, so the balance of the loan can increase significantly, reducing the equity you own in your home.

You can specify a certain percentage of your home's value that you want to remain available for your estate, so that you can only borrow up to a certain amount. This is known as **protected equity**.

What are the repayments?

Repayments and product fees are capitalised on the loan, so the borrower is not required to make any repayments of the principal or interest. The loan is only repaid when you sell your house, move into residential aged care, or pass away.

Reverse mortgages and the Age Pension

Reverse mortgage payments received by the borrower in a **lump sum** are not assessed under the Age Pension assets test unless you use them to buy an asset such as a new car. If the lump sum is used for non-assessable reasons, such as home modifications or a holiday, it does not affect your pension.

Reverse mortgage payments in an **income stream** are not included in the assets or income test if they are drawn down in small, periodic payments and used to meet everyday living expenses or buy non-assessable assets.

We recommend that you speak with a Department of Human Services Financial Information Service officer before signing up for a reverse mortgage, to check how the payments would affect your pension. You can visit an officer in person at your local Centrelink office or a financial information seminar, or you can call Centrelink on 132 300 and ask to speak to a Financial Information Service officer.

There is one type of reverse mortgage that receives a **government subsidy**: the Pension Loans Scheme created by the government in 2014. However, it has received very few customers, and only 0.04% of Age Pensioners were using a government-subsidised reverse mortgage in 2015, according to the Productivity Commission's 2015 report. As the Australia Institute points out, the Pension Loans Scheme is unavailable to the full Age Pensioners who would benefit from it most, and is only available to Australians who only qualify for a part-pension.

Reverse Mortgage
Interest Rates and Fees

Canstar's research of reverse mortgage products found the following interest rates on offer across the providers assessed:

	Reverse Mortgage		
	Minimum	Average	Maximum
Interest Rate	6.45%	6.60%	6.75%

Source: www.canstar.com.au, 2016. Based on a $90,000 loan amount and LVR of 15%, as at 1/12/2015.

How do these interest rates compare to the rates on standard P&I home loans or Interest Only home loans with the home loan providers who also offer reverse mortgages?

	Standard Residential Variable		
	Minimum	Average	Maximum
Interest Rate	5.25%	5.58%	5.69%

Source: www.canstar.com.au, 2016. Based on a $90,000 loan amount and LVR of 15%, as at 1/12/2015.

Unlike the interest rate charged, the fees for a reverse mortgage are identical to the fees charged on a standard home loan, when it comes to the home loan providers who also offer reverse mortgages. That is, of course, unless you would like to pay for certain extra features – which are also similar to those available on standard home loans.

Here are the average fees for a reverse mortgage:

	Reverse Mortgage Fees		
	Upfront Fees	Annualised Ongoing Fee	Discharge Fee
Min	$695.00	$0.00	$250.00
Average	$1,034.00	$112.40	$296.80
Max	$1,345.00	$180.00	$395.00

Source: www.canstar.com.au, 2016.

These are comparable to the average fees for a standard home loan:

	Residential Variable Home Loan		
	Upfront Fees	Annualised Ongoing Fee	Discharge Fee
Min	$0.00	$0.00	$245.00
Average	$601.67	$92.00	$330.53
Max	$800.00	$120.00	$350.00

Source: www.canstar.com.au, 2016.

As you can see, the upfront fees are slightly more for a reverse mortgage; however, the ongoing fee is slightly less, and the discharge fee is about the same.

What Might A Reverse Mortgage Cost?

Based on a $90,000 loan amount and 15% initial loan to value ratio (LVR), Canstar has calculated the following average costs of a reverse mortgage over time, as follows:

	10 Year Loan	20 Year Loan	30 Year Loan
Average Upfront Fees	$1,980	$3,793	$7,266
Average Ongoing Fees	$1,576	$4,599	$10,394
Average Total Cost	$176,209	$338,798	$650,279

Source: www.canstar.com.au, 2016. All of the fees are capitalised and are repaid at the end of the loan term. Based on a $90,000 loan amount and 15% LVR. Rounded to nearest dollar.

Remember there are limits

Some reverse mortgage products allow you to protect a certain portion of the value of your home with a **protected equity** option. This is a useful option for those that wish to ensure, for example that there is $300,000 of home value left to pay the bond for residential aged care if needed, or to provide a bequest.

There are also many **legal requirements** in place to protect you as a borrower.

For starters, legislation states that you cannot go into negative equity. Your debt cannot grow to an amount greater than the market value of your home – so you cannot end up in more debt than you could repay by selling your home.

Also, your mortgage provider must help you to understand all of the costs before you sign up, so that you can plan for your retirement. From 1 March 2013, ASIC requires your credit provider to go through reverse mortgage projections with you in person, before you take out a reverse mortgage. They must:

- Show how your home equity will change over time.
- Show how interest rates will grow your debt over time.
- Use the ASIC MoneySmart reverse mortgage calculator to illustrate these projections.
- Give you a printed copy of these projections to take away with you, so that you can make an informed decision about whether or not to purchase a reverse mortgage product.

Different providers offer different borrowing LVRs for their reverse mortgage products; different providers also offer different interest rates and fees on their reverse mortgage products, meaning the cost can vary greatly. Do your homework!

CANSTAR'S 5-STAR WINNERS

Canstar's Reverse Mortgage Star Ratings Report rated 10 reverse mortgages from 7 lenders, to determine which providers and products offer outstanding value for borrowers.

The product providers assessed were:

1. Bank of Melbourne
2. BankSA
3. Bankwest
4. Commonwealth Bank of Australia
5. Heartland Seniors Finance
6. P&N Bank
7. St. George

WHICH PROVIDERS OFFER OUTSTANDING VALUE?

CANSTAR congratulates all winners of our Outstanding Value - Reverse Mortgage rating.

Heartland Seniors Finance

The Lifetime Loan product from Heartland Seniors Finance had the winning features score. This loan has no ongoing fees, and Heartland Seniors Finance is the only institution that offers the Protected Equity (up to 50% of home value), Committed Funding, and Split Facility features.

Heartland Seniors Finance was formed when Heartland New Zealand bought the ownership to Australian Seniors Finance in 2014. At the time of the purchase, Australian Seniors Finance was known as the largest non-bank lender in the Australian market. Australian Seniors Finance was founded in 2004 in Victoria.

Heartland New Zealand are the force behind Heartland Bank, founded in 1875 as CBS Canterbury, the amalgamation of three large building societies. Heartland Bank converted into a bank in 2013 and is still proudly New Zealand owned and operated. Heartland Bank recently began efforts to support the community and protect the environment through a new specialisation in agricultural lending beginning in 2015.

Heartland Seniors Finance makes three promises to its customers:

1. Lifetime Occupancy: Your home will remain the place you live in for as long as you choose.
2. No Negative Equity Guarantee: The amount required to repay the loan will never exceed the sale proceeds of the property.
3. Loan Repayment: There is no requirement to make any loan repayment until the end of the loan.

Bank of Melbourne

Bank of Melbourne offers two reverse mortgage products: Seniors Access Home Loan and Seniors Access Plus Home Loan. These two products scored top points in the Offset Facility, Additional Repayments, Portability, and Top-Up Facility.

The Bank of Melbourne was founded in 1989 and exists exclusively in the state of Victoria. Check out their Melbourne Made ad campaign that celebrates the Victorian people and businesses who bank with them, including the latest instalment, "For the Makers".

Bank of Melbourne supports the community groups their customers like the most, by providing grants through The Local Project to the deserving community projects that win the most votes. You can also apply for a community grant through the Neighbourhood Fund. Bank of Melbourne also sponsors the Sleep at the G fundraising event for Melbourne City Mission, to combat homelessness in Victoria.Parent company Westpac is also committed to protecting the sustainability of our environment, with their 2014 annual report listing measures such as:

- Ranked most sustainable company in the Global 100 Most Sustainable Corporations in the World at the World Economic Forum.
- Ranked most sustainable bank globally in the 2014 Dow Jones Sustainability Index.
- Lending $6 billion per year to the CleanTech and environmental services sector.