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Editorial

On the profitability of equity release mortgage loans

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Abstract

We obtain projections of the profitability to lenders of equity release mortgage loans both to single borrowers and to couples over a wide range of ages. Results suggest that loans to couples are less profitable than loans to borrowers who are single. Loans to couples are only profitable at all if both members of the couple are in their late 70s or older. These results suggest that the sector is not profitable.

DESCRIPTION

An Equity Release Mortgage (ERM) is a loan made to an older property-owning borrower that is collateralised by their property. In the UK, ERMs usually embody a No-Negative Equity Guarantee (NNEG) that stipulates that the amount due for repayment is capped at the minimum of the rolled-up loan amount and the property value at the time of repayment.

This article examines the profitability to lenders of lifetime lump sum ERM loans to single and couple borrowers. We find that the profitability of these loans is surprisingly low and often negative. The layout of this article is as follows. Section 2 addresses the time to home exit. Section 3 sets out the mechanics of ERM valuation and profitability. We consider loans to a single male, a single female and a male-female couple. Excepting early repayment, an ERM contract specifies that the loan is to be repaid when the borrower permanently exits their home. Assuming away any stay in care, exit occurs when a single borrower dies or when the last surviving member of a borrower couple dies.

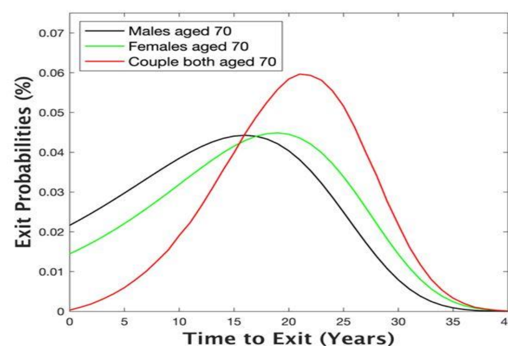

Figure 1. Density functions for time to exit.

Obtained from 1,000,000 Monte Carlo simulations of the mortality rates q_t using the M5-CBD mortality model calibrated on life and longevity markets association death rates data.

ERM valuation and profitability

The present value ERM of an ERM loan is equal to the present value L of a risk-free loan, minus the present value $NNEG$ of the NNEG guarantee.

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