# Could property wealth replace a pension?

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Legal & General

# How long will your client's retirement last?

Our research shows a 65-year-old affluent woman in good health has a 1 in 10 chance of living to 100[1]. While not everyone will live this long, it's possible life expectancy among higher socio-economic groups may continue to rise. As a consequence, your clients could be looking for different ways to maximise their income in retirement while keeping an eye on the inheritance they might leave behind.

Most people's retirement income will be provided by their pension. Some clients may look to secure guaranteed income by purchasing an annuity while others may prefer the flexibility of pension drawdown. However, there is an alternative asset that could be considered to provide income in retirement: equity in the home.

## Is housing equity the solution?

While equity release was historically viewed as a 'last resort', new consumer safeguards such as the 'no negative equity guarantee' mean clients will never owe more than their home is worth. Falling interest rates have led to competitive product pricing; with many now below 3%[2]. This is one of the reasons some advisers are starting to consider the role of lifetime mortgages in financial planning.

## Lifetime mortgages

A lifetime mortgage is a loan secured against the home. As a form of equity release, it allows your clients to unlock some of the wealth tied up in their property. The loan is usually repaid upon death or when the last surviving borrower moves out of the home into long term care.

A lifetime mortgage can be used many ways. Clients could consider using the equity in their homes as a safety net to top up their income if required. An alternative solution is using equity release earlier in retirement to replace pension drawdown.

While there may be cheaper ways to borrow, let's consider why your client may take income from a lifetime mortgage instead of a pension drawdown:

- A lifetime mortgage reduces the equity in the home, and therefore the value of a client's estate. Assuming the estate is greater than the nil rate bands (NRBs) available, this will reduce the Inheritance Tax (IHT) payable on death.
- Using equity in the home to provide an income can avoid 'sequencing risk'. This is the impact of taking pension drawdown in falling investment markets. While the value of a pension in drawdown could fluctuate, property values could also fall and reduce any remaining equity. Before considering a lifetime mortgage for income over pension drawdown, there are other factors to account for: Cost Price Index (CPI), house price inflation and the lifetime mortgage interest rate. These three factors could interreact to make a lifetime mortgage the more expensive option — highlighting the importance of considering a lifetime mortgage on an individual basis.
- Taking income from a lifetime mortgage instead of a pension could be advantageous, depending on when the client dies. Your client's longevity is therefore important to consider.
  - On death before age 75, no income tax is payable on pension savings, and in most cases the benefits will fall outside the client's estate for IHT purposes.
  - On death at or after age 75, whilst the value of the pension will in most cases still fall outside the client's estate for IHT purposes, the amount payable is taxed at the marginal rate of the person receiving the benefit. At current tax rates this could be up to 40% or even 45%, depending on the recipient's overall tax position. The beneficiary might be able to stay in drawdown and take income when they need it. This could reduce the tax rate applied to the payment, depending on their total income for the tax year in which the monies are withdrawn.
- The income from a lifetime mortgage is currently not taxable, so requires a smaller withdrawal than taking benefits from a pension. A basic rate taxpayer taking £10,000 from a lifetime mortgage would have to draw £12,500 gross from their pension to obtain the same figure. For a higher rate taxpayer the amount needing to be withdrawn increases to £16,667. Whilst this approach would keep the pension in a tax-favourable environment, it's important to consider that compound interest will be added to the lifetime mortgage loan each month. The interest charged on a lifetime mortgage could be a more expensive option in the long term.

[1] Data taken from LGRRI's presentation at L&G/FT Adviser 'The long and short of longevity risk', September 2020
[2] Lifetime mortgage interest rates correct as of September 2021

# Nil rate IHT bands

The NRB of £325,000 alongside the Residence Nil Rate Band (RNRB) of £175,000 (both CPI-linked from 2026), can be set against the estate providing certain conditions are met. This reduces the amount of estate assessed against IHT. Other IHT exemptions may also apply, such as leaving all or a portion of the estate to a spouse or registered civil partner where applicable. For estates worth over £2m, the amount of RNRB available is tapered (for every £2 over the £2m threshold the amount of available RNRB will be reduced by £1). Like the NRB, any unused RNRB can be transferred to the surviving spouse or Registered Civil Partner, and set against the estate following their death.

Over time, a lifetime mortgage will reduce the value of the equity in the property. This could reduce the amount of the estate liable to IHT, and in some instances, the total amount of IHT payable. However, before you recommend a lifetime mortgage you should first consider whether any equity in the property is likely to fully utilise the available NRB and RNRBs. Of course, the future value of property upon a client's death remains impossible to predict with certainty, but should be taken into account.

## Lifetime allowance

The consequences of lifetime allowance tests in respect of any pension savings the client has should also be considered.

If the client dies before age 75, the following will trigger a lifetime allowance test when paid from uncrystallised funds:

- Payment of a lump sum
- A dependant or nominee's drawdown
- A dependant or nominee's annuity

These are less likely to arise, given fewer deaths occur before age 75. The lifetime allowance could however be an issue at age 75. Any uncrystallised funds are tested against the lifetime allowance at age 75 in the same way that they would have been if crystallised earlier. Whilst in most cases this should not be an issue, a tax charge could arise if the client exceeds their available lifetime allowance.

Pension savings in drawdown have already crystallised and been subject to a lifetime allowance test. Therefore, only any increase in the value since they were originally crystallised is tested against the client's available lifetime allowance at age 75. If the increase in value at age 75 exceeds the available lifetime allowance, a 25% charge is payable on the excess. The available lifetime allowance is the percentage of the client's lifetime allowance remaining after any previous tests.

## What does this all mean?

For some clients, it could be tax efficient to draw an income using a lifetime mortgage instead of their pension. However, it may not always be the best approach. For example, if the IHT exemptions are eroded by the loan, the lifetime mortgage option is unlikely to make sense. This will also be the case if the client could exceed their available lifetime allowance at age 75 and incur an excess charge.

Alternatively, leveraging the equity in their home with a lifetime mortgage could offer some clients a way to boost their income in retirement. In both scenarios, it's important to look at the total cost of a lifetime mortgage after taking compound interest into consideration.

With varying factors at play, a lifetime mortgage won't be right for everyone. But for many retirees, their bricks and mortar could play an important role in financing their retirement. Whether the money is used to strengthen personal finances or to leave a pension intact for loved ones – releasing equity with a lifetime mortgage provides greater choice to clients in retirement.

# See how much your clients could release

Show your clients the different ways they could release equity from their home. Visit our lifetime mortgage calculator: **legalandgeneral.com/adviser/ltm-calculator**

## Want to see how the numbers work?

We can help. From case studies and webinars through to technical support, there's lots of information available on our website: **legalandgeneral.com/adviser/smart** or you can contact our specialist below.

## Get in touch

**Financial advisers:**

Rob Miles, Head of Adviser Sales
Call: **07979 534637**

Email: **rob.miles@landg.com**

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General enquiries:

**03330 048 444**

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