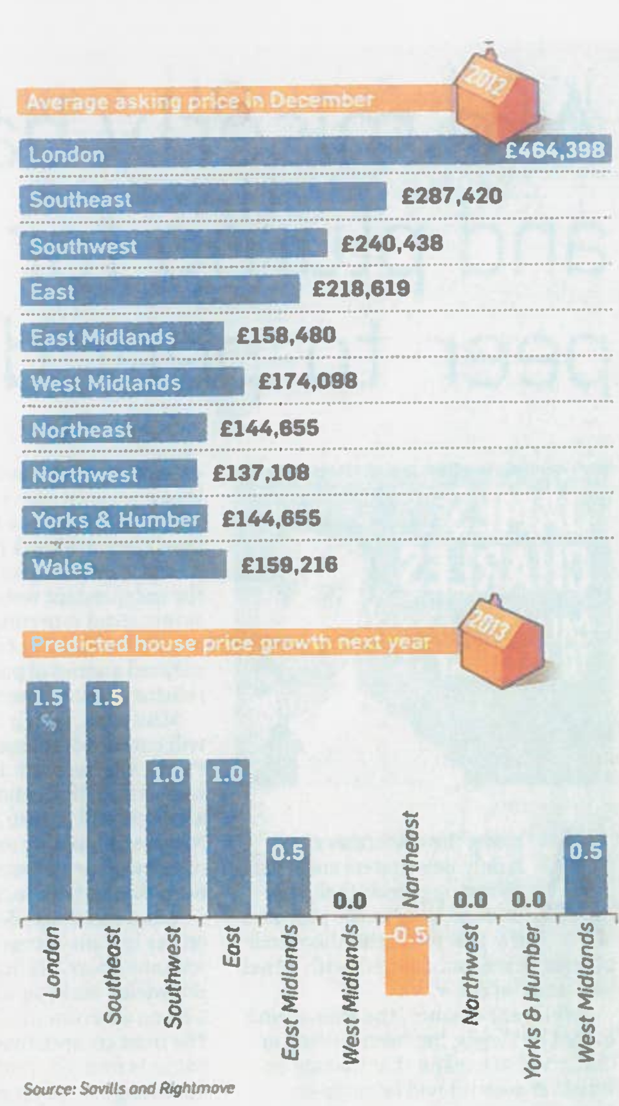
Boom in downsizing to unlock equity in homes

Households opting to move to smaller properties account for as much as a third of the market, writes **Anna Mikhailova**



A GROWING number of parents are set to downsize their homes to fund retirement, cut punishing inheritance tax bills and help their children onto the property ladder, according to research.

Savills, the estate agent, predicts there will be a steady rise in the number of older homeowners moving to smaller properties over the next five years. It estimates that the amount of equity released from downsizing will rise from £7bn to £12.5bn a year by 2017.

Residential property accounted for 34% of total inheritance tax receipts in the 2009-10 financial year, the latest year for which figures are available, according to research by Savills for The Sunday Times. The average detached house is worth just over £462,000 in southeast England and £332,304 in the southwest, Land Registry figures show.

Inheritance tax is levied at 40% on assets worth more than £325,000. The threshold has not risen since the coalition government came to power, and will rise only 1 percentage point in 2015, to £329,000.

Strutt & Parker, another estate agent, said more than 25% of the homes it has sold this year belonged to downsizers. A regional breakdown shows that the highest number was in East Anglia, where more than 35% of vendors were downsizing. In the southeast and southwest the figure was nearly a third of all sales.

INHERITANCE TAX PLANNING

Research by Savills in England and Wales found that local authority areas with the highest house prices had the largest number of estates liable to inheritance tax, as would be expected.

In Kensington & Chelsea, where the average property price is £1.4m, just over 15% of estates incurred inheritance tax in 2009-10. In Elmbridge, Surrey, 12.8% of estates incurred inheritance tax and the average house price is £561,717.

Danny Cox of Hargreaves Lansdown, the adviser, said: "To save on inheritance tax the taxable value of the estate has to be reduced. This can be done either by spending the money raised by downsizing or giving it away — if a house is sold to downsize and then the cash retained, there will be no inheritance tax saving."

One option is to gift the equity raised by downsizing. There are three main types of gift: those exempt from inheritance tax, those immediately subject to tax and those that may be exempt. To qualify, the person making the gift must survive for seven years. Gifts to charities and political parties are exempt, as are gifts of less than £3,000 a year to any individual.

"One alternative is to invest the money raised by selling a property into assets that are IHT exempt," said Cox.

"For example, buying woodland, investing in qualifying AIM shares or in enterprise investment schemes. Investments normally have to be held for two years before the exemption applies. These schemes are often higher risk and illiquid, so they are not for everyone."

RETIREMENT FUNDING

Downsizing is a popular option for those nearing retirement who want an income to supplement their pension.

Savills said that downsizing from a four-bedroom home to a two-bedroom property in London would release £512,897 of equity on average, compared with £249,114 in the southeast, £206,343 in the east of England and £147,411 in Wales.

Moving from a three-bedroom home to a two-bedroom property would release an average of £189,174 in London, £81,290 in the southeast and £49,757 in the east Midlands.

Figures from Better Retirement Group, the adviser, show that £512,897 would buy a 65-year-old man a single person level annuity paying £30,348 a year. A lump sum of £189,174 would buy an income of £11,170.

One alternative to downsizing is equity release. These schemes allow homeowners to release cash by borrowing against the value of their properties. They have been criticised because the interest is rolled up and added to the debt rather than being paid off, creating the potential for a huge debt to clear when the property is sold.

A £50,000 equity release loan, known as a lifetime mortgage, taken out at a typical rate of 6.5% would grow to a debt of £93,857 after 10 years and £176,182 after 20 years, said Key Retirement Solutions, the broker.

FIRST-TIME BUYER DEPOSIT

David Hollingworth of London & Country Mortgages, the broker, said: "Parents are increasingly an essential part of many first-time buyers' hopes of purchasing their own homes. Whereas in the past this would often come as part of an inheritance, the withdrawal of equity to help to finance the child's first or even second purchase is increasingly common."

The average first-time buyer in London requires £61,294 for a 20% deposit, according to Savills. In the southeast, the figure is £34,425 and in the northeast £15,712.

Although mortgage rates have been steadily falling across over the past few months, the size of the deposit required for the most competitive deals is a significant hurdle for first-time buyers. The best rates are concentrated in the sector of the market for buyers with a 40% deposit.

For example, HSBC has a two-year fix at 1.99% with a £1,999 fee for borrowers with a 40% deposit. The best rate for a 10% deposit is 3.99% from Co-operative bank, with no fee. Yorkshire building society also has a deal at 3.94% for 10% deposits but it carries a fee of £995. For 5% deposits, rates are even higher — Newcastle building society has a two-year fix at 5.99%, with no fee.

Some lenders have tried to tackle the problem by harnessing parental assets as a way of guaranteeing the child's mortgage without them needing to release equity. National Counties' building society's Family First Guarantor Mortgage, Bath building society's Parental Assistance Mortgage Scheme and Aldermore's Family Guarantee Mortgage use the parents' home as additional security for first-time buyers.

Alternative options include shared-equity or shared-ownership schemes, such as the government-backed Newbuy and Firstbuy.