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Paying for care costs in later life using the value in people's homes

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Background

Paying for long term care in the UK

- Unlike health care, long term care must be paid for by the individual, though is subject to means testing
- Income in retirement is normally insufficient to pay for long term care especially if a person moves into a nursing home
- As costs cannot be covered by pension income, some people are forced to sell their home to pay for care
- Recent government reforms have now capped care costs at £72,000
- But this is still beyond the reach of most people and only deals with catastrophic costs

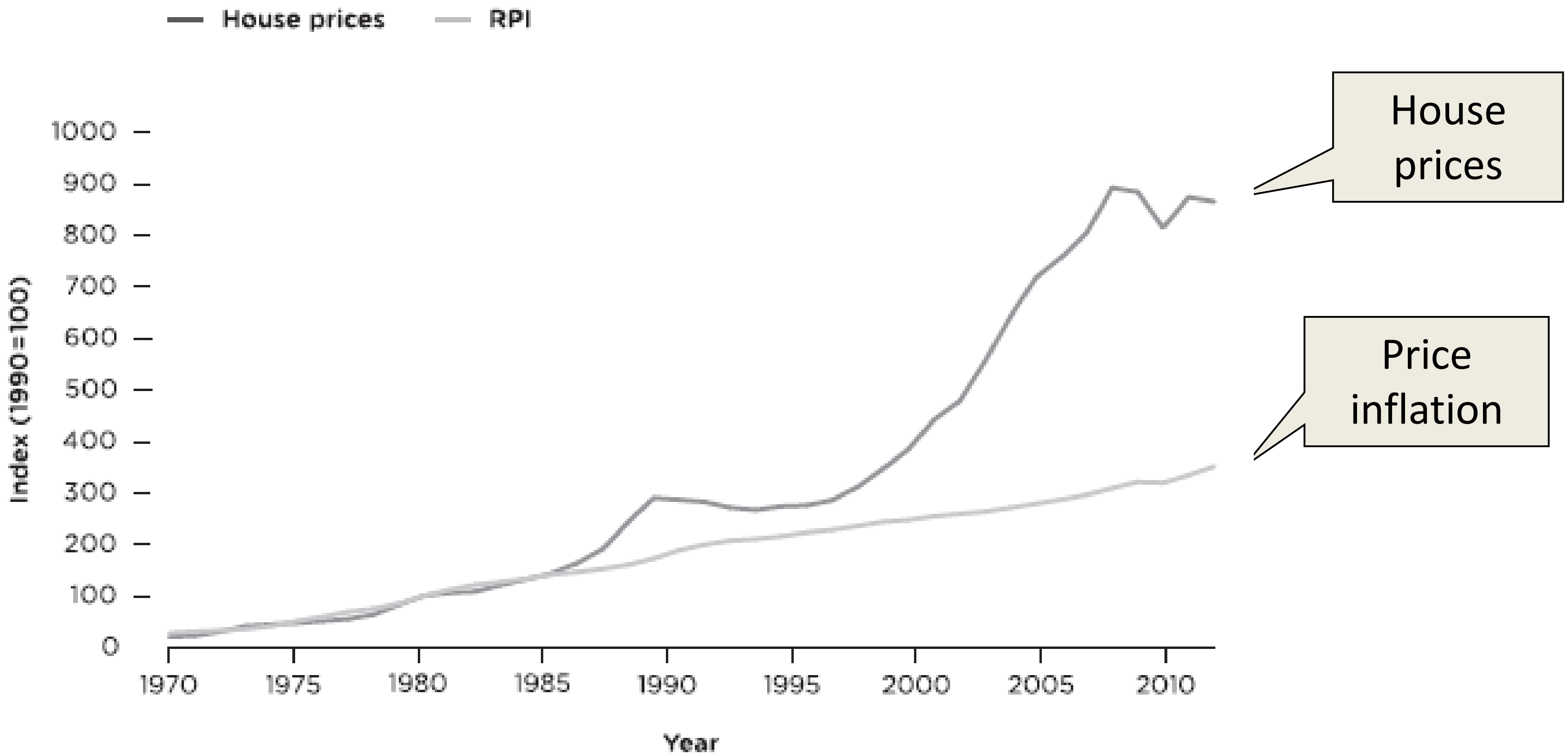
Background

Background and economic rationale

- The population in the UK aged 75+ will double from 5m to 10m by 2040
- Many older property owners have seen large, tax-free capital gains with property worth £1.4 trillion
- Not to use the value in the home increases the cost of welfare to the rest of society
- Current market for equity release is small and suffers from image problems
- Higher levels of equity release would generate modest macroeconomic benefits and create new jobs in local communities when used for everyday spending

Assets

Why housing wealth matters



House prices have increased relative to care costs which rise in step with the Retail Price Index. The multiple between house prices and annual care costs in a nursing home have increased from about 3-fold to 10-fold over two decades.

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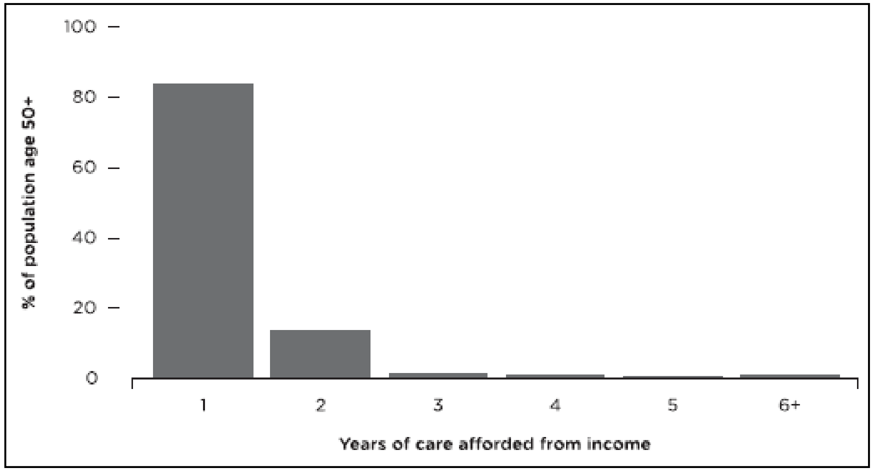
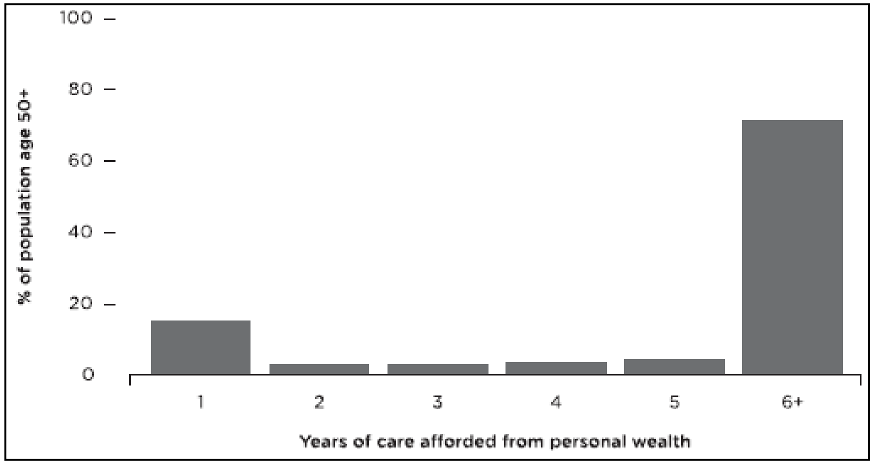
Wealth

Self-funding: Income vs. assets





- Assumes cost of care home is £25,000 p/a.
- Charts show what % of the 50+ population could afford care for up to 1 year, 2 years etc.
- If only income is included most would struggle to pay even for one year of care
- If all wealth is taken into account the picture changes
- Key factor is the value of housing equity

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Policy

Barriers to planning ahead

1. **Information (knowing the costs of care; understanding personal liability for them)**

   48% have given no thought to how they will pay for care.

   50% have no idea how much care costs

2. **Capability (overcoming inertia; understanding the system)**

   Inertia means intentions are not followed through. Optimism bias means people take risks. Complexity of means test and poor take-up of financial advice.

3. **Incentives (moral hazard from means testing)**

   Risk that people either (a) run down assets, (b) do not take active steps to cover costs of care.

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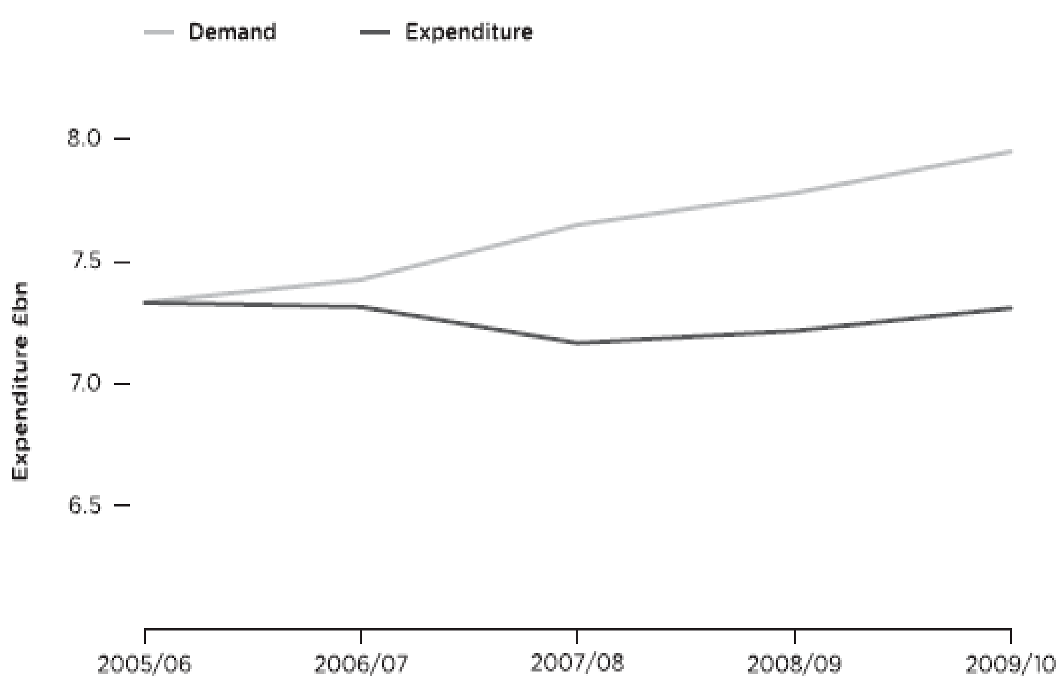
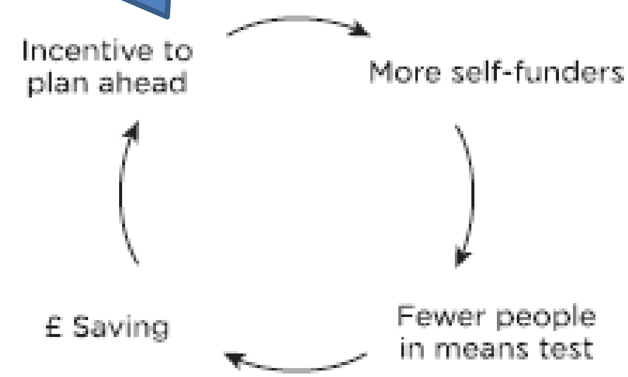
The problem with doing nothing



Incentives important



Overwhelming need to encourage greater self-funding....

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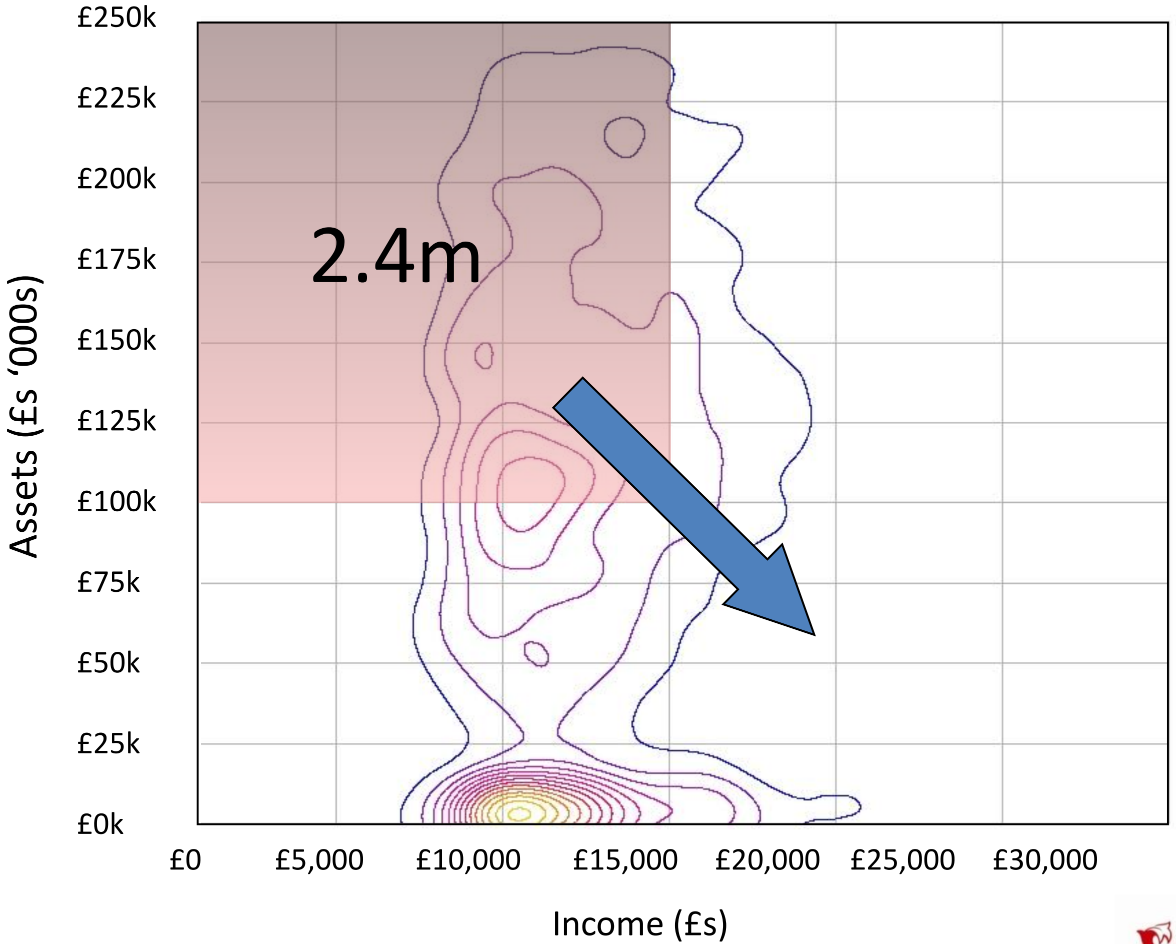
Who are our target group?

Asset-Income map for the 65+ population

Policy



A asset rich income poor

B asset rich income moderate/good

C asset poor income moderate/good

D asset poor income poor

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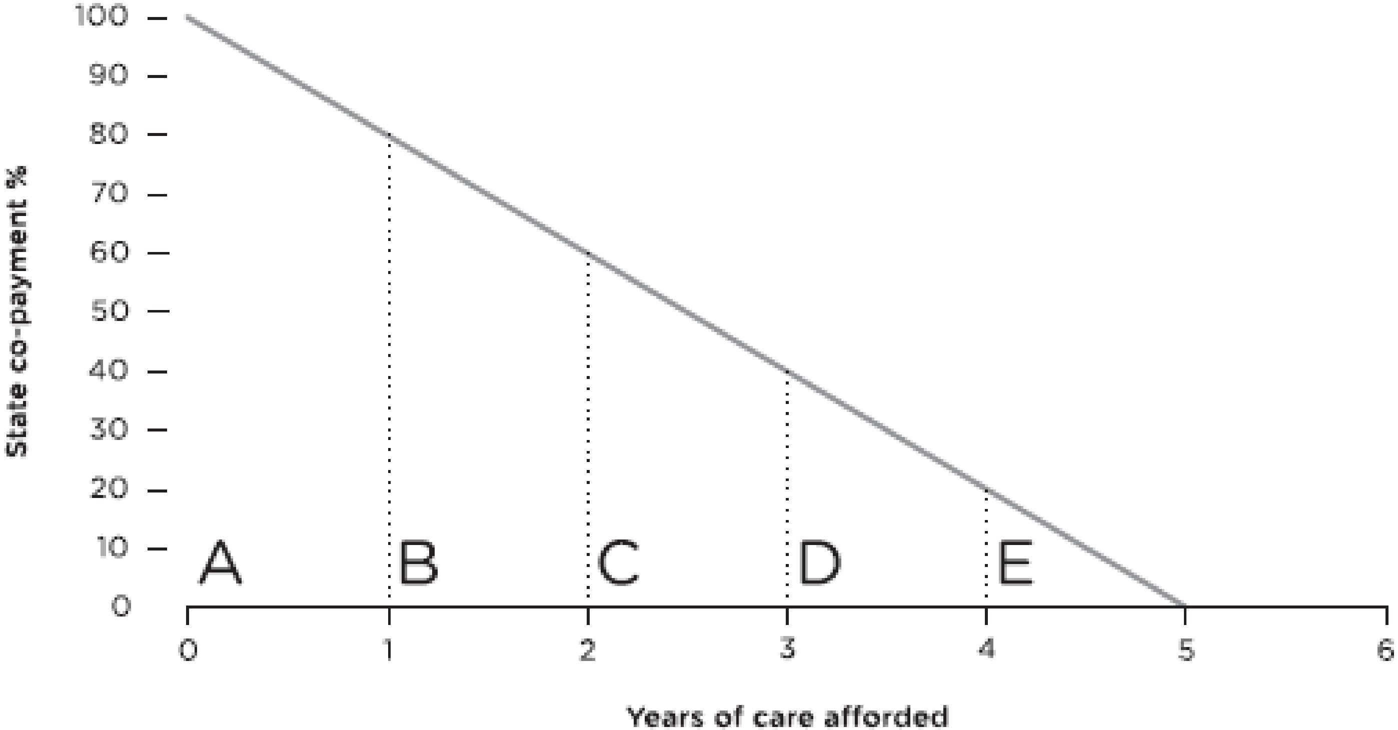
Policy

How it works & levels of support



Support bands

A 80% -100%

B 60% -80%

C 40% - 60%

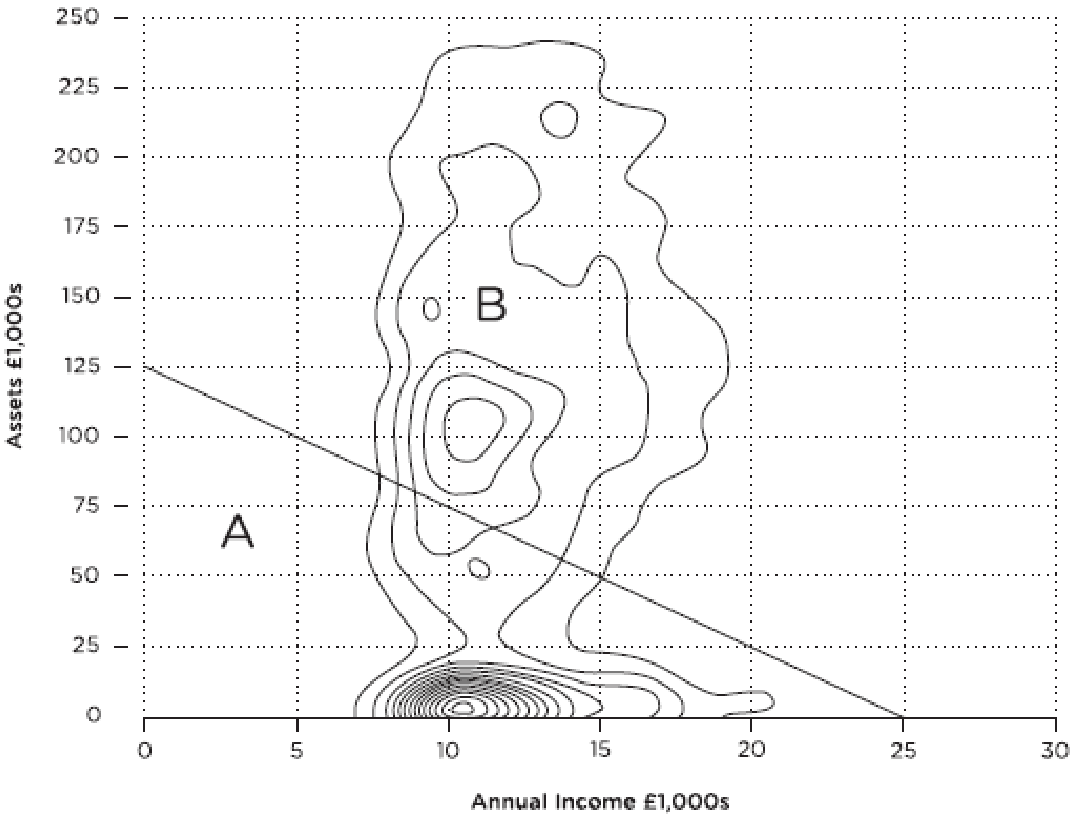
D 20% - 40%

E 0% - 10%

Support is calculated as follows:

(1-Years of care afforded from own assets and income x taper) x Tariff

Means testing and the distribution of wealth



- Assets and income are treated equivalently for assessing state support
- We calculate number of years of care that could be afforded based in income and assets
- The slope indicates the boundary for state support
- There are no cliff edges, and formula is simpler, making planning easier

Contours indicate concentrations of people aged 65+ age group on the income-asset spectrum.

Policy

Our simplified means test: an example

year in care	cumulative care payments	assessable capital at start of care year	state support	cost to individual	contribution to cap £s
1	25,000	100,000	-	25,000	12,000
2	50,000	85,000	-	25,000	24,000
3	75,000	70,000	1,667	23,333	36,000
4	100,000	56,667	6,111	18,889	48,000
5	125,000	47,778	9,074	15,926	60,000
6	150,000	41,852	11,049	13,951	72,000
	Final balance	37,901	27,901	122,099	

Example of person with £100k in assets, an income of £10k and care home costs of £25k per annum

Care cycle for a person who is six years in care. The first two years of care are self financed

State support kicks in from year 3 and gradually increases reaching £11k in year 6

By the time the cap is reached, out of pocket costs are £122k and state support is £27k. £38k of assets remain

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Three new product concepts

- Insurance based in exchange for a percentage of the home with premium paid after death
- Creation of ring fenced care account with notional percentage of home and possibly other assets
- Drawing an annuity or income draw down with debt repaid on death

Products

New product concept:
1. Equity for insurance

Product concept – key points:

- For individuals up to age 70 who cannot afford insurance premiums but who want peace of mind
- Trades a percentage of housing equity for insurance cover up to the care cap
- Payment occurs on sale of home, entry into care or after death
- Avoids means test and assets fully protected but lose out if care never needed
- Premium linked to difference between expected care cap inflation and appreciation in value of home

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New product concept: An example

Expected future difference in annual house price inflation	Equity insurance premium (% of value)
-1	4.3
-0.5	3.9
0	3.5
0.5	3.2
1	2.9
1.5	2.6
2	2.4
2.5	2.2
3	2

- Person ring fences agreed % of housing equity
- If care triggered, insurer meets care bills up to cap
- When house is sold on entry to care or death, insurer recovers agreed % of current home value
- The non-ring fenced % is unaffected
- Consumer continues to benefit from house price appreciation
- Risks to be capped in either direction if house rise or fall

Table showing indicative % of released equity based on current home value of £200k, care cap of £72k assuming 30% chance of incurring care costs.

Products

New product concept: 2. Care accounts

The incentive:

- **Place money or housing equity in a pension-like savings vehicle (a ‘care account’), register with tax authority, be rewarded for doing so**
  - Deadline after which £ could not be added to the account, withdrawals subject to penalty
  - Flexibility: equity could be swapped for cash, or vice versa
  - Living standards protected: people can put equity away without losing short-term purchasing power
  - Reward for pre-committing resources: a set % of the wealth stored in the care account disregarded in the means test

Rationale:

- Encourage higher volumes of self-funders, whilst rewarding those who plan ahead
- Tap into ‘mental accounting’ and ‘loss aversion’, alongside traditional incentive

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'Early-bird' discounts incentives

The incentive:

- **Register the purchase of a Long Term Care product with UK Tax authority, benefit from % reduction in the care cap.**
  - Deadline in people's lives after which discount would no longer be available
  - Reward forward planning with % reduction in the cap for those with LTC insurance with care costs covered
  - Benefit from peace of mind as well as financial security

New product concept:
3. The ‘Equity Bank’

- Many people reach retirement without having planned how much income they will need
- For example, a partner dies and health starts gradually to fail and life becomes more difficult
- Income is reduced, homes fall into poor decorative order; domestic chores mount up because these people cannot afford help
- People do not qualify for home help or other financial support because they do not pass the asset test
- The Equity Bank helps by enabling then to generate extra income from their home from a trustworthy source

Equity released for different levels of annuity and interest rates: A n example

age	1%	2%	3%	4%	5%
60	56.9	63.2	70.0	77.4	85.3
65	46.4	50.4	54.6	59.1	63.7
70	36.7	39.1	41.6	44.1	46.7
75	28.2	29.5	30.8	32.1	33.4

(a) £2,000

Equity released

age	1%	2%	3%	4%	5%
60	85.4	94.9	105.1	116.1	127.9
65	69.6	75.6	82.0	88.6	95.6
70	55.1	58.7	62.4	66.1	70.0
75	42.3	44.2	46.1	48.1	50.0

(b) £3,000

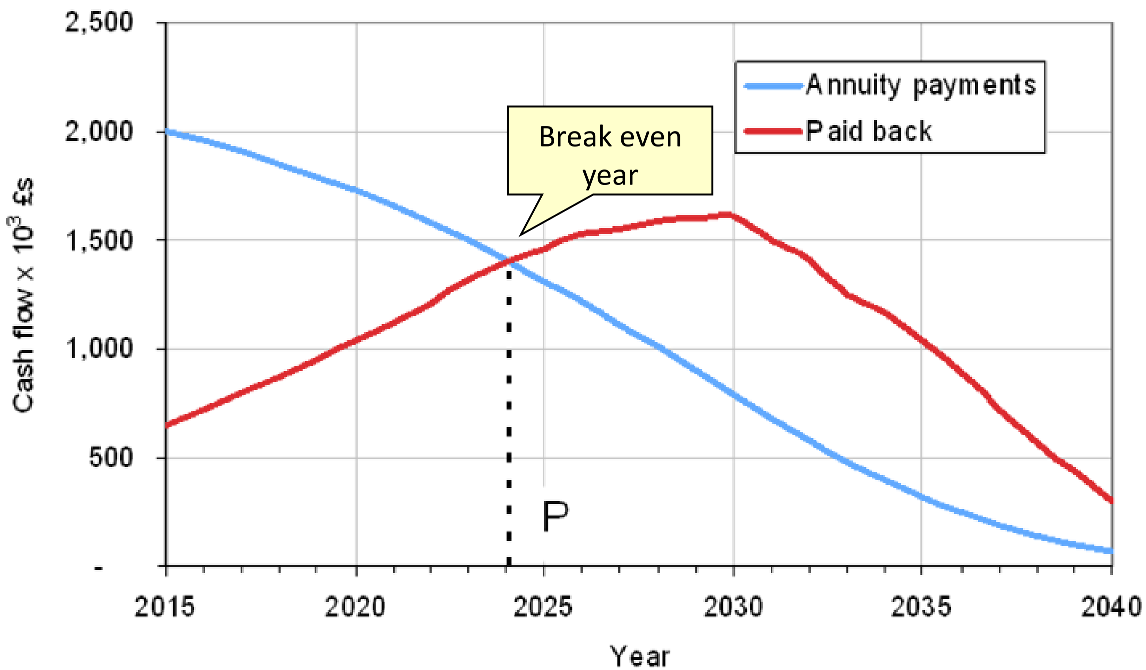
Table shows value of equity to be released in £’000s for given levels of annuity and interest rates with annuity rising with inflation:

(a) £2,000 p.a.

(b) £3,000 p.a.

Note: Capital requirement figures in £’000s

Cash flows and break even point



Age	loan ('000s £s)	break-even year
60	63.2	2033
65	50.4	2030
70	39.1	2027
75	29.5	2024

Chart showing cash flows for 1,000 women aged 75 in 2015 based on £2,000 annuity at 2% p.a.

Interactions with taxes and benefits

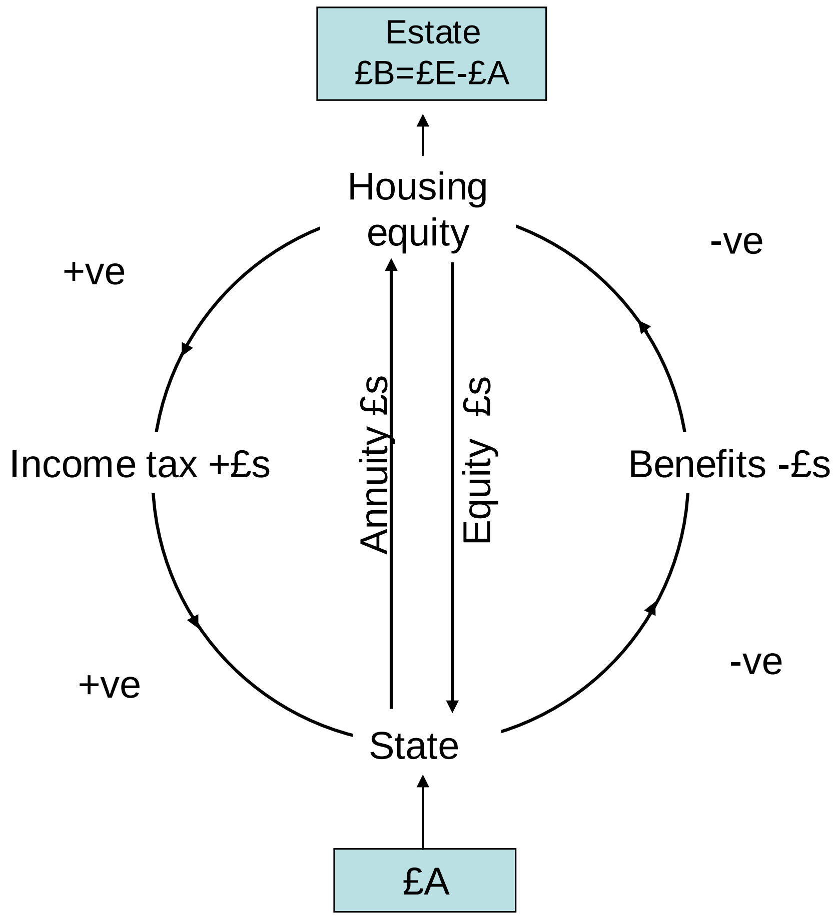


Chart showing money flows in the system (Key: £E is value of home, £A is the equity released; £B is the residual value of the estate). Actual flows will depend on tax benefits rules.

A person releasing equity may lose out financially if their benefits are reduced and they must pay income tax

Summary

Government

1. Tackle information gaps and behavioural biases
2. Simplify the system to aid decision making
3. Reward those willing to make pre-commitments

Industry

1. Explore new products that allow people to hedge risk of care costs using housing equity

Government + industry

1. Partnership on information and advice
2. Dialogue on how to ensure products can 'dovetail' with the means test

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