Sale and rent back – a market study

Annexe I - Impact assessment

October 2008
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INTRODUCTION

I.1.1 This annexe considers the likely impact of our proposals. Given both the limitations of the data and the speed of ongoing developments in the housing and financial markets, it is not possible to quantify the expected benefits or costs with much confidence. Moreover, the exact nature of the impact will depend on the details of FSA regulation. Nevertheless, we provide an indication of where the costs and benefits will lie, and give broad indications of magnitude where possible.

Overall impact

I.1.2 We expect the overall impact of our recommendations to be:

- Higher standards of professional conduct in the sale and rent back sector, on the basis that:
  - 'Rogue' traders will be less attracted to operating in a regulated sector
  - Regulation will require improved standards in some areas, for example disclosure
- A reduction in the numbers of people being persuaded to undertake sale and rent back when it is not in their best interests to do so
- For those that do undertake sale and rent back, a reduction in the risks they face
  - This could lead to an increase in the number of people considering sale and rent back where this type of transaction is potentially suitable
- An increase in the costs of offering sale and rent back
  - This is likely to lead to some operators exiting the industry, and some consolidation among those that remain
• Some restriction on the products that can be offered in the sector

I.1.3 Below we discuss the costs and benefits in more detail.

Benefits

I.1.4 There are three groups of consumers that will benefit from our recommendations:

• Group A: Those consumers for whom sale and rent back is the most suitable way of releasing equity from their home will benefit from a higher quality product. Most significantly, these consumers will face less risk of early eviction or unexpected rent increases, and may have access to redress if things do go wrong. In addition, the increased advice and transparency may enable them to shop around more easily and get a cheaper or more suitable deal.

• Group B: Some consumers who would previously have entered sale and rent back transactions will be diverted towards more suitable alternatives. This will result from a combination of fewer unscrupulous firms operating, and increased access to advice. The increased transparency and increased general awareness of the risk of sale and rent back may also contribute to consumers making better decisions.

• Group C: Some consumers who were previously dissuaded from sale and rent back because of concerns surrounding the product may now proceed with the transaction.

I.1.5 The extent of these benefits to some of these individuals may be significant.

I.1.6 To illustrate the case of consumers who may benefit from the enhanced security of the product (that is, consumers in Group A), assume that, with no regulation, a consumer sold a property worth £150,000 at a discount of 20 per cent to market value, thus foregoing £30,000 of equity in that property. Their alternative option was to sell on the open
market and find alternative accommodation. However, they go through with sale and rent back in the expectation that they will be allowed to remain in their own home for a number of years. If this expectation were not fulfilled because their tenancy was terminated sooner than anticipated, the financial detriment suffered would be a proportionate share of £30,000. The psychological detriment could also be significant. Regulation would mean that the consumer had greater security of tenure, would not be evicted without cause, and therefore would enjoy the full benefit anticipated in exchange for the £30,000 of equity foregone.

I.1.7 A similar level of detriment may be experienced by consumers who undertake sale and rent back when it is not the most suitable option for them (that is, consumers in Group B). For example, they may proceed even though the rent is not affordable on a sustainable basis. In this situation the consumer might be better off selling on the open market, keeping the equity thus released, and moving to a smaller property. When consumers enter into a sale and rent back that is not sustainable for them, they forego the equity in their home but are only able to remain there for a short period longer. Again, the financial detriment suffered would be a proportion of the discount on the sale. Regulation cannot prevent consumers making short-term choices, but by keeping the most unscrupulous operators out of the market, and increasing consumers' access to independent advice it might be possible to reduce the likelihood of this happening.

I.1.8 Quantifying the number of individuals who, without regulation, would face such severe detriment is difficult. The consumer survey suggests that around 13 per cent of sale and rent back customers are currently 'dissatisfied' with their transaction and 17 per cent are 'very dissatisfied'. We would not want to attach too much significance to these figures - it is impossible to gauge how severe this dissatisfaction was, and in any case the figures derive from a small sample base. Nonetheless we note that they relate to what is still a young market – further down the line some of the consumers who declared themselves satisfied with the product at this stage may yet experience difficulties.
I.1.9 To date there have been perhaps 50,000 transactions overall. On the basis of the above figures, this suggests around 15,000 dissatisfied or very dissatisfied customers.

I.1.10 It is hard to estimate precisely how many transactions will take place going forward, but it is likely that, in the short term, the number of transactions will drop, perhaps significantly. (We note, however, that as discounts may be deeper, the amount of potential detriment associated with each transaction may increase.) In the medium to long term, however, it is impossible to say whether the market will disappear, continue to function on a smaller scale, or start growing again.

I.1.11 However, with potential detriment being so severe in individual cases, and with detriment likely to be experienced in a material proportion of cases, the market does not need to be very big for the total detriment to mount up. To illustrate: if the size of the market was around 5,000 transactions per year, and 5 per cent of sale and rent back transactions resulted in detriment of the order of £20,000, the total detriment would be £5 million per year.

I.1.12 We also note that this detriment is likely to be experienced by a highly vulnerable consumer group – lower income consumers facing serious financial and housing difficulties.

I.1.13 Finally, our recommendations will also benefit some individuals who were dissuaded from sale and rent back because of the concerns surrounding the product (Group C). The benefit of the recommendations to these consumers will be the additional gain from a regulated sale and rent back transaction over and above the next best option. However, the consumer survey suggests that a few people were dissuaded from the transaction because of the risk - more commonly it was because of affordability issues. We do not think the benefit to Group C will be particularly significant compared to Groups A and B.
Costs

I.1.14 Regulation will be costly to put in place. These costs will be born by the firms (some of which will be passed on to the consumer), the FSA, the Government, and advisory bodies such as Citizens' Advice.

Costs to firms

I.1.15 The likely costs of regulation of sale and rent back can only be estimated when specific proposals are under consideration. However, by way of comparison, the FSA estimated that the incremental costs associated with regulating home reversion schemes would be fairly significant. Depending on the type of firm, estimates of the one-off costs ranged from £8,000 to £115,000 per firm, while ongoing costs ranged from £2,000 to £13,000 per firm per year.

I.1.16 For other products the FSA has used lower cost approaches. For example, its estimate of the incremental cost of regulation of Home Purchase Plans (HPPs) was £32 per product sold. However, this is unlikely to be indicative of the costs for sale and rent back, as there were generally no serious problems in the HPP market and the regulation primarily formalised existing practice, rather than introducing new requirements.

I.1.17 While the costs associated with regulating home reversion are likely to be more relevant for sale and rent back, the requirements may not be exactly the same. As we are not suggesting that sale and rent back firms should provide advice, costs should be lower in this respect. Also we do not necessarily envisage a standardised format for disclosure documents, just a minimum standard as regards content. On the other hand, many home reversion firms were already regulated by the FSA for the provision of lifetime mortgages, so there will be some additional costs for sale and rent back firms applying for FSA authorisation for the first time.

I.1.18 Even if the requirements were the same for sale and rent back as they are for equity release, it is still not possible to draw a straightforward
comparison. The equity release market, with only a few large firms, is much more concentrated than the sale and rent back market which is highly fragmented. We would therefore expect the cost per firm to be much higher for equity release, even if the costs per transaction were comparable. Without a proper understanding of the balance of fixed and variable costs in each case, we cannot estimate what the cost per transaction or per firm would be of regulating sale and rent back.

I.1.19 Although we cannot estimate the costs of the requirements precisely at this point (because it would be for the FSA to consult on these), it is likely that there would be some fixed costs associated with regulation, and these fixed costs might sit heavily on small firms. For this reason, we envisage that there might be some restructuring and consolidation of the industry in response to regulation. Some players might exit altogether, for example those who are primarily private landlords and who only undertake a small amount of sale and rent back business. Others might merge, or perhaps join a franchise group or other network, as has been common practice among IFAs, for example.

I.1.20 Consolidation could potentially reduce competition. However, given the fragmentation of the industry at present, and the lack of shopping around, it seems unlikely that the impact on competition would be significant. Indeed, improvements to the reputation of the industry might mean that large firms are more inclined to enter. Such firms could be a significant driver for competition in the market.

Costs to consumers

I.1.21 The increased costs to firms will be passed on to consumers, at least in part. It is therefore likely that the number of transactions will be reduced.

I.1.22 In principle it is possible that some consumers would prefer a low cost, risky product; if so they will be harmed by regulation that means this option is no longer available. However, we do not think this is a material concern as our consumer research suggested that for most consumers,
the guarantees of security of tenure were a critical reason for the transaction.

**Costs to government**

I.1.23 There will also be costs to the Government and the FSA. The costs to the FSA are not likely to be very significant as they already regulate equity release. The estimated costs to the FSA of implementing the home reversion regulation were £40,000 - £80,000, with minimal ongoing costs.

I.1.24 We have also recommended that the Government undertake some work on consumer awareness. However, we envisage that this would consist primarily of ensuring that the right message about sale and rent back is reaching consumers through existing channels, such as the arrears pack sent out by lenders.

I.1.25 DWP will also incur some costs in providing clearer guidance on housing benefit but we do not anticipate that these would be significant.

**Cost to advisory centres**

I.1.26 Advisory centres will also be called upon to increase advice to those entering into sale and rent back agreements. However, there should be an offsetting decrease in the number of customers who require advice after getting into difficulty with sale and rent back without taking earlier advice.

I.1.27 The Government has recently committed to an additional £9 million extra funding for face-to-face debt advice provided by third sector partners. This will include more specialised training for Citizen Advice Bureaux staff and local authorities, to provide tailored comprehensive financial advice for consumers, as well as strengthening the capacity and expertise of the National Housing Advice Service to provide independent expert advice for people struggling to pay their mortgage or loan. We envisage that sale and rent back messages could be incorporated within this training.