FINANCIAL CONVERSION OF HOME EQUITY BY LOW INCOME ELDERLY PERSONS.
A Supranational Juridical Comparison and a Focus on the Fundamental Financial Architecture.

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1. Introduction and the Social Problem Setting

Real estate and, specifically, homeownership represent by far the largest single asset class in households' wealth. At European level almost 69% of the household portfolio is allocated in real estate, on average, the residual part (41%) being diversified in financial assets like mutual funds, stocks and bonds, *i.e.* in risky assets (4% of the total assets). Focusing on the real estate investments, the households' main residence ranges to about 51% of the total gross assets, meaning that virtually half of the overall wealth is invested in the primary residence, being the likelihood of owning the main residence positively related with inheritances.[4]
The relevance of home ownership is spread over all demographic classes but decreases with age in all major developed countries. In particular, the owner-occupancy rate declines considerably after age 60, especially in European (Western) nations,[5] other things equal, but still representing the major wealth component.
Moreover, real estate investments show large cross-country heterogeneity in terms of participation rate of wealth allocation in the households' main residence, ranging from 44% in Germany to 54% in Spain and nearly 61% in Italy. Moreover, as it might be expected, homeownership and, generally, real estate investments are positively linked to wealth. The participation rate in homeownership

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[4] Euro area data; L. Arrondel, L. Bartiloro, P. Fessler, P. Lindner, T.Y. Mathä, C. Rampazzi, F. Savignac, T. Schmidt, M. Schürz, P. Vermeulen, *How do households allocate their assets? Stylized facts from the Eurosystem. Household Finance and Consumption Survey. Deutsche Bundsbank*, in «Discussion Paper», n. 12, 2014.
[5] M.C. Chiuri, T. Jappelli, *Do the elderly reduce housing equity? An international comparison*, in «Journal of Population Economics», vol. 23, n. 2, April 2010, pp. 643-663.

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reaches almost 95% (94.8%) in the fifth net wealth quintile in every country of the Euro area,[6] being limited to 4.8% and 28.7% in the first and second quintile of wealth, respectively.
Low net wealth households clearly neglect additional investments in real estate, being the share of Euro area families belonging to the first and second wealth quintile, holding other real estate than the home of residence, restricted to 2.3% and 8.7%.
Interesting, the cross-country differences reduce significantly when focusing on the demographic characteristics of households of senior and elderly (of age over 50) and controlling for families with low wealth.[7]

In general terms, home equity represents an investment decision that reflects sociological deliberations like housing services and related consumptions needs and the willingness to pass on an inheritance but – as a specific major asset class – also financial considerations. This due to the fact that real estate can be viewed as potential store of value to be used for prospective future conversion should the current disposable income of households be insufficient for covering the consumption needs.[8] This however considering the intrinsic illiquidity of real estate assets that poses severe transaction issues and costs when deciding its refinancing or reversion in cash through property sales.

In that context, the possibility of converting into cash the intrinsic property value of the primary residence might be of particular interest to elderly people interested in integrating their post-retirement consumption and (medical) spending capability in the case of a low current income deriving from limited (public or private) pension benefits and a reduced availability of (liquid) financial assets, combined with increased life expectancy, *i.e.* elderlies that might suffer consumption constraints (also called "low income elderly" hereinafter).
In fact, at European stage (EU, 27 countries),[9] in 2015, 17.3 individuals of age 65 and over out of 100 were at risk of poverty or social exclusion (however at decreasing trends, consistently with the Europe 2020 headline indicators, in respect to 2010 and 2006 when the rate used to be 20.0% and 24.7%, respectively)[10]. The percentage decreases to 15.4% (2015) if referred to people aged 75 and

[6] L. Arrondel *et alia*, *How do households allocate their assets? Stylized facts from the Eurosystem. Household Finance and Consumption Survey. Deutsche Bundsbank*, cit..
[7] E. Sierminska, K. Doorley, *Decomposing wealth portfolios across countries: An age-old question?*, CEPS/INSTEAD Working Paper, n. 32, 2012.
[8] A. Benito, *Who Withdraws Housing Equity and Why?*, in «Economica», vol. 76, n. 301, February 2009, pp. 51-70.
[9] EU-SILC Survey, 2016.

[10] Based upon the Eurostat Glossary (2016), the at risk of poverty or social exclusion (AROPE) refers to the situation of people either at risk of poverty or severely materially deprived where "at-risk-of-poverty population rate is the share of people with an equivalised disposable income (after social transfer) below the at-risk-of-poverty threshold, which is set at

over (18.1% in 2010 and 22.2.% in 2006), where female gender is associated with a higher poverty risk in respect to males, on average.
Surprisingly, the share of population at risk of poverty or social exclusion increases for home owner with no outstanding mortgage or housing loan (22.1% of the total population in 2015), where the risk of poverty is higher for people living in rural area than in towns and suburbs (EU, 27 and 28 countries).[11]
In that sense, Italy represents no exception: 20.2 elderly people (aged over 65) out of 100 are at risk of poverty or social exclusion, while the percentage reduces to 16.1% for elderlies above 75 years.

Given that demographic and portfolio background, the present paper addresses the issue of home equity conversion at supranational stage by comparing the legal and institutional framework across several European countries (Germany, France, Italy, United Kingdom, Spain, Belgium) and highlighting the fundamental financial architecture of home equity conversion.
The basic idea is that given the common scope of enhancing the living conditions and consumption capability of elderly households, it is of remarkable relevance, on the one side, to investigate the key legal framework and national peculiarities in terms of institutions and contracts. This because the home equity conversion products, like reverse mortgages, depict complex financial investment schemes that request detailed regulation also because low income elderlies often represent uninformed investors. The comparative analysis serves to identify the factors of success and failure, the structural limits of these products in civil law juridical systems and the institutional distinctiveness of the various reversion schemes in place that facilitates the dissemination and acceptance of home equity conversion forms.
On the other side, from a market perspective, one of the main factors that limits the support of home reversion schemes by financial intermediaries and market participants is represented by the need of effective managing and marketing the underlying real estate properties resulting from the final asset conversion.
In that sense the paper suggests the implementation of investment vehicles devoted to sale and loan equity release. This by executing "social" real estate investment funds (or trusts upon national regulation, REITs hereinafter) specialized in home equity conversion. The participation of selected institutional shareholders like foundations and trusts sensitive to the "social" nature of this type of REITs should also enhance the level of confidence of elderly homeowners in such financial products.

60% of the national median equivalised disposable income after social transfers. This indicator does not measure wealth or poverty, but low income in comparison to other residents in that country.
[11] EU-SILC Survey, 2016.

Despite the potential of home equity conversion by elderly in order to enhance their current income and, therefore, consumption, the effective diffusion of such financial products might however (*e.g.* Italy) be limited by social and psychological constraints inducing elderlies to bequeath real estates and other tangible assets to their heirs. This regardless of personal sacrifice and consumption limitations,[12] so that elderlies *de facto* act as a kind of intergenerational income buffers. These sociological issues and factors might significantly affect the market dissemination of home conversion.

The study is structured as follows. Section 2 depicts the core legal arrangements of home equity conversion in the main European countries. The comparative analysis (2.2.) serves to identify the factors of success and failure and main institutional peculiarities of the various reversion schemes in place. Section 3 presents (3.1.) the overall financial design of home equity conversion and promotes (3.2.) the development of specialized institutional investors capable of enhancing the dissemination of the financial conversion of home equity. Section 4 summarizes the main findings.

2. The Core Legal Arrangements of Home Equity Conversion in the Main European Countries

Europe knows various forms of financialization of home property by low-current income elderly persons, with consistent differences between countries regulated by a civil law system and those with a common law system. In the legal systems analyzed in the present study, the contractual models aimed at home equity conversion are regulated by several basic legal institutes (usufruct, use, right of occupancy, and life-time annuities – provided by the civil codes of each country, with the exception of the United Kingdom) with some peculiarities in each system and by other specific rules (provided by civil complementary legislation, other specific laws, or financial regulatory bodies).

The main types of home equity current in the countries under examination can be subdivided, on the basis of the most used classification, in "Equity Release Schemes" (Loan ERS and Sale ERS).[13]
In the USA, in the 1980s, ERS started with reverse mortgages and spread throughout Canada, Australia, New Zealand and the UK, using different definitions and products. «"Equity Release Schemes" is the term primarily used in Anglo-Saxon countries to describe both the process and the

[12] R. Dilling, H. Prast, M. Rossi, C. Urzì Brancati, *The psychology and economics of reverse mortgage attitudes. Evidence from the Netherlands*, Netspar Industry Series, 2015.
[13] See for example G.M. Hosty, S.J. Groves, C.A. Murray, M. Shah, *Pricing and Risk Capital in the Equity Release Market*, in «British Actuarial Journal», 14 (1), pp. 41-91, 2008, and U. Reifner, S. Clerc-Renaud, E. Perez-Carrillo, A. Tiffe, M. Knobloch, *Study on Equity Release Schemes in the EU*, Part I General Report, Institut für Finanazdienstleistungen, Hamburg, 2009.

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products that allow homeowners to secure substantial lump sums or regular income payments by realizing part of the value of their homes, while being able to continue to live in it».[14] «They transform fixed assets in owner occupied dwellings into liquid assets for private pensions» and consequently «enable a homeowner to access the wealth accumulated in the form of his or her home, while being able to continue to live in it». In this way, «an illiquid asset becomes a source of liquidity, mainly for consumption purposes».[15]

These schemes are distinguished in two main groups.
Loan ERS (like reverse, also called, lifetime mortgage and other similar products) provide a loan to be repaid by the heirs or through the sale proceeds of the property. Sale ERS (like the sale of the bare ownership and other similar schemes) involve an immediate sale of (usually part of) the property but provide for the right to remain in occupation and to use the cash price for income in retirement.[16] UK has a significant ERS market; Spain has an existing ERS market with growing outlook; in the Netherlands – that are not specifically analyzed in this paper –, financial products with similar profile like overdraft facilities and credit lines are preferred to pure ERS schemes. In Germany, Italy, France, and Belgium, ERS are under an intensive debate, but are not yet developed as in the Anglo-Saxon environment (USA, UK, and Australia, overall). Generally, legal conditions for ERS in the six European countries analyzed (UK, Spain, Germany, Italy, France, and Belgium) are rather favorable, except for Belgium where the introduction of equity conversion products is interfered by the prevailing law and fiscal arrangements. Overall, specific ERS legal provisions need to be ruled for some countries and adjusted for others.

In the past, conversion of home property aiming to satisfy the financial needs of elderly people was usually provided by legal institutes such as life rents, dating back to Civil Law Codes or, under Common Law, as provision for the lifetime of a beneficiary.[17] In more recent times, the idea of equity release entered legal systems where loan amortization, personal liability of the borrower and time limits for the duration of the loan agreement remain central for many regulatory schemes.

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[14] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part I General Report, cit., p. 1.

[15] *Ivi*, p. I. For a general description of the equity release products and for a legal and economic landscape of the same products in Europe and in the Anglo-Saxon countries, see A. Joosten, *Equity Release Products. Analysis for the Netherlands*, Netspar Academic Series, 2015, pp. 5-13; for a study concerning the decision problem of the optimal choice between home equity release products from a retired homeowner's perspective in the presence of longevity, long-term care, house price, and interest rate risk, see K. Hanewald, T. Post, M. Sherris, *Portfolio Choice in Retirement – What is the Optimal Home Equity Release Product?*, Netspar Discussion Papers, 2014; for an analysis of the reasons of the reverse mortgage demand and for a brief history of these products, see S. Castagnetti, *Behavioral Models on Reverse Mortgages. Understanding Reverse Mortgage (Low) Demand*, Netspar – Academic Series, 2015.

[16] *Ivi*, p. II.

[17] *Ivi*, p. V.

In the UK, the only country under examination with a common law system, ERSs have already gained large market acceptance. This due to the fact that mortgage and pension legislation has been adapted to the special features, risks and needs of "reverse" financial products. France and Spain favour some equity release schemes within their legal system that, like in other civil law countries, basically contrast loans "eating up" the home value instead of building it up. Spanish legislation, in particular, incentivizes ERS in the form of subsidies and tax benefits in return for certain consumer protection constraints. The other legal orders deal with ERS within their general civil and administrative law systems. In that respect, Belgium is the only country, among the ones considered in this paper, regulating mortgages to impede ERS, in principle.

Equity release schemes are not defined precisely in the European legislation and mortgage law as well as private pension schemes are not regulated at common level. Consequently, they are not applied in the same way and with the same constraints and effects and their market is still fragmented.[18]

The ERS legal framework is created on the basis of three main legal areas, namely credit, mortgages and sales, but insurance law is also important. Moreover, special laws impact both models of home equity conversion. Not all countries have a legal definition of loan and sale equity release models and current definitions in some countries leave space for further sub-types to be introduced by commercial operators, or even privately, inducing a variety of legal frameworks and methodologies in respect to ERS. The exception is the UK, where the Financial Conduct Authority (FCA)[19] regulation and some special legislations (Social Security, Housing, etc.) provide detailed definition of both loan and sale equity release models. So, the country has modern regulation on ERS of both types (and both are described and placed under authorization and supervision).[20]

ERS are traceable in several Civil Law countries that traditionally tend to set their regulation outside the realm of supervision. In France, private sale and lease-back arrangements (*vente en viager*) which fall under sale ERS are governed by contract law and are interpreted as a traditional sale transaction with specific payment modalities. However, where equity release schemes benefit from subsidies like in Spain, sale equity model arrangements also profit from tax advantages if they fulfill specific requirements.

[18] The *White Paper on the Integration of EU Mortgage Credit Markets* (2007) by the European commission indicates that existing impediments restrict the grade of cross-border activity, reducing choice and competition in the EU State Members market.

[19] The FCA is a financial regulatory body in the United Kingdom but operates independently of the UK government, and it is financed by charging fees to members of the financial services industry. The Authority regulates financial firms providing services to consumers and maintains the integrity of the UK financial markets. It focuses on the regulation of conduct by both retail and wholesale financial services firms.

[20] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part I General Report, cit., pp. 88-90.

2.1. Some European Countries in Detail

The selected European legal systems and contractual practices are presented considering the relative relevance of their ERS market. In that sense, the UK ranks first due to the widespread acceptance of home equity conversion, while Spain ranks second considering the growing ERS market. France, Italy and Germany provide home equity release models but their markets are still to be developed. The Netherlands present some ERS products and are recently dealing with ERS.[21] Ultimately, in Belgium legal barriers hinder the dissemination of home equity release schemes and the market is therefore almost inexistent.

The United Kingdom. The UK is characterized by a wide financial market, a high owner occupancy rate and level of homeownership. The market for ERS is favorable and decidedly competitive in terms of product providers also because the population in the age between 55 and 65 is augmenting and savings, pensions, and investments are insufficient to pursue their lifestyle in retirement.[22]
The equity release market in the UK is fully regulated. Both loan and sale ERS fall under the remit of the Financial Conduct Authority. Consumer protection is provided in terms of relevant information to be disclosed in respect to the supply of equity release plan to retail investors. In case of violation the consumer can seek redress through the Financial Ombudsman Service.
Prior to FCA regulation, many lenders signed up to Equity Release Council (ERC) formerly known as Safe Home Income Plans (SHIP), a voluntary code of conduct that provides a number of guarantees. ERC was formed in 1991 in an attempt to improve the equity release market and its previous poor reputation. The ERC guarantees include a guaranteed right to remain living in the property which is the main purpose of equity release, either for life or until entering long term care. In addition there is a vital "No Negative Equity Guarantee" which basically guarantees that the amount to repay the equity release plan on death or entry into long term care can never exceed the value of the property itself, and so no debt can ever be left behind for beneficiaries of the equity release borrower. In 2012, SHIP rebranded as the Equity Release Council (ERC) and extended its

[21] Causes for the lack of formal ERS despite the developed use of mortgage based products in the Netherlands could derive from the fact that these products serve a similar purpose to ERS by allowing homeowners to extract liquidity from an earlier age by assigning claims to their property. One field where the Netherlands seem to be in progress is that of the adequate housing for the elderly.

[22] U. Reifner, S. Clerc-Renaud, E. Perez-Carrillo, A. Tiffe, M. Knobloch, *Study on Equity Release Schemes in the EU*, Part II Country Reports, Institut für Finanazdienstleistungen, Hamburg, 2009, pp. 4-5. In this country, the first home reversion product was sold in 1965. This earlier version of the product was poorly designed and barely sold (A. Joosten, *Equity Release Products. Analysis for the Netherlands*, cit., p. 14).

reach to Equity Release advisers as well as product providers.[23]

The UK home equity release market is basically made up of two types of plans. Loan equity release models are the most offered product but also sale ERS are on the market from a very long time. A considerable move towards the supply of more flexible products is evident, allowing a whole range of possibilities from taking lump sums to a series of smaller sums or access to the equity on an ad–hoc basis. This can be a consequence of competition in the UK ERS market, whereby specific features catering differentiate customer needs.[24]

The most popular plan are lifetime mortgages, where the homeowner retains ownership of the property but the property is charged with the repayment of a mortgage loan; rolled-up interest accrue over the homeowner's lifetime. To help customers decide, a number of companies provide a free equity release calculator to show a rough estimate of the amount of equity that could be released.

In the UK, the term used for the most common type of ERS is "lifetime mortgage". More precisely, with lifetime mortgages the consumer can borrow a sum of money up to a maximum loan-to-value ratio set by the provider depending on the age (and the partner's age, if appropriate). Most products offer amounts based on similar ratios, for a given property value. Some providers are willing to lend higher amounts in return for higher interest rates. Moreover, if the maximum loan size is not taken out from the outset, there may be limitations on such products which restrict the time after that further advances are allowed. Interest rates are generally fixed for the entire duration.[25]

In UK, but particularly in England and Wales, three types of lifetime mortgage are widespread, namely roll-up lifetime mortgages, drawdown lifetime mortgages and interest payment loans.[26]

With a roll-up mortgage the consumer takes out (principally) a loan against the value of his home. The lender pays a lump-sum to the consumer who has not to make any repayments of interest or capital until he sells his home. Instead, the interest is "rolled-up" and added to the total loan. The full amount of rolled-up interest and the principal are repaid when the borrower sells his home.

In drawdown lifetime mortgages, the borrower gets a smaller initial sum and cash amounts either when needed or on a regular basis. Because he is taking out smaller amounts of money over a period of time, his debt will grow more slowly than taking the whole principal at the start.

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[23] At now, the regulatory regime consists of eleven "high-level" Conduct of Business principles, which apply to all financial transactions within the FCA's jurisdiction. Detailed rules are present in the Mortgage and Home Finance Conduct of Business Sourcebook (MCOB), available at the FCA website in the Handbook section.

[24] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part II Country Reports, cit., p. 5.

[25] *Ivi*, p. 6.

[26] For the analysis of the products described in this paragraph (Loan Model ERS, Sale Model ERS, and other schemes), it has been consulted the following factsheet: *Equity Release*, Factsheet n. 65, Age UK, February 2016. See, with this regard, also the large description of I. Hendriks, *Living Longer in Your Own House. Could a Reverse Mortgage Be the Solution?*, Netspar Theses, 2013, pp. 23-28 and *passim*.

With interest payment loans, a loan against the value of the home can be taken out. The consumer receives a lump-sum on which interest payments are charged. He will not have to repay the principal until the sale of the property. The interest rates are normally fixed. The borrower can choose the amount of interest to pay and, if he decides to stop interest payments, the loan will be converted to a roll-up lifetime mortgage. This protection is of particular relevance for couples because if one partner dies and the surviving partner has a reduced income, she or he may not be able to afford the interest payments.
Sale equity release schemes are better known in UK as "Home Reversions". A homeowner sells his property or a part of it to a private reversion company. In return, the seller receives a cash lump-sum or a lesser lump-sum with subsequent payments, normally for a maximum duration. Besides, the seller might be granted a lease which gives him the right to remain in his house rent-free or for a nominal reduced monthly rent for the rest of life. On the other hand, the investor buys a part of the rights of the seller on the real estate.[27] When the seller passes away or moves into residential care, the reversion company gains full ownership of the property. Depending on the contractual terms, which clearly influence the lump-sum amount or monthly income, when the home is sold the heirs may participate in the potential market value increase of the property at maturity in respect to its value at start.[28]

Other schemes, not equity release models *stricto sensu*, consist of two types: Sale and Rent Back (SRB) schemes and Home for Life (or Lifetime lease plans).
SRB schemes are usually offered to homeowners who are in financial troubles and facing repossession action. With this type of arrangement, a firm buys the house of consumer, usually in the range of 70% up to 80% of its market value, and then leases the property back to him at a market rent. The seller can use the cash to settle his existing mortgage and any arrears that he has while remaining in his home. Some companies may offer an option of buying back the house later at market value. In most cases, these schemes do not guarantee occupancy for life. There are two main differences between SRB and equity release schemes: the security of tenure (equity release will usually provide the consumer with the right to live in his home for life); the fact that with equity release schemes, the homeowner usually doesn't pay any rent or rent payment are limited to a

[27] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part II Country Reports, cit., p. 6.

[28] There are usually some conditions that consumers taking out equity release plans have to meet. These will differ between schemes but could include: a minimum age, usually 55, but also over 60 or 65; a maximum amount the consumer can borrow or sell, typically 18-50% of the property's value; the customer must own his home and it must be of a certain value; he will be required to pay off any outstanding mortgage in full either from the equity that he releases or from other funds; he will have to borrow a minimum amount of money; there may be restrictions on the type and condition of property acceptable to lenders. It is important to underline that money received from equity release can affect the consumer entitlement to Pension Credit (PC) as well as other benefits such as help with health costs and Council Tax Support (welfare benefits).

nominal amount. The FCA regulates SRB firms making sure that the deal is appropriate and obliging them to offer for a fixed term assured shorthold tenancies of at least five years.[29]

Home for Life are not regulated. The investor purchases the property at the market value. The seller is granted a lifetime lease of the property. These plans are normally only available for people aged 60 or over where the homeowner pays a one-off sum for his Home for Life plan and no interest repayments or rents. The one-off sum can include a discount depending on age, gender, marital status and property criteria. It is possible to retain a percentage to provide an inheritance guarantee. When the consumer dies or moves permanently into long-term care, the property reverts back to the company. If the consumer has retained a percentage of his property's value for inheritance purposes, his property is sold and his share of the net sale proceeds is paid to his heirs.

Spain. As indicated, in civil law countries likes Spain, the most part of home equity conversion products is regulated by legal norms on usufruct, use and habitation rights (*del usufructo, del uso y de la habitación*).[30] Sale of bare ownership – comparable to sale ERS – in exchange for a cash price (to be used for enhancing retirement income of elderly households), keeping the right of usufruct, use or habitation in favour of the seller with or without a rental fee, is indeed the more common and traditional way for elderly people to convert their home equity into cash but remaining in their house for a fixed period of time or for life.

Institutes such as "life rent" are still present in the Spanish Civil Code. These concepts are less used in the modern welfare state. The idea of equity release entered legal orders, where personal liability of the borrower, time limits for the duration of the loan, and loan amortization remain crucial to some regulatory schemes.

The term "Equity Release Scheme" is not formally known in Spain. Nevertheless, various financial products exist in the Spanish market falling within ERS, both as loan and sale models, as well as other peculiar subtype products. Precisely, the Spanish market was shook by the Act 41/2007 regulating the basic requirements and attaching exemptions on some taxes, notary and registrar fees with regard to reverse mortgages. At present, these types of products are current in the Spanish market and some financial intermediaries are introducing specific reverse mortgages.[31]

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[29] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part II Country Reports, cit., p. 7: «The UK can serve as a good example because the competition authorities publish their study on what is in that country a relatively new type of property transaction whereby firms buy homes from individuals, usually at a discount, and then allow those individuals to stay on in the property as tenants».

[30] The Spanish Civil Code governs usufruct in articles from 467 to 522, while use and habitation in articles from 523 to 529.

[31] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part II Country Reports, cit., p. 43. For a comparative study of the reverse mortgage as known in Spain with other EU State Members, see E. Del Pozo García, Z. Díaz Martinez, L. Fernández Sevilla, *La hipoteca inversa en España: un estudio comparativo con otros países de la Unión Europea y EEUU*, in «Revista Universitaria Europea», n. 15, Julio-Diciembre 2011, pp. 85-106; while for an analysis concerning the utility, the

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The Spanish language underlines the reverse character of the loan, calling it *hipoteca inversa* or *hipoteca revertida* or *re-hipoteca*, whose legal definition is: «Reverse mortgage is a loan or credit warranted with a mortgage over an immovable asset».[32]

In this legal system, several sub-types of loan ERS might exist under private law but only the products as regulated under Law 41/2007 qualify for subsidies[33] if fulfilling the requirements specified in the same law.[34] It is provided that the mortgaged property has to be the permanent residence of the applicant, insured against damages; providers must be financial intermediaries authorized to operate in Spain and provide independent information according to article 1 of the Act. Applicants must be 65 years of age or more, and/or be affected by situations of real dependence. Credit can consist of funds accessed either as a lump-sum or through various installments and is supposed to be for life but may be cancelled by the mortgagor, who must, in this event, satisfy the provider with a refund of capital plus interest or upon the sale of the property. There are a number of benefits provided for such schemes: a reduction in the taxation of notarial documents, a reduction in notary and registrar fees similar to pension funds.[35]

Sale equity release models allow homeowners to release some of the property equity that may have greatly appreciated in value over time. These products are based on a contract whereby the elderly person sells the homeownership while maintaining the lifetime right over its use and the right to receive a life annuity pension. They are partially regulated in articles 1802 to 1808 of the Spanish Civil Code, as *Renta Vitalicia*, although this lifetime rent is usually combined either with a tenancy

convenience, and the success of this product in Spain, see A.J. Quesada Sánchez, *La hipoteca inversa: una opción realmente atractiva?*, in «Revista del Ministero de Trabajo e Inmigración», n. 81, 2009, pp. 135-148.

[32] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part I General Report, cit., p. 2.

[33] This credit has to be provided by a financial institution that fulfils the requirements of any other Spanish mortgage provider, and has to be signed before a public Notary and registered as a charge over the property at the Land Registry.

[34] As provided by the Additional Dispositions 1 and 4 of Spanish Act 41 of 7th December of 2007.

[35] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part I General Report, cit., p. 89. This scheme is usually linked to a life insurance contract (Policy insurance for a life pension or *Seguro de rentas vitalicias)*, which has to be contracted with an insurance company that offers the insured a periodic amount, generally monthly, for his life, according to Spanish insurance regulations. At now, the heirs can implement the following options, on the basis of art. 1, point 7 of Act 41/2007. First, they can choose to cancel the credit repaying the loan, in which case no penalty can be imposed on them. Second, the heirs can decide to obtain a fully new credit agreement with the provider, in which case this possibility is left entirely up to the wishes of the parties to the new credit contract. Third, the heirs can decide to let the financial institution simply repossess the home. If the heirs follow the last option, all schemes that were concluded in accordance with the Loan Model subtype of Act 41/2007 benefit from a certain "cap" on the amounts to be recovered by the credit provider. Art 1.6 of Additional Disposition of the same Act indicates that the provider can seize the mortgaged property and the estate of the deceased, but the provider's recovery action cannot reach the heirs estate (U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part II Country Reports, cit., pp. 41-42).

contract or a *usufructo*. By transferring ownership, the seller is released from encumbrances such as maintenance of common areas and payments of local taxation. Monthly payments enjoy fiscal benefits.[36]

The Spanish personal taxation (IRPF) provides a reduction in notary fees, the exemption from personal gains tax on the capital gain on the property for persons aged over 65, and a beneficial regime for the periodic rents cashed by elderly persons (as for reverse mortgages). The contract can be signed through a realtor acting as a broker for financial intermediaries and insurance companies. The element common to the various subtypes is the sale of property. The law does not typify the contract. In general, in a sale ERS the homeowner sells the ownership of the property and receives a consideration either for himself or for the benefit of a third party included in the contract. The contract could provide the following contents: services (for instance in health care received at home), an advanced lump-sum and a monthly income for life, or a life annuity usually paid in monthly installments. The beneficiary preserves the use, namely the right to use or rent the house for lifetime or for a given duration. The consumer receives a pension payment.[37]

Moreover, the Spanish legal praxis knows contracts regulated by private law that have the effect of ensuring life care for elderly people in exchange of the handing over to the rent/care provider of a property. On the basis of Act 2/2006 of Civil Law of The Autonomous Region of Galicia, a property, which does not need to be a private residence, can be transferred either by a third person or the recipient. Another subtype provides that the owner sells the house and loses possession in exchange for care in a retired person home. Sale model products can be used by a couple or a group of persons, too. In this case, the life annuity payment is calculated with regard to the youngest person. Upon the death of one of the customers the other keeps the home use in exchange of the same monthly payment. Finally, in Spain the owner can sell a house and maintain his possession becoming a tenant. Legal experts observe that this is arranged privately, usually within family relations.[38]

France. The French legal system offers a multifaceted landscape of classical civil law arrangements, differently combined, as well as modern equity release schemes.

Transfer of bare ownership, keeping the usufruct as governed in the Civil Code, is still the most common and traditional way for elderly people to convert their home ownership into cash without giving up the use of the house for the rest of their lives. French academics recently proposed (in

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[36] *Ivi*, pp. 42-43.
[37] *Ivi*, p. 47.
[38] *Ivi*, p. 48.

their Project of Reform of Property Law in 2009)[39] a deep reform of legislative regulation of usufruct, in order to modernize it, to make it more flexible and more collaborative between the parties and to counter the situations, frequent in practice, of deterioration of the goods subject to a right of usufruct.
The conversion of the usufruct of the surviving spouse, provided by French Civil Code (artt. 759-762), can also be a way for an elderly widower or widow to convert ownership into a financial support. In fact, any usufruct belonging to a spouse upon the property of the predeceased gives rise to a power of conversion into a life annuity (or a capital), on request of one of the heirs bare-owners or of the spouse himself or herself entitled to inherit.
Moreover, on the basis of the Civil Code (artt. 1968-1983), contracts of property sales *en viager* (in return for life-time annuities) are widespread (mostly in Ile-de-France and Côte d'Azur), although today they are concurred by reverse mortgages. They are speculative contracts, in the sense that the total price that the buyer (investor) will pay over time cannot be predicted in advance. At the time of the sale, the investor (usually) pays part of the estimated value of the good with the obligation to pay a monthly, life-long pension to the seller. Of course the parties can agree to variously distribute the amount between the initial capital and the life-long pension (the higher the capital, the lower the pension and *vice versa*); they can also agree an indexation clause of the monthly payments or a cancellation clause returning property to the seller if the purchaser fails to pay several monthly disbursements. A preferential right (*privilège du vendeur*) of the seller on the asset usually guarantees the obligations of the investor.
Sales *en viager* can be free or occupied: in the first case, the buyer immediately becomes the full owner. In the second case, which is more common, the seller retains the right of usufruct or of use and habitation on the good (an important difference is that, enjoying a right of usufruct, the seller has to pay the *taxe foncière*, while, enjoying a right of use and habitation, he has not but the purchaser has to). These contracts guarantee a stable and regular income (more appropriate than a principal which is more difficult to manage) for the needs of the elderly and usually are a suitable investment for potential investors, who do not have to pay a large amount at once and can distribute their payments over the time.

Reverse mortgage (*prêt viager hypothécaire*) has been introduced in France by *Ordonnance* n. 2006-346 in 2006, reforming security law, and today, after several modifications, it is governed by articles L315-1 – L315-23 and R315-1 – R315-2 of Consumer Code. The contract can only be agreed between a financial intermediaries and a natural person. The final amount of the obligation of the borrower or of his heirs is only determined when the contractual relationship terminates, which is either at the death of the borrower (or of the couple of borrower spouses, if the contract is in the name and lasts until the death of both of them) or in an early date when his mortgaged property (which can be

[39] H. Périnet-Marquet (edited by), *Propositions de l'Association Henri Capitant pour une réforme du droit des biens*, Paris, 2009.

exclusively a residential home) is sold or his ownership dismembered. After the death of the borrower or of the borrowers, the heirs can pay the debt, within the limits of the property value at the moment of the opening of succession. Otherwise, the creditor can choose between the seizure and sale of the mortgaged immovable, according to the general rules of civil law (and also in this case the debt is limited to the profits of the sale), or the attribution of the ownership of it by a judicial decision or by an agreement.

Detailed rules are provided in order to implement the protection of the borrower from the typical risks of this type of agreements. The final value of the debt cannot exceed the value of the good at the time of the end of the contractual relationship. Periodical repayments can be agreed only for interests, that are capitalized annually, but not for the principal: this option has been recently introduced by Act n. 992 in 2015, aiming to strengthen the attractiveness of reverse mortgages. Canvassing is forbidden and the publicity has to be informative and honest, in accordance with specific rules. A prior offer has to mention clearly and precisely the main elements of the loan and has to be maintained for 30 days at least, the borrower having a 10 days period of reflection during which he cannot accept the offer.[40] Both civil and penal sanctions are provided for violations.

As a variation on the standard scheme, a kind of reverse mortgage called *prêt avance mutation*, introduced by Act n. 992 in 2015,[41] aims to finance the costs of works for home renovations.

Italy. In the Italian legal order, the transfer of the bare ownership, governed in the Civil Code, still remains the more common instrument for home equity conversion. Property sales or transfers of the bare ownership in return for a life-time annuity may be agreed in Italy like in France.[42]

Reverse mortgage (*prestito vitalizio ipotecario* or *mutuo al contrario*) has been introduced in Italy in 2005[43] and recently modified in 2015.[44] The French choice to introduce regulations on *prêt viager hypothécaire* in the Consumer Code seems more consistent with the alleged purposes of this legal institute than the misleading location of Italian legislation on *prestito vitalizio ipotecario*, between norms concerning welfare state, fiscal law and tax evasion.

The reform, following the example of the French legislator, introduces a more detailed regulation in order to encourage the use of such equity conversion schemes,[45] also reducing from 65 to 60 years

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[40] G. Morri, A. Mazza, *Property Finance: an International Approach*, Padstow, 2015, p. 192.

[41] Currently governed by article L315-2 of Consumer Code.

[42] The Italian Civil Code governs life-time annuities in artt. 1872-1881.

[43] Article 11 quaterdecies, paragraph 12, Law by Decree n. 203 of 30th September 2005, converted in Law n. 248 of 2nd December 2005.

[44] It has been more recently modified by Law n. 44 of 2nd April 2015, which substituted the paragraph 12 of the article 11 quaterdecies of Law by Decree n. 203 of 2005 and added paragraphs from 12-bis to 12-sexies. These rules have been integrated for implementation by Decree n. 226 of 22nd December 2015.

[45] S. Cherti, *Prime note sulle modifiche alla disciplina del prestito vitalizio ipotecario*, in «Il Corriere Giuridico», nn. 8-9, 2015, p. 1099.

the minimal age for accessing this particular kind of loan, and excluding that the residual value of the debt can exceed the proceeds of the sale of the property, net of expenses. The contract can only be agreed between a financial intermediary, subjected to precise informational disclosure rules, and a natural person. If the borrower is married or cohabits *more uxorio* from more than five years and the couple lives in the house to be mortgaged, the contract must be signed by both the spouses, even if only one of them owns the property, provided that both of them are above the minimal age of 60 years. The full reimbursement in a single payment can only be requested at the death of the borrower (or of the older of the couple of borrowers, when the contract lasts until the death of both of them) or in an early date when the mortgaged property is sold or real rights or enjoyments rights on it are established.

Periodical repayments can be agreed only for interests and costs (not for the principal); interests are otherwise annually capitalized, as an exception to the Italian Civil Code (article 1283).[46] The mortgage cannot concern simultaneously more than one real estate of the debtor. The debtor is not necessarily the owner of the mortgaged residential property, although it is the normal case. The procedure for the sale of the property in order to use the proceeds for repaying the debt, if the heirs do not take over the debt, is simplified and fast, as an exception to the techniques traditionally provided for foreclosure and succession procedures.

Germany. As in the other civil law countries here compared, the German legal system provides similar norms governing the main legal institutes concerning contractual models to financialize the home property by low current income elderly persons. However, in Germany there is no specific legislation governing ERS in the civil code (*Bürgerliches Gesetzbuch - BGB*), in tax legislation or other laws. Here, home equity release products are not widespread yet.[47]

The main rules regarding usufruct (*Nutznießung*) – not the use and habitation rights, which are not literally foreseen by the German civil code – concern especially elderly who need to convert their property into financial benefits.[48]

German legal order used to have a system of life annuities (*Leibrente*) dating back in the 19th century, which was governed by the Civil Code,[49] arranged between private individuals: it gradually fell out of use and is now of little relevance in the German legal praxis.[50]

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[46] A choice which, authorizing a kind of compound interest, is criticized by some authors: see A. Iuliani, *Il prestito vitalizio ipotecario nel nuovo "sistema" delle garanzie reali*, in «Le nuove leggi civili commentate», n. 4, 2016, pp. 735-737.

[47] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part II Country Reports, cit., p. 100: «payments from reverse mortgages are not a form of income and merely amount to a loan. No income tax is therefore payable. There are however no government subsidies or promotion to encourage reverse mortgage products at the moment».

[48] These rules are present in sections from 1085 to 1088 of *BGB*, Book III - Law of property, Title II – Usufruct, Subtitle III – Usufruct in property; see also artt. 1199 ff. of German civil code (annuity land charge).

[49] Articles 759 ff., *BGB*.

[50] *Ivi*, p. 98.

At present, there are no official government sources and statistical data and documents regarding home equity release schemes and there is no important ERS market in Germany.[51] Current legislative initiatives in respect to home equity conversions are not known, but the debate on their legal introduction is still ongoing where the analogous products are called *Immobilienverzehr*, that literally means "real estate consumption", while *umgekehrter Hypothekenkredit* stays for reverse mortgage.[52]

Belgium. As in France, the most used legal arrangement by elderly people is the transfer of the bare ownership, as governed in the Belgian Civil Code (very similar and inspired by the French rules).

Similarly to France, the conversion of the usufruct of the surviving spouse (or legal partner) is possible, as foreseen in detail by the Belgian Civil Code;[53] this regardless of the source of the usufruct. The regulation allows the conversion, in whole or in part, into a life annuity, into a principal or into the full ownership of the property subject to usufruct, upon request of the surviving spouse (or legal partner) or of the bare owner. As emended by Act n. 2014-05-22/09, in order to reduce and avoid family conflicts, unless otherwise agreed by the parties, the capitalized value of a lifetime usufruct or of a bare ownership subject to a lifetime usufruct is calculated according to the precise rules codified in art. 745sexies, §3.[54] Following these parameters, which are distinctive of the Belgian system, every year the Ministry of Justice establishes the conversion tables. The conversion of the the usufruct of the surviving spouse can be a way for an elderly widower or widow to convert an immovable asset into a financial support, in the form of a life annuity or of a principal.

Property sales or transfers of the bare ownership in return for a life-time annuity are diffused, both in the free and in the occupied version. An indexation clause for an automatic revision of the monthly payments is often provided in the contract, which in several cases also contains penalty clauses (establishing that the seller can retain the annuities he has already received in the case of contract termination) and cancellation clauses if the purchaser fails to pay a number of periodical annuities.

Unlike in France, reverse mortgage in Belgium has not been ruled by the law, although there is public discussion on the matter. Differently from financial intermediaries, Belgian consumer associations contrast the introduction of reverse mortgages and request, in the event of their introduction, strict regulation in order to protect the consumers' interests. Two projects of law

[51] See U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part II Country Reports, cit., p. 99 and for such data see the following documents: Questionnaire of the Bundesverband Öffentlicher Banken Deutschlands (Provider Association) and the Bundesanstalt für Finanzdienstleistungsaufsicht (Regulator).

[52] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part I General Report, cit., p. 2. In the last years, there were two providers of ERS in Germany.

[53] Articles 745quater-745octies.

[54] D. Sterckx, *La valorisation légale de l'usufruit viager*, in «J.T.», 2014/29, n. 6573, p. 561.

aiming to introduce a kind of reverse mortgage (*crédit pension*) were respectively proposed in the 52nd (2007-2010) and 53rd legislature (2010-2014) of the Belgian *Chambre des représentants*, but the legislator has not adopted them.

2.2. A comparative Analysis of the Juridical Success and Failure Factors

The ERS development processes are deeply different in each country: the French legislator is trying to support the working out of Loan Model ERS. In Belgium, these products are not for the time being provided. In the Spanish legal system, particular forms of ERS get tax privileges, while, in other European legal orders, ERS do not qualify for tax privileges for housing finance. In the UK and in Spain, a developed mortgage market and high levels of homeownership are decisive factors making easier ERS. On the contrary, lower levels of homeownership in Germany are seen as elements less facilitating the development of ERS.[55]

Barriers to development of the ERS market on economic and cultural levels depend on the characteristic sense of its "reverse" factor. Cultural positions towards homeownership could be a long-term obstacle and discourage consumers, particularly in rural areas, to use these kinds of financial products.[56]

The United Kingdom. The UK is the country in Europe with more awareness, importance, and extended existence of ERS and markets.[57] This country doesn't know the typical cultural barriers that apply for other EU countries. «Attitudes to indebtedness and the familiarity with the idea of extracting money from the value of your home are favourable to ERS and it is thus no surprise that the UK is by far the most developed market in the EU».[58] A relevant benefit contained by certain schemes and that are almost unique to the UK market, is that a customer can leave a proportion of the equity totally protected, thereby ensuring that not all the potential inheritance is used up during later years. The government involvement with ERS in the UK is also important and this is especially centred around the area of social care funding.[59]

Very generally speaking, what can be observed about the success elements that the UK system

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[55] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part I General Report, cit., pp. II-III.

[56] Converting home in liquidity is indeed based on three concepts (*Ivi*, p. V): believing that «the home is a capital asset, not merely shelter and a consumer asset to be passed on to the next generation; capital can be made liquid without giving it up completely, and liquidation is neither sale nor bankruptcy; this process can be brought forward by means of credit»; radically criticizing these basis, see A. Iuliani, *Il prestito vitalizio ipotecario nel nuovo "sistema" delle garanzie reali*, in «Le nuove leggi civili commentate», n. 4, 2016, pp. 721-722.

[57] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part II Country Reports, cit., p. 3.

[58] *Ivi*, p. 34.

[59] *Ivi*, p. 35.

gained in his financial home equity products history is offered by two elements. The first consists of the large competition existing in this country, which favours the choose for elderly citizens who want to convert their home in liquidity, satisfying more easily the different needs of the elderly population. The second one is the foundation of a specific Authority that regulates under the principles provided by the Government the whole sector concerning the home equity products and at the same time allows the individuals who denounce a violation of the rules claiming directly to a jurisdictional organism.

Spain. Spanish governments have proposed several measures related to dependency over the past years. The reform of the Mortgage Law (Act 41/2007), related to the Personal Tax Law,[60] has been passed to regulate ERS, linking tax benefits and fee exemptions to the use of those schemes, as described in the Law. So, smaller than the UK in terms of size of the market, Spain has an important number of providers and shares a number of similarities that played a favourable role in the development of a market for ERS.[61] In the recent years, Spain had a rise in public acceptance of using homes to obtain funds to complement pension plans or allow for homes to be adapted to cater for the increased disability of the elderly persons. This has also been helped by Spanish banks that have launched Loan Model ERS in 2008. Law 41/2007 gives incentives to Loan Model ERS, only under fulfillment of several conditions.[62]

France. The French example seems to show more a failure than a success of the importation of lifetime mortgage schemes in continental legal systems. French authors variously welcomed and lamented the introduction of this legal arrangements. To be more precise, even if some of them predict a growth of his use, considering that it could provide to both the needs of cash and of security and stability of an ageing population,[63] most of them outline the limitations of the institute, fairly underused until today. Indeed, about 7000 contracts from his introduction in 2006 were

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[60] Additional Disposition 4 of Act 41/2007, referring to art. 51 of Act 35/2006 of the 28th of November concerning the *Impuesto sobre la Renta de las Personas Físicas*. To this aim, annuities perceived are subject to the same treatment as incomes coming from retirement plans as contained in point 3-b of art 51 of the said Law: a tax exemption after 10 years from the receipt of the first annuity payment.

[61] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part II Country Reports, cit., p. 3.

[62] *Ivi*, pp. 49-50; p. 44: «Advantages and protection is offered to potential consumers of these schemes (i.e. tax and fee reductions), their beneficiaries (i.e. by impeding that the provider charge cancellation fees on heirs wishing to repay the loan upon the death of the applicant) and to financial institutions (because the Law provides benefits to only a particular scheme for which financial institutions and/or insurance firms need to be authorized to operate in Spain). This also allows the development of specific mechanisms to increase transparency and consumer protection».

[63] N. Pécourt, *Les réponses apportées par le prêt viager hypothécaire face aux enjeux du vieillissement de la population*, in «La Semaine Juridique Notariale et Immobilière», nn. 45-46, November 2014, p. 1330.

estimated to have been agreed in January 2015,[64] while the sales *en viager* (in return for life-time annuities) had been estimated to be an average of about 3000 each year during the period between 2000 and 2006,[65] Difficulties and obstacles would be linked to cultural (like the strong notion of land ownership in systems based on roman law, as well as the wish to keep immovable assets, to whom moral worth is attributed, within the family), financial (as high interest rates, risks and disadvantages for the heirs and uncertainty surrounding the transaction, when the future trends of housing market and the expectancy of life of the elderly person are difficult to predict), but also juridical reasons,[66] as coordination problems with legislation about debt-reduction plans and with several institutes of succession law, including in particular the usufruct of the surviving spouse and his right of use and habitation envisaged in the French Civil Code.[67]

Efficiency and adequacy of reverse mortgage in France can be meaningfully compared with the traditional arrangement provided for similar purposes by French civil law, that is the transfer of the bare ownership, in particular in return for life-time annuities. Reverse mortgage shows some benefits over sales *en viager*, in which the seller and his successors definitely lose the ownership of the good and face the risk of a later situation of insolvency of the purchaser, who cannot pay anymore the annuities. Reverse mortgage also has some fiscal advantages, because the borrower is not taxed on the amounts he receives from the lender (while people are taxed on the annuities as incomes, for a portion of the overall amount depending on the age of the payee when he starts to enjoy the annuities),[68] that as liabilities are also deducted from the base to calculate the wealth tax (*Impôt de solidarité sur la fortune*). On the other hand, the elderly borrower remaining the owner of the immovable good, he still has to pay the property tax (*taxe foncière*) on it and to afford the major maintenance costs. Ultimately, sales in return for life-time annuities seem to be, according to a number of French experts, still preferable to reverse mortgage because of their much better

[64] As reported in L. Poniatowski, *Rapp. Sénat 2015 relatif à la transition énergétique pour la croissance verte*, n. 263, t. I, p. 122. See also the data in «Journal officiel (Questions réponses) - Assemblée nationale», XIV législature, 9 avril 2013, p. 3867, n. 14944: http://questions.assemblee-nationale.fr/q14/14-14944QE.htm.

[65] *Les viagers immobiliers en France: étude du conseil économique et social présentée par Mme Corinne Griffond au nom de la section du cadre de vie*, n. 8, 2008, p. 78.

[66] C. Gijsberg, L`*insuccès du prêt viager hypothécaire*, in «La Semaine Juridique Notariale et Immobilière», n. 12, Mars 2016, p. 1103. See also L.A. Andrieu, A. Gotman, *Réversion du principe du logement humain - Chronique du prêt hypothécaire inversé: Rapport de recherche pour le Ministère de l'Ecologie, de l'Energie, du Développement Durable et de l'Aménagement du Territoire - Plan Urbanisme Construction Architecture (PUCA)*, 2009 (https://halshs.archives-ouvertes.fr/hal-01064406/document).

[67] Art. 764 of French Civil Code. The situation of the surviving spouse is worst if she/he was not co-borrower in the contract of loan (and she/he could not be part of the contract if he/she was not co-owner of the mortgaged good); but there are possible complications even if she/he was co-borrower, when the succession gives rise to a dismemberment of the property: N. Randoux, *L'avenir du prêt viager hypothécaire (Faut-il l'aménager ou le supprimer ?)*, in «Defrénois: la revue du notariat», n. 21, 2009, p. 2263, e n. 22, 2009, p. 2401.

[68] *Code général des impôts,* art. 158, n. 6.

profitability, even more for elderly people having quite a long life expectancy.[69] In addition, the frequent practice of including in the contract an indexation clause can make it a pretty good deal for the needs of elderly people. In any case, several authors call for a legislative action reforming and adapting both the modern (the reverse mortgage) and the old (sales *en viager*) private law instruments used by the low-current income elderly persons to financialize their home ownership.[70]

The (still unsolved) basic question remains whether arrangements like reverse mortgage, having roots in social environments with a greater propensity to borrowing, and in common law systems, might be a good solution for elderly people issues in civil law systems. In fact, these countries traditionally share a strong and material concept of real property, and thus have several legal institutes aiming to intensively protect the continuity of his transmission from generation to generation as a way to preserve family cohesion and integrity, elderly needs being rather afforded by the welfare state, financed by general fiscal contribution and governed by public law.[71]

Italy. In the Italian legal context, property sales or transfers of the bare ownership in return for a life-time annuity, though possible on the basis of Civil Code rules, are much less used than in France. One of the possible reasons of that can be found in the circumstance that in Italy such incomes are wholly taxed as compensations of employees,[72] while in France they are only partially taxed, in a portion that is digressively proportional to the age of the payee.

There is discussion in Italy among experts and political and social stakeholders about whether use of reverse mortgage, rare until today, following the reform of 2015 is going to have more chances of success then after his first introduction in 2005.[73] Italian regulation of reverse mortgage, as recently

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[69] S. Prigent, *Prêt viager hypothécaire et solutions alternatives : les éléments du conseil*, in «Defrénois : la revue du notariat», n. 4, 2009, 414 ; L. Galliez, F. Pouzenc, *Compléter ses ressources : comparaison entre la vente en viager et le prêt viager hypothécaire*, in «Actualité Juridique Droit Immobilier», n. 5, 2011, p. 351.

[70] F. Rogue, *Le viager, renouveau d´un modèle ancien*, in «Petites Affiches», n. 106, 2016, p. 66 ; N. Tarnaud, *Le caractère aléatoire du viager peut-il être un frein à son développement ?* , in «Actualité Juridique Droit Immobilier», n. 2, 2015, p. 85; C. Deschamps, V. Legrand, *Trois bonnes raisons de reformer la vente d´immeuble en viager*, in «La semaine Juridique Notariale et Immobilière», n. 14, 2016, p. 1117.

[71] C. Gijsberg, in *L`insuccès du prêt viager hypothécaire*, in «La Semaine Juridique Notariale et Immobilière», n. 12, Mars 2016, p. 1103, investigating the legal, economical and cultural reasons of its failure in France, wishes that reverse mortgage will retain a limited role and that, even in the future, elderly needs will be generally financed by the social intervention of the State.

[72] Art. 50, subparagraph 1-h, D.P.R. n. 917/1986.

[73] See for example R. Lungarella, *Prestito vitalizio ipotecario: perché lo chiedono in pochi*, in «Lavoce.info», 2015, http://www.lavoce.info/archives/34824/prestito-vitalizio-ipotecario-perche-lo-chiedono-in-pochi/; M. Causi, A. Misiani, *Prestito vitalizio ipotecario: perche può funzionare*, in «Lavoce.info», 2015, http://www.lavoce.info/archives/35540/prestito-vitalizio-ipotecario-perche-puo-funzionare/.

modified, appears more attentive than the French one to the situation of the surviving spouse and reduces compatibility issues with succession law. Moreover, disadvantages of Italian life-time annuities taxation system, unless modified, could potentially in the next years, for similar purposes, leave to reverse mortgage a space wider than in France. On the other hand, most of financial and cultural reasons that make reverse mortgage quite unattractive in France seem to apply to Italy too, in particular high interest rates, uncertainty of the bargain and risks and detriments for the heirs.

Germany. Dealing with the low interest rates that in Germany are contributing to an upturn in the housing cycle - but related macroeconomic effects are expected to be modest - in 2014 on a report provided by the "International Monetary Fund" is reported what follows: «Because of the features of German housing finance (traditionally conservative loan-to-value ratios absence of equity release products) the effects on consumption are likely to be close to nil or even slightly negative so that the main transmission channel to the economy is through residential investment, which has been robust».[74] Such a thesis has been back upped in the same year by another housing expert, maintaining that «the absence of mortgage equity releases, in combination with prudential appraisal rules, helps to maintain tranquility in the property (…)».[75] Therefore, the ERS market in Germany is not well developed, but it exists in a very reduced measure, in comparison with UK or Spain.
Anyway, impassable legal obstacles don't subsist to reverse mortgage products in Germany. The current barriers consist of the longevity risk against the providers and the prohibition of compound interest (anatocism), which is a problem for ERS. But German lawyers observe that these problems are surmountable. Besides, on the economic level, some providers indicate several barriers to the development of the ERS market. The German market for ERS is too small to be viable. Restrictive German planning laws don't stimulate the private housing market, and the resulting situation is very different from Spain or the UK. Changes to fiscal laws could gradually change the historical tenure breakdown. Another obstacle comes from the fact that the group of older people (60+) not wishing to pass on their home to the heirs results to be too restricted for many providers. Furthermore, German retirement pensions are relatively high and poverty among retirees is not so widespread. Another economic barrier in Germany for potential providers appears to be the demographic factor. Other barriers subsist on cultural level: German consumers result very reticent when they learn the amount of funds the scheme could let them produce from their home, even though they are

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[74] R. Teja, K. Kochhar (approved by), *Germany: 2014 Article IV Consultation – Staff Report; Press Release; and Statement by the Executive Director for Germany*, in IMF Country Reports, 14/216, International Monetary Fund, July 2014, p. 25.

[75] M. Voigtländer, *The stability of the German housing market*, in «Journal of Housing and the Built Environment», vol. 29, Issue 4, November 2014, pp. 583-594; see also A. Hess, A. Holzhausen, *The structure of European mortgage markets*, in Working Paper n. 97 of 22th January of 2008 of «Allianz Dresdner Economic Research», p. 7: «in Germany equity release products, which often entail the repayment of an existing mortgage, are less popular owing to relatively high early repayment fees and the recent weakness of the housing market. In other countries regulatory obstacles and in some cases considerable transactions costs prevent the use of these facilities».

interested in ERS.[76]

Belgium. Probably on the basis of concerns about assimilation of ERS in civil law systems, as well as fearing unfair and unbalanced contracts between elderly people and credit or financial institutions, due to situations of information asymmetry and asymmetry of bargaining power between the parties, the Belgian legislator has repeatedly opted to reject all projects of law aiming to introduce reverse mortgage in the country, in accordance with the wishes of consumer associations. Property sales in return for life-time annuities are possible, based on Belgian Civil Code rules: according to several media reports, their number is increasing, maybe also because of the advantageous Belgian tax regime for such kind of annuities, even though these sales still concern only a small part of the whole housing market.[77]

3. The Financial Design of Home Equity Release Schemes and the Role of Specialized Investment Vehicles

3.1. The Financial Design of Sale and Loan Home Equity Release Schemes

In financial terms, home equity release, even if variously defined and ruled upon national regulations as highlighted in the previous sections, can be summarized in the reversion into cash of the intrinsic market value of the primary residence. This by applying eventually a proper valuation haircut, described next, in order to consider potential real estate market dynamics (*i.e.* future value fluctuations of the property). The swap between homeownership and cash can be done simply by selling the home of residence and switching to leasing (possibly by renting a smaller unit) or by selling only part of the property rights in terms of bare ownership and other home equity withdrawals (*i.e.* Sale Equity Release models as described in section 2) or by taking out specific financial contracts like reverse mortgages (Loan Equity Release schemes) without the need of selling the property.[78] The proceeds can be used for enhancing current consumption including medical expenditures.

In all cases (with the exception of the sale of the primary residence aiming to rent another, smaller or differently located, or the same home), the overall financial design of sale (Figure 1) and loan

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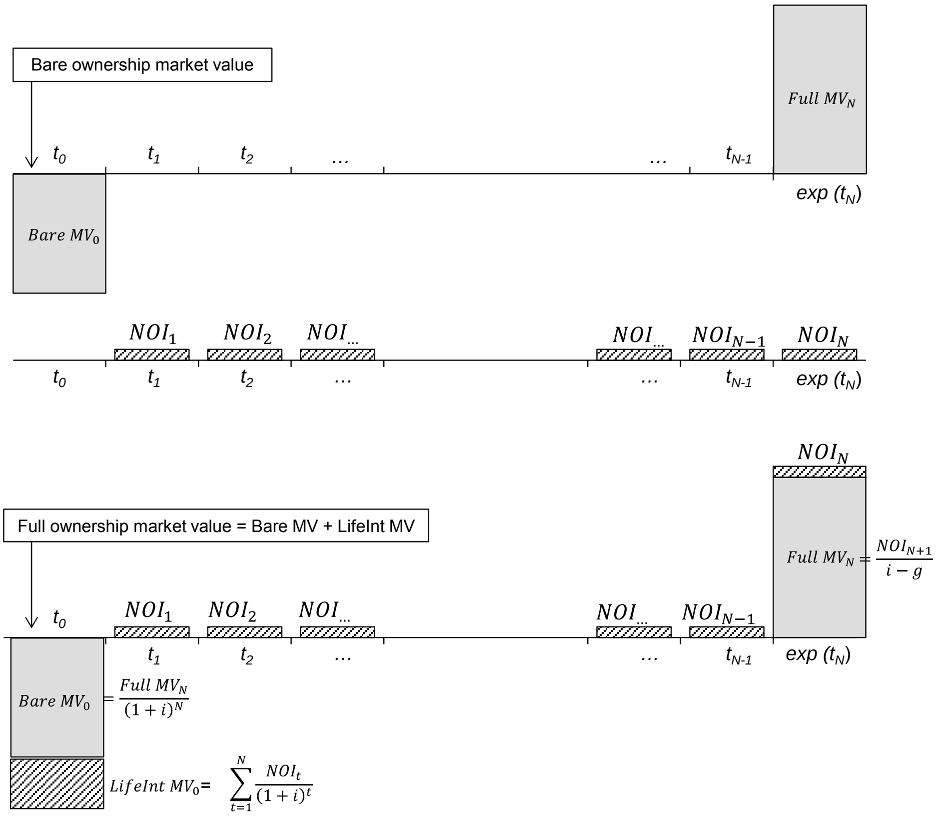
[76] U. Reifner *et alia*, *Study on Equity Release Schemes in the EU*, Part II Country Reports, cit., pp. 100-101.

[77] See in the Belgian press the following works: P. Leonardi, *Le viager, tout le monde (ou presque) en parle*, http://www.lesoir.be/998260/article/economie/immo/2015-09-24/viager-tout-monde-ou-presque-en-parle; P. Leonardi, *La vente en viager doit encore convaincre*, http://www.lesoir.be/1309268/article/economie/immo/2016-09-05/vente-en-viager-doit-encore-convaincre.

[78] E. Hurst, F. Stafford, *Home is Where Equity Is: Mortgage Refinancing and Household Consumption*, in «Journal of Money, Credit and Banking», vol. 36, n. 6, December 2004, pp. 985-1014.

(Figure 2) home equity conversion schemes can be depicted as follows (this from the investor's/lender's perspective):

Figure 1 – *Sale Equity Release Scheme*



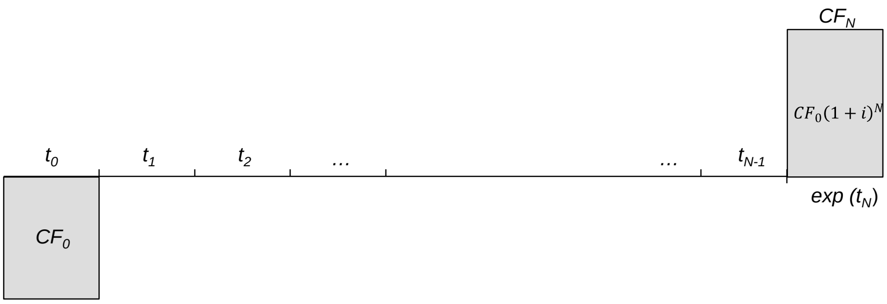
Where MV_t defines the market value of the bare ownership (*BareMV*$_t$) and of the life interest (*LifeIntMV*$_t$), or usufruct, respectively, at time t_0 and at the expected maturity [*exp*(t_N)] (*i.e.* at the end of life of the elderly person). The sum of the bare ownership and of the life interest results in the full market value (*FullMV*$_N$) of the property serving the equity release scheme.

The signing of a sale equity release scheme represents an investment decision in real estate. In that respect, in general simplified terms and beside marginal factors, the overall market value of an income producing property (like a rental home) should equal the present value of all current cash-flows that the property will generate in the future. These are proxied by the so called net operating income (NOI_t) (*i.e.* the expected rents net of the operating expenses) for each period of time.

The discount rate (*i*) to be used for calculating the present value of the periodic *NOI* is the requested total return on the investment; as such it is an opportunity cost of capital for real estate investments, because a sale equity release agreement effectively depicts an investment in that sector.

This means that in the absence of intermediate cash-flows between t_0 and t_N as in the case of bare ownerships and similar sale equity forms, the market value of the bare ownership will simply equal the present value at time t_0 of the expected future (full) market value of the property at the end of life [$exp(t_N)$]of the elderly person holding the life interest.
In turn, the (full) market value at [$exp(t_N)$] is obtained *via* direct capitalization of the *NOI* of time $_{N+1}$(*i.e.* NOI_{N+1} divided by the capitalization rate equal to ($i – g$), where *g* stays for the expected future growth rate of the prospective net operating income of the property).
Other things equal, that means that assuming a constant amount of *NOI* that might be generated by the home between t_0 and $exp(t_N)$, the difference between the bare ownership and the full market value of the home (the latter considered at the end of the sale equity agreement) is simply the present value of all figurative net rents (*NOI*) that would have been cashed by the investor acquiring the bare ownership if he were to own the full ownership of the property to be leased to third parties in the space market. The same difference depicts the intrinsic value of the mere life interest/usufruct ($LifeIntMV_0$).
Put it the other way round, the final market value of the home at maturity should equal the initially price of the bare ownership, capitalized for the entire duration of the contract at the opportunity cost of capital plus the future value of all accrued rents, calculated at the same yield.

Figure 2 – *Loan Equity Release Scheme*



In economic terms, loan equity release agreements are simpler compared to sale ERS due to the fact that they depict financial contracts and do not imply the transfer of the underlying real estate until maturity and this generally only in the case that the heirs of the elderly person engaging the agreement do not repay the debt, if that clause has been agreed on.
In that sense reverse mortgages and similar loan ERS represent a financial investment only indirectly related to the real estate sector due to the fact that the home property is used as collateral.[79]

[79] H. Bartel, M. Daly, P. Wrage, *Reverse Mortgages: Supplementary Retirement Income from Homeownership*, in «The Journal of Risk and Insurance», vol. 47, n. 3, September 1980, pp. 477-490.

As already highlighted, loan equity conversion schemes provide an immediate payment (CF_0) at initial stage (t_0) by the lender (typically financial intermediaries), no intermediate interest payments by the debtor – at least in the basic model – and a lump-sum repayment at maturity (*i.e.* when the elderly passes away). The final cash-flow is the sum of the initially borrowed amount plus the accrued interest, at rate (i) over the entire life of the agreement.[80]
Please note that in this case, the rate (i) is intended as opportunity cost of capital for alternative *financial* investments, that is, the interest rate the lender would apply to mortgages with the same risk profile and expected loss.
At maturity, should the heirs not fulfill the debt obligation (*i.e.* decide not to repay the amount due), the bank will realize the value of the real estate used as collateral.
In the case that a "no negative equity guarantee" is agreed (in which case the debt due can never exceed the value of the property), rational heirs will refuse the debt reimbursement only if the market value of the property at maturity were below the amount due, putting the implicit loss on the lender. Again, the potential market value of the property at maturity (although the effective price in the case of forced sales might significantly lower) is function of the prospective net rents, as described above. Variations in the basic financial design might include periodic interest payments which mitigate the final debt amount and, implicitly, the relevance of the collateral value.

The risk profile of the two equity release schemes and the related risk distribution among the counterparties involved in the transaction are clearly not the same and need to be investigated, representing sale ERS pure real estate investment and loan ERS mainly financial debt obligations.

Both schemes are characterized by uncertainty in respect to: (*i*) the actual duration of the engagement because the end of life might differ from person to person and (*ii*) the market value of the property at maturity which, in turn is positively related to the agreement's duration.
In the case of *sale* equity conversion, at first glance, the uncertain length of time affects both counterparties. This means that if the *ex post* duration of the agreement is shorter than the expected maturity (*i.e.* the elderly passes away before the expiry of his life expectancy), the buyer gains a higher yield than initially expected, due to the fact that he will acquire the full ownership in advance in respect to the expected maturity [$exp(t_N)$]. In turn, higher lifespan than expected would have a detrimental effect on the buyer but would have positive effect on the seller.
However, please note that at investor macro-level, a closer examination of the uncertainty pay-offs between buyer and seller might turn out differently. In fact, a potential investor engaging in a plurality of sale equity release schemes will reduce the overall uncertainty referred to the effective maturity of the single equity release agreement because longer and shorter durations, in respect to

[80] In that sense, as depicted in Figure 2, loan equity release schemes in the form of reverse mortgages are so called because of the fact that the outstanding debt increases over time instead of decreasing due to the progressive loan amortization.

the forecasted life expectancy, will tend to offset each other as the number of engagements increases. In turn, this portfolio considerations typically do not apply to single elderly persons engaging in sale equity release schemes. Consequently they are not able to diversify away the uncertainty and are fully exposed to their own lifespan volatility.
Moreover, please note that the embedded option value increases the longer the expected residual lifespan. This due to the fact that uncertainty is higher for "young" elderly compared to older people.
This other things constant and beside any considerations in terms of real estate market dynamics (*i.e.* without considering positive or negative capital gains). Uncertainty in respect to the duration of the agreement and the final market value of the real estate property impacts the risk profile of *loan* equity release schemes differently from sale equity conversion. This due to the fact that they depict pure credit products, where real estate comes into play only as credit risk protection tool because of its collateral value.
In the case of traditional reverse mortgages and in the event of the presence of heirs, the lender takes over only a downside risk and no upside opportunity. If the market value of the real estate used as collateral drops below the final credit amount, the creditor will suffer a loss but the lender does not profit from real estate market values exceeding his total credit amount because the heirs will call their option to repay for and on behalf of the debtor.
That means that a key element in the credit risk or, more precisely, in the expected loss valuation of loan home equity conversion products is the assessment both of the current and future market value of the property which will be haircutted by a certain guarantee percentage in order to ensure that the expected value of the collateral at the termination of the reverse mortgage equals or exceeds the sum of the (initial) principal and of the future value of the interests accrued on the loan. Consequently, the loan-to-value ratio (LTV) will be limited to a certain percentage based on the real estate market dynamics forecasted by the bank, also considering the recovery costs and time requested for liquidating the collateral.

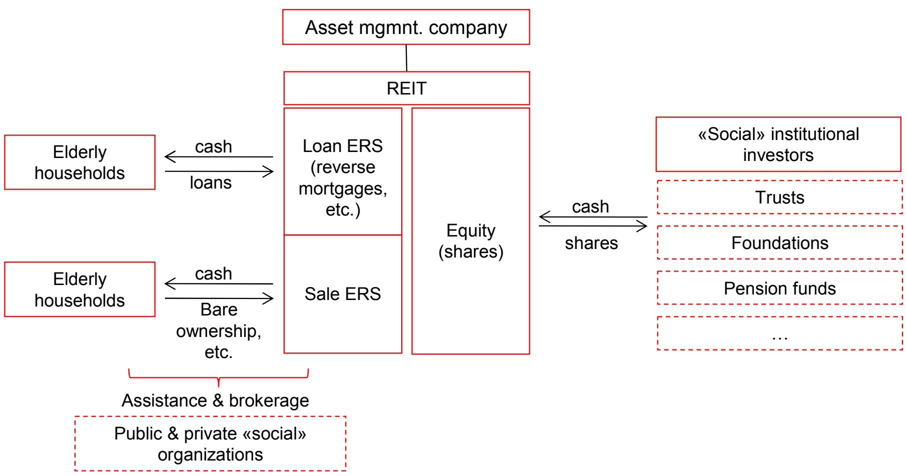
3.2. Focusing on the Supply Side of Equity Release Schemes: The Role of Specialized Real Estate Investment Funds

One of the main constraints in the operational management of loan and sale equity conversion products is the need of real estate expertise.
The requested competences will be highest for sale equity release schemes where a deep knowledge of the local space and property real estate market is required. Moreover, because homes are real assets, as soon as the investors (typically financial intermediaries) acquire possession of the property (which is always the case for sale ERS, while it happens only in the event of implicit foreclosure or absence of heirs for loan ERS), the assets need to be operationally managed at property and facility level and properly marketed and enhanced.

While most banks are used to manage mortgages and so, basically, also capable of offering reverse mortgages, financial intermediaries are usually not confident in real estate management and are therefore reluctant to support sale equity release schemes. This explains the limited number of financial intermediaries supporting both loan and sale home equity conversion and the little market success of such products as highlighted in Section 2.

Considering that market background but, at the same time, the social relevance of enhancing the consumption capability of elderly persons at risk of poverty or social exclusion, it may be useful to consider the further establishment of dedicated investment vehicle specialized in the supply of home equity reversion products. The reference is to real estate investment funds or trusts (REITs), differently defined upon national regulation at international stage. As known, REITs are investment vehicles, usually organized in the form of closed end entities, that collect *via* cash or asset contributions a certain equity capital to be invested in real estate. The REIT is in charge for proper management of the assets, acting on an fiduciary basis on behalf of the REIT's shareholders. The management implies the valuation, acquisition, asset, property and facility management, lease and disposal of the assets in place. As investment vehicles, real estate investment trusts or funds are subject to public vigilance and prudential regulation. Below others, the regulatory authority also assesses the professional capability of the managers, the business governance structure and the implementation of a proper internal control system capable of identifying, measuring and handling risks.
In that perspective the proposal is the establishment of "specialized" REITs dedicated to invest in loan but, especially (because of their higher requested real estate expertise), sale equity release schemes as follows (Figure 3):

Figure 3 – *Specialized REIT's Operating Scheme*



Equity (*i.e.* cash) contributions should derive from selected institutional shareholders like pension funds, trusts and foundations sensitive to the "social" nature of this type of REITs. As such, unaffected the required professional management of the investment vehicle, these type of investors might also be willing to accept lower investment performances in the face of the recognition of higher benefits to the elderly households (*i.e.* the REIT's clients).
In that sense, the REIT managers cooperate with public and private organizations devoted to assisting elderly people in order to be able to properly identify households in need of help and to broker the loan or sale equity reversion products.
The supply of equity release schemes by supervised entities subject to prudential regulation like a REIT is also expected to enhance the level of confidence of elderly homeowners in such financial products and, consequently, their acceptance and dissemination at market level.

4. Main findings and Conclusions

Despite the potential of home equity conversion by elderly in order to enhance their current income and, therefore, consumption, the effective market diffusion of such financial products in many major European countries (e.g. Italy, Germany, France) is limited. This is also due to social and cultural constraints inducing elderlies to bequeath real estates and other tangible assets to their heirs and, often, due to the lack of a special regulation targeted on home equity conversion products.
In fact, as highlighted in the legal analysis, the market widespread of equity release schemes, like in the UK, seems to be positively related to the provision of a specific Authority capable to regulate home equity products and, at the same time, to control for competition between financial intermediaries in a controlled and supervised environment. In turn, this enhances public confidence in the related real estate and financial products and encourages banks and financial intermediaries to enter the market, eventually also considering the reputational effects associated with the social impact of the supply of such products.
Differently from the case of the UK, in the other European countries, like Italy, a specialized ruling of home equity release schemes seems to be weak or in the early stages. Tax benefits like in Spain[81] are intended to further favour the spread of home equity conversion schemes but do not seem to be a very relevant success factor, and continental private law systems seem to be generally less suitable for ERSs like reverse mortgages.
Considering the age of the potential market participants on the demand side and the fact that ERSs deal with the most important wealth asset of households, a strict prudential regulation of such home equity reversion products may represent the key element for enhancing the acceptance and

[81] About Italy, see G.O. Mannella, G.C. Platania, *Il prestito vitalizio ipotecario*, Milan, 2015, pp. 219 ff.

reputation of such products, which need to be clearly explained to the consumer in terms of information disclosure by the financial intermediaries and harrowing situations should be reduced as much as possible.

On the supply side, the analysis of the financial design of equity release schemes has highlighted that one of the main constraints in the operational management of home conversion products is the need of a strong real estate expertise. This is especially the case for sale equity release models where the investor has to manage the underlying property.

That means that not all financial intermediaries may possess the requested competences. In that sense, the implementation of specialized investment vehicle like real estate investment funds or trusts (REITs) might be considered. They could collect cash contributions of institutional investors like pension funds, foundations and trusts, sensitive to the social need of elderly people, in order to invest the collected equity in loan and, especially, sale equity conversion products. As financial entities subject to a severe prudential regulation and vigilance, these specialized REITs could enjoy the confidence of the elderly persons, having a low financial competence and background.

At the same time, the participation of "social" investors could also allow to reduce the expected yield that such home equity release products should otherwise generate. This in the face of the recognition of higher benefits to the elderly households and in order to enhance the consumption capability of elderly persons at risk of poverty or social exclusion.

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