

## PROPERTY

### Table of Contents

1.	Introduction by Adrian Vorbach, AIA Councillor	Page 1
2.	Mortgage Funds – What's the Story? By Dugald Higgins, PIR	Page 2
3.	Reverse Mortgages – The Current State of Play by Kevin Conlon, SEQUAL	Page 4

\* \* \* \* \*

## COORDINATOR'S MESSAGE

**By Adrian Vorbach**

Dugald Higgins, Associate Director of PIR (Property Investment Research), in his article "Mortgage Funds - what's the story?", in his typical lucid style explains:

- What Mortgage Funds are
- How they operate
- The current risks of such funds.

This is essential reading for anyone considering investing in pooled managed funds where your funds are NOT held in property per se.

The recent global financial crisis (GFC) has forced many such funds to freeze redemptions to prevent fire sales in a falling property market.

These pooled mortgage funds have NOT received any Federal Government guarantees in contrast to the banks.

Kevin Conlon, Chief Executive of Seniors Australian Equity Release Association of Lenders (SEQUAL), explains "Reverse Mortgages - the current state of play".

Reverse Mortgages are steadily growing with a 27% increase in the last year to 30 June 2008.

Baby Boomers are often asset rich (own their homes) but cash poor (little superannuation) and as such, often use reverse mortgages to help them maintain their current lifestyles.

This article should be read in conjunction with an earlier property email bulletin (May 2006 Property Bulletin) which explains in detail the advantages and disadvantages of reverse mortgages.

Good reading over the Christmas / New Year holiday period.

*Adrian Vorbach is a Councillor of the AIA.*

\* \* \* \* \*

# MORTGAGE FUNDS – WHAT’S THE STORY?

By Dugald Higgins

Amongst the financial storm occurring in financial markets in 2008 (what financial markets...ouch), the latest niche disaster to grab people's attention is the state of play in the Mortgage Fund sector. As October 2008 drew to a close, there were over 50 various unlisted property backed investment vehicles that had frozen investors redemptions, funds with assets valued in excess of \$30 billion affecting over 150,000 investors. The majority of the vehicles affected in these wide ranging freezes have been mortgage funds, so in the interests of shedding some light on the issue, we'll examine some of the facts about mortgage funds in terms of what are they, how they operate and what are the current risks involved.

For those who are not familiar with these vehicles, mortgage funds in general are a managed investment where investors pool their funds and acquire interests in mortgages over Real Estate. For simplicity, we will concentrate on pooled mortgage funds where investors' interests are in a portfolio of mortgages, not the older style select mortgage schemes where you pick and choose which mortgages you wish to invest into.

As an investor in a mortgage fund, the important thing to remember is that your interests are not held in property per se, but in the mortgages over the properties in the funds loan book. As such, the nature of your investment return is an interest only distribution and a return of your capital when you redeem. The Fund operates as a provider of finance, essentially as a non-bank lender and the returns to investors are generated from the interest paid on loans made and the repayment of principal when those loans are repaid. Key to the successful operation of such vehicles then, is the quality of the loan book and the skill of the managers in managing the loans. Assessment of credit quality is a critical factor in the management of such a vehicle as is being able to manage loan defaults and arrears.

The nature of the industry (which involves over 70 different mortgage funds with \$23 billion in assets), is that there is a wide variety of vehicles available to invest in and the level of risk investors are exposed to can vary widely. Some funds are extremely conservative with large and diverse portfolios and tend to mimic the level of returns available from a bank term deposit. Other funds however operate at the high risk end of the scale and may be involved purely in financing property development, a notoriously chancy occupation and while the returns generated can be relatively high, this obviously needs to be weighed against the significant risks. An industry snapshot of the current characteristics of conservative funds and high yield funds in operation is shown below.

Fund metrics (as at 30 June 2008)*	Conservative mortgage	High Yield Mortgage
Average interest rate to investors <sup>†</sup>	6.81%	8.65%
Average no. of loans in loanbook	1,652	97
Average size of fund (\$m)	1,263.5	286.3
Average LVR	55%	65%
Average maximum LVR permitted	72%	77%
Average arrears	1%	6%
Average no. of sectors in loanbook	5	4
Average no. of different states in loanbook	5	3
Average % of loans to development	12%	58%

† Statistics taken from a sample of 20 funds in operation – October 2008

\* 12 months term, interest paid monthly

As can be seen in these figures, the conservative funds, while paying a lower rate of return to investors, have greater diversification, more conservative lending criteria and a lower incidence of arrears than those in the high yield category. An investor then must take into account when assessing the merits of one of these vehicles, what level of risk they are willing to take for the return offered.

Like unlisted property trusts, funds of this type are not particularly liquid when compared to an ASX listed vehicle. Indeed, the general modus operandi is one of 'we're liquid as long as you don't want to redeem'. In a normal investment climate, the level of inflows from new investors tends to match (or even exceed) the level of outflows from investors exiting. This situation, especially when combined with some loose cash in the Fund, means that investor redemptions are usually easily funded and the Fund is reasonable liquid. However, in times of stress, the problems associated with assumed liquidity in an inherently illiquid asset class become apparent. It has been nearly two decades since we have seen a similar occurrence, where negative investor sentiment has caused a surge in redemption requests and as a result, the funds concerned have taken the precautionary step of invoking a redemption freeze. The freezing of fund redemptions is a logical, though frequently painful, experience that does nonetheless have a valid purpose, to prevent a collapse and a fire sale of assets into a falling market.

While the current redemptions freeze is a distressing experience for many, it needs to be remembered that for the greater majority of mortgage funds, investor distributions are still being paid out regularly and the conservative funds at least, will be unlikely to suffer any downgrades. Those in high yield funds however should perhaps keep a weather eye on the risks involved, especially those heavily involved in financing property development. At the end of the day, mortgage funds still fill useful role in an investors' portfolio as long as investors arm themselves with the knowledge on what they are investing into and the associated risks.

*Dugald Higgins is an Associate Director with Property Investment Research. For more information go to [www.pir.com.au](http://www.pir.com.au).*

\* \* \* \* \*

# REVERSE MORTGAGES – THE CURRENT STATE OF PLAY

By Kevin Conlon

## The Australian Reverse Mortgage Market

The most recent Deloitte SEQUAL Reverse Mortgage Study found that the Australian reverse mortgage market, as at 30 June 2008, consisted of more than 36,600 reverse mortgage loans with total outstanding lending of \$2.3 billion. This represents almost 14% growth over the past six months and 27% growth over the past 12 months from 30 June 2007.

## Funding Retirement - Equity Release Strategies

The family home is now an intrinsic part of the planning process. There is good reason to explore the options provided through equity release.

The strategies for Reverse Mortgages are diverse. For some retirees they are an effective means to supplement income or to provide access to capital. For others, they can be a tool to help manage market volatility. For frail retirees with poor health, it can provide them with choices for accessing the care they need and provides the ability to pay the aged care fees.

Equity Release is not a last resort to access money when all other sources dry up. When used effectively, Reverse Mortgages can help a client to access the significant wealth they have accumulated in an illiquid asset in order to more effectively live the life that they choose.

## Living Longer and Living Well

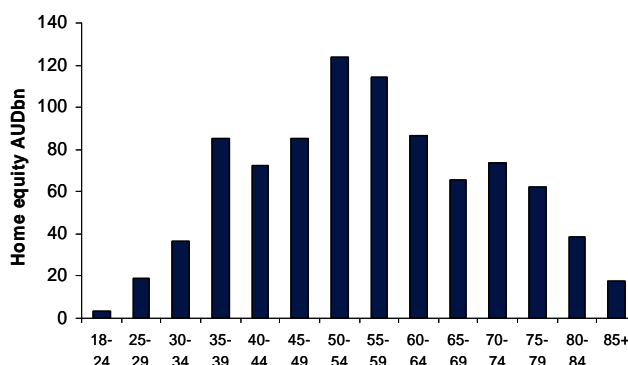
The largest generation within the Australian population, the so-called Baby Boomers, are now aged between 45 and 60. Many of them are poorly prepared for the end of their working life.

For the Boomers, compulsory superannuation came too late for a generation that can expect to live longer than any generation before them and intends to “Live Well” in retirement.

Gender	Age	75	80	85	90	95
Female	55	89%	82%	71%	54%	35%
	60	89%	82%	70%	52%	32%
	65	90%	82%	69%	50%	30%
Male	55	82%	72%	58%	40%	24%
	60	82%	71%	56%	37%	21%
	65	84%	71%	54%	35%	19%

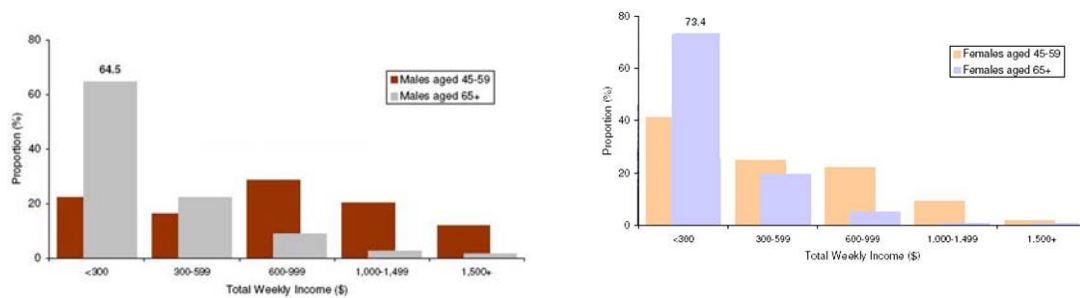
Source: ABS

The good news is that the majority of Baby Boomers have achieved the “Great Australian Dream” of owning their own home. Total Home Equity (Owner Occupied) was \$887 billion, at the end of 2005. The Over 60s accounted for \$345bn (39%).



Source: Datamonitor

The challenge is that the absence of significant levels of savings (superannuation) and a concentration of wealth in an indivisible/illiquid asset (owner-occupied property), has made the Boomers Asset-Rich but Cash-Poor.



Source: NATSEM calculations from ABS 2003-04 Survey of Income and Housing confidentialised data files

In the past, any retiree in this difficult position, had two choices; significantly reduce their living standards or sell the family home - often having to then move away from an established network of family and friends.

With the emergence of the Australian equity release market, the Boomer generation have another option – opt into the stored wealth of their home.

## The Seniors Equity Release Market

The dominant Seniors Equity Release product in Australia is the Reverse Mortgage.

### Reverse Mortgage

- A loan advanced as a lump sum or regular payment to a home-owning senior enabling them to access the equity in their own home.
- No repayments are made during the life of the loan.
- The Borrower must consider Interest Rate and Property Value Risk.
- The No Negative Equity Guarantee limits Client Exposure.
- The Security is provided in the form of a conventional Mortgage Charge.

### Reverse Mortgages –Drawdown Options

Reverse Mortgages provide for a number of draw down options, as follows:

#### Lump Sum

The Borrower can draw down the full Facility Amount at Settlement. The Loan to Valuation Ratios for most Reverse Mortgage Products are comparatively low (e.g. 29% if the Borrower is 74 years) and the average Facility Amount is currently \$60,000.

#### Instalment Draw Down

The Borrower can choose to receive the proceeds of the Reverse Mortgage as a regular payment over time (e.g. monthly instalments over ten years).

#### Combination Option

The most popular form of Reverse Mortgage draw down is a combination of a modest Lump Sum and a reduced Monthly Instalment.

### **A Client Example:**

If the Youngest Borrower is 70yrs, the Maximum LVR = 25%

If the Property Value is \$500k, the Maximum Loan = \$125,000

### **Client Options:**

Lump Sum = \$125,000

Income Plan = \$1,000pm for 10 years

Combination = \$50,000 Lump Sum and \$625pm for 10 years

### **Transaction Size:**

Even a modest draw down under a Reverse Mortgage can provide the opportunity for senior Australians to significantly improve their standard of living in retirement.

The 'It's on the House' SEQUAL- RFI Reverse Mortgage Study, found that a modest increase to their income would significantly improve the lives of most retirees, with 50% of those surveyed indicating that as little as \$300 a month would be sufficient.

The study showed that a third of retirees (31%) expected to rely on their home as a source of retirement funding and revealed that baby boomers are not optimistic about their ability to fund their retirement, with a third fearing their funds would last only five to 10 years.

#### **Note:**

The average loan Size for a Reverse Mortgage is \$50,000 and the average client age is 74years.

### **Industry Standards of Practice**

Since its inception as the peak industry body for the Australian Equity Release market, SEQUAL has worked in the interest of the Australian community.

The SEQUAL Mission is to ensure the professionalism of those who offer or distribute Equity Release products for senior Australians. SEQUAL is dedicated to maintaining professional standards of practice within the Australian equity release market.

*Kevin Conlon is the Chief Executive of Seniors Australians Equity Release Association of Lenders (SEQUAL). For more information go to [www.sequal.com.au](http://www.sequal.com.au) or email [enquiries@sequal.com.au](mailto:enquiries@sequal.com.au).*

\* \* \* \* \*

This bulletin is produced by the:

Australian Investors' Association Ltd  
PO Box 2477  
Fortitude Valley BC Qld 4006  
Tel: 1300 555 061 Fax: 07 3257 3932  
Email: [aia@investors.asn.au](mailto:aia@investors.asn.au)  
Web: [www.investors.asn.au](http://www.investors.asn.au)

#### **Disclaimer**

This Disclaimer is made for the purposes of the Corporations Act 2001 as amended by the Financial Services Reform Act 2001 ("the Acts").

#### **The Australian Investors' Association**

The Australian Investors Association ABN 75 052 411 999 ("AIA") is a non-profit association that aims to assist investors become more knowledgeable and independent. In furthering its aims the AIA offers general information through its **publications**. The AIA has no Australian Financial Services Licence ("AFSL") under Part 7 of the Corporations Act 2001 as amended.

#### **Does not contravene the Acts**

The AIA, its officers, agents, representatives, and employees do not hold an AFSL and does not purport to give advice or operate in any way in contravention of the Acts. The AIA, its officers, agents, representatives, and employees exclude all liability whatsoever, in negligence or otherwise, for any loss or damage relating to this publication to the full extent permitted by law. The AIA has a policy that does not permit the endorsement or recommendation of any product or service regulated by the Acts.

#### **Provides Information only**

This **publication** has been prepared as an information **publication** without consideration of any *reader's* specific investment objectives, personal financial situations or needs. Because of this, no reader should rely upon the information and/or recommendations contained in this **publication**. Readers should, before acting on any information contained herein, consider the appropriateness of the information, having regard to their objectives, financial situation and needs.

The AIA believes that the material contained in this **publication** is based on the information from sources that are considered reliable and is accurate when issued. However, the AIA does not warrant its accuracy or reliability. All views and information expressed by the AIA, its officers, agents, representatives, and employees are for the purposes of discussion only.

If this **publication**, or any information, relates to the acquisition, or possible acquisition, of a particular financial product, the reader should obtain a product disclosure statement relating to the product and consider that statement, and should consult a licenced person before making any decision about whether to acquire the product.

The opinions expressed in this **publication** are those of the authors and do not necessarily reflect the views of the AIA.

**Copyright:** All rights reserved. No re-publication or copying in any way, including electronic means, may be made without the prior written consent of the AIA.