Authored for and in conjunction with Bidwells
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BIDWELLS

MOBILISING HOUSING EQUITY TO FINANCE SENIOR HOUSING FOR RENT

Introduction

As people age, they face growing risks of loneliness, mobility constraints and other health related issues. In consequence, many elderly people might be better-off in specialised 'senior' housing where these issues can be more satisfactorily taken care of as they offer various degrees of improved sociability, support and care. Yet most older people stay in their existing homes and the stock of senior housing remains small, supplemented by only a tiny share of overall housebuilding. Far more say they would like the senior option than are in it.[1]

So, currently older people are unable to achieve their ideal accommodation needs; trapped in unsuitable and often large homes for lack of alternatives and society loses out from this logjam because of the resultant burden of health costs and tighter housing markets. Looking to the future, the need for such accommodation will grow dramatically as people continue to live longer.[2]

The question is how to improve housing options for the elderly? This question has been asked repeatedly in Britain for decades, yet little has changed. The argument here is that there is a deep structural fault caused not by housing policies directly, but rather by the current tax system. It is causing a market failure by hugely favouring the owning over the renting of senior homes. As a result, renting is very limited outside of the social sector and even then it is and even then is not a credible option for most.

It is argued that while senior housing ownership is suitable for some, the unavailability of equally tax-efficient rental options deters many others in need of such accommodation from moving from their current homes. The logjam can only be freed by opening up renting while retaining for the elderly, a sense of ownership and control. This report suggests ways to do that.

The proposals here aim to improve the financial attractiveness of renting in realistic ways that do not presuppose the unlikely prospect of dramatic changes in housing taxation and government subsidies. The route to success, it is argued here, is to mirror in senior renting, the tax advantages of ownership by mobilising in new ways, the housing equity that many seniors have, at virtually no cost to the Exchequer.

Executive Summary

An early paper in this series set out the challenge facing the expansion of the senior housing sector in the UK, despite the numbers of over 65s expected to almost double over the next fifty years.

Ageing presents a range of difficulties from mobility and health constraints to loneliness. It is accepted that specialised housing for seniors can help meet the challenges of age, yet most older people remain in their own homes, despite large numbers stating a preference for a more suitable senior option.

This has implications for wider society creating a logjam in the housing market, in addition to forcing a number of seniors into social care unnecessarily due to limited alternatives, adding to costs and pressures in the care system.

A limited volume of senior housing for owner occupation is available and while appropriate for some older people has limits for others, but the unavailability of equally tax-efficient rental options presents a barrier to others in need of this specialised accommodation.

This paper argues that there is a deep structural fault, not caused by housing policies directly, but rather by the current tax system. This market failure favours home ownership over the renting of senior homes and makes large-scale senior renting virtual impossible to achieve.

Professor Ball puts forward two alternative proposals designed to improve the financial attractiveness of renting for seniors, but with limited implications for housing taxation and government subsidies from the current position.

The first option outlined is Housing Equity Retirement Accounts (HERAs) which are similar to ISAs in form, but contain proceeds of previous house sales with the tax-free income used for the purpose of paying rent on senior accommodation. The second option involves investment in a REIT, where the REIT provides the senior housing.

The two proposals differ in various aspects, but they both have the potential to deliver a greater volume of much needed specialist housing opportunities for the elderly in the UK.

We know the need for such accommodation will grow dramatically as people continue to live longer and the paper presents potential solutions that could be implemented within the next year to kick start a quality senior rented housing market and the delivery of much needed new homes.

12m
People aged 65+ in the UK

5.4m
People are aged 75+

1.6m
People are aged 85+

600k
People are aged 90+

15k
People are aged 100+

Source: ONS

The growing importance of senior housing

Ageing is a global phenomenon. People now live for far longer than in the past and the expectation is that the envelope of life will continue to expand. The older 60+ age group has doubled in size globally since 1980 and it is likely double again by 2050 to over 2.1bn people worldwide. In Europe and North America, more than one person in five is now aged over 60 and, staggeringly, by 2050 over a third of Europeans and more than a quarter of North Americans will be over 60.[3] This huge demographic transformation has considerable implications for housing markets.

Unfortunately, greater longevity has not necessarily been associated with a commensurate increase in 'full health' years. For many people, living longer is accompanied by more or less debilitating but not necessarily life-threatening ailments that increase over time. There are, of course, significant health-care implications of this vast increase in the years of impaired health. But, there are also housing repercussions, with the elderly progressively driven to make often difficult decisions over whether to stay in their existing homes, or to move into specialist accommodation when that better satisfies their needs. Yet in the UK relatively few make the transition, often to their and everyone else's detriment.

A growing issue in the UK that is set to become a major problem

There are currently 12m people over 65 in the UK and official population forecasts suggest that there could be another 8.2m by 2068. Over a quarter of the UK's population would then be over 65 years old, with more people living well into their 90s or beyond.[4] Such longevity should be celebrated but housing problems are mounting because choices are limited in a framework that has not fundamentally changed for decades.

A unique part of the housing market

Older people's housing needs and drivers differ from younger groups:

- Inertia plays a much greater role, partly through a desire to stay in familiar surroundings and close to family and social networks. So, few move until a stress threshold is triggered related to health or loss, although cumulatively the evidence does suggest that many older people do eventually move home at some stage after 65[5]
- Housing options are predominantly structured around accumulated housing wealth as nearly 80% of the over 65s are now homeowners and very few have substantial mortgages. Current 55 to 65 year olds have high ownership rates as well, so this situation will persist in the future
- Meanwhile, ageing tugs ever more strongly at the frailties of the human body, particularly from the mid-70s onwards

In some cases, retrofitting for age-related ailments is done in the existing home. It is expensive and does not solve problems of loneliness and inadequate healthcare. So, progressively, more seniors, as they age, are drawn towards more specialised housing. It is often called 'senior' housing, 'assisted-living', or 'retirement living'. In fact, there is an abundance and confusion of names.[6]

Whatever the nomenclature - senior housing will be used here - its features include:

- Downsizing to more appropriate accommodation
- Shared socialising facilities
- Supervised spaces so that health issues are quickly spotted and properties appropriately managed
- Varying levels of on-site or nearby care

Of course, the housing and care extras are costly but provide huge benefits in terms of personal well-being.

1 House of Commons Communities and Local Government Committee, Housing for older people, Second Report of Session 2017–19, 2018.
2 Ball, M. and Nanda, A. "Household attributes and the future demand for retirement housing", International Journal of Housing Markets and Analysis, 6.1, 45-62, 2013; Demos, Top of the Ladder (2013).
3 World Population Ageing 2017. Highlights, United Nations, New York.
4 Living longer: how our population is changing and why it matters, Office of National Statistics, 2018.
5 The use of housing wealth in older ages, R. Crawford, IFS Briefing Note BN239, Institute of Fiscal Studies.
6 The senior housing industry has been criticised for the confusion created by its plethora of marketing and branding names. House of Commons Communities and Local Government Committee, Housing for Older People, Second Report of Session 2017–19, 2018.

Barriers to senior housing take-up

Many older people happily live out their lives in their existing homes. Outgoings are also small for the majority who own their homes outright. Preferences obviously vary and further limit moves. Some older people do not like living in close proximity to others, mainly like them, appreciating neighbourhood variety instead. Some fear change and dread moving; although in both cases, health and other factors may eventually push them to do so. Others simply cannot afford to buy into senior housing ownership.

Though many older owners have considerable equity in their present homes, many do not. One survey found that 40% of buyers of specialised retirement homes had insufficient housing equity to buy outright.[7] For them, purchase money had to be topped up from family sources or a mortgage lender; otherwise they could not have moved.

Many others cannot make the transition because their housing equity falls well below the prices that make it viable for developers to provide senior accommodation. Such people live across all of the country, but property wealth is notably lower in the Midlands and North; making it particularly difficult for many specialised developments to be profitable there. So, current supply tends to be focused on the South.

Poor affordability is exacerbated on the supply side, which is heavily constrained by land-use planning constraints and exactions that make the senior sector uncompetitive in the land market.[8] There are off-putting transaction difficulties when moving and brand confusion that limits consumer awareness of options. Those obstacles are widely debated,[9] but less attention is given to the financial and investment aspects of housing choices, which tend to reinforce the stay-put option, even though in practical terms it may be a poor choice and imposes social costs related to health and housing supply.[10]

Consequently, many who would benefit from moving into specialised accommodation do not live there. Surveys show that far more are interested in such options than actually live in them.[11] There is little evidence that markets are responding to fill the gap. New build for seniors in England represents only around 2% of all current annual housebuilding. This is despite the fact that the over 65s represent the fastest growing cohort in most localities.[12]

What is known is that most people still want some sense of the financial and psychological independence they have previously enjoyed as homeowners. Additionally, they may hope to pass on some of their housing wealth as inheritances. Those factors make owner-occupied retirement living a popular option with over a hundred thousand homes of this sort in England now, while forecasts suggest that demand could easily rise fivefold over the next 25 years.[13] However, financial constraints and market conditions mean that other options may be preferred by many contemplating senior housing, but currently the choices they have are very limited. That encourages them to stay put.

The limits of owner occupation in senior housing

Owner occupied specialist housing has become the prime form of private senior housing provision in the UK and has brought considerable benefit to many. But, as noted earlier, it remains limited in extent and housing market factors play a part.

Higher ongoing costs

The costs of management and maintenance in senior housing are higher than in the general housing market. Typically, properties are sold on a leasehold basis to facilitate funding of these items. One consequence of that ownership structure is that it deters non-payment of ground rents, upkeep charges and event fees. Less often, developers offer freehold options with other obligations specified in purchase contracts or paid upfront, capitalised as part of the purchase sum, which raise the costs of entry.

Owner occupied senior properties, whether leasehold or freehold, consequently have rental and upfront/deferred payment elements and previous owners are not used to, and costs are incorporated, to which they are unaccustomed. The impact is often amplified by comparison to their previous experience as homeowners, because many older owner occupiers tend to limit ongoing repairs to their homes; essentially running down their housing equity by depressing values at sale. However, this is no longer an option in specialist housing as its buildings have to be managed and maintained in good condition. Moreover, communal and support facilities are costly and have to be funded.

The result is that a higher price has to be paid for the superior living conditions on offer. But one that is paid for in a variety of ways and often poorly understood.[14]

Potential greater price variability

Like all homeowners, the purchasers of senior housing worry about the continued values of their properties. Yet, the limited demand for and supply of it in any locality puts constraints on liquidity and may increase price volatility in comparison to the general local housing market.[15] Rather

[7] Housing markets and independence in old age: expanding the opportunities, M. Ball, R. Blanchette, A. Nanda & P. Wyatt, REP, University of Reading, 2011.
[8] Housing for older people inquiry – response from McCarthy & Stone, 24 March 2017.
[9] House of Commons Communities and Local Government Committee, Housing for older people, Second Report of Session 2017–19, 2018.
[10] Homes and ageing in England Helen Garrett and Selina Burris, Building Research Establishment; House of Commons, ibid.
[11] Office for National Statistics, Overview of the UK population: August 2019.
[12] Ball and Nanda, ibid.
[13] Event Fees in Retirement Properties, Law Commission, Law Com No 373, 2017; Office of Fair Trading, Investigation into retirement home transfer fee terms, a report on the OFT's findings, 2013, OFT1476.
[14] Jenny Pannell, Hannah Aldridge and Peter Kenway, Older people's housing: choice, quality of life, and under-occupation, Joseph Rowntree Foundation, 2012.
[15] See, for example, House of Commons Communities and Local Government Committee, Housing for older people, Second Report of Session 2017–19, 2018, paras 94-5.

than there being hundreds or thousands of purchases and sales in the course of a year, there probably will only be a fraction of that in the senior sector. Finding a buyer may take longer in such thin markets as a result, with price-matching more difficult. Furthermore, a sudden increase in local supply, through new build or higher sale offers in the existing stock, can easily lead to temporary over-supply and weakened prices.

Moreover, schemes when they were completed will usually have been sold to buyers of a similar age and health, so over time there is a growing likelihood that resales will be bunched as residents' experiences are closely matched. This can lead to periodic rises in vacancies for specific schemes and in particular neighbourhoods, with resultant time on the market and downward price effects.

Pricing impacts

There are no good price data on senior housing but the piecemeal, anecdotal evidence that exists - primarily related to properties built by the country's largest provider, McCarthy and Stone – bring out the distinctive features of this segment of the housing market.

At purchase, the additional features of senior housing, combined with the specific supply side problems associated with building it, seem to add a price premium reported to be 10% or more in relation to equivalent local ordinary flats. At resale, while the problems of lower prices may have been exaggerated by some commentators through a failure to take proper account of the housing market cycle, resale prices appear to languish relative to the general housing market. This suggests that the depreciation factors and thin market features noted above have real impacts.

The difficulties of supply senior homes in the current environment are also brought out strongly by looking at the supply side. Developers are not rushing to build senior homes because of the paradox of limited demand in this market segment at viable prices, despite an apparent vast ocean of need amongst segments of the population holding considerable housing equity.

This lack of sustained viability helps to explain the stark contrast in the fortunes of the country's major housebuilders over the past five years. While the mainstream majors have flourished, with their share prices rising, McCarthy and Stone's shares over the past five years to last autumn by 46%. They have risen somewhat since then, partly due to a new strategy of offering renting while previous homeowner's old homes are rented out as well. Some other smaller providers also offer senior housing for rent, showing the potential for this option. However, the fact that senior tenants suffer significant tax penalties compared with those who own has limited the market. None of the UK rental providers operate at large scale. In contrast, some US providers have thousands of senior homes spread across a number of states.

The benefits of bigger markets and larger providers

Such liquidity and pricing issues would be less of a problem if there was far greater market turnover, but unfortunately that is limited in the current context of outright purchase and the risks become much greater the smaller is the catchment area. However, there is a strong possibility that the market for senior housing would be much greater if more flexible and financially viable rental options were made available for those that do not wish to buy.

A larger market would facilitate significant scale economies in both housing and care provision. Large-scale rental providers would also be able to overcome the thin market issues that currently hold back senior housing. If one investor owned rental properties across a wide range of localities, locality specific risks would tend to balance out, with excess supply in one area offset by excess demand somewhere else. Liquidity and vacancy would also be improved for providers via this risk pooling effect. So, there would be positive market efficiency benefits and therefore much greater incentives for firms and other providers to enter the senior housing market.

These pooling benefits are significant but can only be achieved via renting. It is unavailable to individual senior housing owners because they have only one property, their own home.

By contrast, an investor, such as a REIT or a non-profit, could hold a diversified property portfolio and rent out senior housing; simultaneously benefiting from other scale economies.

The potential benefits of renting senior housing

Senior renters have no problems about transactions costs and paying Land-Tax-Stamp duty as they would have done if they purchased; nor with property asset depreciation, illiquidity, raising the capital to purchase and all the complexity of related user charges. They also avoid the complicated and troublesome process of property purchase conveyancing and associated legal fees. They would simply pay a rent and so the move to senior accommodation would be much easier.

Provided the senior housing was rented in a competitive market, competition for tenants would induce landlords to pass on part of the benefits of scale, innovation and diversified holdings to their tenants in the rents charged and quality offered. Providers would have incentives to build reputations for offering high-quality accommodation, but light touch regulation could additionally ensure standards and inhibit rogue providers. The ability to offer long-term tenancies and rents in this sector would be far easier than in the general rental market because the mobility of seniors is generally very low and more predictable.

Renting would also increase mobility over ownership for older people; say, at times when the need arises for a new home with more intensive care facilities. The risk of severe financial loss from the need for a rapid sale when unexpected adverse health events occur is also avoided. Families and friends would have less need to get involved in a senior's legal and financial affairs, often associated with ownership.

Renting would expand market senior housing to areas of the country where currently there is little, like the Midlands and North of England, because far more seniors are able to afford rents than to put upfront, the capital required for purchase. It is easier for family members to top up rent payments than to contribute to large initial lump-sums.

Renting incurs higher tax costs

The arguments made so far highlight the benefits of a greater range of options in senior housing. Renting should be an opportunity worth considering for those older people with insufficient funds, who need to borrow to own, and those who care about the future value of their capital and the flexibility of their accommodation and finances. However, renting hardly exists and the current structure of the tax system helps to explain why.

The equity seniors hold as homeowners in their existing homes is untaxed. So, when they buy into specialist retirement accommodation, the housing equity they carry forward remains untaxed as they remain homeowners. This is not the case for any income flows from realised housing equity which is then invested in other financial vehicles, such as savings accounts, annuities, bonds and equities. The dividend and interest flows are subject to income tax and any capital gains are taxed as well, apart from prevailing exemptions. So, selling a house and investing the proceeds in order to pay a rent incurs a potentially large tax penalty in contrast to continued ownership.

Tax effects act as a huge disincentive to rent in older age for all but the least affluent. In consequence, there is no incentive for providers to offer good quality private specialist rental accommodation and this market for seniors fails to exist.

Widening choice in the face of 'insurmountable' barriers

To summarise the argument: market-based senior housing exists in the framework of the prevailing tax and legal system. This leads to it hardly being offered in any other way than the leasehold ownership form. Housing options are limited, while specific risks are imposed on purchasers and providers alike, and overall supply and affordability are compromised.

The tax system causes market failure. Affordable senior housing is in great demand, which profit and not-for-profit investors would be happy to meet as long as it was viable for them to do so. However, the coordination role of market prices in bringing consumers and providers together cannot effectively happen because of the distorting effect of taxation on the choice between owning and renting.

Although senior ownership is suitable for some households, the unavailability of other options is likely to deter others from moving from their current homes.[16] As a consequence, many elderly people cannot achieve their ideal accommodation needs and society loses out via higher health costs and tighter housing markets. One commentator with little exaggeration has called the elderly 'Generation Stuck' because of the difficulties of being able to move into appropriate accommodation.[17]

Renting has the potential to offer a greater variety of options for older people, both in terms of the types of available provision and their financial implications. Provider scale and scope economies make more possible at lower costs. For example, seniors could move across the housing and care options available from a single provider if their care needs increase, as is common in the USA.

Investment in senior renting could in changed circumstances, generate the necessary returns for large scale investors to mobilise much needed capital resources into the sector; while offering good quality, more affordable, lower risk accommodation to the elderly. The supply logjam could be overcome.

One problem is that older people tend to value property ownership over renting. In part, a lack of existing schemes with good accommodation and sensible rental contracts may make them wary of renting. Undoubtedly, their view is coloured by past memories of their younger years and the consequences of severe rent controls in generating vast neighbourhoods of slums. However, older people respond to financial incentives like everyone else and they are currently stacked against renting. With a tax system that favours ownership, renting is not a viable option for many.

[16] Jenny Pannell, Hannah Aldridge and Peter Kenway, Older people's housing: choice, quality of life, and under-occupation, Joseph Rowntree Foundation, 2012.

[17] B. Beach, Generation Stuck. Exploring the Reality of Downsizing in Later Life. The International Longevity Centre, London, 2016.

Two proposals are made:

1. The introduction of Housing Equity Retirement Accounts (HERAs) into which the proceeds of a previous house sale are deposited. Withdrawels from those accounts are then used to pay senior accommodation rents, tax free.

2. Seniors use the proceeds of a previous house sale to purchase the equity of a REIT. The REIT then provides accommodation to those same seniors who use the cash from their REIT investments to finance the rent, tax free.

The two proposals vary in the degree to which there is a direct relationship between the financial and housing aspects of the move to senior accommodation but, overall, they suggest that much wider specialist housing opportunities for the elderly can be achieved with relatively modest reforms.

Moreover, setting up of these new financial arrangements for seniors moving into specialised rental housing would not add to the existing public subsidies implicit in homeowner tax breaks. Rather those tax breaks are transferred to rental options, making them both more affordable and more tax equivalent to owner occupation. The housing equity tax benefits would have remained with the seniors if they had stayed in homeownership, as they would have almost certainly done. So, these proposals do not require additional public expenditure or tax breaks; just an ability to shift existing ones neutrally across housing tenures.

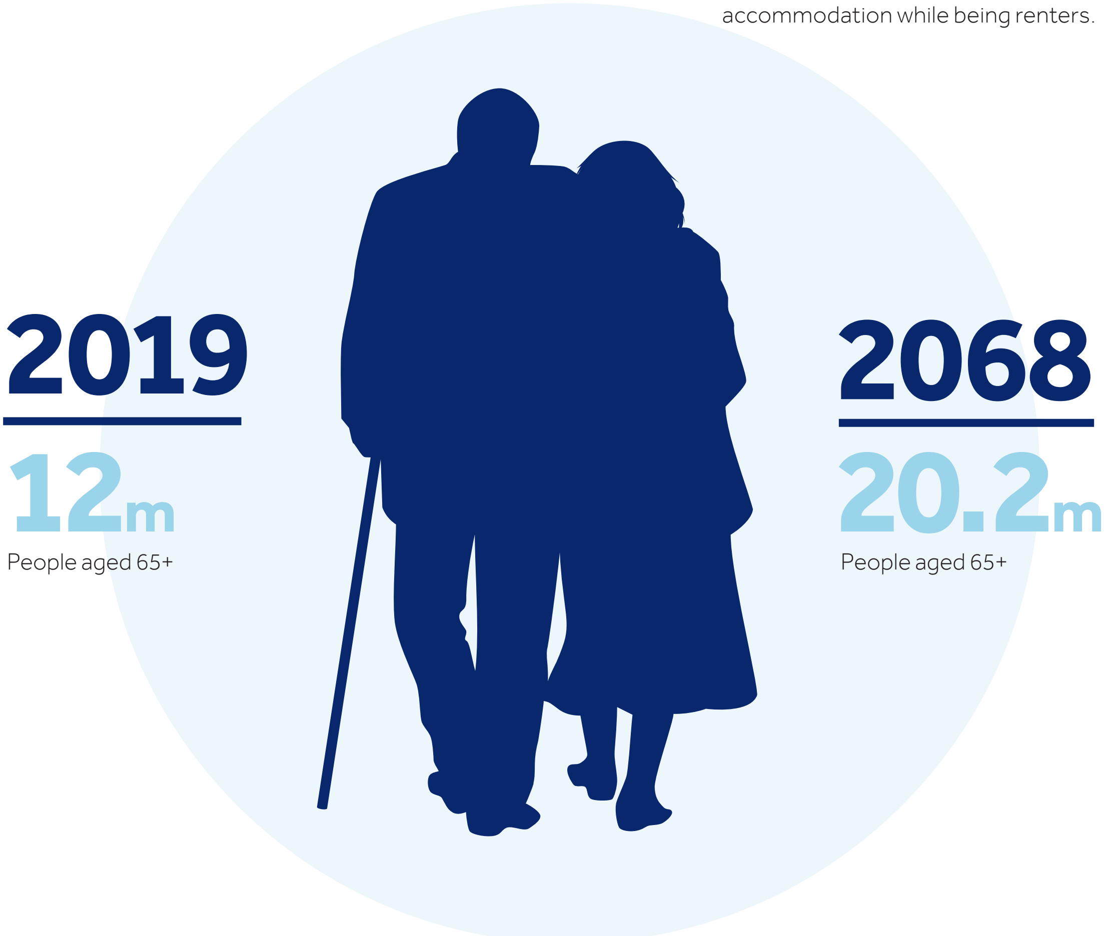
Tax breaks for owner occupiers clearly benefit those who can afford to buy their homes and they increase in attractiveness the more is spent on housing. The proposals here do not alter that situation but remain distributionally neutral.

Meeting the challenges

In order to widen senior housing opportunities the challenges are:

1. To achieve the overriding aim of enabling far more of the elderly to move into specialist accommodation when they need it;
2. To devise ways of levelling the taxation burden between senior renting and owning, without politically unpopular drastic changes to current tax arrangements, such as removing current homeownership tax advantages;
3. To give seniors a sense of ownership and security while they rent their homes.

Ideas presented here offer ways to meet those challenges. The suggestions aim to mirror the tax benefits of ownership by providing financial investment vehicles for older people that utilise the equity they have built up in their existing homes, while locking those vehicles into being sources of funds to pay senior housing rents. Consequently, there is a sense of ownership in that investment vehicles are directly used to fund the rents, enhancing the sense of control seniors have over their accommodation while being renters.



Proposal 1. HERAs (Housing Equity Retirement Accounts)

The investment vehicle

Imagine an older person above the age of retirement is looking to move from an existing home, which they own outright, into accommodation without difficult to manage stairs, a degree of care and the possibility of socialising with others. They have a reasonable expectation of living in that accommodation for five to 10 years, or even more. After this time they may have to move into a care home as they become increasing frail. As well as housing equity, they have a comfortable, if modest pension, and are lucky enough to have it from a company scheme on top of the state pension. So, overall their total pension income draws them well into the income levels subject to tax.

Under this proposal, they will be able to deposit the money they make from the house sale into a Housing Equity Retirement Account (HERA). That account would generate returns from the financial assets into which it is invested. Money could then be draw from the account to fund the rented senior accommodation without incurring tax; in the same way as income and capital gains from Share ISA accounts are tax free.

HERAs would have to be ring-fenced in order to avoid tax arbitrage strategies. So, only released housing equity could be deposited in the HERA. If the person has any other investments or is given cash by relatives, those funds would have to be kept in other retail savings and investment vehicles and subject to taxation in the usual way, as would have been the case when remaining in the old home.

So, when an older person or couple wishes to rent rather than own senior accommodation upon sale of their previous home, they open up such an account and rent a dwelling from a registered provider of retirement homes and fund all or part of the rent with cash flows from the HERA.

The services they would receive as tenants in senior accommodation would be clearly stated in the rental contract and there would be only one item to pay, namely the rent.

Upon proof that the withdrawn funds were being used for senior housing, the HERA income does not have to be entered on the person's income tax return. The housing and HERA providers could liaise to verify the rental payments, thereby avoiding imposing extra administrative tasks on the person using the HERA. However, any non-housing related withdrawals from the HERA would be subject to taxation in the usual manner.

How a HERA would operate would in some ways be similar to features of a Self-Invested Personal Pension (SIPP) or an Investment Savings Account (ISA). HERAs could be promoted by financial institutions in ways used for ISAs and SIPPs. A possible option is that a wide range of financial assets - funds, bonds and equities - could be bought by a HERA holder. However, it is arguable that investing in structured ways may be preferable within HERA contexts in order to minimise risks, charges and potentially poor investment advice and management. Specialist retirement funds investing in assets that closely mirrored expected housing costs would obviously be a sensible strategy.

Potential capital withdrawal plans could also be framed and put in place and equivalents to housing equity release policies could be contained with HERA wrappers, but any incomes generated would still have to be used for accommodation purposes to qualify for the HERA tax benefits.

Capital in HERAs could be drawn down in other prudent ways to fund housing. Furthermore, any capital gains made within the HERA would not be subject to tax. However, capital gains tax (CGT) would be charged for non-housing purpose withdrawals.

Consequently, a HERA would, to a great extent, mirror the current tax situation of homeowners. The main exception would be CGT on non-housing withdrawals, in order to limit the risks of HERAs being used as tax efficient vehicles rather than for senior housing purposes as intended.

To ensure the greatest amount of flexibility and to avoid lock-in, people should be able to switch HERA providers whenever they wish. A HERA should be able to be closed at any time and the funds withdrawn, after which the tax benefits would be lost.

HERAs should be made available in a competitive way by the usual array of retail finance businesses, banks and so on. Each would have to seek approval for their products from the FCA, which would have responsibility for regulating and monitoring their behaviour and charges.

Inheritance tax implications

One commonly cited desire of older people is that they wish to leave bequests to family and other loved ones. Current inheritance tax arrangements favour housing equity below £1m, with higher tax rates for greater property values. The principle of tax neutrality across the senior housing tenures proposed here suggests that equivalent procedures should be put in place for HERAs on death.

However, this may be a matter of some debate as it dilutes a controversial and currently ring-fenced tax provision. It is not central to proposals made here that focus on housing circumstances in later life, except in so far as the housing choices of seniors are altered.

Two factors are likely to influence the extent of the deterrence effect on senior renting that will occur if inheritance equivalence is not there. First, the empirical strength of the bequest motive amongst the current cohort of older homeowners whose estates gain from it and second, the continued existence of the tax break in face of governments in search of funding.

The accommodation offer

HERAs would be used to pay for specialist senior accommodation. This would be rented from registered home providers offering homes associated with various levels of care. The charges for the more care intensive properties would obviously tend to be higher, all other things being equal, commensurate with the costs of the additional services being provided.

In general, rents would be competitively determined as in the wider private market.

Any form of price-controls should be avoided because they would deter investors and developers from providing senior rental accommodation and reduce investment, innovation and competition.

As noted earlier, providers would be registered with a regulatory agency to ensure that standards and practices are reasonable and that they are financially viable. Financially robust senior housing providers are clearly a key requirement of any expansion of senior accommodation because collapses in providers would seriously damage market confidence, as has occurred in the care home industry. Registered providers would need to borrow to fund their investments in senior housing and such borrowing obviously adds leverage benefits to their financial appraisals. However, it is arguable that caps should be put on the degree of debt to limited default risks. Regulation need only be light touch, but its existence would reassure users and their relatives and therefore encourage take-up.

There is little point in prescribing particular ownership types for providers, if competition and innovation are core aims. Both for-profit and not-for-profit senior housing providers should be encouraged but without subsidy (or cross-subsidy), so that competitive pressures alone determine which providers and dwelling types best meet consumer needs. For example, new supply could be offered in build-to-let contexts; by investors/providers purchasing bespoke or ready-built new schemes from developers; by providers of existing senior homes; or, finally, in mixed tenure schemes containing owners and renters.

Rent determination would be driven by the characteristics of the accommodation, its location and the level of available care services in a similar way to the owner-occupier senior market. It is to be expected that developers would market judgements about the types of senior housing to provide in general and in any one project. Tenure-wise the options would include mixes of renters, owners and part-ownership or, alternatively, single tenure approaches. In terms of product, strategies would evolve on levels of care; property types; operating in specific market segments and locations; and scales of projects.

The usual range of real estate investment vehicles should also be permitted to encourage activity and competition, including REITs and special purpose vehicles. Detailed prescriptions of accommodation features are best avoided, apart from setting some minimum standards for what constitutes senior housing.

The underlying aim is to ensure a good supply of senior rental accommodation, its quality and the potential for innovation. That aim would also require a positive approach by planning authorities to the sector to enable new schemes to find adequate and viable land supplies. That commitment would need to cover all aspects of planning policy, including land availability, building control policies, Section 106 and other taxation requirements.

In principle, local authorities have strong incentives to encourage this type of housing as it reduces care costs and improves general local market housing supply. Yet, often these bigger picture perspectives fail to register in local planning committees and their policies.

A need for flexibility

Flexibility is important within the senior housing financial investment and rental offers. The circumstances of the elderly can change rapidly due to health circumstances, for example. This suggests that 'lock-in' situations through long-term impositions in contracts should be avoided. Perceived flexibility would thereby increase demand.

Flexibility on the consumer side, while simultaneously offering continuity and security, is likely to be viable proposition for housing providers, because older people in practice rarely move unless under strong pressure to do so. Therefore, providers can utilise information such as health event incidence at specific ages, to work out actual probabilities of moving and price the resultant costs of vacancies, refurbishment and tenant search into rents accordingly.

Downsizing

The proposal here is that tax-free returns from HERA investments will pay for rents in specialised senior housing. However, such housing does not come cheap. Therefore, it is likely that those returns would require downsizing by moving into senior housing of less equivalent capitalised value than the previous home. Rent payments may also require planned rundowns of capital or top ups from other income sources.

First, returns on investments are at present quite low and, if used to pay rent, may only cover that for a smaller dwelling or one at a cheaper location. However, low interest rates have helped to boost house prices relative to rents as well, so that this effect to an extent is offset for the elderly contemplating moves into rental properties.

Second, rents need to cover provider's costs of shared facilities, the care services offered, repairs, vacancy rates, depreciation, management and offer a viable return on capital to investors. Many of these items also exist with senior owned housing and are either paid upfront in purchase price, ongoing service charges or in exit and other fees. Nonetheless, they again point to the significance of downsizing

Summary of housing equity retirement account (HERA) proposal

- HERAs available through regulated financial providers, at state retirement age or later
- Deposit cash from housing equity in previous home into the account
- Subject to verification and minimum occupancy time in previous dwelling
- Invest in retail funds, bonds and equities, etc. either as in a SIPP or in a more structured form
- Income and capital gains from HERA tax-free as long as used for paying the rent on a senior home from a registered provider. Excess income to be taxed as normal income, while capital gains treated in the same way
- Can switch HERA and retirement home provider at any time (subject to reasonable transfer charges)
- Can close HERA at any time but then subsequently lose transferred housing equity tax benefits if new one not opened. The remaining HERA proceeds conveyable to beneficiaries at death, net of tax liabilities
- Policy option to extend HERA tax benefits to care home costs.

Proposal 2. Retirement Engaged REIT (RET-REIT)

Another way to combine tax-free investment for the elderly with renting specialised senior housing is directly through the Real Estate Investment Funds (REITs) approach by creating Retirement Engaged REITs (RET-REITs) in which seniors both invest and rent accommodation. They could then eventually exit by moving out of the accommodation and selling the shares. This approach offers seniors a direct sense of ownership of the organisation that provides their home while providing greater financial flexibility.

In RET-REITs, promoters build senior developments in REIT frameworks, which allow them to pass through dividends tax-free to shareholders, using loans and capital raised by issuing shares. When they sell their existing homes, seniors would then invest in a RET-REIT's shares and use the returns from those shares to fund the rent of one of the dwellings built. Again, the share returns would be deemed tax-free for people as long as they were used to fund the housing rent payments.

Many of the principles and details of operation are similar to those in the first proposal and so will not be repeated but some salient points still need to be made.

The benefit of this REIT proposal is that seniors would have a direct ownership interest in their landlord and fungible wealth in the form of the REIT shares. This offers a closer correspondence between the desire for ownership that many seniors have and the home in which they live than the previous general investment fund financing rent payments model. However, it does so at the cost of tying the fortunes of seniors into the REITs in which they have invested whereas more diversified portfolios would exist in the HERA investment fund model.

REIT shares are traded so that there is equity market exposure as well as the risk of major property market downturns and periods of high vacancy rates. Even so, they are by no means exceptionally risky investments and may prove attractive to seniors and providers with the tax-free component that they offer.

What sort of REITs should be allowed to operate as RET-REITs is matter a of judgement and choice. If they were small and just operated a handful of senior home developments, there would be a close sense of engagement in ownership by seniors owning shares. However, property market and local management risks might be greatest at such a small scale. They would be more limited with large-scale operations stretching across wider residential and potentially other property markets, with the RET-REIT components bundled together with other REIT investments. Larger REITs could also offer the opportunity for seniors to move across developments and facilities enabling needs to be more closely met.

Conclusion

The needs for specialist housing for the elderly currently outstrip those that actually are accommodated in that way by a large margin. The need and the supply gap are both likely to grow exponentially in the future. As a result, older people suffer far more health problems and greater distress and anguish than is necessary; bringing misery to themselves and their families. Society pays the cost in higher taxes to fund the extra health services required and housing markets lose out from the slower release of often large, family homes.

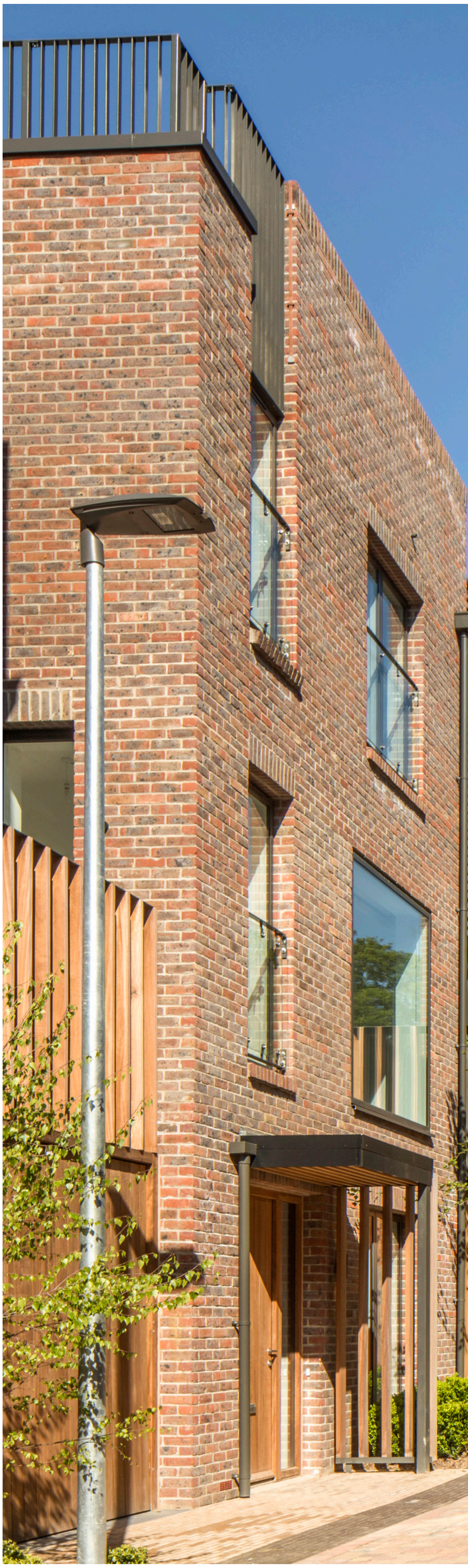
This logjam and its causes have been extensively debated but little attention has been paid to the consequences of a tax system that strongly favours home owning over renting, including in later life. Many of the elderly are homeowners with significant amounts of housing equity. They would face significantly higher tax burdens if they moved from ownership to renting, acting as a huge disincentive to do so. Yet renting offers a way of mobilising large-scale investments into the senior sector that could both offer good accommodation and quality services by reaping economies of scale. The tax biases consequently create a market failure in which the possibility of greatly enlarged and improved senior housing provision is lost.

Two proposals were suggested here and these aim to address this tax anomaly by introducing tax efficient investment wrappers in which people can deposit housing equity in order to fund all or part of the rent on the market-provided senior housing. In addition, this approach offers a sense of ownership and control, which many seniors desire, as they still have a capital asset linked to their current home.

HERAs would be a personal investment fund, with characteristics of ISAs and SIPPs, with the tax-free cash from them used to rent senior housing. RET-REITs would involve seniors using capital from the sale of their previous home to buy shares in the REIT providing their accommodation with the tax-free returns from the investment paying for the rent on the property or part of it. In either case, the move to senior housing is greatly simplified over the ownership route, with much lower transaction costs and no Stamp Duty to pay.

Key differences exist between the two approaches, enabling seniors to make informed choices between them. The latter approach offers a closer link between the ownership and renting dimensions of the senior housing offer and the former, a more balanced investment portfolio. Both contain investment risks but shield seniors from the property market risks inherent in the senior ownership model. An ability to continue to use either investment models for care home costs would be of further benefit and assist in funding of the growing elderly care crisis in the UK.

There is clearly no magic bullet to overcome housing problems in later life. Tackling problems across a range of issues is necessary but confronting current financial imbalances should be high up the list.



[18] Fairer Care Funding. The Report of the Commission on Funding of Care and Support, HMSO 2011.

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