Policy on Household Insurance Requirements – 3.9

Queenstown Lakes Community Housing Trust
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Background

At the 21 July 2009 meeting a draft of this paper was discussed. The household risk of inability to service their mortgage under the Shared Ownership Programme is the focus. The Trust agreed that should adopt a policy in some form, and requested a revised paper looking at a policy to require Life and Temporary Disability Home Loan cover for low deposit households, and recommend that all households consider their needs for Home Loan or Income Protection Cover as appropriate. This is that revised paper.

The author and Julie Scott discussed the range of households in the program and created 5 sample households A-E (see Table 1 below) indicative of the household types where the approval review discussion queried whether some form of loan or income protection would be warranted. These are also referred to as the risk factors associated with the household.

The sample household scenarios were provided to Greg Wilkinson, Otago Financial Management (provider of workplace insurance benefits to QLDC), with a request for indicative policy information and premium quotes. The results are shown in Table 2 and are indicative only, in an attempt to provide an "apples with apples" comparison.

Risk Factors:

The sample households are as follows:

Table 1: Risk Factors	**Age**	**HH Income**	**Mortgage**	**Low Deposit <20%?**	**Low SHO <65%?**	**Kids**	**Could Partner work?**
A = John Kiwi: Male key worker, stay at home mum, two pre-teen kids	45	$92,000	$324,000	Y= 1%	Y=63%	2	Maybe
B = Joanne Kiwi: Single woman	58	$62,000	$230,000	Y=15%	N=76%	0	N/A
C = Sam Kiwi: Male key worker, partner stopped working with first child just born	25	$72,000	$239,000	N=20%	N=68%	1	No
D = Kevin Kiwi: Male key worker, stay at home mum), kids under 6 years old	35	$37,000	$122,000	N=36%	Y=60%	2	Maybe
E = Bob & Betty Kiwi: Two adults both working, child 7 years old.	35	$85,000	$300,000	N=24%	N=24%	1	Already working

What risks face the Trust?

The primary risk to the Trust would be a situation where the household's livelihood is significantly depleted, rendering them unable to meet their monthly expenses for an extended period of time (greater than say 90 days). Such a situation has a high probability to result in mortgage default, where the Trust would be faced with whether to step in and resolve the default by increasing its share percentage, or allowing the property to go to market for immediate sale. Either situation has significant costs impacts to the Trust – whether it be to have cash on hand to increase its ownership of the home by meeting the mortgage repayments or to suffer a potential loss if a sale were required at an inopportune time. This situation is most likely to occur through loss of income due to personal tragedy, injury, or health complication; situations where the emotional toll on the family may impair its ability to adjust to the situation and make sound decisions in a timely manner. A related risk is the Trust being painted as "uncaring" by allowing a family to lose their home in time of such tragedy.

This paper is not concerned with the very short-term risks where a household may be between jobs for less than 90 days. It is assumed that should temporary loss of income be faced, that the household would arrange a 'mortgage holiday' for one or two months while they make whatever adjustments that are necessary, even if those result in a decision to leave the area for work prospects elsewhere in the country.

Which sample households are most susceptible to the primary Trust risk?

<u>Households dependent on one income</u>, where there is limited or no scope for the other partner to significantly replace the primary income, and where there is limited other family support available. The Trust is not in a position to assess whether there is other family support available in case of emergency, therefore it is assumed that there is limited other emergency resources available.

Given that most shared ownership households have entered the programme recently, it is assumed that little in the way of savings have been accumulated to see any family through more than a month (if that long) without income.

Security of income in the face of death, illness, disability, redundancy and bankruptcy are "insurable risks", easily mitigated by the various forms of cover set out in Table 1.

<u>Households with a low deposit:</u> This risk in this case is more of a real estate risk, where a family has little financial investment in the home. The normal risk here is if faced with a sale resulting in little if any proceeds to the household, they simply walk away from the property leaving a legal mess for the Trust and lender to sort out. The low deposit is likely also an indicator that there are few other liquid assets or savings that the family can draw on in time of need

Alternatively, the home may have significant emotional value especially during times of duress which may make the above an unlikely scenario. If faced with personal tragedy as opposed to redundancy, these households would likely have no greater risk beyond loss of income.

Households with an ownership share of less than 65%: The programme is designed to require households to purchase at least a 60% interest in the home. The Shared Homeownership Agreement does enable the trust to increase its share in the event of default of the household; but if the Trust is already committed to 40%- 35% investment, there is little room to increase the Trust's share before it becomes a majority owner. For example a 5% share of the average home price of $431,000 = $21,550, or nearly a year's worth of mortgage payments & rates & insurance. But less than a 5% 'cushion' and without other means to restore the income stability of the household places the Trust in a potentially no-win situation of allowing the property to go to mortgagee sale, or stepping in to purchase greater interest in the property.

How much would insurance cover cost to mitigate the risk for the sample households?

Two types of cover are reviewed, which address different aspects of risk to the family livelihood:

Home Loan Cover: This includes a combined set of Life, Crisis, Redundancy (R) and Temporary Disability (TD) Cover. For all households, the Crisis Cover is a one-time, lump sum payment of $50,000 for a specified, major illness or injury. Redundancy cover includes redundancy or bankruptcy, for 6 months, with a 30 day waiting period. Temporary Disability has a 30 day waiting period, to age 65. Payments are for little more than the mortgage.

Income Protection Cover: provides a monthly payment if unable to work due to illness or injury of 75% of your best 12 month average gross income earned during the three years preceding total disability. Length of the waiting period is a significant factor in the premium; for purposes of comparison, a 4 week wait period has been selected as it is anticipated that few households would be able to survive more than one month without income. In most cases the premium is halved by extending the wait period to 13 weeks. Cover to age 65. The real benefit of this type of cover is that the proceeds can cover any living expense, not only the mortgage.

Both provide for a benefit in case of disability or illness; where they differ significantly is in regard to death, and redundancy. There is also a difference in whether the benefit is paid for you to manage your affairs as you normally would (Income) or for only the specific cost of your mortgage (Loan).

Recommendations for sample households, to mitigate the primary risk to the Trust:

In cases where risk is viewed to be significant, it is suggested that some cover be required.
In cases where the risk is viewed to be moderate, some cover may be recommended.
In cases where the risk is low, there would be no recommendation or requirement

A = John Kiwi: Primary risk is real and significant. There is limited ability for the partner to replace the relatively high wage currently earned. There are two school aged children. Shared Homeownership already at 63%; limited scope for the Trust to increase in case of tragedy. At a minimum, the less expensive of Loan or Income cover should be required. In this example, Loan cover would cost $121.96 per month.

B = Joanne Kiwi: Primary risk is moderate at best. There are no dependents; greatest risk is from disability or injury. Shared Homeownership at 76%. Income cover not available due to age; Loan cover is recommended. To reduce monthly premium from $277.57, consider reducing cover to stop at age 65 at time when NZ Super kicks in. If there are other family resources available, consider no cover and applying the premium amount to reduce the mortgage/staircase the Trust share.

C = Sam Kiwi: Primary risk is significant. Whilst the partner has stopped working due to birth of the first child, there is scope for her to return to work, but that would be difficult if tragedy struck. The relative youth of the family means the premium costs are low. The less expensive of Loan or Income cover should be required.

D = Kevin Kiwi: Primary risk is moderate. The kids are in school, so the partner may be able to work and earn close to the current (low) wage of the primary earner. A close look at the premiums reveals that the Income cover is less expensive for a greater income benefit than is provided in case of disability under the Loan cover. The less expensive of Loan or Income cover should be recommended.

E = Bob & Betty Kiwi: Primary risk is low. The child is in school, and depending on whether the family expects to have another child, it is assumed both parents are working. While it would be difficult, the family may be able to survive on one income for longer than other households at their income level but with one earner. While the household may want to consider some level of cover, there is no recommendation for cover.

Trustees discussed requiring only Life and Temporary Disability Cover; indicative costs are in **bold:**

Table 2: Premium Costs **Sample Household**	**Home Loan Cover Benefits & monthly premium**	**Income Protection Cover Benefits**	**Monthly Premium**
A = John Kiwi:	Sum Insured: $350,000; **Life Cover: $44.31/mo** **Temp Disability Cover: $77.65/mo**	$5750/mo	**Loan: $121.96** Income: $275.41
B = Joanne Kiwi:	Sum Insured: $75,000 (less than mortgage as no dependents) Life Cover: $38.65/mo Temp Disability Cover: $159.03/mo	Not available; max entry age 55	Loan: $197.68
C = Sam Kiwi:	Sum Insured: 250,000 **Life Cover: $20.83/mo** **Temp Disability Cover: $24.82/mo**	$4500/mo	**Loan: $ 45.65** Income: $ 90.73
D = Kevin Kiwi:	Sum Insured: 250,000 Life Cover: $22.31/mo Temp Disability Cover: $31.87/mo	$2312/mo	Loan: $ 53.18 Income: $ 76.84
E = Bob & Betty Kiwi:	Sum Insured: 300,000 Life Cover: (both) $46.92/mo TD (both): 98.29/mo	$2500/month per person	Loan: $145.21 Income: $218.04

See Caveats section at the end of the paper for general conditions associated with the listed cover)

Policy

All households with a significant risk, such as a single, primary wage earner, with ownership share of less than 65% shall be required to keep and maintain Life and Temporary Disability home loan cover, until such time as their ownership share has increased above 65%.

For households with a low risk, such as two wage earners and either no dependents or school age dependents, no cover is recommended or required.

For all other households with a moderate risk, either Loan or Income cover, whichever is less expensive, is recommended, at the discretion of the household.

Should the Trust require cover, the cover premium is allowed for inclusion in the household expenses, and may result in a smaller mortgage than if no cover were required. The Trust reserves the ability to request verification that premium payments are made and required coverage is in force.

The “financial analysis” template has been modified accordingly.