Leah Milner
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With the FSA planning tough new lending rules for next year, the future looks bleak for many homeowners

Millions of homeowners are being warned that they could become “mortgage prisoners”, trapped in expensive deals charging high rates of interest because of a toxic combination of tough new lending rules, faltering house prices and a lack of mortgage funding.

The Financial Services Authority (FSA), the chief City watchdog, is planning strict new rules for the mortgage market next year, which will make it harder for borrowers to remortgage to a cheaper deal. Industry experts fear that the new rules, as well as trapping millions on high rates, will make it near impossible for some borrowers to move house and force others to make a cut-price sale.

This would act as a drag on house prices, which some economists fear are already on the brink of a double-dip downturn. Net mortgage lending fell to its lowest level since October 2000 last month, signalling a sharp slowdown in activity, the British Bankers’ Association (BBA) said this week.

A dip in house prices will add to the problems of those without enough equity in their home to get the best deals. A funding squeeze means that homebuyers with a deposit of less than 40 per cent are still excluded from the most competitive loans, while good deals for those with a deposit of 10 per cent or less are rare.

Ray Boulger, of John Charcol, the mortgage broker, estimates that there could already be as many as two and a half million “prisoners”, who are unable to remortgage because they have little or no equity in their property or were previously granted mortgages that are no longer available. He warns that this figure could rise to four million if the FSA pushes ahead with its plans.

He says: “Even borrowers who have up to 15 per cent equity in their property could effectively find themselves mortgage prisoners because the few mortgage lenders who offer deals above 85 per cent loan-to-value (LTV) require you to have a whiter-than-white credit history.”

The FSA’s plans include a ban on self-certification mortgages, which were originally designed to help the self-employed to obtain home loans. There will also be tougher affordability checks and much stricter guidelines for interest-only mortgages, where monthly repayments cover the interest, with nothing going towards repaying the capital.

The Council of Mortgage Lenders (CML) claims that if the new rules had been in force over the past five years, more than half the successful mortgage applications would have been rejected.

Bernard Clarke, of the CML, says: “The FSA’s proposed regulations for the mortgage market could mean a significant number of borrowers have little or no options to move their existing loan. If, by the FSA’s own

admission, the regulations prompt house-price falls, this would increase the number of borrowers in negative equity and compound the problem."

Borrowers who find themselves trapped will be forced to revert to their lender's standard variable rate (SVR). Over the past year many SVRs have been quite low. The average is currently 4.66 per cent, according to the financial website Moneyfacts.co.uk, but brokers warn that this will change as soon as the base rate starts to increase.

Better than expected economic figures this week mean that this could happen sooner than many had predicted. Gross domestic product jumped by 0.8 per cent from July to September, twice as fast as forecasts. It had been expected that interest rates would remain at 0.5 per cent until the end of next year, but some economists believe that rates will now start to rise earlier next year.

Aaron Strutt, of Trinity Financial Group, another mortgage broker, says: "Borrowers who are forced to remain on their lender's variable rate are not in control and cannot opt for a fixed rate to protect themselves from payment shocks in the future or shop around for a cheaper deal.

"If they revert to a rate that is not pegged to the Bank of England base rate, lenders can decide to increase it by as much as they like."

Brokers recommend that borrowers with limited or negative equity should make overpayments on their mortgage now, if they can afford to do so, while rates are relatively low. Even borrowers who have a reasonable amount of equity can benefit from making over-payments because interest rates on savings are poor and reducing the LTV ratio of your mortgage will open up more remortgage options.

Lloyds Banking Group estimates that a quarter of its borrowers are currently making additional payments. Most lenders allow borrowers to overpay by up to 10 per cent of the mortgage each year without penalty.

Overpaying will also reduce the payment shock when rates start to increase because borrowers will be used to making higher monthly payments and can reduce these as rates rise.
If your family has grown but you do not have enough equity to move to a bigger property, Mr Boulger says that extending your current home might be an option, provided that you have some spare cash. This could have the added advantage of bringing down your LTV ratio if the extension increases the value of your home relative to your current mortgage.

Tougher credit scoring criteria means that it can be difficult for borrowers with a less than perfect credit score to be accepted for a new deal. Very few lenders accept any new customers with a history of missed payments.

However, borrowers can improve their chances by checking their credit report through either Experian, Equifax or Callcredit and disputing any information that is incorrect. If you have missed a payment, do

not rush to close your account with the provider in question because keeping it open and continuing to make future payments on time will help to repair your record.

Kevin Duffy, of Mortgageforce, the broker, says: “Be careful not to make multiple applications to mortgage lenders in your eagerness to find a decent rate. This can leave harmful credit footprints on your file, which could actually prevent you from finding the best solution. A broker will know which lenders are most likely to accept your application so that you do not needlessly damage your credit score.”

Self-employed borrowers are already suffering as lenders tighten standards ahead of the FSA rule change. Some lenders are already asking borrowers to provide three years of accounts to prove that they can afford repayments. Previously, lenders allowed borrowers to take out loans without proof of income. You should make sure that your accounts are in order so that they can document what you earn.

Millions of homeowners who have interest-only mortgages may also need to rethink their plans. The CML warns that if the rules do come in, these deals could vanish altogether because it will be too expensive for banks to comply with the requirements. Lenders such as Santander and Woolwich, the mortgage arm of Barclays, have already limited the maximum LTV ratio available on new interest-only deals to 75 per cent. Lloyds Banking Group, meanwhile, will no longer accept the sale of the home as a repayment strategy. It requires new borrowers to provide proof that they have other means of repaying the mortgage, such as an Isa or other investment plan.

Brokers recommend that interestonly borrowers should start overpaying by as much as they can now and check whether their planned method of repaying their mortgage is in line with lenders’ new requirements. If it is not, they should put in place a more suitable investment. Melanie Bien, of Private Finance, the mortgage broker, says: “Those on interest-only who are fairly wealthy should consider one of the private banks, which are more flexible.”

Ms Bien adds that lenders will need to demonstrate to the FSA that they are treating customers fairly and behaving reasonably, so if you believe that this is not the case, you should complain to your lender. If its response is not satisfactory, consider taking your complaint to the Financial Ombudsman Service.

Boost your chances

• Start overpaying on your mortgage now, if you can, to bring down your loan-to-value ratio.
• If you are self-employed, keep up-to-date and accurate accounts because lenders are asking for more information from borrowers.
• If you are on an interest-only mortgage, make sure that you have thought about how you will repay your loan — lenders are becoming much stricter.
• Find out how to improve your credit rating at thetimes.co.uk/ moneyguides.
• Do not apply to lots of different lenders because this can damage your credit score.

‘We’re starting from scratch with a debt’

Gary and Rachel Wylie found themselves trapped with a mortgage that they didn’t want after taking out a Northern Rock loan to buy a two-bedroom flat near Glasgow. This was before the run on the bank that led to it being bailed out by taxpayers.

The couple took one of the controversial deals that were available at up to 125 per cent loan-to-value but, as they did not borrow the maximum, they believed that they would have the flexibility to move the mortgage to a larger property in the future.

But after they had Naomi and Rebecca, Northern Rock would not allow them to increase the size of the loan because the bank was now in public ownership.

Reluctantly, they decided to sell, move in with Rachel’s parents and begin saving again for a deposit. They still owe Northern Rock £18,000 because the sale price did not cover the mortgage, the hefty early repayment charge and other fees.

Mr Wylie says: “We took out the mortgage because it was flexible and we thought we could use our first flat as a stepping stone. But now we have to start from scratch with a debt and are paying for our furniture to stay in storage.”