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Borrowers given mortgage lifeline

Following protests from both lenders and brokers, interest-only mortgage holders will be allowed to keep their loans when moving

Alexandra Goss Published: 18 December 2011

Previous FSA announcements amounted to a ban on interest-only deals (Getty)

Millions of borrowers with popular interest-only mortgages are expected to escape a crackdown when the City regulator unveils a long-awaited review of the mortgage market tomorrow.

Previous drafts of the review, the result of a two-year inquiry by the Financial Services Authority (FSA), would have prevented many existing interest-only borrowers from keeping their loans when they moved home or remortgaged.

However, following protests from lenders and brokers who said the proposals would have damaged an already stagnant housing market, the FSA has relented and existing borrowers will now be able to keep their interest-only loans.

The Money section has repeatedly highlighted the plight of borrowers who took out interest-only deals at the top of the housing market in 2007 and are now trapped by tighter rules imposed after the credit crunch. In 2007, 33% of all residential mortgages were taken out on an interest-only basis, according to the FSA. It was common for borrowers to take out such mortgages to benefit from lower repayments, with a view to paying off the loan when they eventually sold the property.

In 2009, however, the FSA proposed that borrowers would have to prove they could repay both capital and interest, and that they should no longer count on selling a property to repay their loan.

Many existing borrowers who took out their deals before the credit crunch would have fallen foul of the stricter criteria when they remortgaged or moved home, but tomorrow's proposals are expected to give lenders greater flexibility when dealing with existing borrowers.

New borrowers, on the other hand, will be required to prove they can afford to repay both capital and interest — unless they have a repayment vehicle in place, such as an Isa.

Ray Boulger at John Charcol, the broker, said: "We welcome any flexibility on interest-only deals as the previous announcements by the FSA effectively amounted to a ban."

The review comes amid growing fears about the state of the housing market. The Council of Mortgage Lenders, the trade body, said last week it expects repossessions to increase by more than a fifth next year.

What will the FSA announce?
The mortgage market review will bring in new rules to ensure risky lending seen before the credit crunch is not repeated.
Lenders will have to check borrowers' income and there will be tougher affordability tests — including an assessment of the impact of a future rise in interest rates — to prevent consumers from taking on loans they cannot afford.

It is expected most mortgages will have to be assessed on a capital repayment basis. Interest-only loans will be available solely to borrowers who can prove they have a repayment strategy, such as an Isa.

What about existing borrowers?
Existing interest-only borrowers, who find themselves trapped and unable to remortgage because they do not meet new, stricter criteria, are

to be offered a lifeline in the form of transitional rules that will allow lenders to be more lenient.
David Hollingworth at London & Country Mortgages, the broker, said: "These are only proposals, however. The FSA cannot force lenders to lend even when the borrower meets the criteria."

What are lenders' current policies on interest-only?
Aaron Strutt at Trinity Financial Group, a broker, said: "Most lenders require you to have a 25% deposit. This essentially means the average first-time buyer will have to take a capital repayment mortgage."
Lenders also impose strict rules on borrowers' repayment strategies. Woolwich, part of Barclays, insists borrowers must have had a repayment plan in place for at least 12 months before applying for an interest-only mortgage. It accepts only an endowment, stocks and shares Isa, unit trust or investment bond as suitable repayment vehicles.

Rates will rise next year
Experts predict that mortgage rates could rise further next year if the eurozone debt crisis is not resolved.

ING Direct raised its tracker rates for new borrowers by up to 0.25 points last week, meaning its lifetime tracker now costs 3.24% if you have a 40% deposit. Santander, Lloyds TSB and Halifax have also raised tracker rates.

Some fixed deals, which until recently had been falling to record lows, are also heading up.

ING and Santander increased some of their fixed-rate deals last week, although the Co-operative bank cut fixes by up to 0.6 points. This means, for example, that the Co-op's five-year fix for buyers with a 10% deposit now costs 5.39%.

Bob Pannell, the chief economist at the Council of Mortgage Lenders, said: "As a by-product of sovereign debt worries, lenders face challenging conditions in wholesale funding markets, and these could have negative effects on the cost and availability of residential mortgages through some or all of next year."