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Doubts over 5% home deposit scheme

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Troels Graugaard/Getty Images



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Leah Milner

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Mortgages: Efforts to help house buyers could be of limited value, reports Leah Milner

The Government has announced further details of a scheme to help people to move house or buy for the first time even if they can afford a deposit of only 5 per cent, but doubts remain over how useful it will be.

The NewBuy guarantee scheme is aiming to help 100,000 people to get on to the property ladder — or move home — with a deposit of about £10,000, instead of the £40,000 which is typically required. The scheme is due to launch in March and is only available on new-build properties.

Ministers had initially planned to only offer the scheme to first-time buyers, but they have decided to widen access to include home movers, such as growing families who now find themselves trapped in cramped properties that have fallen in value, leaving them without enough equity to move up the ladder. The NewBuy guarantee is an indemnity funded by taxpayers and housebuilders to protect lenders that offer mortgages to borrowers with a small deposit on properties worth up to £500,000. This means that if the property falls in value and is repossessed the lender will not lose money, but there is no extra protection for borrowers so they could still lose their home and find their credit status ruined.

Grant Shapps, the Housing Minister, insisted that the scheme would not distort house prices. Critics of the scheme argue that it is using taxpayers' money to prop up the value of new homes that housebuilders cannot sell for the price they want. Others have warned

that mortgage lenders may not lower their prices much for borrowers with a 5 per cent deposit even when the guarantee comes into force, meaning many will remain frozen out of the market.

Mark Harris, of SPF Private Clients, the mortgage broker, says: “We are still awaiting crucial information — which lenders will be involved and what the mortgage rates are likely to be. We expect that rates will be similar to current 95 per cent deals, meaning that borrowers will pay a premium compared with those with bigger deposits.” Although the scheme will offer help to some people to buy their first home, a further stumbling block will be placed in their way from April, as the stamp duty exemption for first-time buyers on properties worth up to £250,000 comes to an end.

What are the best mortgages for borrowers with a small deposit?

The number of mortgages for borrowers with a 5 or 10 per cent deposit has been growing and, according to Moneysupermarket.com, the price comparison website, there are at present more than 300 deals at 90 per cent loan-to-value and 48 at 95 per cent. All the deals will require a squeaky-clean credit history and many require a parent to act as a guarantor or to put money into a linked savings account in case the borrower falls behind with payments. The cheapest for borrowers with a 5 per cent deposit is a variable rate from Market Harborough Building Society starting at 3.99 per cent with a £95 fee. However, it requires a guarantor and the rate could increase at any time. Another option for borrowers with a 5 per cent deposit is the Lloyds TSB Lend a Hand mortgage, which is fixed for three years at 4.04 per cent with a £1,094 fee. However, this requires a friend or family member to put savings worth 20 per cent of the property’s value into an account where it will earn interest at 3.7 per cent but could be confiscated by the lender if the borrower misses payments. For borrowers with a 10 per cent deposit, the cheapest deal on offer is a two-year variable rate from HSBC starting at 3.84 per cent with no fee.

What is happening to mortgage rates?

Mortgage lenders’ funding costs have come down over the past week, but that does not necessarily mean borrowers will get a cheaper deal.

Nationwide Building Society increased some of its fixed-rate mortgages by 0.2 percentage points this week, although it also cut the cost of some other deals.

The latest increases follow a succession of other rises by the building society in the past few weeks. Northern Rock, which was recently sold to Virgin Money, also increased rates by up to 0.26 percentage points.

Mortgage lenders offer cheaper rates to borrowers with a larger deposit, but Aaron Strutt of Trinity Financial Group, the broker, says that Santander has scrapped special rates it used to offer borrowers with a 20 per cent deposit. This means that anyone applying to the bank with a deposit this size would have to pay as much as someone who only has a 15 per cent deposit — around 4.09 per cent.