FINANCIAL TIMES

November 21, 2014 5:34 pm

Interest-only loans tipped for resurgence

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Interest-only mortgages will make a comeback over the next two years as providers jostle for new business and fears of irresponsible lending recede under new regulations, brokers said.

Largely abandoned by lenders after the financial crisis exposed lax lending practices, interest-only home loans are showing signs of a resurgence following the introduction this year of strict affordability rules under the mortgage market review (MMR).

Leeds Building Society this week announced new interest-only deals for borrowers with a deposit of at least half the value of the property. It is offering a two-year fixed rate deal at 2.49 per cent and a five-year deal at 3.19 per cent, with a fee of £199 and repayment permitted by the borrower selling their property.

Martin Richardson, general chairman of Leeds Building Society, said the new deals were aimed at "underserved customers in this market".

Last month, Clydesdale Bank raised the age at which borrowers could apply for an interest-only mortgage from 65 to 70 and cut the minimum loan size from £300,000 to £100,000.

Interest-only home loans grew rapidly in the 2000s, from 13 per cent of the market in 2002 to 33 per cent in 2006/7. But the financial crisis exposed borrowers' vulnerability when regulators found most had no plan for repaying the capital sum.

Politicians and charities have since issued warnings about the "time-bomb" of interest-only borrowers who face a shortfall in settling the final bill. According to the latest estimates from the Council of Mortgage Lenders, about 2.2m interest-only home loans were outstanding at the end of last year, with a further 620,000 part interest-only, part repayment mortgages yet to be settled.

However, brokers said the new safeguards put in place by MMR and intense competition among lenders would trigger a gradual revival in the loan category.

Jonathan Harris, director of mortgage broker Anderson Harris, predicted more lenders would offer the mortgages over the next year. "The pendulum has swung too far [against interest only]. It's a sensible concept for the right sort of borrower and as long as someone has a considered repayment strategy in place, there is no reason why they shouldn't utilise this option."

Interest-only has long been popular with wealthy buyers, who may have irregular sources of income from bonuses or investments and prefer the option of repaying the capital debt at their own pace. Those with annual net income of at least £300,000 or net assets of no less than £3m are exempted from the full rigour of MMR, though they are still required to set out a repayment strategy.

2.2m

Interest-only mortgages estimated to be outstanding in UK at the end of 2013

Largemortgageloans.com, a broker whose average mortgage size is £1m, said 30 per cent of its clients were on interest-only loans, the majority with private banks.

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Nigel Bedford, senior partner at broker Largemortgageloans.com, said it had become easier in the past three months to place mortgages, as long as borrowers had an appropriate repayment strategy. "Interest-only is not really what the lenders want but they recognise it's a part of the market they can't ignore, because there's some good business to be done there."

Notwithstanding recent signs of life in the interest-only market, the days of easy borrowing are unlikely to return. Mainstream lenders are highly selective about the type of borrower they will take on, with the maximum proportion of loan-to-value at 75 per cent, and most around 50 per cent. Aaron Strutt, of Trinity Financial, said: "Most new borrowers don't have a big enough deposit or sufficient investments to qualify and this limits demand."

Older people are another segment of the market for whom interest-only lending may often be appropriate, interest rates and forbearance among lenders, the Council of Mortgage Lenders said. In the three months to September, the proportion of mortgages in arrears fell to 1.12 per cent from 1.18 per cent in the previous quarter, the equivalent of 125,100. The threshold for arrears is 2.5 per cent of the total loan value.

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since their savings allow them to keep up interest payments, while the capital could be repaid when they move into a care home or pass away. But they are largely shut out by the strict age limits applied by most lenders and the insistence that income, rather than investments, savings or other assets, can count towards the affordability assessment.

Ray Boulger, technical director at John Charcol, said: “In many cases people are struggling to get a mortgage when they’ve got quite a lot of assets, decent savings and can easily afford payments on an interest-only basis.”

He added that, without a change of approach, lenders would find it increasingly difficult to serve older customers as the annuities market continued to decline and retirees drew their income comes from a variety of sources.

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