May 2009

Our Moneymadeclear guides –
here to help you

This guide is part of our **Buying a home** series.

Available from our helpline or website

www.moneymadeclear.fsa.gov.uk

No selling. No jargon. Just the facts.

If you would like this guide in Braille, large print or audio format, please call our Moneymadeclear helpline on 0300 500 5000 or Typetalk on 1800 1 0300 500 5000.

(Calls should cost no more than 01 or 02 UK-wide calls, and are included in inclusive mobile and landline minutes.)

To help us maintain and improve our service, we may record or monitor calls.

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No selling. No jargon.

Just the facts about dealing with your mortgage shortfall.

Moneymadeclear

from the Financial Services Authority (FSA)

With our Moneymadeclear range of guides, we cut out the jargon and give you just the facts about financial products and services, helping you to make an informed decision.

Just the facts about dealing with your mortgage shortfall.

We try to ensure that the information in this guide, some of which comes from sources outside the FSA, is correct at the time of print. It is possible that some of it is oversimplified, or may become inaccurate over time, for example because of changes in the law. You should check the current position before you take any action.

This is general information to help you make financial decisions. It is not advice, and cannot take account of your individual circumstances. When making decisions about your own circumstances you should consider whether to consult a financial or other professional adviser.

FSA®

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This guide is for you if

You are

using an investment, savings or pension plan to pay off your interest-only mortgage.

It's about:

- why you need to regularly review your investment, savings or pension plan; and
- what to do if you think it won't pay out enough to pay off your mortgage.

It also answers some of the questions you may have.

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How interest-only mortgages work

With an interest-only mortgage, your monthly payments pay only the interest charges but not the mortgage itself. You will be expected to make arrangements to pay off the mortgage at the end of the term.

If you haven't already made arrangements to do this, you should think carefully about doing so now. Talk to your lender as soon as possible as they may be able to help.

You may have decided to pay off the mortgage by putting money in an investment or savings plan such as an endowment policy, Individual Savings Account (ISA), or Personal Equity Plan (PEP), or you may decide to use money from a personal pension.

The investment, savings or pension plan will need to grow to give you enough money to pay off the mortgage at the end of the term. If it doesn't, you'll be left owing money. This is known as a **shortfall**.

If you think you may have a shortfall, you should consider taking action as soon as possible to ensure you can repay your mortgage – see page 4.

If you don't think you can avoid a shortfall, there are options available to you – see page 10.

See the *Jargon buster* on page 14 for an explanation of some words you may come across.

Key points

- Talk to your lender if you haven't already arranged how you will pay off your loan.
- Act now if you think you have a shortfall – see page 4.

Are you on track to pay off your mortgage?

Endowment policy

If you are using an endowment policy to pay off your mortgage, you should have received regular letters telling you whether your policy is on track to repay it. These are called 'reprojection letters'. They will be marked 'red' if there is a high risk the policy is not on track, 'amber' if there is a significant risk it's not on track, and 'green' if it's currently on track to repay your mortgage.

Endowment policies are linked to investments such as bonds and shares, which can vary in value. Make sure you check each reprojection letter, even if the policy has so far been on track.

ISA, PEP or personal pension

If you are using an ISA, PEP or personal pension to pay off your loan, you will probably need to ask your product provider to give you an up-to-date projection of the value of your plan.

Remember that with a personal pension you can only take part of your fund in cash to help you pay off your mortgage (up to 25% under current tax law, which may change in the future).

What to do if you're not sure

Contact your provider if you're not sure where you stand on any of your investment, savings or pension plans. You will need to continue checking the value until you repay your mortgage.

Never just cash in or stop paying into your plan without getting professional advice – you could lose out financially.

Key points

- Check your plan regularly to make sure it's on target.
- Never just cash in or stop paying into your plan without getting professional advice – you could lose out financially.

Making up a shortfall

There are different ways you can try to make up the shortfall – some offer more certainty than others.

For example, you can:

- make changes to your mortgage;
- start an extra investment or savings plan; and/or
- make changes to your existing plan.

We explain these options here and have used the following symbols to help you:

✔ An advantage of this option

? Check this out before you decide

✘ Take care – there is a drawback to this option

Think about the pros and cons of each option, and if you're not sure which one is right for you, get professional advice – see *Useful contacts*.

Make changes to your mortgage

1. Ask your lender to switch the projected shortfall to a repayment method.

✔ Your current projected shortfall will be paid off by the end of the term as long as you keep up the payments.

✔ It should be fairly cheap and simple to arrange.

✔ If the projected shortfall grows, you can switch more of your loan to a repayment method.

✘ The repayment method will cost you more each month, as you are paying back both the interest and the capital.

The figures mentioned in the example here and on page 10 are for illustration only.

Example

Helen is 48 and has an interest-only mortgage of £50,000 linked to an investment. The mortgage has seven years left to run and the interest rate is 5.95%.

She asked her investment provider to give her an up-to-date projection, and this told her that her investment may only pay £40,000, a shortfall of £10,000.

Helen wanted to change £10,000 of her mortgage to a repayment method, which means her payments will increase from £247.92 to £344.18 a month.

The repayment method will now repay the £10,000 shortfall. When her interest-only mortgage of £40,000 ends, she will pay it off if the investment pays out the projected £40,000.

If Helen could not afford the £344.18 a month, she could have asked her lender if it was possible to extend the term of the £10,000 repayment mortgage. Although this would mean that she would pay less each month, she would have to pay more in total.

Making up a shortfall

2. Ask your lender to convert your whole mortgage to a repayment method.

✔ Your mortgage will be paid off at the end of the term as long as you keep up the payments.

✔ The longer your mortgage has to run, the smaller the increase in your monthly repayments will be.

? If you can afford it, and if your plan is doing well, you could continue with it just for saving. Some investment products include useful insurance cover.

✘ If you cash in your investment you could lose out financially, and you may need to arrange other insurance cover. So make sure you get advice first if you're unsure.

✘ The repayment method will cost you more each month, as you are paying back both the interest and the capital.

If you want to convert your whole mortgage to a repayment method but are worried that you might not be able to afford higher payments talk to your lender.

The increase in payments may not be as much as you think, and your lender may be able to come up with a plan that can help you.

For example, a repayment mortgage of £50,000 and an interest rate of 6.29% with 15 years to run will cost you £429.80 a month.

You may also be able to extend the term of your repayment mortgage – a mortgage of £50,000 with 20 years to run and an interest rate of 6.29% would be £366.63 a month.

This would limit the increase in the monthly payments, though it does mean that you would pay back more in total over the mortgage term.

Think very carefully about extending the term into your retirement, unless you're sure you can afford it.

3. Repay part of your mortgage early by paying off a lump sum or by overpaying each month.

✔ This will reduce what you owe and what you need your investment, savings or pension plan to cover.

✔ It may end up being cheaper than saving separately to pay off the shortfall in the future.

? Check whether your lender will make an early-repayment charge.

? Check when your lender will give you the benefit from extra payments – some do so only once a year.

Making these changes to your mortgage is probably the lowest-risk way of making up a shortfall. Ask your lender if there will be any charges for this, and how much they will be.

4. Extend the term of your interest-only mortgage and investment or savings plan. See *Make changes to your existing plan* on page 8.

Start an extra investment or savings plan

1. Use a cash savings account or a cash ISA.

✔ The amount you get back does not depend on the performance of the stockmarket.

✔ It may be a good option for the short term – for example if you have to delay paying off a lump sum from your mortgage because of early-repayment charges, or your mortgage is near the end of its term.

✔ Taxpayers can avoid paying tax on their interest by saving in a cash ISA. You can pay in £3,600 in 2009/10, going up to £5,100 on 6 October 2009 if you're 50 or over. The £5,100 limit applies to everybody from 6 April 2010.

✘ Cash products may not grow sufficiently over the longer term to meet the shortfall.

In the longer term, other options (such as overpaying your mortgage payments) are likely to be better value for money.

Making up a shortfall

2. Use a stocks and shares ISA.

✔ Potentially a good way of saving over the longer term. Historically, stocks and shares have grown more than cash savings accounts which have interest added. You can pay in £7,200 in 2009/10, going up to £10,200 on 6 October 2009 if you're 50 or over. The £10,200 limit applies to everybody from 6 April 2010.

? This is currently a tax-efficient way of saving.

✘ This product is linked to the stockmarket, and the value of your investment could go down as well as up. So there's no guarantee your investment will grow enough to make up your shortfall.

✘ This product is meant for investing over the long term, and may not be suitable if you only have a short time to build up a lump sum.

If you decide to start an investment or savings plan to make up a shortfall, it's a good idea to get financial advice.

Make changes to your existing plan

1. Extend the term of your plan.

? You may be able to rearrange your plan over a longer term. You will first need to ask your provider if this is possible. If so, ask your lender to extend the mortgage term to match.

✔ This means you could make more payments into your policy if you can't afford to increase how much you pay each month.

? You may face extra charges and a tax liability if you vary an endowment policy, so it's a good idea to get professional advice first.

✘ The growth of your investment or savings plan is still linked to the stockmarket, so there's no guarantee it will reach its target amount.

✘ Not a good idea if it means taking your mortgage into retirement, unless you're sure you can afford it.

✘ The longer the mortgage term, the more interest you'll end up paying in total.

2. Top up your plan by paying in more each month.

? You should ask your product provider if you can do this and, if so, whether there are any charges.

? You may also face tax liabilities, so you may want to get professional advice first.

✘ Your plan is still linked to the stockmarket, so there's no guarantee you'll reach your target amount.

✘ You could be worse off than if you used the same monthly payments to reduce your mortgage.

✘ Under a personal pension, you can only take part of your increased savings in cash. You can't take anything before you are 50 (rising to 55 by 2010).

If you want to make changes to your plan, you should talk to your product provider or financial adviser.

Key points

- There are pros and cons for each option – you must decide which is the right one for you.
- Talk to a financial adviser if you are thinking of cashing in or stopping any financial plan – otherwise you could lose out financially.

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Your questions answered

Question

What can I do if the mortgage term is ending and I can't avoid a shortfall?

Answer

When your investment pays out at the end of the term, pay all the money into your mortgage to find out exactly how much you still owe the lender. Then talk to your lender as soon as possible.

You may have several options:

- You could pay the shortfall from savings you have elsewhere.
- You could discuss a new repayment period. The quickest way may be to carry on with your previous monthly payment, although you may be able to agree lower payments over a longer time. You should avoid extending the term into your retirement unless you're sure you can afford it.
- You could sell your property to repay the mortgage, and buy a cheaper property so you don't need a mortgage.

In general, provided you keep up the new agreed mortgage payments, you should not lose your home as a result of the shortfall.

Example

Joe has come to the end of his mortgage term and is left owing his mortgage lender £8,000.

The interest rate on his mortgage is 5.95%. Joe could carry on with his current monthly payment of £154.48. This would repay the remaining capital and interest in five years, and would cost £9,268 in total, but this is more than Joe wants to pay every month.

Joe will retire in seven years, so he has agreed with his lender that he will repay the £8,000 over seven years and his monthly payment will be £116.68, which will cost him £9,801 in total.

Question

I'm about to retire and my payment plan isn't going to be enough to pay off my mortgage. What can I do?

Answer

Pay off what you can, then talk to your lender. Often, once you reach retirement it's harder to keep up the repayments as your income is usually much lower.

You could sell your property to repay the mortgage, and buy a cheaper property so you don't need a mortgage.

Alternatively, you could consider a home reversion plan or lifetime mortgage. These are both types of equity release schemes, either where you:

- sell all or part of your home in return for regular income, a cash lump sum or both, and continue to live in your home for as long as you wish; or
- secure a loan on your home, which is repaid by selling your home when you die or go into long-term care.

You should think very carefully about equity release, as there are risks as well as benefits. For example, they can be expensive and inflexible if your circumstances change in the future, and they may affect your current or future entitlement to State benefits.

Get our **Equity release schemes – raising money from your home** guide – see *Useful contacts*. You should also think about seeking professional advice – see *Useful contacts*.

Question

I want to complain about my mortgage endowment policy. What should I do?

Answer

If you think you have grounds for complaint about how you were sold your endowment policy but haven't yet made a complaint, do it now – time may be running out. Get our **Endowment mortgage complaints** guide – see *Useful contacts*. But remember, having a potential shortfall doesn't always mean you were mis-sold your endowment policy.

If you do get compensation from making a complaint about the way you were sold your endowment policy, you should think about using it to reduce the amount you owe on your mortgage.

Next steps

Step 1

Think about how you will pay off your mortgage at the end of its term. If you haven't already arranged a way to repay it, talk to your lender or a financial adviser as soon as possible.

Step 2

Regularly review any savings, investment or pension plans you have to see if they are on track to repay your mortgage.

Step 3

If you think you may have a shortfall, do something about it as soon as possible to make sure you can repay your mortgage.

Step 4

If you can't avoid a shortfall, talk to your lender. There are several options open to you.

Remember, a mortgage is a loan secured on your home. This means the lender can sell your home to get their money back if you cannot repay the loan.

If things go wrong

Complaints

If you have a complaint about the advice you received when you bought your savings, investment or pension plan, or when you took out your interest-only mortgage, you should first contact the firm you dealt with.

They have a procedure to follow when dealing with complaints.

If you're not satisfied with their response, you may be able to take your complaint to the Financial Ombudsman Service.

The firm should give you the details of this free service – see *Useful contacts*.

For more information get a copy of our **Making a complaint** guide – see *Useful contacts*.

Compensation

If a regulated firm is unable or likely to be unable to pay claims against it, you may be able to get compensation from the Financial Services Compensation Scheme. This will be subject to a number of conditions and exclusions.

There are limits to the amount of compensation it can pay depending on the type of claim.

The service is free to claimants – see *Useful contacts*.

Jargon buster

Some key words and phrases explained.

Annual statement
A statement your mortgage lender sends you each year showing, among other things, what you've paid and what you still owe.

Early-repayment charge
A charge you may have to pay if you pay back a mortgage early (including if you move to another lender).

Endowment policy
An investment plan that you usually pay into each month, which pays a lump sum when it matures.

Home reversion
A type of equity release scheme – you sell all or part of your home to a scheme provider in return for regular income or a cash lump sum or both, and continue to live in your home for as long as you wish.

Individual Savings Account (ISA)
A tax-efficient way of saving or investing, with limits on how much you can pay in each tax year.

Interest
The charge that lenders make when you borrow their money.

Interest-only mortgage
A mortgage in which you pay only the interest charges of the loan each month. You are not reducing the loan amount (the capital), and you must repay this in some other way at the end of the term.

Lifetime mortgage
A type of equity release scheme – a loan secured on your home, which is repaid by selling your home when you die or go into long-term care.

Mortgage
A loan secured on your property. If you don't keep up the mortgage repayments, your home may be repossessed.

Mortgage lender
The company you take out your mortgage with.

Pension-linked mortgage
An interest-only mortgage linked to a personal pension. You use the tax-free cash from your personal pension when you retire to pay off the capital you owe on your house.

Personal equity plan (PEP)
A way of holding investments that is sometimes used to pay off a mortgage. You cannot get a new PEP now. All PEPs automatically became stocks and shares ISAs from 6 April 2008.

Product provider
The company you take out an investment or savings plan with.

Repayment mortgage
A mortgage in which you pay off the loan amount (capital) and interest at the same time.

Reprojection letters
Regular letters you should receive if you have an endowment policy. They tell you whether or not your policy is on track to repay your mortgage.

Shortfall
The money left owing at the end of the mortgage period (the term).

Term
The length of your mortgage, normally stated in years.

Useful contacts

Financial Services Authority (FSA)

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Helpline: 0300 500 5000
Typetalk: 1800 1 0300 500 5000
(Calls should cost no more than 01 or 02 UK-wide calls, and are included in inclusive mobile and landline minutes.)

Other Moneymadeclear guides

- Endowment mortgage complaints
- Equity release schemes – raising money from your home
- Getting financial advice
- Making a complaint
- What to do when you can't pay your mortgage

For more titles, call us or go online
www.moneymadeclear.fsa.gov.uk

On our Moneymadeclear website you can find

- a **Mortgage calculator** to help you find out how much your monthly mortgage repayments are likely to be.
- a **Budget calculator** to help you work out your spending.
- **Compare products** tables to compare mortgages and savings accounts.

Call rates may vary – check with your telephone provider.

Money advice agencies

Consumer Credit Counselling Service (CCCS)

Wade House
Merrion Centre
Leeds LS2 8NG

Main helpline –
0800 138 1111

Mortgage arrears helpline –
0800 975 9558

www.cccs.co.uk

Debt Advice Network

0300 011 2340
www.debtadvicenetwork.org

National Debtline

0808 808 4000
www.nationaldebtline.co.uk

Finding a financial adviser

IFA Promotion

www.unbiased.co.uk

For mortgage brokers or independent financial advisers in your area.

Personal Finance Society

www.findanadviser.org

For financial advisers in your area.

Institute of Financial Planning

www.financialplanning.org.uk

For help in planning your finances.

MyLocalAdviser

www.mylocaladviser.co.uk

For a mortgage, insurance or investment adviser in your area.

Complaints and compensation

Financial Ombudsman Service

South Quay Plaza
183 Marsh Wall
London E14 9SR

0845 080 1800
www.financial-ombudsman.org.uk

Financial Services Compensation Scheme (FSCS)

7th Floor, Lloyds Chambers
Portsoken Street
London E1 8BN

020 7892 7300
www.fscs.org.uk