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Interest-only mortgages to become niche

Interest-only mortgages are likely to become a niche product, with fewer borrowers able to take out deals, after two high street lenders joined rivals in issuing stricter lending criteria.

Nationwide Building Society and Coventry Building Society this week restricted interest-only mortgages to borrowers with deposits – or equity – of 50 per cent or more, up from 25 per cent.

This latest tightening comes a month after Santander, one of the UK's biggest mortgage lenders, became the first lender to restrict interest-only lending to as low as 50 per cent of a property's value.

The move by Nationwide and Coventry further limits options for homeowners seeking an interest-only mortgage on the high street. Mortgage brokers say interest-only mortgages are likely to become "niche products", suitable only for certain homeowners.

"For interest-only borrowing, 50 per cent loan-to-value is the new 75 per cent loan-to-value," says Nigel Bedford of Largemortgage- loans.com, the broker. "It is going to be increasingly hard for other lenders to keep their current policies, as they will receive more interest-only applications as the options above 50 per cent loan-to-value diminish," he adds.

Evidence of this knock-on effect has already emerged. NatWest temporarily withdrew interest-only deals on Friday, citing "rapidly changing market conditions" and said it would launch new criteria for its interest-only mortgages next week.

While Santander, Nationwide and Coventry have limited their maximum loan-to-value ratios to 50 per cent, other high street lenders have introduced restrictions on what they will accept as a repayment vehicle to pay off capital at the end of the mortgage term.

This month, Clydesdale Bank cut its maximum loan-to-value to 50 per cent where an interest-only customer uses cash savings or downsizing as their chosen repayment strategy.

Meanwhile, Lloyds Banking Group – which operates the Halifax, Lloyds TSB, Cheltenham & Gloucester and Scottish Widows brands – imposed tougher rules on how to calculate the value of accepted repayment vehicles.

A stricter approach will also hit existing customers who want to move home and increase their loans, as they will need to meet the new lending criteria, or switch to a capital and repayment mortgage.

Customers who want to "port" their existing deal without borrowing more will not be affected by the changes. However, mortgage brokers say there are still lenders with more flexible interest-only policies, such as Accord Mortgages and Aldermore Bank.

Aldermore will lend up to 80 per cent of a property's value, as will smaller building societies such as Market Harborough and National Counties. But borrowers will have to ensure they have an acceptable repayment vehicle in place, as lenders who have not yet tightened loan-to-values, may impose tough restrictions on this instead.

Mark Harris of broker SPF Private Clients says there are fewer options for those with mortgages exceeding 80 per cent of a property's value.

"If your loan-to-value exceeds 80 per cent and you want to remortgage you will have to reduce the loan-to-value by paying down a chunk of the loan using savings," he explains. "Otherwise, you will have to stay on your lender's standard variable rate."

Bedford says borrowers with irregular income from bonuses who seek large mortgages will find their options reduced the most.