MARKETWATCH

The risks and benefits of debt consolidation mortgages - Marketwatch

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Consumers in the UK are increasing their use of credit cards and unsecured debt as confidence in the economy returns.

Before the credit crisis, racking up unsecured debts and folding them into a mortgage, eating into housing equity was commonplace and lenders were happy to provide remortgages on this basis. Post-2008 and the landscape was very different. Lenders restricted loan-to-values for debt consolidation and capped the level of debt which could be repaid with a mortgage.

But consumer credit statistics released this year show a renewed appetite for unsecured debt. Figures from the Finance and Leasing Association showed 9% growth in consumer finance new business in September year-on-year while credit cards grew 4%.

The Financial Conduct Authority published a report into the credit card market which revealed around 60% of UK adults had at least one credit card. But, while being encouraged by the competition in the market, it said it was concerned about the scale of 'potentially problematic debt' in this market.

This week we've asked our panel of experts if they have seen a change in lender appetite toward debt consolidation mortgages, if clients are to wrapping up debts to secure against their home and what this means for the market.

Michelle Brook, business principal for Mortgage Advice Bureau, Barnsley, talks about the risks of consolidating debts into a mortgage.

Noel Edmonds, mortgage manager for Largemortgageloans.com, looks at lending criteria around debt consolidation mortgages.

David Hollingworth, associate director, communications London and Country, considers how attitudes have changed as the market recovers.

Michelle Brook is business principal for Mortgage Advice Bureau, Barnsley

We have seen some demand from borrowers looking to consolidate debt although the majority of those remortgaging are people who are looking to switch their current mortgage on a pound for pound basis to a more attractive rate, to reduce their outgoings and lock into almost all time low rates.

With risk-based pricing offering significantly reduced rates for lower loan to values, rising equity levels are invariably helping many of those borrowers looking to switch their mortgage. For those who are remortgaging and consolidating other consumer debt, credit cards and personal loans, for example, this can significantly cut their current debt servicing costs and help them manage their overall household income and expenditure onto a more sustainable level.

There will be circumstances where we would advise borrowers not to consolidate debt, in particular where the debt servicing costs of doing so would significantly increase the total cost of borrowing over the longer term of a mortgage, or where switching the client's existing mortgage would result in them incurring significant early repayment charges, and or where a second-charge loan may prove more appropriate.

For some borrowers who do have significant levels of household debt that they are looking to consolidate, the generally more restrictive lender affordability models do exclude some from achieving this even though the ability to do so would improve their overall household finances.

If and where we came across a borrower who was really struggling with debt we would encourage them to engage with appropriate and free-to-consumer debt counseling services, for example, the Citizens Advice Bureau and or for the individuals to engage in dialogue with their loan product providers.

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Noel Edmonds is mortgage manager for Largemortgageloans.com

From time to time we have demand from clients looking to use the equity in their homes to consolidate debt through remortgaging.

Debt consolidation is very much assessed on a case by case basis. For high net worth clients it really is situational and it's about how the case is presented. There usually needs to be a good reason to consolidate the debt, for example, we agreed a case with Scottish Widows recently for an additional £180,000 to pay off credit cards and loans that were used for property refurbishment. The property refurbishment would add value to the property in the long run and was therefore deemed as an acceptable risk.

Some lenders do set limits to the amount that can be consolidated. Santander generally limit to £35,000. Also, some lenders still take into account the monthly debt commitments even if they are being cleared.

A client's credit score is also important. Often late payments on credit cards, or even utilising too much credit, can negatively impact the score.

Interest-only debt consolidation is an option for some but is increasingly difficult to place and will be assessed on the repayment vehicle of the mortgage. Often we find this is not in the client's best interest and is used as a last resort strategy.

Remortgaging for debt consolidation is not as well served by lenders as some other alternatives, such as secured loans.

David Hollingworth is associate director, communications, London and Country
There was a shift away from borrowers looking to pull equity out of their homes following the credit crisis. That was especially true of capital raising for non essential expenditure but tighter criteria and fears around falling high house prices will also have had the effect of limiting levels of equity withdrawal more broadly.

Although house prices have recovered in many regions, there has been little to suggest a rapid return, or even much of an increase in appetite, of borrowers to tap into any growth in equity. Our experience is that any amounts tend to be a very small proportion of the overall lending.

Lenders can place more restrictions on raising capital for debt consolidation than for other reasons such as home improvements, either through LTV restriction, maximum amount or both.

Replacing expensive debt at what could be a much lower mortgage rate can clearly carry benefits. However, reducing the monthly cost is only part of the equation and turning short-term debt into one that could last for 20 years or more could end up costing much more in the long run.

Consolidating expensive debt could help borrowers meet affordability requirements in cutting a monthly cost that weighs heavy on disposable income. However, the borrower needs to understand the long-term implications and make sure it's in their best interests before going ahead.