Warning! If you have an interest only mortgage – you need to be taking action NOW!

"The Interest Only problem for the over 60s"

A market report from
www.laterlifeadvice.com

“The Interest Only problem for the over 60s”

Tomorrow’s market, not today’s, is the one which will determine outcomes and the biggest aspect of this problem is the one nobody ever seems to mention.

Today’s market conditions alleviate the greatest concerns.

Low interest rates and healthy house price values, which in most regions have increased and are increasing, can take care of the problem for the majority people.

But what if ***tomorrow’s conditions*** are different?

What if, as an example, house prices **fall** and interest rates **rise**, so that in 10 year’s house prices are a third less than today and interest rates 10 times higher?

Can’t happen, won’t happen?

Don’t you believe it!

Who would ever have said ten years ago that interest rates would have reached 0.25%?

“Most people think there will be a housing crash within the next five years, amid a stuttering property market.

In a YouGov poll of more than 2,000 people for The Sunday Times, 53% said they expected a housing crisis in five years’ time, while 24% expect it within two years.

YouGov defines a crash as a sudden drop in house prices and demand after a period of rises.”

Sunday Times September 2017

“London house prices are falling at their fastest pace since the aftermath of the financial crisis, confirming the capital as the worst-performing part of a slowing market.”

The Independent October 2017

We are not predicting anything, merely that the risks of a property price fall, which are always present, are not factored in to many people’s planning or circumstances.

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The Perfect Storm

The riskiest scenario is where property prices fall, interest rates rise and people are on interest only mortgage terms, with a term **that runs out during this perfect storm period.**

They would then, at a later stage in their lives, face a situation of trying to sell in a falling market or, worse, a forced sale.

That would represent a major problem.

You do not need to believe that this will happen, just that it ***can*** happen.

The history of market problems, shocks and various scandals is they tend to occur when conditions change over time and the plans, arrangements and legal agreements were set in place under different conditions.

It is our view that the interest only mortgage falls into the category of a market position which is vulnerable to changing conditions.

At a market level this can be addressed in various ways, but it is at the individual level where each person in this position can individually take pre-emptive action – and should do so!

People in this position, especially the over 60s who have such mortgages, should not wait to see what happens, but should plan well in advance and **take steps now** to protect themselves against the market turning against them.

What do the Rules or Regulations State?

The most important thing to understand is that the mortgage contract has two parties, the lender and the borrower. This is clearly an obvious point!

However its basic ramification is not so obvious.

The mortgage lender has legal and financial responsibilities, which will NOT INCLUDE obligations or expectations of offering support or generosity to customers who experience difficulties if that support/generosity is against their basic commercial interests.

Or breaches the terms of the agreement formed.

The regulator – the Financial Conduct Authority – and the Council of Mortgage Lenders, issue guidelines to lenders to help them deal with situations where a borrower has an interest-only mortgage and has difficulties paying the mortgage off at the contract end date.

However those guidelines place no obligation on a lender to extend or reorganise a mortgage at such a point.

They simple set down an expectation that lenders will act reasonably, which will include exploring all possible avenues of dealing with the difficult position.

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It is our view that in a future market, which is not so favourable as today's, lenders will be unable to find solutions to help borrowers and will have no option but to ENFORCE the contract terms upon their borrowers.

We have to remember that lenders have their own set of interests and concerns, including responsibilities to savers, shareholders and other mortgage-holders, which they will need to adhere to.

If they have to act to repossess or force a sale on a later life interest-only mortgage borrower – they will do so.

There is no regulatory block to this eventuality.

And nor should there be.

Exactly What Could Happen?

To emphasise our basic point: we are considering future market positions which may be very different than today.

Let us consider an example.

John and Joan are currently 68 and 66 respectively and have a £200,000 interest-only mortgage due to expire in 2022.

They are currently paying interest at 3.99% fixed until expiry.

Their property is today worth an estimated value of £300,000.

They pay £665 per month in interest-only payment to their lender.

Let us now look at a position where – unexpectedly - market rates of interest double between now and 2022. And house prices fall by one third.

John and Joan will then arrive at a position where their mortgage will expire at a time when their home is worth £200,000. **The same as their mortgage**.

If they could find another mortgage in the market it would cost them £1,300 per month or more. But the reality is that they will ***not*** find another mortgage. There will be no lender offering a retired couple a 100% interest only mortgage.

They will not be able to downsize, they may even find their home has to be sold for a sum lower than the true market value as it is a falling market and they could be forced sellers. They will not be eligible for an equity release loan (because of the loan to value).

Their existing lender will have no obligation to help them and will surely be obliged to **enforce the mortgage conditions and insist on a full repayment, there and then.**

This may be seem an extreme position, but people like John and Joan face this sort of threat.

If they are not prepared they are running a real risk of this type of market position completely ruining their lives.

Even if the market conditions don't worsen over the next few years, this type of scenario can play out in many cases to one extent or another.

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How many people face this threat – the market position?

Our research into this market shows that there is **a complete lack of reliability over the numbers of mortgage holders** who have a problem. It is simply not possible to produce a pinpoint number.

To deal with this and produce meaning ful conclusions we have to extrapolate from a series of numbers which *are* known.

- In 2013 the FCA published research showing that up to 2.6m interest-only mortgages will mature by 2041, of which almost half of the homeowners may be unable to repay the loan at the end of the term. However, 90% of the borrowers "said" they had a repayment strategy in place to repay what they owed.
- But then in 2015, Citizens Advice research, which included a YouGov poll, suggests the regulator may have underestimated the scale of the problem. It puts the number of people holding interest-only mortgages at 3.3 million. The charity said that included 1.7 million who said they had no linked repayment vehicle, such as an endowment or Isa, and 934,000 who had no strategy for repaying the loan. More than 430,000 people "have not even thought about how they will repay the capital", it said.
- Then in 2017, The Council of Mortgage Lenders (CML) estimates that around 1.9 million borrowers are just paying off the interest on their debts without making a dent in the capital. Adding it is believed that one in 10 households do not have an appropriate strategy to repay them once the loan expires.

You will note, as we have, two aspects to this. One is that the number of interest only mortgages looks like it is around 1.9 million today (this makes sense because of the original 3.3 million, some will have converted to repayment basis, some will have been paid, this corroborates with other evidence).

The second aspect is that the proportion who state they have a strategy to clear the mortgage is vague and varies and seems to be somewhat anecdotal.

We suspect that many of those strategies will include an idea around downsizing or taking out a fresh loan, rather than a structured plan of actual repayment via savings.

In late 2016 the Council for Mortgage Lenders reported:

> *"Broadly, the evidence suggests that mortgages maturing in the near future are likely to have adequate or near-adequate repayment plans in the majority of cases.*
>
> *However, looking further ahead the picture becomes less clear, as a greater number of borrowers who took out interest-only mortgages in the early 2000s may not have sufficient arrangements to repay their mortgage."*

We are working with evidence that is very sketchy and somewhat thin on reliable data when it comes to maturity and repayment.

So what do we know?

1. There are roughly 1.9 million interest-only mortgages.
2. These are residential mortgages. There are estimated to be another 1.7 million buy-to-let mortgages on an interest only basis.
3. This buy-to-let market is relevant in a number of ways (which we will cover further shortly)
4. There are three 'peaks' when these mortgages come to their maturity period.
5. The first is 2017/18 (i.e. NOW!); 2027/28 and 2032.
6. There is quite a bit of evidence that the 2017/18 peak is commonly covered by endowment and/or ISA repayment vehicles.
7. There is evidence that endowments/ISAs are not generally in place for later mortgage repayment periods.
8. The later maturity periods show a rise in the average age of the borrower at maturity.
9. And also the average size of the loan.
10. And also the average loan to value (which includes expectations of future increased property prices)

If you follow these 10 points in respect of the way they link together, then it would be perfectly reasonable to become concerned, possibly even alarmist about ***the risks of serious problems for hundreds of thousands of people in later life in the coming years***.

The Buy-to-Let Position

It is estimated that there are 1.7 million interest only buy-to-let mortgages. These are in addition to the 1.9 million residential interest only mortgages.

The typical profile here will be a private individual (or couple) who want a second income and/or to use residential property as an asset to make capital gains. They are not living in the property, so it is reasonable to assume in nearly all cases this is an investment.

Again, the evidence is sketchy, but what evidence does exist suggests that these mortgages are not linked to repayment vehicles.

They are reliant on some future repayment generated from the house sale or they may be passed to next generation landlords (e.g. the children of the current owner) and run into the longer-term.

In recent times, the market has been extremely favourable, by and large, to buy-to-let landlords and will probably cause no difficulties should market conditions remain unchanged.

We know however market conditions can change, often unexpectedly (and in many cases very swiftly). If the buy-to-let market became stressed, probably because of price issues or tenant troubles, this could easily weigh on the main market, in very many ways. All of which would be negative.

There is a delicate balance at play here. The buy-to-let market is significantly reliant on favourable market conditions, because the only surety in the market is the house value and the tenant's rent level. There are some further structural aspects (for example tax incentives or disincentives).

"The property market" is much like a house of cards, it can be dependent on each card standing for the stack to stand. As evidenced by the American sub-prime position in 2007.

If the buy-to-let card wobbles or falls, the whole stack will probably be affected.

The buy-to-let interest only loans are not linked to people's incomes and are not supported by alternative repayment methods, they are reliant on house prices/tenant behaviour.

We consider this is a major risk which could have negative effects on normal residential mortgage holders down the line.

Repayment Strategies

Anyone holding an interest only mortgage, by definition, does not have a capital repayment mortgage. Which means they have no "in-built" repayment plan. This suggests one of three things:

1. They have no plan, of any type at all, or strategy in place to repay the mortgage.
2. They have a repayment vehicle, which is not "in-built", for example an endowment or ISA.
3. They have a defined strategy to repay the mortgage, but it is not directly linked. For example "I will sell the shares in my private limited company".

We think the number of people in position 1 above may be very much higher than the evidence has indicated. However even if the number as predicted is correct, this does not mean that people (in any category) are 'safe'. The only safe way is having a capital repayment mortgage.

If we take our example from earlier of John and Joan and now assume they have £150,000 in ISAs, plus they are paying £1,000 per month ongoing into ISAs, then they are probably on course to repay their mortgage.

And they probably will.

BUT, as before, what if the tide turns? Assume they have the ISA money "invested" to make it grow. The economy implodes, asset markets start to fall, rapidly and sharply. Their ISAs lose value and plummet to £100,000, their house to £200,000.

Now what? They reach their maturity point on their mortgage. Suddenly their options are now very thin and unappealing.

They are boxed into a corner.

They ***might*** be able to pay off half the mortgage and get an Equity Release loan. But their ISAs are now being cashed at the bottom of a falling market, their Equity Release being locked in at a high point in the rate cycle.

Although research shows that many people "say" they have a strategy in place we wonder (a) how accurate this assertion really is and (b) far more importantly how - on a risk comparison basis – this strategy stacks up.

How many strategies relying on selling something (shares, cashing in ISAs and so on) are robust and risk proofed?

Summary

There are basically two pathways, one is the expected, the other the unexpected.

The expected pathway is the one outlined by the FCA in their research document from 2013. This is somewhat based on predictions about borrower behaviour and future borrowing conditions, plus house price movements which paint a picture of some problems, but hardly market-shaking ones.

Even allowing for the diligence of this work, there are questions about exactly how accurate these predictions will be (they don't need to be very wrong to start changing the picture) and even if they were absolutely 100% accurate they still predict problems for thousands of individuals.

The second pathway is a different matter altogether.

This is where conditions change, interest rates rise, house prices fall and borrowers find themselves arriving at maturity date with limited options.

We know there are lots of interest rate mortgages coming up for maturity, we know a proportion are at risk (but don't know the full extent of this proportion) and we know that the people facing this interest-only mortgage crunch are getting older on average.

If that second pathway proves the one we go down in the next 5-10 years, then **there will be** enormous market problems. Which will include thousands upon thousands of retired-aged persons losing their homes. **We need to act NOW to stop this and to manage this risk.**

What can you do?

The basic premise of this document is that there is a risk of a big problem for hundreds of thousands of people in their retired years of having to sell their home.

If you accept this as a cogent argument then unless you are a government minister or a mover and shaker of some description, you can probably do little to affect the market position.

However, if you have an interest only mortgage yourself and think this sort of risk may apply to you, either in part or in full you can make a life-changing difference at an individual level.

There are many ways of risk managing this position if you act now, which will not be available to you if you act later. These can include changing the terms of your mortgage, putting in place risk-free repayment arrangements, de-risking investments which sit alongside your mortgage position, earlier adoption of lifetime mortgages and/or equity release loans, looking at family positions around inheritances, reorganisation of other financial aspects, changing retirement dates, downsizing or a combination of one or more of the above.

Each situation and therefore solution will be different, which is why you are best served getting a bespoke assessment of what options you have.

www.laterlifeadvice.com

Interest Only Personalised Report

We have a service that you may find invaluable. It is our **interest only personalised report**.

If you have an interest only mortgage and can supply us with the basic details, such as the lender, amount outstanding and the maturity date we can then produce a report for you, detailing your options to risk-manage this position.

Click here for more details of the www.laterlifeadvice.com report service

About www.laterlifeadvice.com

MaxLyte Financial specialises in Later Life Advice.

We work with clients as they approach retirement and those already in retirement, with a specific focus around helping individuals meet their income needs – for the rest of their lives.

There is no time or stage more important to individuals than their retirement stages, our service is dedicated to this stage of life.

We are Registered Life Planners with a particular emphasis on helping people with Later Life financial planning.

In many cases this includes a cash flow forecasting approach, which means we work with you to study your income and expenditure patterns through the rest of your life, however long this may be.

We use this to determine whether you have enough money for the rest of your life, how best to allocate your assets, how to invest given your circumstances, your risk approach and how to ensure you have maximum tax efficiency.

With our Equity Release speciality (something most advisers do not have in-house) we can advise on the best Equity Release solutions, where this is relevant or required.

We also help with legacy requirements, working with you to understand what it is you want to happen after you have gone and how you want to protect your wealth within your family bloodline.

We can meet with you in your own home or you can visit our office at 42-44 Grosvenor Gardens SW1W 0EB near Victoria Station, London.

For testimonials from our existing clients please check our Feefo feedback on ***http://www.maxlyte.co.uk***