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Prepare for a mortgage shortfall

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The City watchdog has this week warned millions of homebuyers on interest-only mortgages that they face a "ticking time-bomb" as they have no means of repaying their lender when their loans fall due.

Nearly four million borrowers have interest-only home loans, where they do not have to repay their outstanding debt until the end of the term. As many as 1.5 million of these loans are due for repayment in the next ten years — with 80 per cent of the borrowers thought to have no repayment plan in place.

The worst hit will be home owners who are close to retirement, as many lenders do not allow borrowers to extend their loans beyond the point at which they start drawing a pension. These borrowers are unlikely to be able to afford to repay their loans over such a short period unless they have other investments or a sizeable pension from which to draw a lump sum.

A report this week from The Intergenerational Foundation, entitled *Understanding Downsizing*, found that there are 16 million people in under-occupied properties, but that while some older people feel liberated by moving to a smaller property with lower bills, many are put off by the thought of having to get rid of their possessions to move into a cramped home.

For older borrowers whose mortgage lenders demand that their loans are repaid imminently, equity release could be an option, but there may be alternatives. Here we answer your questions.

Could you still qualify for a conventional mortgage?

Before considering equity release it is worth finding out whether you are still eligible for a mainstream mortgage, which is likely to be much cheaper.

Aaron Strutt, of Trinity Financial Group, the mortgage broker, says: "Equity release is not suitable for all home owners. Interest is added to the outstanding balance and equity in the property can reduce quickly."
Most lenders require borrowers to pay off their mortgage by the time they reach the age of 75 and where the loan extends past their state pension age, the home owner will have to show that their income will continue to be high enough to sustain repayments. But Leeds Building Society will consider lending to borrowers up to the age of 80 at the end of their mortgage term and National Counties Building Society will also lend to borrowers into retirement.

Is downsizing the best option?

If you have owned your home for a decade or more it is possible that even if you have only been repaying the interest it may have increased in value by enough to cover your outstanding mortgage.

Does equity release add up?

The main form of equity release is a lifetime mortgage, whereby you take out a loan against your property and the interest is rolled up for as long as you live and paid back from the proceeds of the property sale after you die.Stonehaven Equity Release will allow the borrower to pay interest every month instead of letting it roll up, if they want to leave a larger share of the property's value to their children.

The sector has been plagued by mis-selling scandals in the past when borrowers ended up in negative equity because their loans were worth more than the value of their properties. But now a code of conduct that has been drawn up by the trade body Safe Home Income Plans (Ship), means that most providers now offer a no negative equity guarantee. Tread carefully if you are considering an equity release mortgage from a lender that is not part of Ship.

Ian Atkinson, of Retirement Solutions UK, the independent financial adviser, says: "Some lenders that are not part of Ship offer variable rate mortgages, which is risky as if the rate increased sharply it could erode all your equity."

Borrowers should also consider seeking advice from a financial adviser in case taking out an equity release loan would cause them to lose any means-tested benefits they might receive, such as council tax benefit or pension credit.

Number crunch

• A couple aged 65 with a property worth £300,000 who wanted to repay an interest-only mortgage of £50,000 with an equity release loan could take out a lifetime mortgage from Stonehaven Equity Release at a fixed rate of 6.08 per cent if they chose to pay off the interest each month rather than allow it to roll up. There is a £650 fee which can be added to the loan.

• The couple would also have to pay solicitors fees and valuation costs and a fee for financial advice, which is likely to total around £1,500.

• They would pay £257 per month and, according to life expectancy for their age group, would be likely to live for a further 22 years until 2024. After the death of both partners, the property would be sold and the total cost of interest payments plus the outstanding loan amount would be £118,335 — leaving £181,665 to pass on to their children, plus any growth in the home's value over two decades.

• Alternatively, if the couple had a low income and did not want to pay anything towards the loan during their lifetime they could take out a loan from Just Retirement at 6.05 per cent, with a £500 fee, free valuation and £700 cashback on completion. This mortgage also allows the couple to draw down extra money if they need to. But, over 22 years they would pay £183,876 because of the impact of rolling up the interest. This would leave £116,124, plus any growth in the property's value for their children.
Calculations by Retirement Solutions UK