How you could be refused a mortgage for taking a holiday

Houses for sale in the window of an estate agent
Leah Milner for The Times

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- **Houses for sale in the window of an estate agent** Ben Gurr for The Times

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First-time buyers will be particularly hard hit by rules demanding stricter affordability tests, says Leah Milner

First-time buyers who are struggling to get a foot on the property ladder could soon find the first rung even farther out of reach because tough new rules could mean that mortgage applicants are rejected because they spend too much on holidays, clothes or even have a gym membership.

The Council of Mortgage Lenders estimates that 45 per cent of the first-time buyers granted mortgages in the first half of this year would have been rejected or only allowed to borrow a lesser amount if the mortgage rules planned by the City watchdog had been in force.

Since the start of the year there has been a big rise in the number of first-time buyer mortgages available, but most still require a 20 per cent deposit. To qualify for the best rates, borrowers would need an even bigger deposit, of up to 40 per cent, according to the comparison website Moneysupermarket.com. But even this moderate improvement in prospects for first-time buyers could be reversed when the regulator introduces stricter rules for lenders.

Under Financial Services Authority (FSA) plans, lenders will have to take many more factors into account when deciding whether or not a borrower would be able to afford a mortgage, and they will also be ultimately responsible for the decision. As well as looking at a borrower's financial commitments, such as utility bills, council tax and home insurance, mortgage lenders will also have to take into account leisure expenses, even though borrowers could cut back on these costs if they were to get into financial difficulty. In its consultation on the new rules, the FSA says that it will expect lenders to deduct the amount that borrowers spend on holidays, food and drink, clothing and recreation from their income to calculate how much they can afford.

Ray Boulger, senior technical manager at John Charcol, the mortgage broker, says: "Mortgage application forms will be a lot more intrusive. The FSA is effectively saying that lenders will have to assume that borrowers will keep spending in the same way they have previously, but many people spend a lot more before they have the commitment of a mortgage and then cut back accordingly. If you are a first-time buyer who has just taken on a mortgage, you are likely to cut down on the number of holidays you take each year or go somewhere less expensive. Likewise, if you were to get into financial difficulties, you might cut out expenses such as Sky TV or gym membership to keep up with your mortgage payments. It does not make sense for lenders to be too restrictive when it comes to factors such as these, where the borrower is in control and can make adjustments to spending as necessary."

Under the planned rules, lenders will also have to take into account "foreseeable" changes in a borrower's income or expenses when deciding how much they are prepared to lend. While the FSA says that it does not expect lenders to predict future events, the rules could push them to be much more cautious to make sure that they are not blamed if a borrower starts to get into repayment difficulties.

The research consultancy Oxera has branded this aspect of the FSA's plans "unworkable", but some lenders are already starting to be stricter ahead of the implementation of the rules. Skipton Building Society recently began asking mortgage brokers to provide more detail on borrowers' current and future monthly income, attributing the move to changes in regulation. Under the proposed rules, lenders would also have to restrict how much customers can borrow if they have a tainted credit history, make sure that the borrower could afford to pay back the mortgage over a 25-year term and check whether borrowers could afford repayments if interest rates rise. The combined impact of these measures will curtail severely how much people will be able to borrow.

Many lenders are already factoring in student loan repayments when they calculate whether or not a mortgage is affordable, but with tuition fees set to increase dramatically, a large number of first-time buyers will be saddled with university debts for many more years, restricting their ability to get a mortgage for longer. The impact of student debt is already significant.

Calculations by Aaron Strutt, a mortgage broker at Trinity Financial Group, indicate that a borrower with an income of £35,000 would be making student loan repayments of £150 a month, deducted from his or her salary. He says that this loan repayment would restrict the amount that could be borrowed from Halifax by £29,000, from Yorkshire Building Society by £21,000, from HSBC by £20,000 and from Santander by £13,000. The difficulties that first-time buyers face have implications for the housing market as a whole. The FSA has acknowledged that its planned regulations could lead to falls in house prices, which are already wavering. The latest house price index from Halifax shows that prices dropped 1.2 per cent in the three months to October, though some monthly indices have shown increases.

Clare Francis, of Moneysupermarket.com, says: “First-time buyers are integral to keeping the housing market moving — if there aren’t enough people jumping on at the bottom of the market, it will eventually grind to a halt. A shortage of first-time buyers is evident around the country, with many people struggling to sell their properties. Unless more lenders start offering 90 per cent mortgages at affordable rates, it is difficult to see how this will be resolved.”

Most first-time buyers struggle to save a decent deposit, and there are very few mortgages at 95 per cent loan-to-value (LTV). Those that do exist usually require a friend or family member to guarantee the mortgage in some way.

Lloyds TSB will lend to borrowers with a 5 per cent deposit under its Lend a Hand scheme, at a rate of 4.99 per cent fixed for three years, with a fee of £994. But this mortgage requires a “helper”, such as the borrower’s parents, to put 20 per cent of the property’s value in a linked savings account. This means that Lloyds could recover the money from the savings account if the borrower misses a payment.

National Counties Building Society also has a 95 per cent LTV mortgage at a rate of 4.99 per cent, fixed for three years, with a fee of £495. But the Family First Guarantor Mortgage requires the borrower’s parents or grandparents to accept liability for repayments if the borrower falls into arrears. Nottingham Building Society has a 95 per cent LTV mortgage without a guarantor requirement. The deal is fixed at 6.39 per cent for three years with a £295 fee, but you can borrow up to only £150,000.

Shared ownership or shared equity might be an option for some first-time buyers but the criteria to qualify for one of these schemes is also very restrictive.
Shared ownership is where a borrower buys part of a property with a mortgage and pays rent on the remainder to a housing association.

Under shared-equity schemes the borrower buys part of the property — usually about 70 per cent — with a mortgage and the remainder is owned by the Government or housebuilder through an equity loan. The borrower then has to come up with only 10 per cent to 20 per cent of his or her share as a deposit, which is much less than would be required if buying the property outright.The loan remains a percentage of the property, so it will increase if the house’s price appreciates.

Since the spending review, it is not yet clear what types of government schemes will remain open.
Barratt Homes runs a scheme in which it funds the 25 per cent deposit through an interest-free loan that has to be repaid in ten years or when you sell. Because you have to borrow only 75 per cent of the purchase price from the bank, you should qualify for more competitive rates.

Shared-equity schemes are usually limited to new-build properties, and government-run initiatives have been restricted to households earning less than £60,000 a year. Not all lenders are prepared to provide mortgages for these types of deals, though, and some people who bought in this way during the boom are now in negative equity because many new-build properties fell more sharply in value than other types of home.

Mortgage application tips

Don’t ask to borrow more than is realistic.
Explain any discrepancies in your bank statements, such as missed payments. If these were not your fault, request a letter from the parties involved.
Sort out your paperwork. Most lenders need at least three months of bank statements and will not accept online banking printouts, so ask for hard copies.
Check your credit report from Experian, Equifax or Callcredit. Challenge any discrepancies.
Make sure that you are on the electoral register.
Be scrupulous when declaring income and bonuses.

Case Study: ‘We are caught in the middle’

Crystal Evans, 27, a research consultant, and her fiancé Edward Holdstock, 27, a barrister’s clerk thought that they had saved up a big enough deposit to buy their first home.

The couple, from Teddington, southwest London, saved up £24,000 over five years — enough for a 12 per cent deposit on a £200,000 property. They began making appointments with all the high street banks, but received a disappointing response. Crystal says: “We met with a number of big banks, including Barclays and NatWest. Both said that we were unlikely to be accepted. They said that most of their lending was to borrowers with a deposit of 40 per cent and that they were being much more cautious at the moment. When we looked into shared-equity schemes we found we were also unlikely to qualify, leaving us caught in the middle.

“Another factor which counts against us is that the property we are renting has been blacklisted by the credit reference agencies because of the previous tenants. We are now looking at Santander and Yorkshire Building Society, and we have gone to an independent financial adviser for help, but it is still up in the air.”