What's next for mortgage rates?

Francesca Steele January 21 2011 12:01AM

Rising inflation could push the cost of borrowing higher for homeowners — and sooner rather than later

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Homeowners concerned about the rising cost of food and other necessities may also soon find they are paying more each month for their mortgage. Economists now forecast that the Bank of England will be compelled to raise the base rate as early as May to curb inflation. As was revealed this week, December's consumer price index (CPI) increased from 3.3 per cent to 3.7 per cent. The target is 2 per cent but economists are warning it could now reach 5 per cent by September, and that the base rate could rise from 0.5 per cent to 1.25 per cent this year. This would lift payments on an average £121,500 mortgage from £659 a month to £711.

Howard Archer, of IHS Global Insight, the economics consultancy, said: "There is now mounting pressure on the Bank of England to enact at least a token near-term interest rate hike to send out the message that it has not taken its eye off the inflation ball."

Lenders responded swiftly. First Direct withdrew its market-leading fixed rates and the Yorkshire Building Society increased the rates on some of its fixed-rate products by up to 0.3 per cent. Base-rate rises could leave homeowners who have not already taken shelter in a fixed-rate loan deal exposed to sharp increases in their repayments.

Is the link between the base rate and mortgage rates as strong as ever?

The base rate, set by the Bank of England, remains key to the level of variable-rate loans. Fixed rates are more dependent on money market swap rates, which tend to rise in advance of a base-rate change. Swap rates are the rates that banks pay to lend from each other.
Currently the base rate stands at 0.5 per cent; it could be as high as 2 per cent by the end of next year.

What is likely to be the timing of the base-rate changes?
Liam Bailey, head of research at Knight Frank, says: "The Bank of England will have to raise rates in the first half of this year to retain some confidence from the City and the political world. However, I suspect that when they hit 1 per cent they will pause." Not everyone agrees though. The typically bearish Capital Economics says rates are actually unlikely to increase this year or even next.
Ed Stansfield, its chief housing economist, says: "We expect the Bank to stick to its line that this recent rise in inflation is a passing phase and that rates need to remain low as the economy continues to be very weak."

How quickly will a rate increase affect mortgages?

Once a change in the base rate has been announced, lenders react almost immediately, says Aaron Strutt, of Trinity Financial Group, a broker. Lenders had already started to put up the price of their fixed-rate mortgages before this week's inflation figures because swap rates have soared since the beginning of the year in anticipation of rate rises. Northern Rock, Halifax and the Skipton Building Society are among many lenders who have withdrawn their leading rates. Skipton also reneged on a promise to keep its standard variable rate within 3 per cent of the base rate.

So, what type of home loans are available now?

There are still some good fixed rates around if you have a big deposit, says Melanie Bien, director of Private Finance, a broker. First direct has a five-year fix at 3.89 per cent for those with a 35 per cent deposit or equity in their homes, with a £99 fee. Strutt says that more lenders, such as HSBC and Clydesdale, are offering 90 per cent loan-to-value deals. "I expect more first-time buyer deals to be available through the year, although they will continue to have tough qualifying criteria. Some of the building societies are trying harder to attract business and offer a wider range of mortgages because they are in a position where they can manage the amount they lend and pull rates very quickly."

How can I ensure I get the best rates?

Equity, equity, equity. Buyers with equity or a hefty deposit (more than 40 per cent) will secure the best rates. Also, use a broker who can match you to the lender most suitable to your situation, and if you are refused find out why. Unfortunately, if you apply for a mortgage and are refused, this can lower your credit score, so you want to avoid this. Check your credit ratings with the three main reference agencies (Equifax, Experian and Callcredit); if there is anything you think is unfair, query it or add a comment explaining that there were unusual circumstances.

I want to buy a shared-ownership property; will I be able to get a mortgage?

Almost certainly, if you have a decent deposit. Mark Porter, associate director at SPF Sherwins, a broker specialising in finance for shared-ownership properties, says that mortgage availability in the sector is unlikely to change much this year. Woolwich, Nationwide, Halifax, and Leeds Building Society all offer rates to shared-ownership buyers, although using a broker can ensure you have access to the best rates. Read about a popular new shared-ownership property project in East London, right.

I need to remortgage this year. What kind of loan is best?

This depends on when you think rates will rise and whether your standard variable is currently very cheap — below 4 per cent. Strutt says that fixed loans are unlikely to get much cheaper but if you just go for a cheap two-year fix you may have to remortgage just as rates are starting to climb quite steeply.

Will rising rates cause more people to lose their homes?

The Council of Mortgage Lenders expects 40,000 people to have their homes repossessed this year, due to "the continuing pressure on household finances, the persistence of cases of long-term arrears and the Government's decision to cut help for borrowers by cutting payments of support for mortgage payments." However their prediction, which is only slightly higher than last year, is based on minimal rate rises.

Bailey warns: “Rates much higher than 1 per cent will be very problematic for the UK housing market. Lots of owners are hanging on to properties because of very low debt costs. When rates climb back to 2.5 per cent and above, repossessions could rise steeply because with many mortgages, rates will suddenly convert to 5 per cent or 6 per cent.”