

First-time buyers told to be wary as house prices ‘could fall 20 per cent’

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Borrowers with small deposits could still fall into negative equity

First-time buyers are being urged to be cautious about deals that allow them to buy property with a deposit of as little as 5 per cent because any significant fall in house prices could push them into negative equity.

Last week four local authorities launched a scheme with Lloyds TSB, allowing first-time buyers to get a mortgage at 95 per cent loan-to-value (LTV). Under the scheme the local authority will put forward 20 per cent of the property's value as a security, which will be held on deposit by the lender but which will also earn interest for the council. Another 11 councils are set to join the scheme and other mortgage lenders are considering similar deals. Several lenders already offer mortgages to borrowers with a 5 per cent deposit, some of which require a friend or relative to act as a guarantor.

But with continuing uncertainty about the economic outlook, some forecasters are predicting that house prices could fall by as much as 20 per cent from today's levels, leaving anyone who buys with a small deposit at risk of negative equity. Standard & Poor's, the ratings agency, estimates that 400,000 borrowers are trapped in mortgages

that are greater than the value of their homes, after house prices fell by nearly 20 per cent from their peak in 2007 to the bottom of the market in 2009.

Capital Economics, a research consultancy, is expecting a 10 per cent drop in prices this year and a further 10 per cent fall in 2012. Other economists also expect prices to fall, but by a lesser amount. Howard Archer, of IHS Global Insight, predicts that prices will drop by 10 per cent from 2010 levels by the middle of 2012, while Rightmove, the property website, is expecting prices to drop by 5 per cent this year.

The biggest lenders are less pessimistic, with Nationwide not expecting price falls on the scale of 2008. Halifax forecasts that house prices will dip 2 per cent this year but recover in 2012.

Being in negative equity can be a problem for borrowers looking to move home because their lender may not allow it. It will also prevent borrowers from being able to remortgage with another lender, which can leave them trapped on a high rate. Melanie Bien, of the mortgage broker Private Finance, says: "Drumming up a sizeable deposit is a big challenge for first-time buyers. Many can scrape together a maximum of 5 per cent of the purchase price, but the danger of such a modest deposit is that even minor house price falls would mean you would find yourself in negative equity. While this is nothing to panic about, it does mean you will struggle to remortgage at the end of your mortgage deal. If you cannot remortgage, you will revert to your lender's standard variable rate, which is likely to move higher as interest rates start rising. Negative equity is also an issue if you need to sell your home, as the outstanding mortgage is greater than the value of your property and you will have to make up the shortfall."

While borrowers may intend to stay in their homes for the long term — in which case negative equity may not be a problem — many find that a change in circumstances, such as splitting up with a partner or having to relocate for work, means that they need to move earlier than anticipated. Figures released last week revealed that UK unemployment hit a 17-year high in the final quarter of last year, rising to 2.53 million, meaning that many could find themselves having to move to find work.

Another particular risk is borrowing at a high LTV on new-build properties, which suffered particularly badly in the property crash. Many people who bought new-build properties in the boom have seen sharper than average falls in the value of their homes. The Lloyds scheme, Local Lend a Hand, will not apply to new-builds, on which the lender requires a 20 per cent deposit, but Ms Bien says: "Many of these 95 per cent LTV schemes apply to new-build properties, which typically lose their value faster than older homes. So borrowers need to be cautious and save up as big a deposit as possible to safeguard their equity position."

Taylor Wimpey, the housebuilder, is offering a scheme called the Take5 deal through Melton Mowbray and Saffron building societies, which allows borrowers to buy new-build properties from the company with a deposit of only 5 per cent, but it is available only on houses and not flats. The scheme is currently limited to Taylor Wimpey developments in East London, East Anglia and the East Midlands, and the mortgages range from 5.49 to 5.99 per cent for a two-year fixed rate. The mortgage lenders are able to offer the product because Taylor Wimpey pays for an insurance policy that covers the risk of the borrower defaulting. But there is a risk that borrowers could struggle to

remortgage in two years' time, when their fixed rates come to an end, if their property falls in value and they are in negative equity.

Aaron Strutt, of the mortgage broker Trinity Financial, says: "If you are buying in an area where house prices have fluctuated and the property is a new-build, then there is an increased chance of being in negative equity if you put down a very small deposit. There is an extra risk in certain parts of the country and it can often be hard to put an accurate market value on some new properties."

The Japanese conglomerate Hitachi Capital recently teamed up with a number of housebuilders, including Barratt Homes, to offer a deal by which parents could take out an unsecured loan to help to fund their children's deposits. Hitachi has set up a £1 billion fund for the loans, which must be paid back within 12 years at a fixed rate of 5.4 per cent, with no early repayment charges. Parents can borrow up to £50,000, which is added to the deposit to lower the LTV of the mortgage, although the buyer must have a deposit of 5 per cent under the scheme.

Bellway Homes also offers a deal for buyers who have only a 5 per cent deposit, called the Sharp Start Scheme. The borrower takes out an 80 per cent LTV mortgage arranged through a specified broker and the housebuilder lends the borrower the remaining 15 per cent, secured by a legal charge on the property. The loan is interest-free for five years, after which interest is charged at 1.75 per cent in year six and then Retail Prices Index inflation plus 1 per cent every year thereafter.

Yorkshire and Clydesdale banks, which are part of the same group, offer a 95 per cent LTV three-year fixed rate at 6.99 per cent with a £599 fee, which is available on new-build properties. Nottingham Building Society offers a 95 per cent LTV three-year fixed rate at 6.39 per cent with a £195 fee, available on new-build houses but not flats. Skipton Building Society has a 95 per cent LTV two-year fixed rate at 6.49 per cent with a £195 fee exclusively through the estate agency Connells, which is owned by the building society. It does not offer the product on new builds.

Colin Dale, the head of residential lending at Skipton, says: "We didn't think it appropriate to make it available for new-builds, which do, in current market conditions, represent a greater risk — particularly at higher LTVs — partly because there is no track record on comparable values and resales to fall back on in underwriting loans." Mr Dale says that Skipton is a prudent lender and rigorously assesses the affordability of home loans.

Lloyds says that applicants are assessed by its usual criteria. In line with its own house price forecast and the repayments that borrowers will be making, it expects them to be at 90 per cent LTV or less by the time their three-year fixed rates end. Yorkshire and Clydesdale banks say that their mortgages are based on individual valuations and buyers should look at their home as a long-term investment. Nottingham BS says it assesses every individual application and property very carefully and its 95 per cent LTV mortgage is available only face-to-face in branches.

Saffron Building Society echoes Halifax's house price outlook and says that its decision to lend on new-build homes but not flats reflects the greater volatility in the latter. It says that it assesses mortgage affordability carefully, but that its role is to support home ownership in the community.

Taylor Wimpey says that the building societies it uses are committed to responsible lending and that it directs buyers to take independent advice on its scheme.

Case study

Apartment value falls 23 per cent

Adam Fearnley, 30, an accountant, bought a new-build apartment in Leeds in 2006 near the peak of the market. He says: “As house prices were moving up I thought it seemed like the right time to buy and so I took the opportunity to get on the property ladder. At the time it seemed like everyone was saying you could not lose money on bricks and mortar, especially in a city centre.”

Mr Fearnley bought his one-bedroom apartment for £137,000 and took out a three-year fixed-rate mortgage. His deposit was less than 10 per cent. But the value of his flat has crashed and a recent surveyor’s estimate said that it could now be worth as little as £105,000 – 23 per cent less than he paid. This has put him into negative equity on his mortgage, which has reverted to a variable rate.

He says: “As soon as interest rates start rising I will have to prepare for a payment shock as I will not be able to remortgage until I get out of negative equity, so I will be stuck on a variable rate. Before you know it a mortgage can become a noose around your neck if house prices are falling and interest rates rising. I hope it will sort itself out when the value of my property recovers.” He says that with hindsight he would not have rushed into buying.

Coping with negative equity

- Negative equity may not be a problem unless you are looking to move or you are stuck on a high variable rate and are unable to remortgage.
- If you need to move house, some lenders, such as Halifax, Lloyds TSB and Nationwide Building Society, have schemes to allow existing borrowers who are in negative equity to port their mortgage to a new home.
- If you are on a low variable rate and can afford to make overpayments on your mortgage, this could improve your situation.
- Prepare for a rise in interest rates and work out how much your costs will increase.
- Speak to your lender as early as possible if you are worried about repayments and visit direct.gov.uk.