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Struggling borrowers switch to interest-only



Estate agents boards in London Anthony Devlin/PA

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Last updated May 31 2011 1:59PM

Up to 300,000 struggling home owners switched their mortgages to interest-only in order to cut their monthly costs, figures from the City regulator have revealed.

Financial Services Authority (FSA) data has shown that since the financial crisis began in the third quarter of 2007, borrowers have switched more than £60 billion of mortgage debts from capital repayment loans to deals where they only pay back the interest. The FSA said much of this movement was down to lenders offering more flexible arrangements to borrowers who found themselves in financial difficulty. Payments on interest-only loans are lower than for equivalent repayment mortgages. Without the option of switching to interest-only payments some of these borrowers may have struggled to make repayments and could ultimately have been repossessed.

The regulator wants to clamp down on interest-only lending as part of its wide-reaching Mortgage Market Review, as it believes there is a risk of many borrowers taking out this type of home loan without any plan for how they will ultimately repay their debts. However, reflecting the usefulness of the loans in times of crisis, the FSA still wants lenders to show “forbearance” and offer interest-only as an option for borrowers who have difficulty making their monthly payments.

Many mortgage lenders have already introduced much tougher criteria on interest-only, in anticipation of a more stringent regulatory stance. Before granting an interest-only mortgage, Lloyds Banking Group now requires proof that a borrower has a suitable repayment method in place, such as an endowment or other investment and a statement showing projected returns. Most mortgage lenders now restrict interest-only mortgages to borrowers who have a deposit of at least 25 per cent.

Aaron Strutt, of Trinity Financial, the mortgage brokers, said: “Interest-only is an important option, particularly when borrowers need a payment break, but they should keep an eye on their situation and make sure that they think about how they will repay the mortgage in the long term.”