FRONT COVER

UK FINANCE

INTEREST-ONLY MORTGAGES

Act now and talk to your lender

ABOUT UK FINANCE

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms across the industry we help drive forward positive change to enhance standards, support customers and promote innovation.

We work for and on behalf of our members to promote a safe, transparent and innovative banking and finance industry. We offer research, policy expertise, thought leadership and advocacy in support of our work.

We provide a single voice for a diverse and competitive industry. Our operational activity enhances members' own services in situations where collective industry action adds value.

WHAT IS AN INTEREST-ONLY MORTGAGE?

With an interest-only mortgage, the monthly mortgage payments only cover the cost of interest on the amount borrowed, and do not cover repaying the full mortgage amount borrowed. This means that at the end of the mortgage term, the amount borrowed (the capital) needs to be repaid in full.

Interest-only mortgages have lower monthly payments than equivalent capital-and-interest mortgages, as only the interest is being repaid and not the capital amount borrowed. Many customers initially started out on interest-only terms and converted to a repayment mortgage later, to ensure the entire balance would be paid off by the end of the term.

If you have an interest-only mortgage, there are a range of solutions and advice available on how to ensure you have or can create a suitable plan to repay it. By talking to your lender about your situation early on, you will find you have the most options.

WHAT OPTIONS ARE AVAILBLE?

Below is a non-exhaustive list of the potential options which can help make paying off your interest only mortgage more manageable.

Switching to a full repayment mortgage (or a part-repayment and part interest only mortgage):

You might be able to afford to move to a capital and interest mortgage where you pay of the mortgage gradually in each monthly repayment. This way, there is no amount left to repay once the mortgage term ends.

Making larger monthly payments (overpayments):

If you can afford to make optional larger monthly payments, this can reduce the amount you owe and also reduce the amount of interest that you'll repay over the mortgage term. These can be through regular overpayments or lump sum payments. This is often a simple solution which requires no contract change, so speak to your lender to see what overpayments options they offer.

Switching to a lower interest rate:

You may be able to switch to a lower interest rate. For example, if you are on your lender's standard variable rate, contact them to see if they have any other mortgage options for you which may be able to lower your monthly repayments. Any savings you make could be used to overpay your interest-only mortgage. The above options may not be workable for every customer, as their feasibility will depend on the circumstances of the individual.

However, new mortgage products may be available to you which allow you to remain in your home indefinitely, even if you are not able to afford to own the property outright.

Retirement interest only mortgages:

This is a new type of loan, available since 2018, where the you would agree to continue paying monthly interest until either you pass away or go into long-term care. After one of these events occurs, the property is sold, and the lump sum is paid to the lender from the sale proceeds. Not all lenders offer retirement interest-only mortgages and if you are joint borrowers, both borrowers will need to be able to afford the mortgage on their own separate retirement incomes. If your mortgage lender does not offer this type of mortgage, a broker should be able to identify whether you are eligible for a retirement interest-only mortgage and suggest lenders which could offer you one.

Lifetime mortgages (also known as equity release):

If you hold enough equity in your property and meet a minimum age threshold, you might be eligible for a lifetime mortgage. With this mortgage, you typically do not need to make any monthly payments. Instead, the interest builds up (compounds) over the course of the loan and the balance of the loan is paid from the proceeds of sale after you pass away or are transferred into long-term care. Although not all lenders can directly offer this type of product, a mortgage broker or independent financial advisor may be able to assist in navigating this market.

We understand that major financial decisions can be difficult. This is why we have included two case studies which show real-life examples of interest-only customers who found solutions which work for them.

CASE STUDIES

Referral to a Lifetime mortgage

An interest-only mortgage customer's term was coming to an end. After some time, the lender managed to reach the customer and found that he had been avoiding the lender's letters and calls, our of fear that his home would be taken from him. According to the borrower, he had no way of repaying the mortgage.

The lender informed the customer that they had a relationship with a leading lifetime mortgage broker. The customer was passed through on a 'live' transfer. The customer was told he could obtain a "Service Lifetime" Mortgage through the broker, but a shortfall was found in the amount lent and the outstanding mortgage balance. Following a further discussion with the customer, a plan was agreed for the customer to repay the lender a higher monthly payment for seven months to make up the shortfall. After that, the lifetime mortgage would complete.

The account was tracked monthly, and the lifetime mortgage was completed as agreed. The customer able to stay in his property and was very happy with the outcome.

Switching to a repayment mortgage

Twelve years before her mortgage term expired, a customer with an £80,000 interest-only mortgage started to recognise that she would not have a repayment plan in place, such as an endowment or an investment, to cover the lump sum payment. She contacted her lender, who carried out an assessment of income and expenditure and asked about her retirement plans.

The customer knew she would be aged 50 at the time her lump sum payment was due, and was able to afford to extend the term of her mortgage so that it would end at age 67, when she planned to retire. By taking this option, she was able to make capital payments every month and meaning that she would not need to find a lump sum to repay her mortgage when it ended.

This gave her peace of mind that the mortgage would be repaid in full when she retired.

CASE STUDY

Agreeing a plan to make higher payments

With no plans in place to repay their interest-only mortgage, Mr. and Mrs. X contacted their lenders' interest only specialists to discuss their circumstances.

Mrs. X said that although they regularly pay their interest-only mortgage payments each month, they were worried about what would happen when their mortgage came to an end. They had no way of repaying their total remaining mortgage amount, and they felt that their income was too low to increase their monthly repayments.

After two one-hour discussions over the phone about their circumstances and current budget, their lender recommended a solution for them:

- Their mortgage was changed from interest-only to repayment, so every payment they made would reduce the amount they owed.
- They were transferred to a new lower mortgage rate which was fixed for a two-year period, which provided stability in their payments.
- They increased the term of their mortgage so it could be more affordable.

After making these alterations, the customer was able to get the reassurance that their mortgage would be paid off if they continued to follow the plan.

WHAT IS THE MAIN MESSAGE?

We hope this has helped inform you of the potential solutions available to you. However, in order to come to the best solution, it's critical that you talk to your lender about your circumstances as early as possible.

WHERE TO GO FOR MORE HELP

You can contact the following organisations for free, confidential and impartial advice, and on where to get this advice in your area.

Money Advice Service

For free, unbiased and easy-to-access money tools, information and advice, visit www.moneyadviceservice.org.uk or phone 0800 138 7777 to speak to a Money Adviser. Money Advice Scotland – If you live in Scotland, phone 0141 572 0237 or visit www.moneyadvicescotland.org.uk to find contact details for debt advice in your local area

Citizens Advice

For advice and information on debt and other topics, visit www.citizensadvice.org.uk or phone 03454 04 05 06

Stepchange

For free, and impartial mortgage advice visit www.stepchange.org/mortgageadvice or phone 0800 027 4536 to speak to an advisor

AdviceUK

Member centres offer specialist advice for minority communities and people with disabilities – www.adviceuk.org.uk or phone 0300 777 0107

Other useful organisations

Civil Legal Advice

You may get legal aid if your home is at risk. Check at www.gov.uk/civil-legal-advice or phone 0345 345 4345

Financial Ombudsman Service

If you have a complaint that you can't resolve with your lender or mortgage adviser, the Financial Ombudsman Service may be able to help. Phone 0300 123 9123 or 0800 023 4567 or visit www.financial-ombudsman.org.uk