

# Residential Mortgage – Repayment Ability Check

## You can afford your mortgage now, but what if...?

(Source: consumer information from Financial Services Authority's website)

Taking out a mortgage is one of the biggest financial commitments you can make, both in term of amount you borrow, and the time you may take to repay it.

### Are you sure you can afford it?

You may be able to afford the repayments now, but if you borrow a large amount over a long period of time think what could happen if, for example, your income falls or you lose your job. Or what if interest rates rise and your monthly repayments go up?

### How could your income fall?

Your income could fall if:

- you lost your job, or had to take a drop in income;
- you or your partner stopped work to have a child or to look after a dependant; or
- you became ill and couldn't work.

### Could you keep up your mortgage payment if your income falls?

### How could your mortgage payments go up?

- Your mortgage payments to your lender could go up (or down) if interest rates change. Mortgage interest rates are related to the interest rate set by the Bank of England and your lender will usually apply some or all of any change to your mortgage.
- Unless your mortgage rate is fixed for the full term of your mortgage, this will affect you.
- Often, special rates are for a set period only, so when this comes to

an end your payment will change – it could be much higher.

Although interest rates have been stable over past few years, this could change. In the past, interest rates have risen from 7.5% to 15% in just a few years. Interest rate rises could increase your monthly payments considerably, making it difficult for you to afford them.

The following examples show how different interest rates can affect your payments.

### Example 1: repayment mortgage

You borrow £100,000 over 25 years on a repayment, initially at a rate of 4%:

Interest rate	Monthly repayment	Increase from 4%
4%	£528	-
6%	£644	+£116
8%	£772	+£244
10%	£909	+£381

Interest calculated monthly

### Example 2: Interest-only mortgage

You borrow £100,000 over 25 years on a repayment, initially at a rate of 4%:

Interest rate	Monthly repayment	Increase from 4%
4%	£333	-
6%	£500	+£167
8%	£667	+£334
10%	£833	+£500

Interest calculated monthly

Don't forget that rates could be higher than those shown here.

With an interest-only mortgage you only pay the interest on your loan – but you will also need to have a way of paying off the loan at the end of the term

(borrowing period). This will usually mean having a savings plan or investment to build a lump sum to pay off the mortgage.

Could you afford your mortgage if interest rates went up significantly?

### **What can you do now to help protect yourself against the risks of changes in your circumstances and interest rate rises?**

- Plan your budget based on what you might have to pay in future as well as the initial cost – don't forget to include all your household expenses, such as buildings and contents insurance premiums and council tax.
- Try not to take the maximum mortgage on offer – just because you can afford it now, doesn't mean you can afford it in the future.
- Think about whether you need a fixed rate so that you know your mortgage payment will stay the same for a given period – but don't forget that if rates fall, your payment won't.
- Build up your savings so that in an emergency (for example, if you lose your job) you can still afford to pay your mortgage and bills for a short time.
- Work out how long you could live on your savings if you lost your job.
- Check what benefits your employer will provide if you became ill.
- **Insurance** – various products can insure you in the event of redundancy, critical illness, or accident. You should consider these but make sure they meet your needs; there are restrictions on when and how much they will pay out. Make sure you understand the limitations of any policy and how it protects you.

For information on all types of insurance, see the Association of British Insurers (ABI) Information Zone at [www.abi.org.uk](http://www.abi.org.uk).

### **If you do get into difficulties**

Talk to your lender if you cannot meet your mortgage payments – they will have a set procedure for dealing with your case.

**State benefits** – may be available but may cover you only after an initial waiting period; for example:

- you won't qualify if you have a joint mortgage and only one of you loses your income;
- you won't qualify if you have savings of more than £8,000;
- you may only qualify for help nine months after you become unemployed (unless you took your mortgage out before October 1995);
- payments will only cover the 'interest' part of the mortgage; and
- there is a limit on the amount of mortgage that qualifies.

A mortgage is a long-term loan secured on your home. 'Secured' means that, if you don't keep up the loan repayments, the lender can repossess your home and sell it to get their money back.

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