Dealing with your mortgage shortfall

The **Money Advice Service** is here to help you manage your money better. We provide clear, unbiased advice to help you make informed choices.

We try to ensure that the information and advice in this guide is correct at time of print. For up-to-date information and money advice please visit our website – moneyadviceservice.org.uk.

About this guide

This guide is for you if you are using an investment, savings or personal pension to pay off your interest-only mortgage.

When you read it you will know:

- why you need to regularly review your investment, savings or personal pension, and
- what to do if you think it won't pay out enough to pay off your mortgage.

Contents

How interest-only mortgages work

With an interest-only mortgage, your monthly payments pay only the interest charges but not the mortgage itself (which is the amount you borrowed – the capital). You have to make arrangements to pay off the mortgage at the end of the term.

You may have decided to pay off the mortgage by putting money in an investment or savings plan such as an endowment policy, a cash or investment Individual Savings Account (ISA), or you may have decided to use money from the lump sum part of a personal pension.

The investment, savings or pension plan will need to grow to give you enough money to pay off the mortgage at the end of the term. If it doesn't, you'll be left owing money. This is known as a **shortfall.**

If you think you may have a shortfall, act now to ensure you can repay your mortgage – see page 4. By delaying, you will pay more in the long run to make up the shortfall.

If you don't think you can avoid a shortfall, you may still have some options – see page 10.

If you haven't already made arrangements, talk to your lender or a professional financial adviser now. The sooner you act the more likely it will be that you can arrange a way to repay your mortgage. Some of the options in the guide will still be relevant for you – see page 4.

See the *Jargon buster* on page 14 for an explanation of some words you may come across.

Key points

- Talk to your lender or professional financial adviser if you haven't already arranged how you will pay off your loan.
- Act now if you think you have a shortfall – see page 4.

Are you on track to pay off your mortgage?

Endowment policy

If you are using an endowment policy to pay off your mortgage you should have received regular letters telling you whether your policy is on track to repay it. These are called 'reprojection letters'. They will be marked 'red' if there is a high risk the policy is not on track, 'amber' if there is a significant risk it's not on track, and 'green' if it's currently on track to repay your mortgage.

Endowment policies are linked to investments such as bonds and shares, which can vary in value. So you need to check each reprojection letter, even if the policy has so far been on track.

ISA or personal pension

If you are using an ISA or personal pension to pay off your loan, you will probably need to ask your product provider to give you an up-to-date projection of the value of your plan.

If you are relying on your personal pension, remember that you can only take part of your fund in cash to help you pay off your mortgage (up to 25% under current tax law, which may change in the future). And you can normally only take it when you are 55 or over.

What to do if you're not sure

Contact your provider if you're not sure where you stand on any of your investment, savings or pension plans. You will need to continue checking the value until you repay your mortgage.

Take care if you want to cash in or stop paying into your plan, as you could lose out financially. Check with a professional financial adviser if it's right for you.

Key points

- Check your plan regularly to make sure it's on target.
- Never just cash in or stop paying into your plan without getting professional financial advice – you could lose out financially.

Making up a shortfall

If you need to make up a shortfall, there are different ways you can try – some offer more certainty than others.

For example, you can:

- make changes to your mortgage
- start an extra investment or savings plan – see page 7, and/or
- make changes to your existing plan – see page 8.

We explain these options here and have used the following symbols to help you:

✔ An advantage of this option

? Check this out before you decide

✖ Take care – there is a drawback to this option

Think about the pros and cons of each option, and if you're not sure which one is right for you, get professional financial advice – see *Useful contacts* on page 16.

Act now. Delay will cost you more in the long run as you may have to make higher payments to a new mortgage or investment plan over the same term, or have to make the same payments for longer. The longer you delay, the higher the cost of making up the shortfall.

Make changes to your mortgage

1. Ask your lender to switch the projected shortfall to a repayment method.

✔ Your current projected shortfall will be paid off by the end of the term as long as you keep up the payments.

✔ It should be fairly cheap and simple to arrange.

✔ If the projected shortfall grows, you can switch more of your loan to a repayment method.

✖ The repayment method will cost you more each month, as you are paying back both the interest and the capital.

The figures mentioned in the example here and on page 10 are for illustration only.

Example

Helen is 48 and has an interest-only mortgage of £50,000 linked to an investment. The mortgage has seven years left to run and the interest rate is 5.95%.

She asked her investment provider to give her an up-to-date projection, and this told her that her investment may only pay £40,000, a shortfall of £10,000.

Helen wanted to change £10,000 of her mortgage to a repayment method, which means her payments will increase from £247.92 to £344.18 a month.

The repayment method will now repay the £10,000 shortfall. When her interest-only mortgage of £40,000 ends, she will pay it off if the investment pays out the projected £40,000.

If Helen could not afford the £344.18 a month, she could have asked her lender if it was possible to extend the term of the £10,000 repayment mortgage. Although this would mean that she would pay less each month, she would have to pay more in total.

2. Ask your lender to switch your whole mortgage to a repayment method.

- ✔ Your mortgage will be paid off at the end of the term as long as you keep up the payments.
- ✔ The longer your mortgage has to run, the smaller the increase in your monthly repayments will be.
- ? If you can afford it, and if your plan is doing well, you could continue with it just for saving. Some investment products include useful insurance cover.
- ✖ If you cash in your investment you could lose out financially, and you may need to arrange other insurance cover. Get professional financial advice first if you're unsure.
- ✖ The repayment method will cost you more each month, as you are paying back both the interest and the capital.

If you want to switch your whole mortgage to a repayment method but are worried that you might not be able to afford higher payments, talk to your lender.

The increase in payments may not be as much as you think, and your lender may be able to come up with a plan that can help you.

For example, a repayment mortgage of £50,000 and an interest rate of 6.29% with 15 years to run will cost you £429.80 a month.

You may also be able to extend the term of your repayment mortgage – a mortgage of £50,000 with 20 years to run and an interest rate of 6.29% would be £366.63 a month.

This would limit the increase in the monthly payments, though it does mean that you would pay back more in total over the mortgage term.

Extending the term into your retirement is not a good idea, unless you're sure you can afford it.

3. Repay part of your mortgage early by paying off a lump sum or by overpaying each month.

✔ This will reduce what you owe and what you need your investment, savings or pension plan to cover.

✔ It may end up being cheaper than saving separately to pay off the shortfall in the future.

? Check with your lender how much extra you can repay without paying an early-repayment charge.

? Check when your lender will give you the benefit from extra payments – some do so only once a year.

Making these changes to your mortgage is probably the lowest-risk way of making up a shortfall. Remember to check for any charges.

4. Extend the term of your interest-only mortgage and investment or savings plan. See *Make changes to your existing plan* on page 8.

Start an extra investment or savings plan

1. Use a cash savings account or a cash ISA.

✔ The amount you get back does not depend on the performance of the stockmarket.

✔ It may be a good option for the short term – for example if you have to delay paying off a lump sum from your mortgage because of early-repayment charges, or your mortgage is near the end of its term.

✔ Taxpayers can avoid paying tax on their interest by saving in a cash ISA. From 6 April 2011 the amount you can pay in one tax year is £5,340 (up from £5,100). This limit will go up each tax year in line with inflation.

✖ Cash products may not grow sufficiently over the longer term to meet the shortfall.

In the longer term, other options (such as overpaying your mortgage payments) are likely to be better value for money.

2. Use an investment (stocks and shares) ISA.

✔ This is potentially a good way of saving over the longer term. Historically, stocks and shares have grown more than cash savings accounts which have interest added. From 6 April 2011 the amount you can pay in one tax year is £10,680 (up from £10,200). This limit will go up each tax year in line with inflation.

✖ This product is linked to the stockmarket, and the value of your investment could go down as well as up. So there's no guarantee your investment will grow enough to make up your shortfall.

✖ This product is meant for investing over the long term, and may not be suitable if you only have a short time to build up a lump sum.

If you decide to start an investment or savings plan to make up a shortfall, it's a good idea to get professional financial advice.

Make changes to your existing plan

1. Extend the term of your plan.

? You may be able to rearrange your plan over a longer term. You will first need to ask your provider if this is possible. If so, ask your lender to extend the mortgage term to match.

✔ This means you could make more payments into your policy if you can't afford to increase how much you pay each month.

? You may face extra charges and a tax liability if you vary an endowment policy, so it's a good idea to get professional advice first.

✖ The growth of your investment plan is still linked to the stockmarket, so there's no guarantee it will reach its target amount.

✖ This is not a good idea if it means taking your mortgage into retirement, unless you're sure you can afford it.

✖ The longer the mortgage term, the more interest you'll end up paying in total.

2. Top up your plan by paying in more each month.

? You should ask your product provider if you can do this and, if so, whether there are any charges.

? You may also face tax liabilities, so you may want to get professional advice first.

✖ Your plan is still linked to the stockmarket, so there's no guarantee you'll reach your target amount.

✖ You could be worse off than if you used the same monthly payments to reduce your mortgage.

✖ Under a personal pension, you can only take part of your increased savings in cash. Normally you can't take anything before you are 55.

If you want to make changes to your plan you should talk to your product provider or professional financial adviser.

Key points

- There are pros and cons for each option – you must decide which one is right for you.
- Talk to a professional financial adviser if you are thinking of cashing in or stopping any financial plan – otherwise you could lose out financially.
- Act now. The longer you delay, the higher the cost of making up the shortfall.

Take our online **health check**. Answer some straightforward questions and get your personal action plan to help you with your money must-do's and longer-term goals.

moneyadviceservice.org.uk/healthcheck

Your questions answered

Question:

What can I do if the mortgage term is ending soon and I can't avoid a shortfall?

Answer:

When your investment pays out at the end of the term, pay all the money into your mortgage to find out exactly how much you still owe the lender. Then talk to your lender as soon as possible.

You may have several options.

- You could pay the shortfall from savings you have elsewhere.
- You could discuss a new repayment period. The quickest way may be to carry on with your previous monthly payment, although you may be able to agree lower payments over a longer time. Extending the term into your retirement is not a good idea unless you're sure you can afford it.
- You could sell your property to repay the mortgage, and buy a cheaper property so you don't need a mortgage.

In general, provided you keep up the new agreed mortgage payments, you should not lose your home as a result of the shortfall.

Example

Joe has come to the end of his mortgage term and is left owing his mortgage lender £8,000.

The interest rate on his mortgage is 5.95%. Joe could carry on with his current monthly payment of £154.48. This would repay the remaining capital and interest in five years, and would cost £9,268 in total, but this is more than Joe wants to pay every month.

Joe will retire in seven years, so he has agreed with his lender that he will repay the £8,000 over seven years and his monthly payment will be £116.68, which will cost him £9,801 in total.

Question:

I'm about to retire and my payment plan isn't going to be enough to pay off my mortgage. What can I do?

Answer:

Pay off what you can, then talk to your lender. Often once you reach retirement it's harder to keep up the repayments as your income is usually much lower.

You could sell your property to repay the mortgage and buy a cheaper property so you don't need a mortgage.

Alternatively, you could consider a home reversion plan or lifetime mortgage. These are both types of equity release schemes, either where you:

- sell all or part of your home in return for a cash lump sum, an additional income or a combination of both, and continue to live in your home for as long as you wish, or
- secure a loan on your home, which is repaid by selling your home when you die or go into long-term care.

Equity release schemes are complex as there are risks as well as benefits, so consider getting professional financial advice – see *Useful contacts*. For example they can be expensive and inflexible if your circumstances change in the future, and they may affect your current or future entitlement to state benefits.

For more on equity release schemes go to our website at moneyadviceservice.org.uk/equityrelease.

Question:

I want to complain about my mortgage endowment policy. What should I do?

Answer:

If you think you have grounds for complaint about how you were sold your endowment policy but haven't yet made a complaint, do it now – time may be running out. Get information on endowment mortgage complaints on our website at moneyadviceservice.org.uk/emc. But remember, having a potential shortfall doesn't always mean you were mis-sold your endowment policy.

If you do get compensation from making a complaint about the way you were sold your endowment policy, you should consider using it to reduce the amount you owe on your mortgage.

Next steps

Step 1	Think about how you will pay off your mortgage at the end of its term. If you haven't already arranged a way to repay it, talk to your lender or a financial adviser as soon as possible.
Step 2	Regularly review any savings, investment or pension plans you have to see if they are on track to repay your mortgage.
Step 3	If you think you may have a shortfall, act now. The longer you delay, the higher the cost of making up the shortfall.
Step 4	If you can't avoid a shortfall, talk to your lender. There are several options that may be open to you.

Remember, a mortgage is a loan secured on your home. This means the lender can sell your home to get its money back if you cannot repay the loan.

If things go wrong

Complaints and compensation

If something goes wrong, contact your professional financial adviser or lender to put it right. They are regulated by the Financial Services Authority (FSA) – the UK's financial services regulator. This means they must follow a set of procedures when dealing with complaints.

If you're not satisfied with their response, you may be able to take the matter to the Financial Ombudsman Service. The adviser or lender will give you details. See also our **Making a complaint** guide – see *Useful contacts* on page 16.

If the adviser or lender has stopped trading and can't (or is likely to be unable to) pay claims against it, the Financial Services Compensation Scheme may be able to help – see *Useful contacts*. Both services are free to consumers.

You won't lose your home simply because a lender stops trading, but you must continue to pay your mortgage.

Mortgage difficulties

If you can't pay your mortgage, talk to your lender – they have a set procedure for dealing with this.

For more information read our **Problems paying your mortgage guide** – see *Useful contacts.* You may be able to get state benefits – but sometimes only after an initial waiting period.

For more information contact your local Jobcentre Plus (details will be in the Phone Book).

Jargon buster

Some key words and phrases explained.

Annual statement

A statement your mortgage lender sends you each year showing, among other things, what you've paid and what you still owe.

Capital (loans and mortgages)

The amount you borrow.

Early-repayment charge

A charge you may have to pay if you pay back a mortgage early (including if you move to another lender).

Endowment policy

An investment plan that you usually pay into each month, which pays a lump sum when it matures.

Home reversion

A type of equity release scheme – you sell all or part of your home to a scheme provider in return for regular income or a cash lump sum or both, and continue to live in your home for as long as you wish.

Individual Savings Account (ISA)

A tax-efficient way of saving or investing, with limits on how much you can pay in each tax year.

Interest (on loans and mortgages)

The charge that lenders make when you borrow their money.

Interest-only mortgage

A mortgage where you pay only the interest charges of the loan each month. You are not reducing the loan amount (the capital), and you must repay this in some other way at the end of the term.

Lifetime mortgage

A type of equity release scheme – a loan secured on your home, which is repaid by selling your home when you die or go into long-term care.

Mortgage

A loan secured on your property. If you don't keep up the mortgage repayments, your home may be repossessed.

Mortgage lender

The company you take out your mortgage with.

Pension-linked mortgage

An interest-only mortgage linked to a personal pension. You use the tax-free cash from your personal pension when you retire to pay off the capital you owe on your home.

Product provider

The company you take out an investment or savings plan with.

Repayment mortgage

A mortgage where you pay off the loan amount (capital) and interest at the same time.

Reprojection letters

Regular letters you should receive if you have an endowment policy. They tell you whether or not your policy is on track to repay your mortgage.

Shortfall

The money left owing at the end of the mortgage period (the term).

Tax year

6 April one year till 5 April the following year.

Term

The length of your mortgage, normally stated in years.

Useful contacts

Money Advice Service

For advice based on your own circumstances or to order other guides

Money Advice Line: 0300 500 5000
Typetalk: 1800 1 0300 500 5000

Calls should cost no more than 01 or 02 UK-wide calls, and are included in inclusive mobile and landline minutes. To help us maintain and improve our service, we may record or monitor calls.

Other Money Advice Service guides

- Getting financial advice
- Making a complaint
- Problems paying your mortgage
- Your bank account

For more titles, call us or go to **moneyadviceservice.org.uk/publications**

On our Money Advice Service website you can find:

- a **mortgage calculator** to help you find out how much your monthly mortgage repayments are likely to be
- a **budget planner** to help you work out your spending
- **comparison tables** to compare mortgages and savings accounts, and
- a **health check** to help you build up some good financial habits and reach your goals.

Go to **moneyadviceservice.org.uk/interactive**

Call rates to the following organisations may vary – check with your telephone provider.

Financial Services Authority (FSA)
To check the FSA Register, or to report misleading financial adverts or other promotions.

0845 606 1234
Minicom/textphone: 0845 730 0104
www.fsa.gov.uk

Debt advice agencies

Consumer Credit Counselling Service (CCCS)
Main helpline –
0800 138 1111

Mortgage arrears helpline –
0800 975 9558
www.cccs.co.uk

National Debtline
0808 808 4000
www.nationaldebtline.co.uk

Payplan
0800 716 239
www.payplan.com

Finding financial advisers/planners

Unbiased.co.uk
For mortgage brokers or independent financial advisers in your area.

www.unbiased.co.uk

Personal Finance Society
For financial advisers in your area.

www.findanadviser.org

Institute of Financial Planning
For help in planning your finances.

www.financialplanning.org.uk

MyLocalAdviser
For financial advisers in your area.

www.mylocaladviser.co.uk

Ethical Investment Research Service (EIRIS)
Information about product providers and other sources that provide ethical investments.

www.yourethicalmoney.org

Complaints and compensation

Financial Ombudsman Service
South Quay Plaza
183 Marsh Wall
London E14 9SR

0800 0 234 567 or 0300 123 9123
www.financial-ombudsman.org.uk

Financial Services Compensation Scheme (FSCS)
7th Floor Lloyds Chambers
Portsoken Street
London E1 8BN

0800 678 1100 or 020 7741 4100
www.fscs.org.uk

the Money Advice Service™

This guide is part of our buying a home series.

Other titles in this series include:

- You can afford your mortgage now, but what if...?
- Problems paying your mortgage
- Sale-and-rent-back schemes

All our guides are available from:

Our website
moneyadviceservice.org.uk

Money Advice Line
0300 500 5000

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Plain Language Commission Clear English Standard Winning Document