Local banking
for Britain

Getting Britain

#ReadyForRateRise

#ReadyForRateRise
December 2015

Foreword

Buying a home can be one of the biggest moments of a person's life. They've saved a deposit, hunted for the perfect pad, arranged all the legal, secured a mortgage and finally got the keys. It's a busy time, filled with lots of excitement and decisions, not least about what colour to paint the lounge.

But it can also be a daunting time. Taking out a mortgage for 25 years is a big commitment, never mind the increasingly common trend of a 40-year term. It can be scary thinking about the future; will my house keep its value, what will happen if I lose my job, what if I need to move quickly?

The Bank of England base rate hasn't budged from 0.5 per cent since early 2009, and since then more than two million Brits have become new homeowners. Bearing this in mind, TSB have produced this report to understand how prepared Britain's homeowners are for a rate rise, and what we can do to support them.

TSB's research shows that seven in 10 people will be affected by a rate rise, but a fifth of people have 'no idea' how it will affect them. Over half of Britain's homeowners say they are already struggling with their monthly bills, and a quarter say they'd have real difficulty paying their mortgage if their monthly repayment increased by £99.

The statistics are fairly shocking and clearly there's a lot of work to be done to get Britain #ReadyForRateRise. But there is no need to panic; a little bit of planning now can make a big difference in the future.

Over the next few pages we've included lots of hints and tips from our TSB Bank Managers across the country. It's their job to help the public understand their finances every day and plan for the future. There's also a handy top 10 tips at the end of the report, with practical steps to help homeowners take control today.

We don't know when the Bank of England will change the base rate, but we do know preparing early and helping homeowners understand their options is the first step in helping get Britain #ReadyForRateRise.

Ian Ramsden, *Director of Mortgages, TSB*

Getting Britain #ReadyForRateRise

For almost seven years, British homeowners have enjoyed rock-bottom interest rates on their mortgages, with millions of Brits never experiencing a rate increase before.

Normally, the underlying interest rate – the Bank of England base rate – changes from time-to-time in response to a range of different economic pressures but, for the past six and a half years, the base rate has been held at a record low of 0.5 per cent and hasn't budged.

Now, speculation about when the base rate will start to creep up is gathering pace on the high street, in the media and in homes up and down the country. But with such a long period of no change, how prepared are Britain's homeowners for a rate rise and what can they do to help alleviate any potential problems before it kicks in?

New research from TSB has found that seven in 10 (70%) homeowners are likely to see their mortgage payments rise when the base rate changes, with one in five (20%) having "no idea" how even a small change could have an impact on their monthly mortgage bills. That's worrying news for more than half of the home-owning population (56%) who are already struggling with household bills[1] and the two million people who have never experienced a rate rise before[2].

TSB has spoken to thousands of people across the length and breadth of Britain to understand their concerns and has uncovered some shocking evidence about how prepared consumers are for a rate rise. This report outlines these findings and offers practical advice to homeowners on how to be #ReadyForRateRise.

When could interest rates rise?

"I wish I had a pound for every time someone asked me this question. No-one really knows when the Bank of England base rate will change. Most economists agree the base rate will change, they just can't agree when this will happen. Reassuringly the Monetary Policy Committee, the group of people that decides the rate, has also stated that 'when the base rate does begin to rise, it is expected to do so more gradually and to a lower level than in recent cycles.' Although we don't know when the base rate will rise, it is best to be ready for a rate rise as soon as possible."

– Andrew Bryceland, Bank Manager, St. Vincent Street TSB, Glasgow

Source:

[1] TSB commissioned a Onepoll online survey conducted from *15th to 25th September 2015* of 2,000 UK adults who have a mortgage

[2] Bernard Clarke, *spokesman for Council of Mortgage Lenders*

What would a rate rise really mean?

Anyone who took out their first mortgage in the past few years could be forgiven for thinking that mortgage rates are always low, but the luxury of ultra low-cost borrowing hasn't always been the norm.

Those who have owned property for many years will remember the painfully high Bank of England base rate of 14.875 per cent that lasted for an entire year from October 1989. It meant many mortgages were costing borrowers 14.5 per cent interest a year or even higher. If Britain were living in those times today, the average interest charge on a £150,000 repayment mortgage could be in excess of £1,000 extra each month.

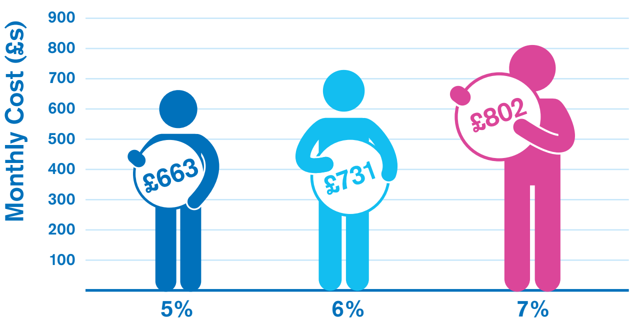
While no-one is suggesting that interest rates will jump into double figures any time soon, clearly the base rate won't stay at its historic low of 0.5 per cent forever and even a small rise could be keenly felt by many if it is passed on by a lender. TSB's research has found that many consumers have already had to tighten their belts in light of the last recession with precious little wriggle room when it comes to monthly budgets.

According to the latest figures, the typical outstanding residential mortgage is £113,439[3]. A homeowner paying the average lender Standard Variable Rate (SVR) of 4.48 per cent on this amount will pay £629 every month.

If mortgage interest rates increased to five per cent, the monthly cost of a loan would increase to £663 a month. At six per cent, that rises to £731 a month, and at seven per cent it's £802 a month. In other words, at seven per cent interest, homeowners could need to find an extra £324 every month just to maintain their current borrowing.

Homeowner on an SVR mortgage?

UK homeowners pay an average of £629 a month on a typical outstanding residential SVR mortgage of 4.48%.



But if the base rate increases, see how the monthly payments increase on an SVR mortgage rate rise of 5, 6 and 7%.

Such an increase is certainly possible, and the Governor of the Bank of England, Mark Carney suggests an interest rate two percentage points higher than it is today could become 'the new normal'.[4]

Should interest rates climb even further though, a 10 per cent rate on the average existing loan could mean a monthly bill of £1,031 – up to a staggering £553 more every month on mortgage costs alone.

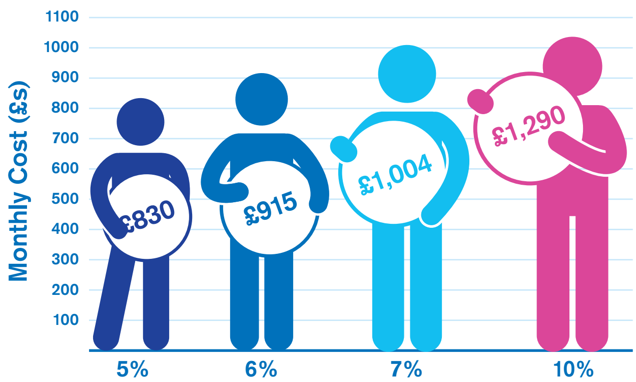
And that's just the people with a typical existing home loan. Meanwhile, the average mortgage for a first-time buyer is much higher, at £141,995[5]. For these new homeowners, the implications of a rate rise could be far greater.

On a two year fixed rate deal at 1.95 per cent, first time buyers are currently paying an average of £598 a month. After the two years has passed, their deal will revert to a typical SVR of 4.48 per cent meaning their average monthly mortgage payments will rise to £788.

At five per cent interest, the bill rises to £830, or £915 if it goes up to six per cent. By seven per cent it's £1,004 – more than £400 more expensive each and every month. If the cost of borrowing increases to 10 per cent, their bill could reach an eye watering £1,290. They would then have to find an additional £692 every month to simply tread water.

First time buyer changing from fixed to SVR mortgage?

First time buyers can benefit from low-rate borrowing on fixed deals, paying an average of £598 a month.



But when the fixed terms ends and the deal reverts to an SVR, see how the monthly payments increase on a mortgage rate rise of 5, 6, 7 and 10%.

Source:

[3] Council of Mortgage Lenders – *average existing residential mortgage (stock) in Q2 2015*

[4] http://www.bbc.co.uk/news/business-28053045

[5] Council of Mortgage Lenders – *average new residential mortgage in Q2 2015*

A sudden shock, but that's not all.

In recent years, as borrowers have increasingly sought the certainty and security of a predictable monthly repayment, there's been a move away from variable rate mortgages towards fixed rates.

In fact, the proportion of fixed rate mortgages among existing borrowers has increased from 28 per cent to 44 per cent in the past three and a half years[6] alone. Knowing exactly what's coming out every month is even more attractive for new mortgage borrowers, and nine in 10 (90%) of the new residential mortgages taken out in 2014 were fixed rates[7].

But all good things must come to an end and the risk now is that many of these short-term 'fixes' will end, just as interest rates start to increase. In these cases, a potentially huge jump in monthly costs could kick in overnight.

In the past, most mortgages used to be taken out over a 25-year standard term but increasing house prices and affordability issues have seen many (41%) opt to take out their mortgage over longer terms[8], sometimes up to 40 years, in a bid to reduce their monthly repayments. For these borrowers, not only will a rate rise be felt immediately, but the extended term of their mortgage will mean having to find more money for longer.

That also means a rise in interest rates has other implications for the way consumers borrow money and pay it back. When interest rates are high it's undoubtedly the hardest time for most people to make repayments but, for those who can make overpayments, there's a real incentive to do so right now to take full advantage of the current low rates.

This is particularly true for homeowners who have opted for an interest-only mortgage, meaning that they only pay back the interest on the loan, not the loan itself, each month. For these people, it is a good time to plan for a possible base rate rise.

For example, with a mortgage of £150,000 and an interest rate of three per cent, a homeowner would pay £375 a month on an interest only deal, or £711 if they opted to repay the interest and the loan itself over 25 years, a difference of £336. But if interest rates soared to, say, 15 per cent, the difference between just covering the cost of the interest on an interest-only mortgage (£1,875) and also repaying the underlying loan (£1,921) is only £46.

Though it is unlikely interest rates will soar to 15 per cent any time soon, clearly a base rate change is something which all homeowners should be prepared for no matter what the current term of their mortgage is.

I am worried about how a rise in interest rates could affect me…

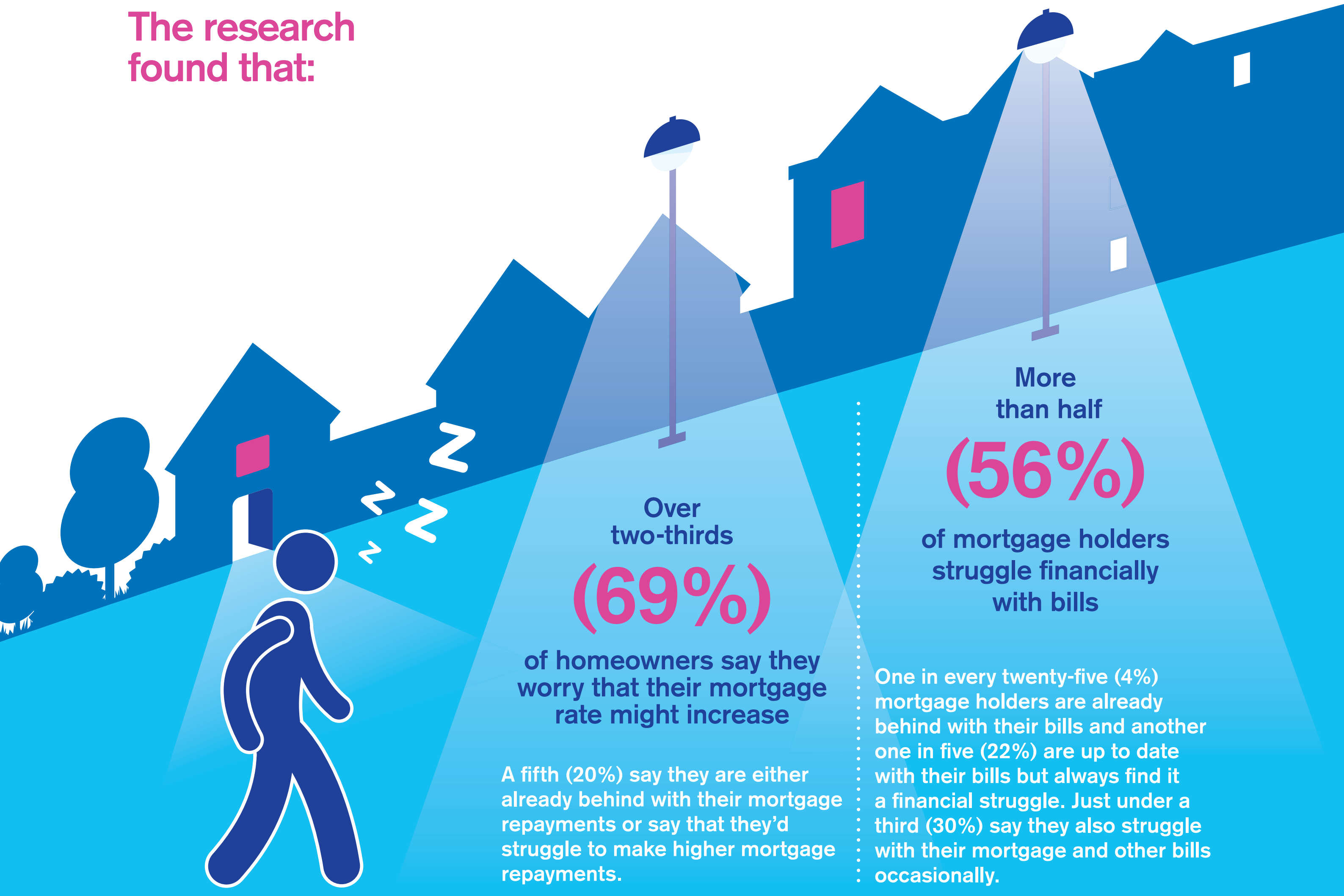
"Everyone's situation is different and a lot depends on the details of your existing mortgage, but if you're worried about the effect of an interest rate rise on your finances, consider speaking to your mortgage provider about your options, including re-mortgaging. It's a good idea to create a budget to plan your income and expenditure, and see what expenses you may be able to cut out. For some people, it might be possible to take on a second job, work overtime or perhaps take on a lodger, as long as your provider allows you to do so." – *Ritchie Bowman, Bank Manager, Leith TSB, Edinburgh*

Source:
[6] Bank of England
[7] Council of Mortgage Lenders
[8] Council of Mortgage Lenders

Sleepwalking into trouble

The most disturbing evidence that TSB's research has uncovered isn't how much mortgage costs could increase by, it's how few people are prepared for that change. Many people who currently have variable rate mortgages, or fixed rate mortgages ending soon, have little or no spare cash to meet increased monthly mortgage repayments if, or rather when, interest rates rise.

The research found that:



Over two-thirds

(69%)

of homeowners say they worry that their mortgage rate might increase

A fifth (20%) say they are either already behind with their mortgage repayments or say that they'd struggle to make higher mortgage repayments.

More than half

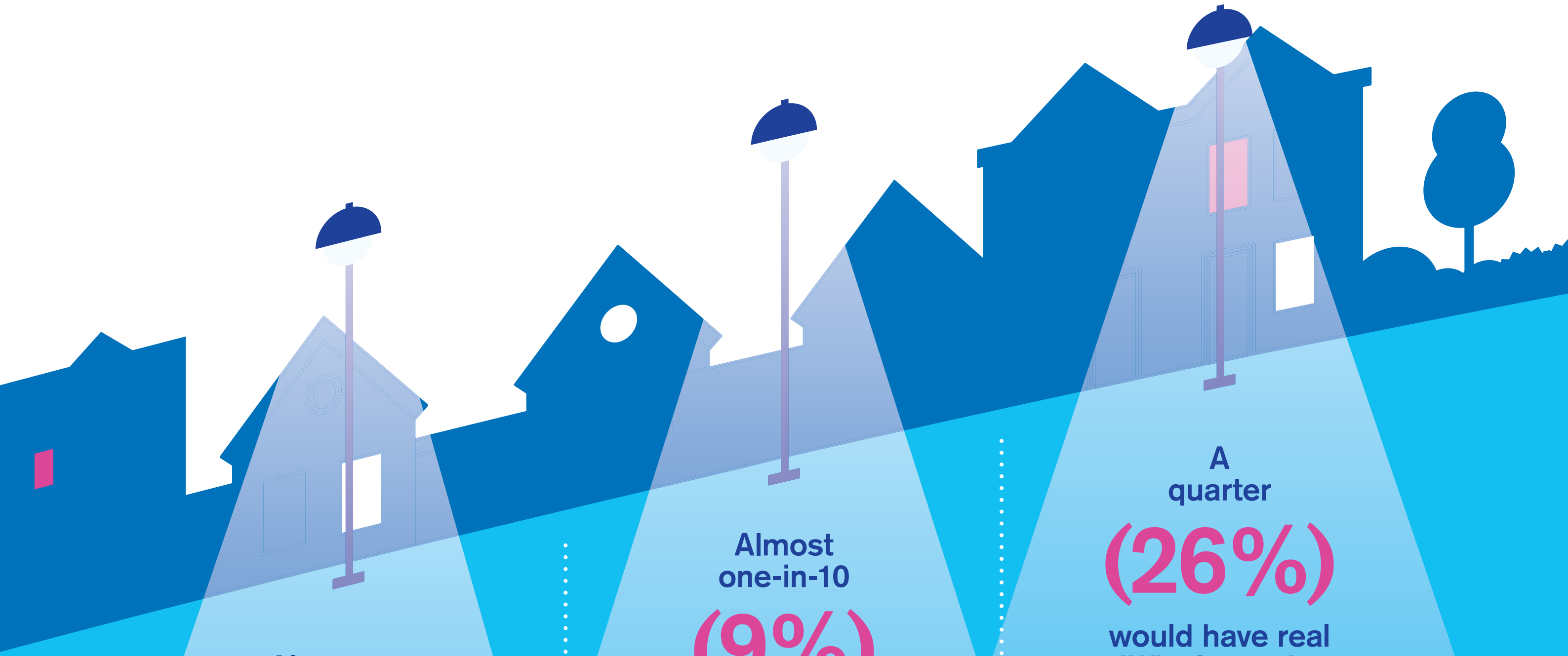
(56%)

of mortgage holders struggle financially with bills

One in every twenty-five (4%) mortgage holders are already behind with their bills and another one in five (22%) are up to date with their bills but always find it a financial struggle. Just under a third (30%) say they also struggle with their mortgage and other bills occasionally.

I am already struggling with money, what should I do?

"You won't be the first or the last person to be struggling with your finances, but recognising that you need help and doing something about it is the first step. Don't be embarrassed – banks are used to discussing this kind of problem and you might be surprised at the amount of avenues we can explore to put you back on track. This does not always include further borrowing but sometimes just rearranging your debt onto better rates and reducing the terms can take the pressure off your day to day budgeting and save you money in the long term." – *Fran Bell, Bank Manager, Enfield TSB, London*



Almost three quarters

(72%)

of mortgage holders could see their mortgage repayments increase

Almost half (45%) of mortgage holders have a variable rate mortgage and a further quarter (27%) have a fixed rate mortgage ending within two years. Although some may pay off their mortgage soon, this means around seven out of 10 existing mortgage holders could see their mortgage repayments increase if the bank base rate is higher than its current 0.5 per cent in two years' time.

Almost one-in-10

(9%)

say they have nothing left each month after paying all their living costs and essential bills

Almost two fifths (39%) of those on their lender's SVR[9] mortgage have less than £100 left each month after they've paid all their living costs and essential bills. Three in 10 (29%) of those with a base rate tracker mortgage and one in four (25%) with a discounted rate mortgage are in the same situation.

A quarter

(26%)

would have real difficulty paying their mortgage if their monthly repayment increased by £99

Almost a third (32%) of people currently on their lender's SVR would struggle if their monthly mortgage payments increased by £99. Bearing in mind that someone with a £150,000 capital repayment mortgage on a 25 year term would see their mortgage repayments increase by £81 a month if their interest rate increased from three to four per cent, many people could face a difficult financial situation.

Source:
[9] Standard Variable Rate

Where would people cut back?

If mortgage payments increased, many people would be prepared to make some big changes, including:

33% would prioritise debt repayments and pay the most important ones first.

74% would budget and make spending cutbacks.

14% would seek help from debt advice organisations.

43% would try to switch to a cheaper loan / mortgage.

12% would try to borrow from friends or relatives.

31% would ask their lender for solutions.

9% would check their social security entitlements.

I am considering re-mortgaging, what do I need to think about?

"Find out what sort of mortgage deal you have. Is it fixed, a tracker, discounted, capped and for how long? Are any early repayment charges payable and, if so, how much? If you're not sure about any of these details ask your lender or broker. They can also explore whether re-mortgaging would suit your circumstances, and offer guidance on whether it would be financially worthwhile taking account of all the relevant costs, fees and interest rates. You shouldn't compare mortgages on the interest rate alone as some mortgages have high product or other fees. It's important to take all of them into account. Also remember that a mortgage lender is only likely to consider its own mortgage range whereas a broker may present more options, but is likely to charge for their advice." – *Greg East, Bank Manager, East Street TSB, Bristol*

Reducing their supermarket shopping bill is top of the list for almost seven-out-of-10 (69%) people closely followed by eating out less (62%), limiting non-essential spending (62%) and taking cheaper holidays or not going away at all (61%).

Over two-fifths (44%) would cut TV and entertainment subscriptions, while **two-fifths (42%)** of people would cut out take-away coffee in the morning or lunchtime trips to the sandwich shop.

Two-fifths (40%) would opt for a night in on the sofa, rather than spending money out seeing friends, and more than a third of people **(36%)** would cut back on presents.

Three in 10 (30%) would work overtime or take on an additional job, closely followed by just over a **quarter (28%)** who would turn the heating down to save on energy bills.

One-in-five (20%) drivers would try to use their car less to save cash on fuel and repairs.

Time to act

Given that many UK homeowners have never experienced a rate rise before, and the question seems to be 'when' not 'if' the Bank of England base rate will rise; now is a good time for homeowners to consider their options and be well prepared for a rate rise.

There is no 'one-size fits all' solution for the seven in 10 (70%) Brits who may see their mortgage payments rise and indeed some people may be able to comfortably afford any potential increase, but for consumers who are concerned about what a rate rise would mean for them, now is a good time to speak with their lender and start preparing for a rate rise.

I've fallen behind on my mortgage payments, how can I get back on track?

"The first thing to do is speak to your lender. Your lender can review your borrowing to see if they can make your repayments more affordable and, depending upon circumstances, may also agree to a reasonable amount of time to pay the debt. They may be able to extend the term of the mortgage or switch from a capital repayment mortgage to an interest only mortgage in order to help reduce your monthly payments. It's very important to be proactive and speak to your lender as soon as possible as your home may be repossessed if you do not keep up mortgage repayments." – *Dhara Shah, Bank Manager, Coventry TSB*

Top 10 tips

on how to be #ReadyForRateRise

1 Understand your current mortgage

Do you know if it's a tracker, SVR or a fixed rate mortgage? When does the term end? Do you have any early repayment charges? It's important to understand the current terms of your mortgage first before you make any changes. Contact your provider to find out this information.

2 Keep a realistic track of your spending

Knowing how much money you are spending each month is really important; as you can then measure it against your income to see what you might have leftover. It's important to be accurate, so remember to add in any entertainment subscriptions, take-away lunches or nights out into your monthly plan. Apps such as 'On Trees' from MoneySuperMarket can really help with this, or just good old fashioned pen and paper to keep track of your spending.

3 See where you might be able to cut back

After you have kept a realistic track of your spending, you might realise that you are spending more than you are earning – in that case, it's time to start thinking where you can cut back. Spending money on lunch and coffees at work can be a real drain, why not commit to taking in lunch every other day? TV and entertainment packages are also another expense which you may be able to cut back.

4 Think about how to increase your income

As well as cutting back, you might be able to increase your income. For some people, this could be taking on a second job, working overtime or perhaps taking on a lodger, as long as your provider allows you to do so. It's also worth ensuring you are receiving all of the Government benefits and tax credits that you're entitled to.

5 Speak to your lender

Once you understand what type of mortgage you have, and also have a solid understanding of your spending, it's a good idea to go and speak to your lender. It is likely they'll be thinking about base rate changes too, and so can explore whether remortgaging would suit your circumstances, taking account of all the relevant costs, fees and interest rates.

6 Shop around

Remember there are many lenders which provide mortgages, not just the bank where you have your main current account or existing mortgage. Also remember that a mortgage lender is only likely to consider its own mortgage range whereas a broker may present more options, but is likely to charge for their advice.

7 Look beyond just your mortgage

Any increase in the base rate may affect your finances beyond just your mortgage, including interest rates on overdrafts and credit cards, but may also positively affect your savings rate. Think about moving your savings or current account to see if you can make your money work harder for you, or possibly switching credit card provider to a 0 per cent balance transfer card.

8 Speak to an independent debt professional

If you are struggling with debt, it is worth seeking debt advice from registered and recognised organisations that have extensive experience providing advice to consumers in financial difficulties. These include, Citizens Advice (www.citizensadvice.org), National Debtline (www.nationaldebtline.org) and Step Change Debt Charity (www.stepchange.org).

9 Be in the know

Find out more hints and tips on how to be ready for rate rise by searching the TSB hashtag #ReadyForRateRise on Twitter and Facebook, and also keep an eye on the news. The Bank of England's Monetary Policy Committee, the people that set the base rate, usually meet on the first or second Thursday of every month so look out for any base rate news then.

10 Don't panic

No-one is suggesting the base rate is going to increase significantly any time soon so don't panic. There is still time to plan for any future increase, and like anything, preparing early is always the best plan of action.

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