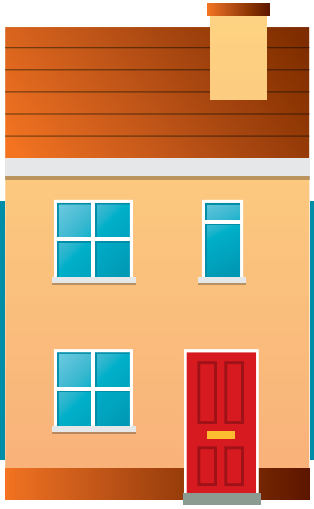
the Money Advice Service

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



- Planning for a change in circumstances
- Understanding different types of mortgages
- Sort out your saving and insurance needs

The **Money Advice Service** is independent and set up by government to help people make the most of their money by giving free, impartial advice. As well as advice about mortgages, we offer information on a wide range of other money topics.

Visit our website today for advice, tips and tools to help you make informed decisions and plan for a better future.

moneyadviceservice.org.uk

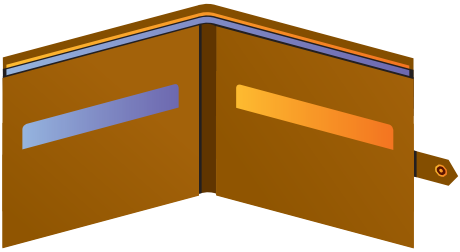
Free impartial advice

- on the web
- on the phone
- face-to-face

Here to help you

This guide is for you if you are buying a home for the first time.

A mortgage is a long-term commitment. Find out how to prepare for situations where your payments or income may change, so that you can cope more easily and minimise the risk of losing your home.



Lenders assess what level of mortgage payments you can afford taking into account your personal expenses as well as income.

Contents

First things to do

There are a number of actions you can take to safeguard your home in the future

1 Understand how interest rate changes could affect your payments

Check whether you can afford your mortgage if interest rates rise or a fixed-rate or discounted rate mortgage comes to an end.

Use our **Mortgage calculator** on
moneyadviceservice.org.uk/mortgagecalc

2 Work out your budget

Make sure you include all your household expenses, including utility bills, home insurance and Council Tax, so that you can decide how much you can afford to borrow. Don't forget the costs of moving either.

Use our online **Budget planner** on
moneyadviceservice.org.uk/budget

3 Start saving

Put some money aside to help you deal with unexpected emergencies. It can also provide a cushion if your income changes.

Use our **Savings calculator** on
moneyadviceservice.org.uk/savingscalc

4 Get the right insurance

Think about insurance to protect yourself and your household from life changing events such as property damage or loss, illness and redundancy.

Read about insurance on
moneyadviceservice.org.uk/insurance

Work out how much you can afford to borrow

Make sure:

- You're not taking on too much if you are borrowing the maximum available. Just because you can afford it now doesn't mean you can afford it in the future.
- You get keyfacts® documents from your adviser or lender. These give details of the costs and features of the mortgage including how much your payments will increase if the interest rate rises by 1%. Remember that rates can rise by more than this.
- You understand the difference between repayment and interest-only mortgages, and how to make sure you pay off your mortgage by the end of the term.
- You understand the difference between fixed interest rates and variable interest rates and know which kind you have and when any fixed-rate period is ending. See pages 7 and 8.
- You understand the interest rate deals on offer. The lowest rate isn't necessarily the cheapest as there may be fees that are added to your mortgage.
- You understand the overall costs of buying a house, including stamp duty and any redemption charges should you decide to repay your mortgage earlier. See page 11.

Planning ahead for a change in circumstances

Buying your first home is an exciting time – moving in and beginning your new life.

But mortgages are a long-term commitment and it's easy for your circumstances to change during that time. By thinking about your long-term goals and the potential problems that can arise, you can plan for the future and be better placed to deal with the unexpected.

Common changes over the mortgage term

During the course of a typical 25 year mortgage many things can change for you and your partner if you are buying jointly.

Interest rates can change often; you need to understand what yours is and what will happen if rates go up.

Find out more about interest rates and how they can change over time – see page 7.

Your job situation could change
Most mortgage lenders consider what you can afford to borrow at the time you apply for a mortgage. They will look at your income and your expenses, but what about your future income?

If you are lucky you can get promoted and earn more, but you could also be made redundant, put on short-time working, be asked to take a pay cut or face a salary freeze while your bills are still going up.

You may also want to make changes such as retraining, setting up your own business, working fewer hours to improve your work-life balance, or care for dependants. You may need to give yourself a financial cushion to be able to do this.

For advice on saving to create an emergency fund – see page 14.

To find out about insurance to protect your income if you are made redundant – see page 17.

You or your partner could become ill or be injured in an accident

If you and your partner depend on each other's income to pay the mortgage, you can help reduce the risk of losing your home by putting in place insurance to help pay the mortgage if you die or are unable to work. If you have children, the need for insurance is potentially greater still.

There are different kinds of insurance to protect you in different situations:

- life insurance
- income protection insurance
- critical illness insurance.

See pages 15 and 16.

You could become a parent

You may already have children or could be planning to have them later. This can impact your finances. One or both of you may not work as much – or at all. Could you afford your mortgage on just one income? And you may face the additional costs of childcare as well as the costs of raising a child.

Childcare can be costly. To get an idea of what you might need to pay, search for '*Cost of childcare*' on **moneyadviceservice.org.uk**

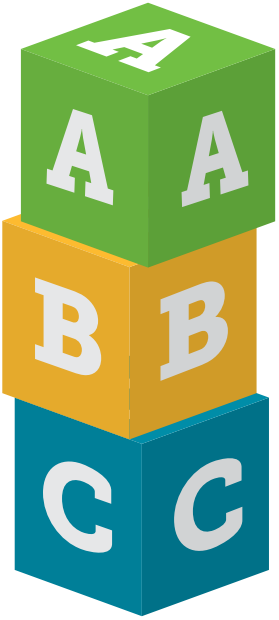
Find out about budgeting for a family on our website **moneyadviceservice.org.uk/familybudget**

Your living situation could change

Buying with a friend or partner is an exciting time and it may seem not quite right to discuss what you will do if you want to go your separate ways. But the decisions you make at the time of buying a property can impact further along the line.

The legal arrangements you make when you buy your home will affect how you own the property, what happens if one of you dies, and what your rights are if you split up. You should talk to your solicitor to make sure you have the right arrangements in place.

See more on sorting out the legal arrangements when you're buying with someone else – see page 12.



Mortgage calculator

Use our **Mortgage calculator** to find out what your monthly mortgage payments could be. This can help you work out how much you can afford to borrow.

Visit **moneyadviceservice.org.uk/mortgagecalc**

the Money Advice Service

Understand interest rates

You can see how affordable your mortgage could be in future by understanding what kind of mortgage you have and what will happen to your payments if interest rates rise.

How a mortgage works

A mortgage is a loan taken out to buy property or land. The loan is secured against the property, which means that if you fail to keep up the repayments on the mortgage the lender could repossess your home. Most mortgages run for 25 years but the term can be shorter or longer.

A mortgage has two parts:

- **the capital**, which is the money you borrow, and
- **the interest**, which is the charge made by the lender until the loan is paid back.

Repayment mortgage

This is the most popular repayment option and the preferred option for most people.

If you have a repayment mortgage you'll make monthly repayments for an agreed period of time (known as the term) until you've paid back both the capital and interest.

With this type of mortgage, you have the benefit of knowing your mortgage balance will get smaller every month and that if you keep up the repayments your mortgage will be repaid at the end of the term.

Interest-only mortgage

With an interest-only mortgage you only pay the interest due on the amount you borrowed each month. So while you'll be paying out less than with an equivalent-sized repayment mortgage, you will still owe the amount you originally borrowed at the end of the mortgage term.

Most lenders will require that you have a repayment plan in place.

This may mean paying separately into an investment plan each month to build up enough money to pay off the capital at the end of the term.

In addition, some lenders may ask for a higher deposit than with repayment mortgages.

Unless you can meet all of these criteria **it's likely to be difficult to get an interest-only mortgage – especially for first-time buyers**. With no repayment strategy in place, you could end up without the means to repay your lender when your mortgage term ends.

Variable and fixed-rate interest options

The interest rate you pay on your mortgage is set by your lender. Mortgages come with fixed or variable interest rates. With a fixed-rate mortgage your repayments will be the same for a set period of time regardless of what interest rates are doing in the wider market. If you have a variable rate mortgage, the rate you pay could move up or down.

Find out about the different kinds of fixed-rate and variable mortgages and their pros and cons search for '*Mortgage interest options*' on **moneyadviceservice.org.uk**

Interest rate rises

Interest rates are at an all-time low level, but they could go back up again and your lender will usually increase your mortgage payments to match.

In the past, interest rates rose rapidly, from 7.5% to 15% in just a few years. Interest rate rises could increase your monthly payments considerably, making them difficult to afford. See the next page for an example of how much this could be.

How to get the best mortgage deal

Make sure you understand the interest rate deals on offer. The lowest rate isn't necessarily the cheapest because of arrangement fees and other charges. Compare the total amount payable before you decide, using our table.

Use our **Mortgage comparison table** at **moneyadviceservice.org.uk/mortgagecomparison**

Special rates ending

When you first take out a mortgage you may be offered a 'discounted' rate which ends after a set period (two or three years for example). When it ends your payment will change and it is likely to be much higher and switch to the lender's variable rate.

Key point

Unless you have a fixed-rate for the full term of your mortgage, the interest rate you are charged can go up.

See the impact that interest rate rises could have on your monthly payments.

Example 1: repayment mortgage

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

Interest rate	Monthly repayments	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 an interest-only mortgage, initially at a rate of 4%:

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

Interest calculated monthly

Remember

With a repayment mortgage, you can be sure that your mortgage will be paid off at the end of the term if you keep your payments up. This is because you are paying back the loan as well as the interest.

Work out your budget

Many people fall in love with a dream property and can potentially put themselves at risk by over stretching their finances to get it. Before you buy, make sure your mortgage payments are affordable.

Weigh up how much to borrow carefully

As well as your mortgage payments you need to factor in all of your other monthly outgoings – and be sure that you could still meet your payments if interest rates rise or your circumstances change.

Don't overstretch

If possible, don't take irregular income such as bonuses, overtime or commission into account. When you take out a mortgage borrow only on the basis of the money you can be sure of receiving. If you rely on what you get in a good month, you'll find it hard to manage if you have several poor months.

Weigh up whether increases in the cost of living and rising bills could move your mortgage from being affordable to difficult to manage, particularly if you are in a situation where you have a pay freeze.

If you are relying on two salaries to pay the mortgage think through what would happen if one of you lost your job or stopped work or reduced your hours to concentrate on childcare, for example.

Work out what you can afford to repay while leading the lifestyle you want.

Search for '*How much can you afford to borrow*' on **moneyadviceservice.org.uk**

If you don't borrow the maximum you can afford, this can offer you more financial flexibility, both at the time you move in and later on.

Government backed affordable housing schemes

If the sums don't add up and you're on a low income and trying to buy your first home, or you're a key worker, there are several schemes available that may help, including those that allow you to part-rent/part-buy a home – with a view to buying it outright gradually.

There are also government schemes which can help first time buyers and others to buy homes (particularly new builds) with a smaller than average deposit.

Search for '*Affordable housing schemes*' on **moneyadviceservice.org.uk**

You can check how affordable your mortgage will be by working out a budget for your new property.

There are two things to think about:

- the extra costs of buying a property
- the new and ongoing costs and expenses.

Make sure you've got money in your budget for all the costs, bills and fees involved.

Use our online **Budget planner** to help you **moneyadviceservice.org.uk/budget**

Extra costs of buying a property

Additional costs can soon mount up. These include:

- mortgage arrangement fees, valuation and money transfer
- legal fees
- stamp duty land tax
- removal costs.

If your mortgage fees get added on to the mortgage, this will add to the total cost of borrowing over the lifetime of the mortgage.

Search for '*Mortgage related fees*' on **moneyadviceservice.org.uk**

Find out what your moving costs could be online. Search for '*Buying costs*' on **moneyadviceservice.org.uk**

New and ongoing costs and expenses

Your household bills may also change in your new property. If you are buying a flat, for example, there may be management or service fees. These can be thousands of pounds. Find out as much as you can about what they will be before you buy.

Your heating and power bills may be different if you move to a larger property, or it uses a different kind of power. If you move to a different area your Council Tax bill may vary – it could be considerably more for a property in the same band.

Key point

Check your budget carefully. If you can't afford it don't just go ahead hoping it will all work out. Consider a cheaper property or see if you can find a better mortgage deal. **moneyadviceservice.org.uk/budget**

Sort out legal arrangements if ownership is shared

Buying with a friend or partner can be an ideal way of making property more affordable – and for couples, the start of a new life together. But you need to consider what could happen further down the line if you want to separate and go your own way.

If you move in with someone else it may seem unromantic or unnecessary to work out what will happen if you split up or want to move on. But sorting out the arrangements when you buy means everyone knows where they stand and it can make dealing with a split much easier.

You need to sort out how the ownership of the property is shared. This may depend on:

- your relationship
- how much each of you is putting in to financing the property, and
- what you want to happen to your share of the property when you die.

Legally there are two types of joint ownership:

- joint tenancy
- tenants in common.

Joint tenancy (Beneficial joint tenants)

Joint tenancy is where the two people own the property together and don't have a particular share in it. When one dies the other person becomes the sole owner of the property. If the property is sold while both people are still alive the proceeds are usually divided equally, but this can be altered in divorce proceedings. This is usually how a married couple or those in a civil partnership would buy a property. It is not appropriate for friends buying together.

Tenants in common

Owning property as tenants in common means the property belongs to you jointly but you also own a specific share of its value. You can give away, sell or mortgage your share. If you die, your share of the property passes to the beneficiary (the person or people you've left money to) in your will. You decide on the proportion each owns. This could be different amounts if, for example, one person contributes more to the deposit or the monthly mortgage payments. This can help avoid potential disputes in the future.

Unmarried couples

Unmarried couples moving in together should think about protecting their interests if they split up. Make sure you understand your situation. The rights you have are very different from those of married couples who split up. If a property is in one person's name, the second person is not automatically entitled to anything, even if they paid towards the mortgage or left work to raise children.

A solicitor can help you by drawing up a Declaration of Trust which sets out how a property is to be divided up if the couple splits up. A Cohabitation Agreement is far more extensive and can include things like bank accounts, pensions and things that you each bring to the home and those that you buy together.

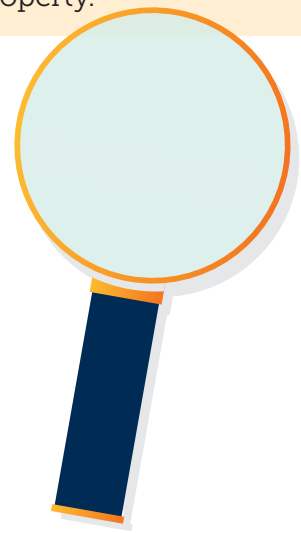
Find out more about living arrangements when an unmarried couple splits up. Search for '*Divorce and separation*' on **moneyadviceservice.org.uk**

Protecting a third-party

With high property prices, some buyers may get help from a parent towards the deposit either as a loan or a gift. They might want to make sure that this is recognised if the property is sold. Your solicitor should be able to give you advice on how to do this.

Key point

Talk to your solicitor, who can explain in detail the different types of ownership and what you can do to protect your financial interest in the property.



Start saving to create an emergency fund

Make sure you have some money put by for a rainy day.

We recommend that you have three months of essential outgoings available in an instant-access savings account. So, if you spend £1,000 a month on mortgage or rent, food, heating bills and other things you can't live without, you should aim for £3,000 in emergency savings.

This will provide you with a financial cushion if you face an expensive emergency in your home such as a boiler breaking down, and have some cash to tide you over should you face a drop in income.

Start saving for your emergency fund as soon as possible, and make sure you save regularly.

- To check how much money you need to put aside for unexpected expenses search for '*Emergency savings*'
- To find out tips on how to get into habit of successful savings search for '*Set a saving goal*'
- To see what type of account is right for your cash saving search for '*Cash saving at glance*' on **moneyadviceservice.org.uk**
- Shop around to find the best place for your savings **moneyadviceservice.org.uk/savingscomparison**

Work out what insurance you need

Different kinds of insurance can protect you, your dependents, your income, your payments and your property against a variety of risks and help keep your home safe.

Because of the many different kinds of insurance available you should understand what the different kinds of policies cover and work out if you need it and can afford it.

Home insurance

There are two types of home insurance – buildings and contents.

Buildings insurance covers the cost of repairing or rebuilding your home if it's damaged by storm, floods, fire, lightning and subsidence.

Contents insurance covers you for loss or damage to things like your furniture, TVs and personal possessions from theft, fire or flood.

Your mortgage lender will normally insist that you have buildings cover – but you needn't buy home insurance from them. Levels of cover and prices vary widely so shop around to make sure you get the right deal.

Make sure you get the right cover and get tips for shopping around – search for '*Home insurance*' on **moneyadviceservice.org.uk**

Life insurance

Life insurance pays your dependant(s) a lump sum or regular payments if you die. You need it if your children or partner depend on your income to cover the mortgage or other living expenses. It only covers death so won't cover you if you can't work because of illness or disability.

Life insurance can be very good value. Often just a few pence a day is all you need to provide your loved ones with plenty of financial protection. Even if you have an employee package that includes life insurance, it's a good idea to buy a policy to cover your mortgage. But premiums do vary, so shop around.

Search for '*Life insurance*' on **moneyadviceservice.org.uk**

Critical illness insurance

This pays out a lump sum or a regular payment, helping you cover a mortgage or other expenses, if you suffer from one of the illnesses or injuries specified in your policy, for example heart attack, stroke and certain types of cancer.

It can help if you couldn't support yourself or your dependents if you were too ill to work.

There are different types of critical illness insurance policies available, so it's important to know exactly what is covered.

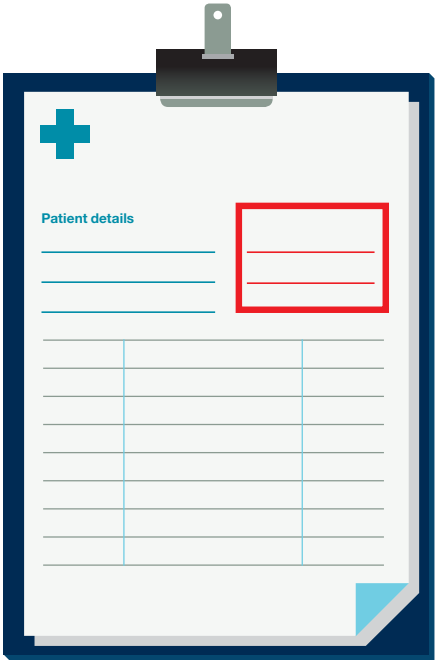
Search for '*Critical illness insurance*' on **moneyadviceservice.org.uk**

Income protection insurance

Income protection insurance covers a wider range of illness and disability, and pays a percentage of your take-home pay regularly until you are able to return to work, retire or reach the end of the policy payment term.

You should consider it if you can't rely on savings or employee benefits to see you through an illness. It can cover most illnesses that leave you unable to work but doesn't cover you for unemployment.

Search for '*Income protection insurance*' on **moneyadviceservice.org.uk**



Payment protection insurance and mortgage protection insurance

These kinds of policies are designed to cover your monthly mortgage, loan and credit card repayments if you:

- have an accident
- become ill and can't work, or
- become unemployed.

It can ease your money problems if you get made redundant and are likely to be out of work for a long time, or you have little or no savings.

You probably don't need it if you have enough savings, you could get by on your sick pay or your partner could cover the mortgage and other loan repayments.

You might have to wait 90 days to be paid out and some policies will only pay for up to a year, even if your unemployment lasts longer, or you are still too ill to return to work.

Payment protection policies tend to have very strict criteria on when they will pay out, so make sure a policy fits your needs before you buy.

For information about the pros and cons of payment protection insurance search for '*Payment protection insurance?*' on **moneyadviceservice.org.uk**

For more information about the pros and cons of different types of insurance search for '*Types of insurance*' on **moneyadviceservice.org.uk**

Key point

Income protection, payment protection and critical illness insurance can be complicated. Consider using an independent financial adviser to help you.

Understand the limits of state help

Many people think that if they get into financial difficulty, government benefits will help them out. But most people overestimate how much state benefit they would receive…

Benefits are designed as a safety net. But it isn't likely that they would cover your mortgage payments, utility bills, food and living expenses if you fall ill or lose your job. So you need to make sure you have alternative arrangements in place.

Changes to benefits from 2013

There are lots of changes to the benefits system starting in 2013. Disability Living Allowance and Council Tax Benefit are being replaced. There are changes coming in for Housing Benefit and the Social Fund. There will also be an overall cap on the amount you can get in benefits.

Read our guide – '*Benefit changes in 2013*'
moneyadviceservice.org.uk/benefitchanges

From April 2013 some benefits and tax credits will be replaced by Universal Credit. Universal Credit is a single monthly payment for people looking for work or on a low income. It is being introduced from April 2013 onwards.

For more information search for '*Universal Credit*' on **moneyadviceservice.org.uk** or visit **moneyadviceservice.org.uk/universalcredit**

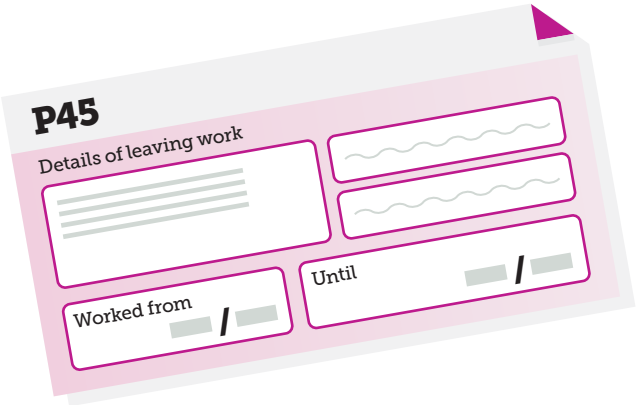
Unemployment – you may be able to claim state benefits if you lose your job, but these are unlikely to be enough to cover your mortgage. You need to have a plan in place to make sure you can continue to pay in these circumstances.

Illness – if you haven't been able to work because of illness or disability, you may be able to get state benefits. However, again these are unlikely to be enough to cover your mortgage.

Sick dependants – if you face a situation where your child or other dependant becomes seriously ill and needs full-time care, you might be able to get some benefits to help you manage. These are not paid automatically and you have to claim. You may be able to claim disability benefits for your child and a carer's allowance for you.

It's sensible to get expert help from advisers who understand the system if you need to claim, because benefits can be complicated.

To make sure you're getting the right entitlements visit **moneyadviceservice.org.uk/rightentitlements**



Useful contacts

Money Advice Service

The Money Advice Service is independent and set up by government to help people make the most of their money by giving free, impartial money advice to everyone across the UK – online, over the phone and face-to-face.

We give advice, tips and tools on a wide range of topics including day-to-day money management, savings, planning your retirement and for your future, as well as advice and help for life changing events such as starting a family or losing your job.

For advice and to access our tools and planners visit
moneyadviceservice.org.uk

Or call our Money Advice Line on
0300 500 5000*

Typetalk
1800 1 0300 500 5000

Financial Conduct Authority (FCA)

To check if your adviser is registered with the Financial Conduct Authority, check the FCA register.
fca.org.uk/register

Finding a financial adviser

These websites can help you find financial advisers in your area.

Unbiased.co.uk
unbiased.co.uk

The Personal Finance Society
findanadviser.org

Organisations that give free and confidential help if you have money problems

StepChange Debt Charity
0800 138 1111
stepchange.org

National Debtline
0808 808 4000
nationaldebtline.co.uk

Payplan
0800 280 2816
payplan.com

Citizens Advice
adviceguide.org.uk

Debt Action NI
0800 917 4607
debtaction-ni.net

Use this page to record your notes

the Money Advice Service

You can afford your mortgage now, but what if...? is one of the guides available from the Money Advice Service. To see our full range of guides and request copies visit **moneyadviceservice.org.uk**

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

If you would like this guide in Braille, large print or audio format please contact us on the above numbers.

*Calls to 0300 numbers are free if you have free or inclusive call minutes as a part of the contract you have with your landline or mobile phone provider. If you don't have free or inclusive call minutes then calls to 0300 numbers will be charged at standard rates for UK geographic numbers (eg UK numbers starting with 01 or 02). To help us maintain and improve our service, we may record or monitor calls.

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