THE MONEY DOCTOR

With John Lowe

LOANS THAT ARE IN YOUR INTEREST - INTEREST ONLY HOME LOANS

Many *patients* have expressed misunderstanding on the whole area of "**interest only home loans**". This is defined by taking out a loan where no capital (the amount being borrowed) is repaid and only interest on that amount borrowed is paid on a monthly basis.

The borrower may repay lump sums during the term of the loan (defined at the start of the facility) **at no cost if variable interest rate** or may elect to repay the amount borrowed IN ITS ENTIRETY on maturity of the loan. In *Bank of Scotland (Edinburgh)*'s case and if the borrower is young enough, that could be 40 years later – this lender has the longest term allowable for home loans in Ireland.

ALL lenders offer interest only home loans but the majority would require an **identifiable take out** to repay the original amount borrowed at the end of the loan term (i.e. maturity) e.g. a pension or endowment plan – the latter which attracted adverse publicity over a decade ago.

There are now four official lenders in Ireland offering a home loan facility whereby **no** identifiable take out is required until the end of the loan term, and that is

- *Bank of Scotland (Edinburgh)* maximum 80% loan to value but offer up to 40 year terms, tracker mortgages and currently have the most competitive interest rates
- *Permanent TSB* (borrower must have in excess of € 100K income, so it slightly inhibits the would be clients)
- *IIB Homeloans* (1st 3 years only after which you must repay the capital over the balance of the term).
- *Ulster Bank* (1st year only interest only)

By availing of an interest only facility, your repayments could be half of the capital and interest monthly repayments.

For instance, the monthly repayment for € 250,000 on a 25 year 3.25 % variable rate *capital and interest plan* (or *annuity mortgage*) is **€ 1218.29** as opposed to **€ 677.08** per month if on *an interest only* basis – **a saving of € 541.21 per month.**

Remember, the interest makes up most of the annuity repayment in the early years anyway <u>and</u> the average mortgage lasts only seven years. At some stage however, the capital must be repaid, whether it is through

- By electing to repay voluntarily though your pension plan (maturing at 60/65) which then repays the capital.
- An investment plan (for the term of the mortgage, like the old style *endowment* mortgage) that also repays the capital on maturity.
- Selling the property (after a number of years) and repaying the loan.
- Arranging to commence an annuity plan (capital and interest repayments over a new agreed term) with a defined term to pay back the capital.
- Passing the property on to your estate where the loan is either renegotiated or repaid by your beneficiaries (in continental Europe, some families pass on home AND mortgage to their children, having only paid interest in their lifetime)
- Winning the lotto or other such cash windfall.

However **it is up to you what way you pay back the capital**. Obviously a mortgage protection insurance policy (or life cover as it is also known) must be taken out so that if the applicant/s die, the mortgage, i.e. the outstanding capital borrowed, is repaid immediately. Life cover on home loans in Ireland is mandatory. For interest only loans, *level term cover* would be insisted by the lenders as opposed to *decreasing term life cover* – with the latter, the policy pays out on death whatever the balance of the mortgage which would be reducing from the capital payments being made.

This *interest only* system is particularly attractive to young professionals whose earnings increase with experience and promotion, media / artiste types / lotto winners who earn large lump sums from time to time rather than on a regular basis, soon-to-be-retired executives awaiting company trade sales and /or golden handshakes, together with cash strapped individuals who want to reduce their monthly outlays to manageable proportions until their incomes pick up. Soon most lenders will follow this trend.

In the case of **Residential Investment Loans** (RILs), virtually all the lenders offer an interest only facility and in order of length of facility they are

- *Irish Nationwide Building Society* - 20 years (full term but you will pay 0.5% over the home loan rate)
- *ICS Building Society* & *Bank of Ireland* – 10 years
- *First Active plc, Permanent TSB, IIB Bank, National Irish Bank, EBS, AIB* - 5 years
- *Ulster Bank* - 1 year

The same rules apply as in home loans except that life cover may be waived for RILs. There are still some lenders offering home loan interest rates on RILs – shop around.

John Lowe is a Fellow of the Institute of Bankers and managing director of *Providence Finance Services Ltd,* a Stillorgan based advisory company while also in the *Money Doctor* chair at *Newstalk 106FM* on Mondays at midday.
If you have any questions you want answered on any financially related issue please write to *The Money Doctor*, C/o Irish Independent , email *jlowe@providence.ie* or fax +353 1 278 5556