SimplyMoney

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Your independent window on home finance issues

A Budget to secure the recovery

The mood of the Budget was understandably up-beat, in view of the forthcoming election. Whether or not it will be adequate to satisfy money markets will emerge over the next few months. Certainly, the Chancellor was able to announce a reduction in the amount of borrowing this year from a staggering Pre-Budget Report estimate of £178 billion to an eye-watering £167 billion. In fact, the reduction is quite encouraging because it appears to come from stronger than expected tax revenues from businesses, individuals and VAT, alongside lower expenditure on unemployment benefits.

What will be important to money markets is whether the plans outlined in the Budget for reducing national borrowing are adequate to ensure that we continue to be able to service the debt. If the ratings agencies do not believe we plan to cut borrowing rapidly enough, the cost of borrowing will rise and the problem exacerbated. As has been pointed out, we are currently spending more on servicing debt than on educating our children.

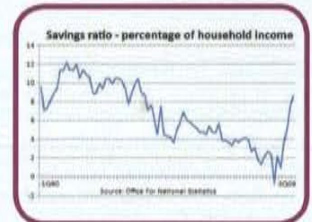
Importantly, the £2.5 billion one-off growth package announced in the Budget appears to be fully funded by switching spending from some areas, together with the product of the bank bonus tax, which has apparently generated some three times as much as expected, for 2009/2010, at £2 billion. On the other hand, spending is expected to rise by as much as 2.2% in real terms next year, and it is essential that the efficiency savings outlined actually do feed through, or we will simply be building more problems for the future.

At the individual level, the much-heralded increase to £250,000 of the stamp duty threshold for first time buyers will be welcomed by many as a much-needed boost to the housing market, although it is accompanied by a hike to 5% of the stamp duty on houses sold for £1 million plus from April 2011. This represents a missed opportunity to make the entire system fairer by altering it to a top-slicing basis, under which purchasers would pay the tax at a different rate on each tranche of value, rather than all at the higher rate once each threshold is reached. Under the existing system a house sold for £1 million attracts stamp duty of £40,000, whereas one sold for £1,000,001 will soon be 'taxed' at just over £50,000. Under a top-slicing method, the stamp duty would only be slightly higher (because the 5% would only apply to the value above £1m).

The ISAs investment limit, which for the over 50s increased to £10,200 last October, is not only increased to this level for everyone, but will also be indexed in future. On the other hand, the inheritance tax threshold will remain at its current level of £325,000 for the next four years to "help pay for the cost of care for older people". The Entrepreneurial relief that cuts the rate of capital gains tax for qualifying individuals and assets from 18% to 10% will henceforth apply to the first £2 million of realised gains, rather than the first £1 million.

Businesses are intended to benefit from an increase in the amount of finance available to them from the banks, as well as from a reduction in business rates for small to medium sized firms. It will, however, be interesting to see whether the banks deliver this time round and it is unfortunate that the Chancellor did not restore the empty-property rate relief, which once reduced the financial burden on businesses of owning an empty property but was abolished two years ago.

INSIDE



Savings ratio is rising

Later retirement looms

Tracker Mortgages

"Non-working" parents

Self-certification to end

Money under the mattress?

Consumers may have lost faith in banks and are instead hoarding cash, if the increase in high-denomination bank notes in circulation is anything to go by.

There may be many reasons for people using cash more than previously, not least of which could be a desire not to pile too much debt on their credit cards, to avoid high interest rates - which are much higher than those for mortgages.

Of course mortgages and credit cards are totally different. But according to Credit Action the average household owed £9,000 on non-mortgage debt at the end of last year. This represents about one pound in six of overall household debt, so there is a significant amount on which higher interest is being paid.

Is there anything wrong with banks?

If the reason for keeping cash rather than leaving money in the bank is a fear of possible failures within the banking system, it is important to remember that the Financial Services Compensation Scheme provides a high level of protection; £50,000 per individual per authorised banking institution. So a couple with up to £100,000 on deposit with one bank will be fully protected - although it is not clear how quickly the FSCS could actually pay out in the event of a bank default.

The limit applies per banking institution, based on its regulatory relationship with the Financial Services Authority. If two banks within the same group share a single FSA registration number, then the deposits held with them will be aggregated for the purpose of the compensation limit. If, however, they have separate registration numbers, this should not occur.

Investments and home finance advice are also protected up to £50,000, although not against normal market fluctuations, of course. Life insurance is protected up to 90% of any loss sustained (as is home insurance, for example).

Are we really saving less?

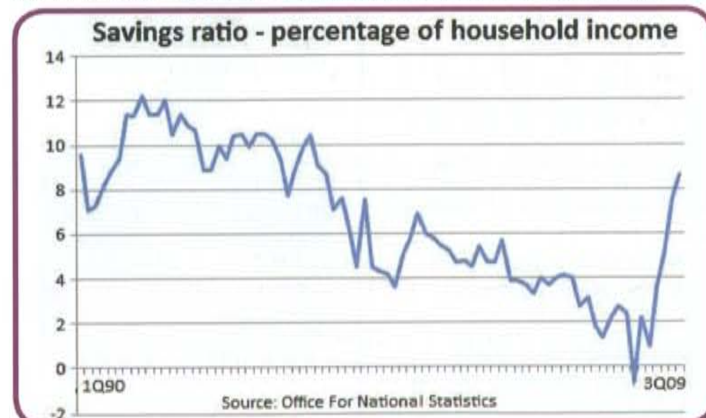
According to the Banking Times, we are as a nation actually saving more than a few years ago - 8.6% towards the end of last year, as against nothing at the start of 2008. But there is still some way to go to beat the 12% peak seen in 1992.

This almost always happens in a recession because, as we become more nervous about future prospects, we tend to save more. This can actually be bad for the economy, as less spending tends to reduce Gross Domestic Product (GDP) but in the current case, this does not appear to have been a problem (at least so far).

If you do decide to 'stash your cash' ...

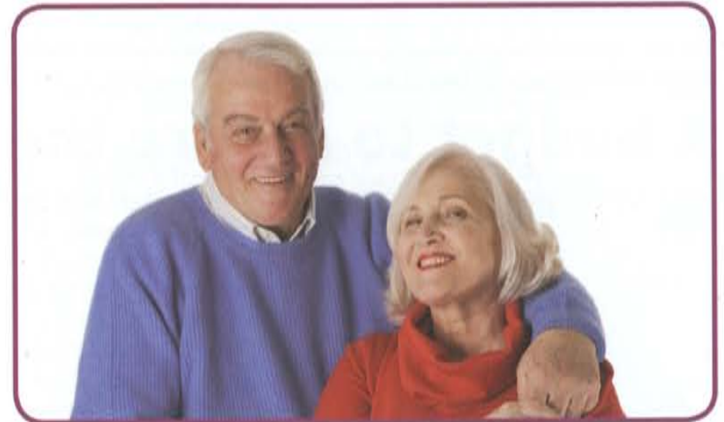
Please remember household insurance is most unlikely to provide anything like enough protection for cash; in the event of a fire or theft, you could lose far more than you expect!

And don't forget, despite the historically low bank rate, there are some good deals on the market, although many of these can carry restrictions and penalties if you need to get at your money before the end of a fixed period of time.



Planning for later retirement

The downside of us living longer is that our pension plans have to last longer.



For the basic state pension, this is important because of the parlous state of public finances in the wake of the credit crunch and recession. With extended life expectancy and a falling birth rate, the 'support ratio' that is the number of people working and paying national insurance contributions compared with the number of people eligible to claim state benefits, such as pensions, is falling.

Add to this the fact that we taxpayers have had to pour billions of pounds into the banks and it is clear that the basic state pension is rapidly becoming unaffordable. This is why, from this year, the state retirement age for women will gradually start rising from 60 to 65.

It is also why the Government has already announced that the state retirement age for everyone will then have to rise (in stages) from 65 to 68 between 2024 and 2046.

Does this really matter?

This change will start to affect people more quickly than they may imagine. Those now in their 50s will quickly be 'caught' by the higher state retirement age. Of course, for most people the basic state pension is likely to form only part of their retirement income with the balance being provided by an occupational or personal pension.

However, except for those lucky enough to be in one of the few remaining 'final salary' (or defined benefit) pension schemes (if not closed in the meantime), the company or personal pension they build up will be affected by the need to last longer than was expected at the time they started planning. That - together with low interest rates - is why annuities are more expensive than a decade or so ago and a given pension pot secures a lower income than was once the case.

So where does that leave us?

Unfortunately, this means that not only will most people receive a smaller income than expected, but they will also have to wait longer for part of it. And, with the basic state pension currently being worth just under £5,000 for a single person, that represents a quarter of the entire retirement income of a man who had built up a pension fund of about £220,000, by age 65.

By having to wait a year or more longer, the situation is simply exacerbated.

What can we do?

The best solution is to take advice and then start planning to 'fill the gap'. This can be achieved in a number of ways, from increasing your pension contributions to making better use of the Individual Savings Account limits that cut in for the over 50s last October and for everyone else in April 2010.

News in brief

During the first part of this year, the FTSE100 suffered an initial reversal following a strong finish to 2009, but has subsequently recovered to continue its growth trend. Towards the end of March, it had already gained almost 5% on the year.

The housing market continues to be relatively unstable with the January rise partially offset by a fall in February. However, the annual growth rate remains positive and the Budget announcement on stamp duty for first time buyers (see page 1) should help the market.

Oil prices fluctuated, during early 2010, from below US$70 to above US$80 a barrel for Brent Crude 1-month futures. At the time of writing it is only just above its level at the start of the year, but motorists still seem to be paying more at the pumps.

Sterling has continued to fall against the dollar, with the post-Budget exchange rate 7.5% below the start of 2010. It is fairly stable against the euro, having lost just 0.5% of its purchasing power; but with 60% of our exports going to Europe, a weaker pound would help overseas sales.

Tracker mortgages

According to recent reports, one lender has seen a big shift towards borrowers seeking tracker mortgages. Why is this ... and is it a good thing?

This is a good time to start off with the usual warning about always seeking individual advice before making any decision about your personal finances, because nothing written in an article like this can possibly apply to everyone.

However, it is worth considering the broad principles, to which individual circumstances can be applied.

What are trackers?

Most mortgages were historically based on variable interest rates. This meant that the lender could vary the interest payable up or down virtually at will, with no regard to external conditions (other than, perhaps, competition). Unsurprisingly, this did not appeal to many borrowers and the trend developed for lenders to offer fixed rate mortgages or, sometimes, capped rate mortgages. The latter were a kind of fixed/variable rate hybrid; they could go down if prevailing rates fell, but future fluctuations could not take them above the cap.

Some lenders, however, recognised that borrowers might prefer a level of predictability without having to be tied in for a fixed term to one rate. As a result they created the tracker mortgage, tying the interest rate they charge to a fixed differential compared with an index - often the Bank of England's base rate, although some other indices are also used, including the lender's own base lending rate.

So if the fix was 0.5% above Bank of England base rate, while that rate stood at 5%, borrowers in the tracker would pay 5.5%; now they would be paying 1%. In fact at one time, some ties were actually set at 0.5% below base and these lucky borrowers could now be paying nothing (most are actually paying a modest amount as lenders' systems will not cope with receiving nothing each month).

Why are they becoming more popular?

There are currently a number of tracker deals available, typically at between 1.9% and 2.8% above base rate, depending on the type of mortgage. The reason why people like them is that they offer some protection against lenders hiking interest rates by a larger percentage than the Bank of England. Whether or not these offer good value depends on your view of how the market generally will go; that is, will lenders push up their interest rates more quickly - or more slowly - than base rate rises? And, of course, what will actually happen to base rate?

What are the possible pitfalls?

Another potential issue is the so-called 'collar' that lenders now apply to trackers. As indicated earlier, some lenders have been badly caught out by the fall in base rate to such historically low levels. As a result most, if not all, will now apply a level below which their interest rates will never fall, whatever happens to base rate.
Whether or not a tracker is for you - or you might prefer one of the alternatives currently available - will depend on your personal circumstances.

Your home may be repossessed if you do not keep up repayments on your mortgage. Think carefully before securing other debts against your home. Fees for mortgage advice may be charged and for details of these please contact your usual adviser.

"Non-working" parents

"Non-working" in this context means not economically active; anyone who thinks looking after children (or older generations, for that matter) is not work, has never done it!

It can be all too easy to focus insurance on what might happen if the principal breadwinner is lost to the family; yet the loss of a carer can be just as financially devastating. Yet if you consider what many carers actually do, it can consist of: part-time paid work, cooking, cleaning, washing, looking after sick children, as well as preparing those who are 'fit' for school, games, leisure activities and then getting them there!

In most modern families, many of these are actually shared responsibilities - but in practice primary caring usually falls to one person and that is frequently the lower earner (almost irrespective of the hours worked).

Does this matter?

If the carer were no longer available to undertake these tasks, not to mention possibly contributing towards the family budget as well, they would have to be undertaken by someone else. In the short term, this will fall to the remaining parent. But from then on, his or her own earning potential becomes even more important to the family; time devoted to caring, while socially important, detracts from the ability to earn sufficient for the family to carry on.

There is an alternative

The importance of an alternative source of income to cover the longer term cannot be over-emphasised. Having access to a lump sum sufficient to remove all financial concerns is one way of allowing the family to address other, more important issues, such as starting the grieving process. Ideally, insurance should be adequate to cover the entire amount of any outstanding borrowing, including mortgages, credit cards and other secured and unsecured loans, plus something more to provide for living expenses for a few months.

The longer term

It is important, however, also to consider the longer term. As the immediate impact of what has happened fades, so can the support provided by the extended family and friends, leaving the immediate family to 'pick up the pieces'. During this period and beyond, having a source of income that allows the surviving parent to focus more on the family than might previously have been the case is one of the factors that could speed the recovery process.

Insurance can provide both a lump sum and an income for as long as may be deemed necessary in order that the family can regroup and move forward. The cost need not be expensive, because insurance companies know that most people tend to live longer than earlier generations, so the number of claims will be less than may once have been the case.

What about sickness?

It is also usually possible to arrange insurance to provide an income should the caring parent become incapacitated through injury or illness for a sustained period although the level of cover available may be limited.

Back-page Briefing

The end of self-certification?

The regulators are suggesting an end to the system whereby people could avoid giving lenders evidence of their earnings by opting for a 'self-certification' mortgage.

A self-certification mortgage means that the lender accepts the borrower's word on how much they earn - and thus their ability to repay the mortgage - rather than demanding formal evidence of income. This type of mortgage helped those without a regular source of income to buy a home more easily, without having to jump through hoops to do so.

What is wrong with them?

The problem is that this has been open to abuse, with people exaggerating their ability to pay their mortgage and then getting into trouble if expected earnings failed to materialise. This is not necessarily widespread but in the wake of the credit crunch, regulators have apparently decided to tar self-certification mortgages with the same brush as lending to NINJAs (no income, no job or assets) in America.

Who will be affected?

Not only the self-employed would be affected by this proposal. Anyone who wants to borrow close to the maximum in terms of multiples of earnings could find that new responsibilities on lenders to assess affordability based on the borrower's free disposable income and borrowing capacity might reduce their ability to obtain a loan.

This could adversely hit first-time borrowers as well as those seeking to move up the housing ladder.

Is there a solution?

It is not clear that this is actually an issue that needs to be addressed. What is clear, however, is that the role of professional mortgage brokers and independent financial advisers is set to become even more important in future.

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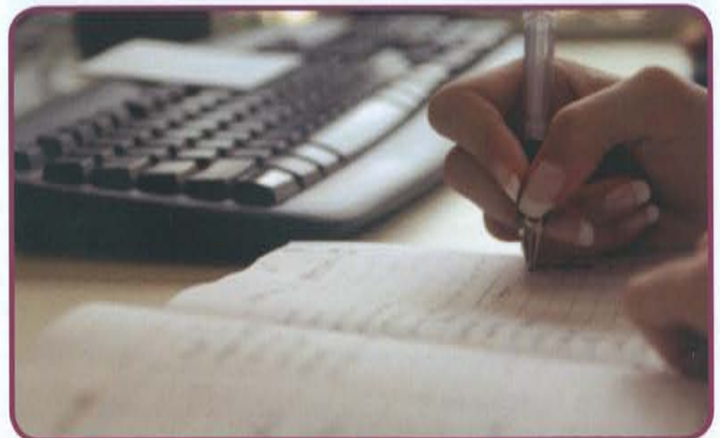

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