Keeping Positive

Negative equity can quickly become an issue for homeowners, especially during a time when house prices drop quickly, as has been the case in recent times. So what are your options when you find yourself in this situation?

The term negative equity is commonly used to describe the circumstance of having a home that is worth less than the mortgage. The truth about negative equity is that it doesn't cause difficulty unless you have to sell or re-mortgage.

Home ownership is a long-term business and there is no easy solution to the problem of negative equity. You may want a bigger house, need to move to a different area for employment reasons or in the worst case, be unable to meet your mortgage and have to surrender the house to your lender.

For those whose finances and circumstances allow, the answer is to stay put, and realise that eventually house prices are likely to go back up. On the other hand, if this is not an option, there are a number of avenues to explore.

Lending a Helping Hand

Generally, lenders don't want to repossess properties. It's a costly procedure and the end result is that they have to sell the property and so crystallise their loss as well as yours. Even if – as some lenders are currently doing – they keep hold of the property for the time being and let it out, it involves costs and administration problems they would prefer to avoid.

Contact your lender and ask if there are any schemes they run to help with negative equity. Some lenders may have packages for their existing borrowers, but usually only if you have a good payment record. There may be a maximum amount of debt on your old mortgage that can be included in your new one. Also you may have to pay off the old mortgage debt over a shorter time period than a usual mortgage, such as ten years rather than 25 years. This is not necessarily a cheap option as the interest rate may be higher and there may be a fee. You are also putting your new home at risk if you cannot keep up the total mortgage payments on the new home. Payments will be larger than normal as the shortfall is included.

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Some lenders may agree to accept less than the full amount of the shortfall debt by securing part of the debt on a new property as part of your mortgage and writing off the rest. Some schemes ask for a guarantor on the new loan, such as a relative, and may want the loan secured on their home as well as your own.

Shop Around

You may be able to clear the negative equity by obtaining an unsecured loan from your bank or building society. This will probably be more expensive than a secured loan because a higher rate of interest is usually charged, but an unsecured loan does not put your new house at risk. The loan may also be over a shorter period which would mean the monthly payments are likely to be larger. A limited number of lenders may run schemes that offer assistance to all borrowers. So you can apply even if your mortgage is with a different lender. Shop around high street banks and building societies and ask about these schemes.

Rent it Out

Another option is renting out your house with your lender's permission. Some lenders add an extra percentage on to the mortgage interest rate for allowing you to rent out the property. You could ask them to waive this if it will cause you hardship. You also need to check if your buildings and contents insurance will be affected when renting.

It can be difficult to deal with letting your house if you live far away. You may need to ask an estate agent or letting agency to act for you and find tenants. Your lender may insist that you use a specific agency and type of tenancy agreement. It is also worth approaching local housing associations. These are sometimes willing to take over renting out your property to people on their waiting lists.

If you do decide to rent out your house then you will have to find alternative accommodation. This may be useful if your aim is to move to another part of the country. You may be able to buy another property with a new lender if your income is sufficient. Most lenders are likely to be reluctant to do this except in very specific circumstances.

Remember you will still be liable for the mortgage when your tenants leave, and the rent you receive may not cover the whole monthly mortgage payment. You will also be responsible for repairs to your property.

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Selling Up

You may have to sell your house, in which case you may have to prove to your lender that sale is the last resort, that it is in everyone's financial interest, as well as persuading them that you have obtained the best possible price for the property. It may be useful to point out that if the house was sold by the lender they would be likely to get a lower price as the property would be empty and could fall into disrepair.

Provide your lender with full information about your financial circumstances. You will need evidence from several independent estate agents that you have found the best sale price for your home. The lender may ask you to sign an extra agreement saying how you will repay the shortfall debt.

SURVIVAL TIPS

- Treat mortgage payments as if they were rent – you have to pay for somewhere to live and mortgage payments should mean you eventually own an asset
- Don't just walk out on the debt – lenders can now keep records for longer than before and are unlikely to forget bad debtors.
- Bear in mind that the national average house price remains slightly higher than it was a year ago – and short-term setbacks are unlikely to reverse the long-term upward trend.
- Pay more off your mortgage if you can afford it – most flexible mortgages allow you to repay up to 10 per cent of the outstanding debt.
- Simple home improvements, such as a lick of fresh paint, can raise the value of a home.
- Take in a lodger and use the money to reduce debt.