The London Institute of Banking & Finance

Level 3: Certificate in Financial Studies (CeFS) 600 / 8537 / X

Unit 2 – Financial Capability for the Medium and Long Term (FCML) D / 504 / 8110

May 2019 Examination

EXAMINATION COPY
Case Study Information and Data

Instructions to learners:

This material has been designed to provide background information / research material for the examination. It is intended to help students familiarise themselves with the enclosed material prior to the examination.

The information and data is made up of:
- Case study 1 information and data.
- Case study 2 information and data.

Candidates are advised to read **both** sets of case study information and data prior to the examination. At the beginning of the examination, candidates are advised to review the case studies in conjunction with the question paper before committing to answering a particular case study.

Please note:

- You may annotate the case study material.
- The figures and products featured in the case study information and data were correct at the time of writing. Learners are not expected to know current interest rates of specific products and services, nor to have detailed knowledge of changes to products and services.
- Although this material contains certain information relating to the examination scenarios and questions, the actual scenarios / questions are provided in the examination question paper.

The London Institute of Banking & Finance is a registered charity, incorporated by Royal Charter.

Case study 1: Information and Data begins on page 3

Case study 1

Marcus and Miriam want a place of their own

Marcus and Miriam are both 27 years old and have been living together in a rented flat in North Devon for two years. They both work full time for a manufacturing company, with a combined salary of £48,600pa paid into their joint current account. They have used a number of different borrowing products in the past, namely a personal loan and a number of credit cards. Marcus and Miriam have always paid back their borrowings in full, and the couple are fortunate to have built up an excellent credit history.

Marcus and Miriam have decided that they would like to buy a house of their own. They would prefer to make payments towards a mortgage rather than spending part of their incomes on rent. Since first discussing their plan to buy a property, Marcus and Miriam have decided to get married as soon as they can afford to. They have managed to save £4,500. Miriam is also keen to start a family as she has always loved children.

Marcus's parents are retired and Miriam's parents divorced when she was nine. Therefore, neither set of parents is likely to be able to help the couple financially. However, Marcus's godmother recently passed away, leaving Marcus £22,000 in her will. The couple intend to use the money to help them with their planned house purchase. In view of the uncertainties in the property market, Marcus's parents are worried about the couple buying a house. They have urged Marcus and Miriam to do thorough research before committing themselves.

Marcus and Miriam have given you the following 'snapshot' of some of their key monthly expenditure:

Table 1: Marcus and Miriam's key monthly expenditure

Monthly income:	£4,050 before tax
Monthly expenditure:	
Rent	£1,100
Utility bills	£120
Food	£350
Travel	£240
Entertainment	£200
Sundries	£200
Savings	£200
Total expenditure	**£2,410**

The couple are conscious that there are many factors that will affect their ability to buy a house. These include the cost of the mortgage, the other financial products that they will need to purchase, together with other expenditure on items such as furniture (Marcus and Miriam currently rent a furnished flat and do not have any furniture of their own).

Marcus and Miriam were at college at the time of the financial crisis in the UK and they have asked you to investigate to see what effects it had and to help them to make an informed decision in terms of their major purchase.

The Research

The financial crisis in the UK had a major impact on consumers' ability to borrow as providers had become more cautious about lending money. This was particularly obvious in the mortgage market due to the changes in mortgage products available to consumers and the associated costs.

Mortgage lending in the past – deposits then and now

Traditionally, it was always considered wise to pay 10% of the purchase price of a property as a deposit (which would be saved up in advance), resulting in taking out a mortgage of 90% of the remaining property value.

However, as the level of competition in the mortgage market increased, when interest rates were relatively low and house prices were rising rapidly, some financial

services providers offered 100% mortgages (requiring no deposit) and even 125% mortgages where consumers were able to borrow more than the value of their property, in the expectation that prices would continue to increase rapidly.

Because of the financial crisis, the availability of such large mortgages was unlikely to continue. The financial crisis resulted in changes in the interest rates charged, the associated fees that are payable and criteria that borrowers must meet in terms of their income and loan-to-value ratio (the value of the mortgage needed after consideration of the deposit provided compared to the value of the property).

Table 2 shows the information relating to mortgages offered by Cheltenham & Gloucester (C&G) in 2009 in comparison with 2018 offerings by TSB, the company that eventually bought the business and rebranded all the branches.

Table 2: A selection of the mortgages previously available from C&G in 2009 and comparable products from TSB in 2018

Mortgage type	C&G 2009 interest rate	C&G 2009 maximum LTV	Fees	TSB 2018 interest rate	TSB 2018 maximum LTV	Fees
2 year tracker	5.69%	60%	£1,995	1.64%	60%	£995
2 year tracker	5.99%	60%	£495	1.89%	85%	£995
2 year tracker	6.29%	60%	None	3.39%	95% (not first-time buyers)	None
5 year fixed rate	5.09%	75%	£995	2.04%	95% (not first-time buyers)	£995
5 year fixed rate	6.49%	90%	None	2.44%	95%	None
10 year fixed rate	n/a	n/a	n/a	2.39%	75%	£995

Source: C&G website (www.cheltglos.co.uk) and TSB website (www.tsb.co.uk)

Stephen Maunder, writing for which.co.uk in September 2018, said, “In the current mortgage market you’ll need a deposit of at least 5% of a property’s value to get a mortgage. A lender would then lend you 95% of the property’s value. So, if you wanted to buy a £150,000 property, you would need to save up at least £7,500 and borrow £142,500.

However, the bigger the deposit you can save the better. According to research from Halifax, the average deposit put down by those buying their first home in the first half of 2018 was 16%” (Source: which.co.uk).

He then goes on to list four reasons to save a bigger mortgage deposit:

1. Cheaper mortgage repayments.
2. Less risky.
3. Better mortgage deals.
4. Better chances of getting a mortgage.

Changes consumers can make

Paloma Kubiak, writing for yourmoney.com, offered this advice for those considering longer terms for their mortgages: “Longer mortgage terms tend to have lower monthly repayment options, which provides people with an affordable route to homeownership.” However, Rachel Springall, finance expert at data site Moneyfacts, said that opting for a longer mortgage may seem like a good idea at the outset, but borrowers will ultimately repay more in interest.

Rachel said: “Borrowers will find that the monthly repayment can be more manageable than if they opted for a shorter mortgage. However, lowering the monthly repayment does not lower the overall cost of your mortgage, as you end up paying out more in interest due to taking longer to repay the debt (as interest is charged on the borrowed sum until it is repaid)” (Source: yourmoney.com).

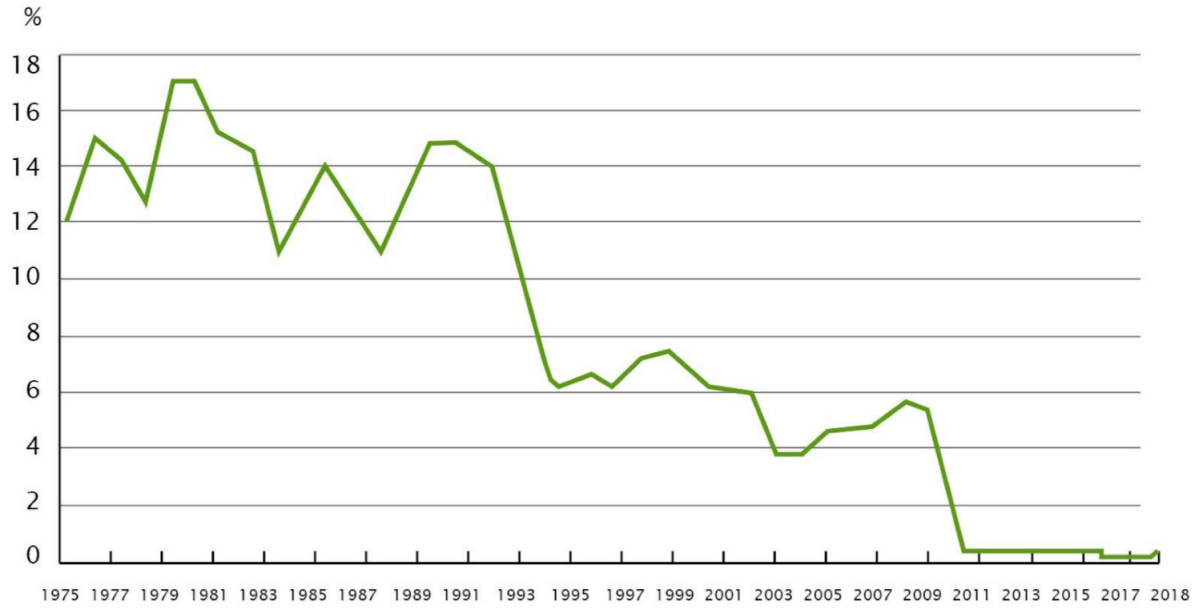
The changing face of mortgage fees

As seen in Table 2, there are mortgage fees on top of the interest, which must be paid at the time the mortgage is agreed. Fees do not have to be paid upfront but can be added to the mortgage. The consumer must make a choice between a higher rate

of interest but a lower (or zero) arrangement fee, or a lower rate of interest but a higher arrangement fee. The top arrangement costs from 2009 are not so common anymore.

Changes in UK base rate also have a significant effect on the cost of a mortgage. This is because when the UK base rate changes, lenders alter the interest rates they charge. However, some mortgage products have fixed interest rates for a specific period.

Graph 1: The Bank rate from 1975–2018



Source: Bank of England website

Government to the rescue for first-time buyers

An additional cost that consumers need to pay when purchasing a house is stamp duty, which is a tax paid to the government.

However, in the 2018 Budget, there was some good news for first-time buyers, as reported by Sarah Guershon, writing for Money Saving Expert:

“First-time buyers in shared ownership homes will pay zero stamp duty on the first £300,000 of any home that costs up to £500,000 with immediate effect, the Chancellor has announced. The change will be retrospective back to the last Budget (22 November 2017).

The changes apply to purchases by first-time buyers in England and Northern Ireland – there is no change for buyers in Scotland or Wales. Until this announcement, first-time buyers purchasing shared ownership properties still had to pay stamp duty, despite the relief offered to all other first-time buyers following the last budget in November 2017.

This means on a home worth less than £300,000, first-time buyers (both in and out of shared ownership schemes) won't need to pay stamp duty"
(Source: www.moneysavingexpert.com).

Table 3: Changes in the average house price in the South West of England compared to the average for England 2016–2018

	August 2016		**August 2017**		**August 2018**	
	Average price	% annual change	Average price	% annual change	Average price	% annual change
South West	£243,226	+9.0%	£251,984	+6.4%	£257,659	+2.9%
England	£235,573	+9.2%	£243,520	+5.3%	£249,748	+2.9%

Source: www.gov.uk

Getting expert advice

"A financial adviser is someone who provides advice to an individual or company on how to manage their money.

As with any profession, their desire is to earn a living and one of the common complaints regarding financial advisers will quite often be that they offer or sell financial opportunities which may not be in your best interest, but actually provide them with the largest income.

Independent financial advisers (or IFA) are not affiliated to any particular financial products or services. This is important because it should enable them to review the full range of financial products and services, rather than being limited to only offer what any one or more particular company offers"
(Source: www.expertsforexpats.com).

Case study 2: Information and Data begins on page 10

Case study 2

Saving up for a gap year that will not break the bank

Miles is a 17 year old student in Year 12 studying PE (physical education), physics, biology and English at the local sixth form college. He has recently passed his driving test and has been looking forward to travelling independently since going on a family holiday to France when he was 14.

Due to the rising costs of higher education, and the subsequent debt incurred by students, Miles is undecided as to whether he wants to go to university. He is planning to take a gap year to travel and decide on his future plans after completing Year 13. He is hoping to work full time in the UK for eight months, before travelling around Slovenia, Croatia and Italy. After his travels, and having returned home, Miles will decide either to start a university course or to find full-time employment.

Miles has a part-time job as a pool attendant at the local leisure centre. He usually works a total of 15 hours per week (on Thursdays, Fridays and Saturdays) at a rate of £7.15 per hour. He has a balance of £900 in his Lloyds Under 19s Account, earning interest at a rate of 0.5% AER. He goes to the bank because he likes their customer service.

Miles opened the account with Lloyds as his parents have always held their main current accounts with the bank. Miles is fortunate that, despite earning a regular income of his own, his parents currently allow him to live at home rent-free.

Miles has listed his typical weekly income and expenditure as follows:

Table 1: Miles' typical weekly expenditure

Weekly income: 15 hours' work @ £7.15 per hour **£107.25**	
Socialising	£30
Food	£18
Travel	£10
Mobile per week	£7
Total expenditure	**£65**

Miles has estimated that he should be able to save around £800 while he completes his studies and then £300 per month during the eight months that he is working full-time – this should give him a total amount of at least £4,100 to pay for his trip or to use in the future.

Miles is aware of the importance of saving to limit any borrowing that is needed to cover his spending while he travels. He has seen coverage in the media about the various rates of interest paid on savings accounts and the effects of inflation. He has asked for your advice regarding putting funds aside for his gap year.

The Research

The attractions of taking a gap year

The Higher Education Liaison Officers Association, writing on which.co.uk in April 2018, gave this advice about gap years:

"However you choose to approach it, the universities you're interested in applying to will be keen to hear a sentence or two (in your personal statement) about your intended plans and what you hope to gain from your gap-year experience – this could be earning some money, gaining further experience in a related field or travelling the world.

However, you decide to spend your gap year, make sure that it's a constructive use of your time. Don't just spend the year having a good time and not doing anything that will add value to your time at university – it won't do you, or your application, any favours.

The best way to avoid wasting your gap year is to ensure that you plan out your time effectively. Do your research well in advance to avoid any unexpected pitfalls, such

as costs for travelling or volunteering that you can't afford to meet, or not getting a work experience application in on time" (Source: www.which.co.uk).

Instant access savings accounts – more to them than meets the eye

When shopping around for a new savings account, consumers may be attracted by the flexibility of an instant access savings account. However, these accounts may not always be as straightforward as they appear due to the number of terms and conditions that may apply.

Table 2: Examples of conditions attached to some 'instant access' savings accounts

Possible conditions applied on a savings account
Limiting the number of withdrawals or imposing penalties on withdrawals
'Introductory bonuses' may require a minimum investment amount
Applying minimum age requirements
Instant access rates are not necessarily that much worse than notice accounts
High interest rates penalised by very low rates in months you make a withdrawal

Such conditions, along with the reluctance to save money rather than spend it, may result in consumers actually having very little savings at all.

Introductory bonuses – not such a bonus after all

Most consumers look carefully at the rate of interest paid on any savings account they may be looking to open in order to make a decision about where to deposit their money. The banks and building societies, however, have responded to this by manipulating the rate of interest paid.

"Savers face an array of hidden catches on accounts that are supposed to be easy-access. Some banks will let you access your money only twice a year without paying a penalty. Others are bolstering rates with a large short-term bonus, which means savers are left earning next to nothing after 12 months unless they switch again.

Even if savers jump through these hoops, they end up with little or no more interest than if they had just picked a straightforward easy-access deal.

For many, the hassle of having to move your cash after 12 months just won't be worth it" (*Source:* ThisIsMoney.co.uk).

After the initial discount period is over, consumers are then able to change accounts.

Table 3: Additional bonuses added to the interest rates paid on some savings accounts

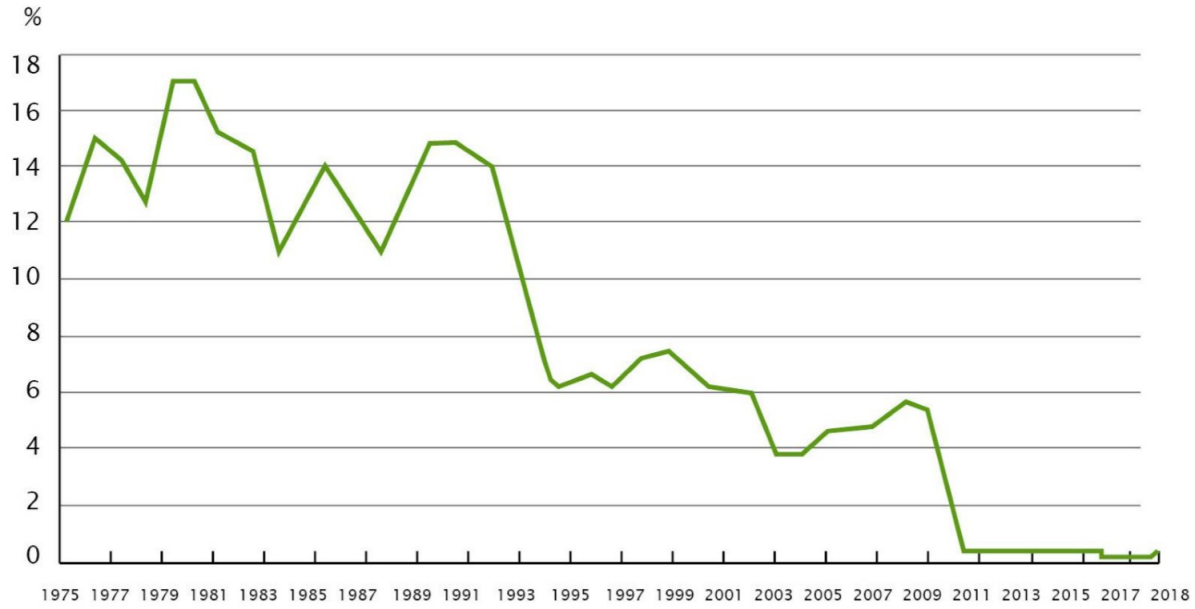
Name	AER (as of November 2018)	Terms and conditions
Virgin Money's Double Take E-Saver	1.42%	• You can only take out money twice in a calendar year. • If you take out cash twice, you will not have access to the remainder of your money until the following year.
Sainsbury's Bank Defined Access Saver	1.4%	• Access money up to 3 times a year. • You can make more withdrawals, but the rate will drop to 0.5%.
Coventry Building Society Limited Access Saver	1.4%	• Offers up to 3 withdrawals per year. • Exceed this limit and you will be charged a fee equivalent to 50 days' interest. • Includes a 0.4-point bonus for 12 months. After this, the rate drops to 1%.
Post Office Money's latest edition of its Online Saver	1.45%	• Includes a 1.20% fixed-rate bonus. • After 12 months the rate will revert to 0.25%.

Source: provider websites

Bank of England UK Bank rate

The interest rate paid on savings accounts is also likely to be affected by changes in the UK base rate, which is set by the Monetary Policy Committee of the Bank of England.

Graph 1: The Bank rate from 1975–2018



Source: Bank of England website

What about bonds?

In order to achieve a higher return on their savings, some consumers may choose to open fixed-term savings products, which pay a higher rate in exchange for imposing minimum deposit requirements or a limit on withdrawals for a fixed period.

“Fixed rate bonds, also known as fixed rate savings bonds or fixed rate savings accounts, usually offer a higher interest rate than instant access savings accounts, in return for locking away your money for a set period, usually between one and five years” (*Source:* Uswitch.com).

Inflation – the enemy of savings?

In order to maintain the value of savings, accounts need to deliver at least the rate of inflation. To be beneficial to the saver, the rate needs to be greater to achieve returns on the real value of the money.

Consumers are constantly faced with the effects of inflation as the prices of items generally rise over time. Graph 2 shows how the rate of inflation has changed over time.

Graph 2: Changes in the UK rate of inflation (CPI) from October 2013 to October 2018

Source: tradingeconomics.com

Savers can achieve some protection from inflation by utilising their annual cash ISA allowance each year and receive the interest paid tax-free.