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MORTGAGE FACTSHEET

MORTGAGE MATTERS

Deciding which type of deal to go for is a key decision

As part of the mortgage agreement, the borrower is contractually obliged to repay the loan amount plus any interest charged by the lender. This usually happens through monthly repayments which are structured to reflect the type of mortgage product used and the rate of interest charged by the lender.

When you're choosing a mortgage, deciding which type of deal to go for is a key decision, so it's really important to understand how they work. After taking out your mortgage, you'll pay an initial interest rate for a set period of time. This rate can be fixed (guaranteed not to change) or variable (may increase or decrease). Two, three and five-year deal periods are the most common.

TYPES OF REPAYMENT

With most mortgages available today, there are broadly two types of repayment options for the borrower:

REPAYMENT MORTGAGES

These are sometimes also known as 'capital-and-interest mortgages'. As the name suggests, with this type of mortgage the borrower makes monthly repayments to the lender which includes an element of the capital and also the interest. The proportion between capital and interest will vary over the term of mortgage. Over time, as more capital is repaid, the interest element decreases. At the end of the mortgage term, if all repayments have been made, the mortgage will be repaid and the borrower owns the property outright.

INTEREST-ONLY MORTGAGES

With this type of mortgage, the monthly repayments only comprise the interest and do not include any repayment towards the original loan amount. The borrower is still responsible for repaying the full loan amount at the end of the mortgage term. Therefore, there are some additional risks with this repayment model – namely that the borrower may not have sufficient funds to repay the full loan amount at the end of the term. To help the borrower avoid this scenario, it is very important that the borrower has a suitable repayment vehicle in place to repay the capital at the end of the term.

MORTGAGE INTEREST OPTIONS

Regardless of the repayment model the borrower opts for, they will have a further choice as to the type of mortgage product they have. There are several options aimed at helping borrowers with different needs.

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VARIABLE RATE (OR 'STANDARD VARIABLE RATE')

These payments can move up or down depending on changes to the rate of interest being charged by the lender. Though there may be changes in the Bank of England's Base Rate, individual lenders will decide how they set interest rates for their own products.

TRACKER RATE

This is a variable rate loan with an interest rate that tracks movements in the base rate set by the Bank of England or LIBOR (the rates at which banks lend to each other). The lender will set the interest rate initially, and this can be set to be equal, above or below the base rate. The rate then moves up or down with the base rate.

FIXED RATE

The borrower is subject to a fixed interest rate for a specified period. Though usually between one and five years, it can be for longer. The main advantage of this is that monthly repayments are 'fixed' for the duration of that period, helping the homeowner budget effectively. This is usually of particular benefit to first-time buyers or those on tight budgets.

DISCOUNTED MORTGAGE

The borrower receives a discount off the lender's standard variable rate usually for a specified time period. At the end of the deal, you will move to the standard variable rate. This type of interest option can be good for those who know they will have a tight budget in the immediate term and are confident that they will be able to increase their payments when the deal comes to an end.

'CAPPED' AND/OR 'COLLARED' RATES

These are variable rates but with limits. For example, the lender may not be able to increase their rate above a certain amount ('cap') or reduce it below a certain floor ('collar'). ■

REQUIRE FURTHER INFORMATION?

We can help you with your mortgage needs. Whether you're a new customer or we've previously arranged a mortgage for you, please contact us to discuss your requirements.

Think carefully before securing other debts against your home. Your home may be repossessed if you do not keep up repayments on your mortgage.