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MORTGAGES EXPLAINED

Once you have decided how much you can borrow and how much you can afford, there are 2 more main decisions you need to make :

- What type of interest rate deal do I want ?
- Which repayment method should I have ?

The main types of mortgage product are :

1. Tracker
2. Fixed
3. Discount
4. Capped
5. Offset

There are variations on these themes and see the mortgage glossary for detailed explanations of these and other terms.

There are two types of repayment method for paying back the monies you have borrowed :

1. Capital and Interest (repayment)
2. Interest Only

The next few pages will look at giving you an idea of how these work but are no substitute for actual advice.

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Types of interest rate deals

Type of interest rate deals	How does it work	Early repayment charges	What does it mean for you?
Standard variable rate	Your payments move up or down at the lender's discretion. The lender may not reduce, or may delay reducing their variable rate even if the Bank of England rate goes down.	Not usually, but check and see.	• Usually you can leave your lender without any penalties or problems. • You're in control. You can usually pay back extra amounts (and cut your interest costs) without a penalty. • It moves with interest rates. So if the lender decides to increase the rate your monthly payments will increase. • It may be expensive compared to other deals. • The lender may not reduce, or may delay reducing, their variable rate even if the Bank of England rate goes down.
Tracker rate	A variable rate loan with an interest rate that's equal to or a set amount above or below the Bank of England or some other base rate. It tracks (moves up or down with) that rate.	Sometimes during any special deal period and maybe even after the period too.	• It can pay to go for a tracker if you can afford to pay more when interest rates go up, in exchange for benefiting when they go down. • It's not a good choice if your budget won't stretch to higher monthly payments.

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Discounted interest rate	Your monthly payments can go up or down, but you get a discount on the lender's standard variable rate for a set period of time. At the end of the deal, you usually change over to the full standard variable rate.	During the special deal: yes, almost always. They can apply even after the end of the special deal period as well.	• It gives you a gentler start to your mortgage, at a time when money may well be tight. But you must be confident you can afford the payments when the discount ends. • The discount period is limited, so don't get used to those early low repayments. • You may not be able to make overpayments and pay off the loan early without penalties • The lender may not reduce, or may delay reducing their variable rate even if the Bank of England rate goes down.
Fixed interest rate	Your payments are set at a certain level for an agreed period. At the end of that period, they'll usually switch you to the standard variable rate.	During the special deal period: yes, almost always. They can apply even after the special deal period, too.	• Your payments will stay the same in that period, even if interest rates go up. • This gives you the security of knowing that you can afford your payments and will make it easier for you to budget. • If rates go down, you won't benefit. Your payments will stay at the higher rate. • You may not be able to make overpayments and pay off the loan early without penalties.
Capped rate	Your payments are variable and often linked to a base rate, but fixed not to go above a set level (the 'ceiling' or 'cap') during the period of the deal. At the end of the period, you are usually charged the lender's standard variable rate.	During the special deal: yes, almost always. They can apply even after the end of the special deal period as well.	• You know the maximum you will pay for a set period of time. • Useful if you want the security of knowing that your payments can't rise above the set level, but still benefit if rates fall.

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Collared rate	May be used in conjunction with a capped rate or a tracker (or both). Your payments are variable but will not fall below a set level (the 'collar').	Not usually, unless it is used in conjunction with a capped rate or a special-deal tracker rate (or both). But check and see.	• It may be part of another interest-rate deal which otherwise appears attractive. But note that if the rate payable is only just above the 'collar' and you think rates will fall, you may not get the full benefit of a reduced payment.

Mortgage features

Cashback mortgage

This may be offered with an interest-rate deal. The lender pays you a substantial sum (for example 3-5% of the amount you borrow) shortly after you take up the loan. If you move to another lender in the early years you'll have to repay some or all of the cashback received.

Is it right for you?

Possibly yes, if you need a large cash sum – for example, to buy furniture, or you expect the sum to more than compensate for any higher interest rate you may have to pay during the penalty period.

Possibly not, if you can manage without the cashback now and can get a better overall deal elsewhere.

Flexible mortgage

A flexible mortgage gives you some scope to change your monthly payments to suit your ability to pay. It's also useful if you want to pay off your loan more quickly. Several flexible features are becoming common and they aren't limited to mortgages with 'flexible' in their name. Here are some flexible features:

- **Overpayments** – you can pay more than your normal monthly mortgage payment or pay off a lump sum, or both.
- **Underpayments and payment holidays** – you pay less than the normal monthly payment for a limited period (say six or twelve months). You may even be able to stop making payments altogether (a payment holiday). This could be useful if, say, you lose your job or take time off to care for a child.
- **Borrow extra (loan drawdown)** – you can borrow extra without further approval from your lender, provided the total loan does not go above an overall limit. Alternatively you may be able to 'borrow back' against earlier overpayments.

Is a flexible mortgage right for you?

Possibly, yes, if you are likely to use these features, for example if you're self-employed and have a variable income.

Possibly not, if you are unlikely to use these features. A less flexible mortgage may be cheaper or more suitable for you.

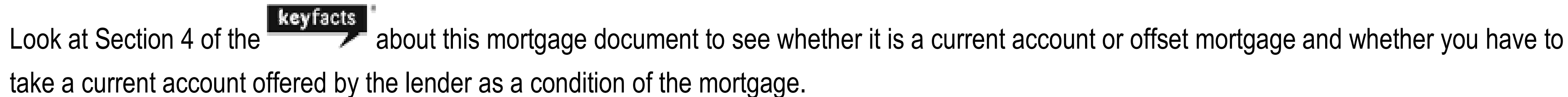
Offset mortgage

With an offset mortgage, your main current account or savings account (or both) are linked to your mortgage and are usually, but not always, held with the mortgage lender. Each month, the amount you owe on your mortgage is reduced by the amount in these accounts before working out the interest due on the loan.

So as your current account and savings balances go up, you pay less on your mortgage. As they go down, you pay more.

Current account mortgage

A current account mortgage is similar to an offset mortgage in that it **offsets** the balance of your savings against your mortgage. However, in this case, rather than your mortgage and current account being separate pots of money, they are usually combined into one account. This means that the account acts like one big overdraft.



Look at Section 4 of the keyfacts about this mortgage document to see whether it is a current account or offset mortgage and whether you have to take a current account offered by the lender as a condition of the mortgage.

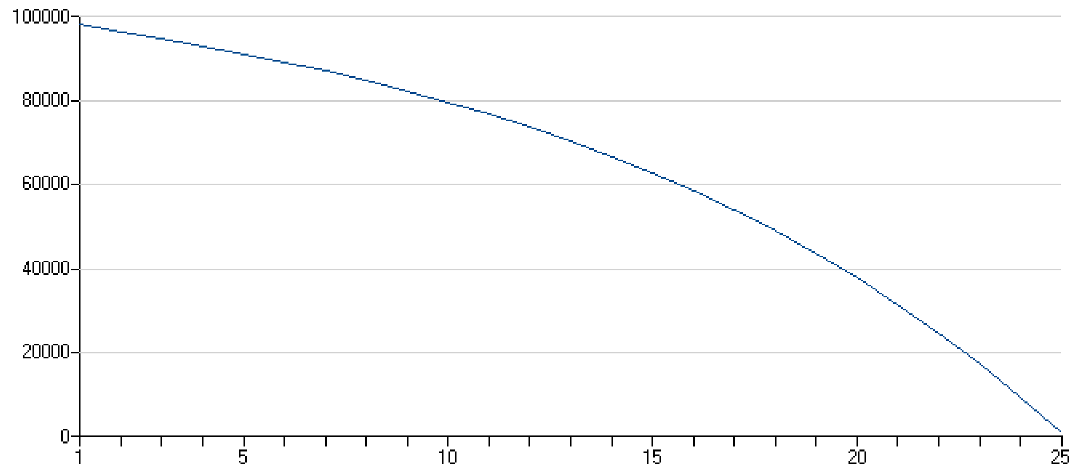
Is an offset or current account mortgage right for you?

Possibly, yes, - if you are a higher rate taxpayer, have substantial savings to offset and like the idea of built-in flexibility to make overpayments and underpayments.

Possibly not, if after paying your deposit you don't have much left in savings and if other mortgages have a lower interest rate or other features that are more important to you

Then you need to decide on your repayment method :

Capital & Interest (Repayment) Mortgage



Every month, your payments to the lender go towards reducing the amount you owe as well as paying the interest they charge. So each month you're paying off a small part of your mortgage.

The pros: It's a simple, clear approach - you can see your loan getting smaller. The loan is certain to be paid off if you meet the monthly payments over the term of the mortgage.

The cons: In the early years your payments will be mainly interest, so if you want to repay the mortgage or move house in the early years, you'll find that the amount you owe won't have gone down by very much.

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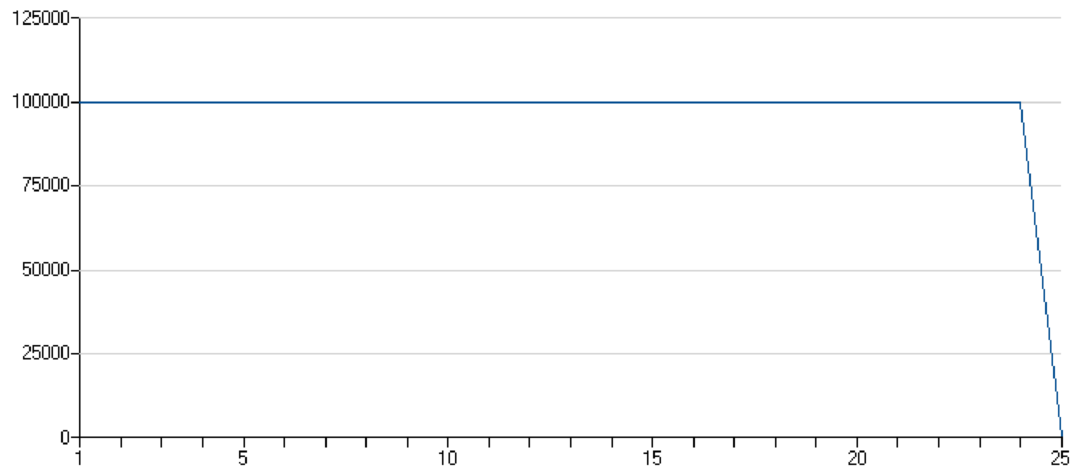
Interest Only Mortgage



As the name suggests, your monthly payment only pays the interest charges on your loan - you're not actually reducing the loan itself. This is why it's very important you arrange some other way to repay the loan at the end of the term; for example, through an investment or savings plan.

If you choose this option you will need to check that your investment or savings plan grows accordingly, so that at the end of the term you'll have enough money to pay off the loan. If it doesn't grow as planned, you will have a shortfall and you'll need to think about ways of making this up.

The pros: Because you're only paying off the interest, and not the loan itself, your monthly payments will be lower.

The cons: That debt is not going to go away. Throughout the life of the mortgage, you'll need to check your investment or savings plan is on track to repay your loan at the end of the term. If you can't repay it at the end of the term you could lose your home.

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