Thinking about your mortgage options?

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Mortgages - A Summary

Mortgages can be confusing, since there seem to be so many different types of home loans available. However, with a little homework it is possible to quickly gain a sound working knowledge of the subject and an understanding of the terminology.

Even armed with this information it makes sense to talk to a professional mortgage adviser. With the number of mortgage choices available - well over 1,000 different deals (which are constantly changing), from over 100 lenders - we at Sterling Financial Services are well placed to help you select the type of mortgage that best suits you. We have access to the majority of the latest mortgages (including many that aren't available through high street lenders), as well as providing invaluable assistance in highlighting potential pitfalls.

However, to help you make sense of the mortgage market we have prepared a brief description of each type of mortgage available.

Right at the outset it is important to understand that there are two facets to a mortgage: how the loan is repaid; and how interest is charged on the debt. Get this clear in your mind and logically, everything else should fall into place.

How the Loan is Repaid

There are two basic ways of paying off a mortgage: repayment and interest-only (backed by a separate investment).

Repayment - with a repayment or capital and interest mortgage, you pay your lender a monthly sum, which consists of repayment of the outstanding debt and interest on the outstanding loan. Month by month the debt will reduce.

Providing you make all your monthly payments in full, the loan will be paid off at the end of the agreed term (which is usually 25 years, but could be longer or shorter).

☑ Easy to understand
☑ Loan guaranteed to be repaid if all payments made
☒ Monthly payments higher than for an interest-only mortgage
☒ You'll need to arrange separate life assurance

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Interest Only - As the name suggests you simply pay interest to the lender during the course of the loan. Your debt never reduces and, at the end of the agreed mortgage term, you owe your lender exactly the same sum as at the outset.

Monthly payments to your lender are lower than for a repayment type mortgage but you will have to clear the debt at the end of the term.

In order to pay off your mortgage you will normally have to make payments into a separate investment plan which is designed to build up sufficient funds to repay the loan in full. You have a number of choices of investments:-

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Endowment - an endowment is an investment plan with built-in life assurance (which will pay off the loan if you die before the end of the mortgage term):

- ☑ May pay off your mortgage in advance of expected date if funds perform well and, therefore, save future mortgage interest payments
- ☑ Built in life assurance
- ☑ Choice of policies
- ☒ Rely on investment performance
- ☒ Potential shortfall in value of fund when mortgage due to be repaid
- ☒ May have to increase premiums

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ISA – It is possible to use an Individual Savings Account (ISA). Beneficial tax treatment includes no capital gains tax to pay on investment gains at the end of the term.

Some plans have life assurance built-in, so you pay a single monthly premium. Otherwise, you may have to arrange separate life cover.

Since investments are in, or linked to, the stockmarket, the value can and will go up and down. There may be a potential shortfall, which could mean increased monthly premiums.

- ☑ Tax efficient
- ☑ Potential for growth
- ☒ Value of fund can go down
- ☒ Potential shortfall in the fund at the end of the mortgage term

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Personal Pension - It is possible to use some of the tax-free cash lump sum available from a personal pension to repay a mortgage.

Personal pensions enjoy considerable tax concessions making them an efficient way to save. However, you must be aware that you will use a significant amount of what is designed for your retirement in order to clear the mortgage debt.

- ☑ Tax efficient
- ☒ A pension is designed to provide for one's retirement, not to clear a debt
- ☑ Potential for growth
- ☒ Value of fund can go down
- ☒ Potential shortfall in the fund at the end of the mortgage term

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Other - You can use unit trusts, shares or maybe an inheritance to provide the funds to pay off an interest-only mortgage. However, a mortgage is a long-term commitment. Can you be sure that you will have the funds available from other means to clear the debt at the end of the mortgage term?

- ☑ Flexibility of ways to pay off the debt
- ☒ Uncertainty

How Interest is Charged

Whether you have a repayment or interest-only mortgage you'll have to pay interest to the lender. There are a number of options:-

Variable rate - Most people take a mortgage with a variable rate - the rate goes up and down, usually in line with movements in bank base rates. Falling rates are good news, since monthly charges go down but, of course, rising interest rates means increased repayments.

☑ The chance to benefit from falling interest rates
☒ Rising interest rates mean higher monthly payments
☒ Lender's variable rate may not be competitive

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Discounted - Many lenders offer variable rates with an initial discount for a period of months or years. As a rule of thumb, the longer the discount period, the lower the discount.

☑ The chance to benefit from falling interest rates
☒ Rising interest rates mean higher monthly payments
☒ Lender's variable rate may not be competitive

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Fixed Rate - You can get a fixed interest rate mortgage, with a set interest rate for as little as a year or as long as 25 years (most people choose to fix for between two and five years). Many fixed rates are lower than the standard variable rate and, usually the longer the fixed term, the higher the rate.

Fixed rates are good for budgeting since you know exactly how much you will pay each month for a set period. They also provide protection should variable rates rise during the fixed period. However, if variable rate drop below the fixed rate you could pay over the odds.

Most fixed rates have early redemption penalties during the fixed term and possibly after the fixed rate runs out. This is a penalty, which is often equivalent to several months interest or a percentage of the outstanding loan, that you have to pay if you repay your home loan before the end of the fixed term. In some cases, early redemption charges may apply for a set period after the fixed period expires.

☑ Good for budgeting
☑ Rate may be lower than variable rate
☑ Choice of periods to fix over
☑ Protection against rising variable rates
☒ Will not benefit from falling variable rates
☒ Hefty early redemption penalties (during and even after the fixed rate period) may lock you into the lender and loan

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Capped Rate - Offers the benefits of variable and fixed rates. Great for budgeting as there is a maximum interest rate (the cap) you will be charged for a period of years. But if the lender's variable rate falls below the capped rate, so will your rate, and you will benefit from lower monthly charges.

Some capped rates have a collar or floor, a floor is the minimum rate that will be charged for a period.

This could be an ideal mortgage for many borrowers and, although early redemption penalties may apply, for the capped period.

☑ Good for budgeting
☑ Protection against rising variable rate
☑ Chance to benefit from falling variable rates
☒ Limited choice of loans
☒ Possible collar or floor below which the rate won't fall below
☒ Early redemption penalties may lock you into the lender and loan.

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Offset Rate - With an offset mortgage, you use the money in your savings and current accounts to help to reduce your monthly mortgage repayments or your mortgage term. You will not pay tax on your savings as they will not be earning interest and you can still access them when you need to. Of course, accessing your savings may increase your mortgage term or monthly repayments.

☑ Can help reduce your mortgage term
☑ Can help reduce your mortgage payments
☑ Tracker or Fixed rates available

Summary

You have a wide choice of mortgage options and it is possible to mix and match methods of paying back the loan with interest charging options.

We at Sterling Financial Services have information and access to most, if not all, of the mortgage deals available from high street lenders, as well as exclusive offers that you can't get from bank or building society branches. In addition, we are able to highlight and explain potential pitfalls, like early redemption penalties and tied-in insurances, that can often take the gloss off mortgages that have attractive headline interest rates.

Due to the fact that Sterling Financial Services are a totally independent firm, we are able to provide you with information on both the best mortgage deals and the best insurance products available.

Since your mortgage is likely to be your single largest financial commitment, it pays to explore all your options. Sterling Financial Services are well-placed to guide you through all your choices to help you select the most suitable mortgage for your needs and save you time and money.

FOR A FREE CONSULTATION
CALL US ON 01444 871661