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Types of Mortgage Interest

Summary

1. There is a large difference between the mortgage offers available and the prevailing interest rates offered by lenders.
2. The UK mortgage market is very competitive. Borrowers should consider re-mortgaging, if appropriate. Care: penalties/fees incurred in doing so.
3. Individuals should ensure that they review the mortgage deals available in the marketplace to ensure that their mortgage continues to be competitive and suitable. The UK mortgage market changes rapidly in terms of rates and types of mortgages on offer.
4. Most, although not all, mortgage deals involve potentially expensive redemption penalties for repayment beyond the agreed amounts within the deal period. Some even extend the redemption penalties beyond this period, and should generally be avoided. The likelihood of redeeming the mortgage within the redemption period should therefore be carefully considered.
5. We recommend that independent mortgage advice is sought prior to taking out a mortgage.

Standard Variable Rate

A Standard Variable Rate ('SVR') mortgage charges interest at the lender's prevailing general rate. The rate is likely to change with the movement of the Bank of England base rate, although not necessarily by the same amount. The difference between SVRs offered by different lenders can be significant.

In general, variable rate mortgages offer the potential to benefit from generally falling interest rates over the mortgage period. However, they also expose the borrower to rises in interest rates.

Advantages

A consistently low standard variable rate can save significant amounts over the term of the mortgage.

Disadvantages

A better deal, involving discounts, is likely to be available.

Base Rate Tracker

With a Base Rate Tracker mortgage the prevailing variable rate paid by the borrower is determined by reference to the Bank of England base rate, rather than the lender's SVR. For example, the mortgage rate may not exceed the Bank of England base rate by more than an agreed margin, and may be a certain amount less than the base rate for an introductory period. The rate may also have to change to reflect the base rate within a specified number of days of the base rate change.

Risk Warning: The past is not necessarily a guide to future performance. The value of your investment and the income from it can fall as well as rise and is not guaranteed. You may not get back the full amount invested.

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Your home may be repossessed if you do not keep up repayments on your mortgage.



Advantages

Could help a borrower who is concerned about the possibility that the lender will increase the margin between the base rate and their mortgage rate. For example, lenders have historically increased SVRs at least by the amount of base rate increase, and have been more reluctant to fully reflect any base rate decrease in SVRs.

Disadvantages

If the tracker term is set for a certain period of time the borrower may find that they are paying an uncompetitive rate. Also, a better deal involving discounts could be available.

Cash Back Mortgage

A number of lenders offer a Cash Back Mortgage, whereby the lender will pay a sum of money to the borrower for placing a mortgage with them. This can be in conjunction with a fixed or variable rate.

Advantages

A borrower may find this useful to repay other more expensive debt or to make home improvements.

Disadvantages

The lender may require that the borrower pays an uncompetitive standard variable rate or face a redemption penalty.

Discounted Variable Rate

Many lenders offer a Discounted Variable rate, as an incentive to take out a mortgage with them. The discount usually only applied for a limited period, after which the rate payable reverts to the lenders standard variable rate.

Advantages

The discount may allow the borrower's budget to meet other household costs. The overall deal may work out to be very competitive compared to the standard variable rate, especially if the borrower is willing to re-mortgage after the end of any redemption period, to obtain the best deals.

Disadvantages

After the discount period the borrower may be locked into paying the standard variable rate or face expensive redemption penalties.

Capped/Collar Rates

Where a Capped interest rate is offered the rate payable will not rise above a set interest rate, regardless of what happens to prevailing variable rates during the capped period. Sometimes the lender will specify a Collar below which the interest rate will not fall, even if the standard variable rate falls below this level.

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Advantages

Gives the borrower the comfort that interest rates will not increase dramatically over the period, whilst potentially enjoying an initially low interest rate.

Disadvantages

A discount or straightforward fixed rate may give a better deal overall. After the capped period, the borrower may be locked into a standard variable rate for the specified period, or face expensive redemption penalties. The collar may result in a higher interest rate than would otherwise be the case.

Fixed Rate

Fixed rate mortgages are available over different terms. This option should be viewed by the borrower as offering peace of mind, in that they will continue to be able to afford the mortgage over the fixed period in question. Equally, if a borrower has strong opinions of the direction of variable rates over a period of time, they may be able to utilise a fixed rate mortgage to back their judgement and potentially save money over variable rates during the fixed rate period.

Advantages

The borrower is certain of the payable interest rate over the fixed period, and may achieve a better deal overall than with other options.

Disadvantages

The borrower may be locked into an uncompetitive standard variable rate for a period after the fixed rate finishes. There is a risk that a better deal would have been achieved via a variable interest rate if interest rates fall over the period. Some lenders impose significant penalties on early repayment.

Combination of Fixed and Variable Rates

Sometimes a lender may allow a mortgage to be taken out using a mixture of Fixed and Variable Rates. This may appeal to a borrower who wishes to hedge their bets as to how interest rates will fluctuate over an agreed period.

Advantages

Allows a borrower to tailor their mortgage to their own requirements. Reduces the risk of relying on one option.

Disadvantages

It is unlikely that the same lender will offer the most competitive rate on all options. Mortgage arrangement fees may be charged for both the fixed and the variable rate elements of the mortgage.

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