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Types of Mortgage Repayment

Summary

1. 'Capital Repayment', and 'Interest Only' mortgages linked to endowments, have historically been the two most popular types of mortgage. Flexible Mortgages are becoming increasingly popular in the current climate.
2. Borrowers considering Interest Only mortgages should ensure that they seek financial advice when considering the repayment vehicle.
3. The selected mortgage should take into account your personal circumstances.
4. 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.
5. In addition, individuals should review any investments and level of outstanding mortgage debt to ensure that the investments remain appropriate.
6. We recommend that independent mortgage advice is sought prior to taking out a mortgage.

Capital and Interest / Repayment Mortgages

A Capital and Interest, or Repayment, mortgage is one where interest is paid to the lender each month along with a further amount, calculated to repay the mortgage over the agreed term. For instance, on a £100,000 mortgage over a 25 year term with an interest rate of 5% per annum, total payments would be around £585 per month. This would initially comprise £417 interest and £168 capital repayment. On a long-term mortgage, capital repayments are relatively small in the early years and comparatively larger in later years.

The lender may require that sufficient life cover is available to repay the mortgage in the event of death, and also that sufficient buildings and contents insurance is in place.

The frequency with which interest is calculated should also be considered. All things being equal, interest calculated daily should result in less interest costs than interest calculated annually, as capital repayments are taken account of more quickly.

Advantages

The mortgage is guaranteed to be paid off at the end of the term.

Disadvantages

By investing the equivalent capital repayment amount elsewhere, a higher return might be achieved.

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.

Our views are based upon our understanding of current legislation. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances. You should not act on any of the information without seeking professional advice.

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



Interest Only Mortgage

With a mortgage arranged on an Interest Only basis, interest is paid to the lender, and usually a separate investment arrangement is established. The investment is designed to repay the capital at the end of the mortgage term, and examples include ISAs, unit trusts/investment trusts and endowments. Financial Advice should be sought before establishing any of these investments. There is usually no guarantee that the investment amount will be sufficient to repay the mortgage owing.

The lender may require evidence of the repayment vehicle and that sufficient life cover is available to repay the mortgage in the event of death. In addition, they may require that sufficient buildings and contents insurance is in place.

Advantages

At the end of the mortgage term, if the investment returns have proved more attractive than anticipated, then an amount in addition to the mortgage could be available. Also, the borrower has greater flexibility over their financial affairs.

Disadvantages

The investment may not repay the mortgage in full. Therefore, there is an investment risk.

Flexible Mortgages

Increasingly available in the marketplace, Flexible Mortgages vary in their nature and operation. They are designed to allow borrowers the opportunity to dictate how quickly they repay their loan. Overpayments to reduce the mortgage can be made on a regular or one-off basis. Underpayments may also be available, whilst many lenders offer the facility to borrow additional amounts without actually having to apply for the funds. Interest is often calculated daily or monthly to ensure that over/under payments are promptly taken account of in the interest calculations.

The lender may require that sufficient life cover is available to repay the mortgage in the event of death, and also that sufficient buildings and contents insurance is in place.

Advantages

Can increase payment options. Borrowers may find that they repay their mortgage earlier than would otherwise be the case.

Disadvantages

May not be as flexible as the borrower would like. A better interest rate deal may be available elsewhere.

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“All in One” Flexible Mortgages / Offset Mortgages

Lenders are offering “All in One” Flexible Mortgages where some or all of a borrower’s current, savings, credit card, overdraft and mortgage account are all combined. The features are as for a flexible mortgage, as above. In addition, the main advantage is that, rather than putting savings in a deposit account and paying tax on the interest earned, a borrower uses surplus cash to reduce the mortgage, which has the effect of reducing the interest incurred on the mortgage. In effect, the interest saved is the “gross” interest and so is tax efficient.

The lender may require that sufficient life cover is available to repay the mortgage in the event of death, and also that sufficient buildings and contents insurance is in place.

Advantages

Every pound paid into the account is used tax efficiently. A higher savings rate may be obtained than available in a standard deposit account. A lower credit card and overdraft rate may be obtained than by using stand-alone products.

Disadvantages

The borrower may find that a better interest rate deal can be obtained elsewhere. The amounts saved on credit card and overdraft debt, and gained on a better savings rate, may not be sufficient to offset the higher interest rate paid on the mortgage.

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