

Choosing the right mortgage

Following are a selection of the most common mortgages available.

- **Affordability**

Your first consideration should be determining what you can reasonably afford to borrow. Your independent financial advisor will have a process of understanding your income and out-goings to make sure you're not overstretching yourself. You should be confident you can handle the repayments comfortably. Remember, interest rates can do up as well as down, so make sure you've got enough flexibility to cover potential increases in your repayments. Mortgage repayments tend to be one of the largest monthly financial out-goings, so it's always worth shopping around, switching to a better deal if you can, or negotiating with your existing lender to make sure you're getting the best mortgage deal for your money.

Types of mortgage available include:

- **Repayment mortgages (or 'capital and interest repayment')**

With a repayment mortgage, every month you are essentially paying back both the interest and the capital (the amount you borrowed) to the lender. This is a popular mortgage option as it offers the reassurance that at the end of the agreed term, your property will be totally paid off and you will not owe your lender any more money.

The repayment option also means you're not relying on a linked investment vehicle to generate the money required to pay off the capital at the end of the mortgage term. Although you will have the confidence that you're paying your lender back the full amount each month, this option is more expensive than the interest-only option.

- **Endowment mortgages**

An endowment is an investment vehicle and used to be a very popular means of helping mortgage holders pay off their mortgage. A homeowner would make the interest payment to the mortgage lender each month and pay a separate amount into the endowment. As well as being a means of saving, it also contains a life insurance element to pay off the mortgage, should you die during the term of the mortgage.

Being an investment linked to the stock market, returns can go down as well as up. A large number of homebuyers who were sold endowment policies in the late eighties found that by the end of their mortgage term, there were insufficient funds available to cover the capital repayment, forcing them to find the capital elsewhere. For this reason, endowment mortgages tend to be less popular these days.

- **Fixed rate mortgages**

Fixed rates are one of the most popular interest rate options for consumers, particularly in an environment of rising interest rates. With a fixed rate, you guarantee that your rate and therefore your monthly repayments remain constant every month for a set period of time, whatever the lender does with the standard variable rate, or what base rates do. The length of time the fixed rate can run for varies depending on the mortgage you choose.

The most common fixed rate periods range between 1 and 5 years, although there are now 25-year fixed rate mortgages on the market. After the fixed rate period expires, the rate reverts to the lender's standard variable rate, which will fluctuate along with base rates. If interest rates are rising, you remain protected against them, but should they fall, you'll miss out on any potential reduction in your repayments.

Be careful, as many lenders will charge you a penalty if you move your mortgage before the fixed term ends. Be sure to shop around for the best deal for you and make sure you read the small print.

- **Discounted rate mortgages**

With a discounted mortgage rate, you pay a set amount below the lender's standard variable rate for a fixed period of time. For example, if the lender's standard variable rate is 7% and you choose a 2% discount, the interest rate you will pay will be 5% for the agreed term. The terms can range between 6 months and 5 years. Generally speaking, if the term is short, the discount is likely to be greater, while for longer terms the discount is likely to be smaller. These mortgages are particularly helpful if you want to reduce your monthly payments at the outset and are comfortable that you will be able to afford the payments after the discounted period.

In some cases the discount can be 'stepped', which means the rate reduces in two or three stages.

- **Capped rate mortgages**

A capped rate mortgage is like combining a fixed rate with a variable rate. For example, for a defined period of time, your interest rate is guaranteed not to rise above an agreed fixed rate, but you should retain the benefits of smaller repayments should the interest rate go down. The terms can range from between a few months to the duration of the mortgage in some cases. Capped rates tend to be more popular in a rising interest rate environment.

However, capped rate mortgages tend to be more expensive than fixed rate mortgages. As with discounted and fixed rate mortgages, you may incur a charge if you move your mortgage before the end of the agreed period of the offer.

- **Variable rate mortgages**

This is essentially the lender's standard variable rate. It will be higher than any introductory interest rate and your repayments will generally go up or down with base rate changes. Most borrowers will find themselves better off with an alternative special

interest rate option, particularly if you switch when introductory offers come to an end. Be aware of any charges that might be incurred for switching mortgages before taking any action.

- **Tracker rate mortgages**

Tracker rates are relatively new mortgage options whereby the interest rate you pay is guaranteed to stay at a certain level above the Bank of England base rate. The rate will stay in line with interest rates and the market in general. This can go up or down, usually for the term of the mortgage. For example, you might find a deal whereby you pay 1% above the base rate, whatever it may be or change to. Although you pay more if the base rate rises, you will benefit from any reductions in the base rate over the term.

Other options to consider:

As well as interest rates and repayment vehicles, there are a few other options worth considering when choosing a mortgage.

- **Deposits**

You may also qualify for a better deal depending on how much of a deposit you can put forward. For example, if you have chosen a mortgage that requires a 15% deposit, see what the repayments would be if you decided to pay a 16% deposit.

- **Flexible mortgages**

Originating from Australia, many mortgages now contain flexible features. In essence, they provide you with the ability to overpay or underpay each month. This is valuable if you get regular bonuses, or if your income fluctuates. Interest is often calculated on a daily basis, meaning that overpaying has an instant effect on reducing the balance, and therefore the term, of your mortgage.

Usually, in order to make an 'underpayment', or payment holiday, you will be required to have built up an equivalent amount of credit through overpayments first.

- **Current account mortgages**

A current account mortgage allows you to use your mortgage through your current account. Effectively, your current account becomes a huge overdraft. For example, if your mortgage was £100,000 and you have £5,000 of credit in current account, your balance will be -£95,000. By paying in your salary and/or savings, the interest you earn will go towards cancelling out some of the interest you owe on your mortgage. If you're disciplined, you can eventually repay your mortgage more quickly.

- **Interest-only mortgages**

With an interest-only repayment option, your mortgage payments only cover the repayment of the interest from the amount you borrowed, so although your monthly repayments will be lower, you are not repaying the capital (the amount you borrowed).

It is advisable; therefore, that you pay a sufficient sum of money into a separate investment vehicle that will produce the capital at the end of the term to allow you to pay off the mortgage.

Note: This type of mortgage is not always acceptable for a Homebuy product as it is considered to carry more risk

- **Self-certification mortgages**

For those who have problems verifying their income, or whose income is irregular (like the self-employed), there are lenders who will consider granting mortgages under these circumstances.

Note: This type of mortgage is not always acceptable for a Homebuy product as it is considered to carry more risk

- **Mortgage payment protection**

Having a mortgage is a big commitment. You should consider the implications of not being able to meet the repayments, through unemployment, accident, sickness or even death. Many borrowers take out a payment protection policy to protect both themselves and their loved ones should the unthinkable happen.