



Fact Sheet | Mortgage

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Mortgage Repayment Methods

Capital Repayment Mortgage

This is the recommended and historically the more traditional type of mortgage and remains the only way the property is guaranteed to be yours at the end of the mortgage term. This is provided that you have made all your monthly payments as advised and on time.

Your mortgage debt is divided into capital repayments, i.e. repayment of the money borrowed and interest on the money borrowed. As you pay off your mortgage every month you're paying off a bit of capital and a bit of interest until the full debt is repaid.

You usually pay off mostly interest in the early years and then gradually more of the capital debt. It may seem as if this is costing more but that's because unlike the other types of mortgages you're paying off the capital and not just the interest.

Interest Only

As the name suggests, with an Interest-only mortgage, the monthly pay-

ment includes interest and therefore the Capital balance is not reduced. The upside of this is that the monthly cost is considerably lower than for a comparable repayment mortgage.

The downside is that at the end of the mortgage term you still owe the original amount you borrowed and if you can't repay it, your mortgage lender is perfectly entitled to repossess your home. That's why, if you go for this option, you need to organise a way to repay the capital debt. Unless you can be certain of a sizeable inheritance or other windfall, this means saving as you go along. There are several Repayment Vehicle options as detailed below.

Repayment Vehicles for Interest Only Mortgage Loans

Endowment

An endowment policy is a type of stock market investment which runs alongside your mortgage.

You make a monthly payment into this policy, and the idea is that the value grows substantially, so that at the end



of the mortgage term, you are able to pay off the outstanding capital. Most forms of Endowment will include life assurance.

ISA

ISA stands for "Individual Savings Account", the concept is that you use this to save the cash to repay the capital at the end of your mortgage term. However, this is not a particularly popular way of repaying a mortgage for good reason. Unless you're an especially disciplined saver, who can afford to put away a sizeable sum each month and are fortunate with the investment returns you achieve it's probably best avoided.

Pension

Pensions are a viable repayment strategy, providing the contributions are realistically going to provide an adequate tax free lump sum to repay the capital at the end of the interest only mortgage term. In these circumstances clients must be warned of the reduction in pension income resulting from taking a lump sum.

Repayment vehicles such as Endow-

ments, Pensions and ISA's are higher risk strategies for Repayment of a mortgage and returns are not guaranteed. You need to be aware that they rely heavily on investment returns that are not guaranteed.

Other possible methods for Repayment of an Interest Only Mortgage

Sale of non-principal residence

The sale of a non-principal residence can be a viable repayment strategy providing there is a realistic chance the equity in this property will be adequate to repay the capital on the principal residence at the end of the interest only mortgage term.

Inheritance

You may be due a sizeable inheritance, which could be utilised to repay the mortgage. However, many lenders will not allow this form of vehicle as it is not necessarily guaranteed.

Repayment from sale of property (Downsizing)

Downsizing is a viable repayment strategy as long as there will be sufficient equity in order to downsize at the end



of the interest only mortgage term. In order to mitigate the risk that there will not be sufficient equity, the current loan to value (LTV) must not exceed 75% and the term must have 10 years or more to run. The minimum number of years can be reduced where there is substantial amount of equity in the property, as substantial current equity reduces the risk that there will be insufficient equity to downsize in the future, by reducing reliance on the property increasing in value.

It should be noted that most lenders have severely restricted their criteria for Interest only mortgages and some may well not lend on this basis. For those Lenders that may offer Interest only, they will generally require evidence of the repayment vehicle and want to see whether it is on track.

Information on Mortgage Rates

Bank Base Rate

The Bank of England base rate is set by the Monetary Policy Committee and is reviewed on a monthly basis and set in order to try and influence inflation. Inflation is when the amount of

money spent is growing faster than the volume of output produced. The base rate is the interest rate that the Bank of England lends to financial institutions and it affects the interest rates commercial banks and building societies set for their savers and borrowers.

A reduction in interest rates is better for borrowers – it reduces repayments on loans and mortgages. A rise in the rate does the opposite and is more attractive for savers, increasing the interest earned on savings and investments. Lowering or raising interest rates affects spending in the economy and therefore, inflation.

Standard Variable Rate Mortgage

A Standard Variable Rate (SVR) is a mortgage rate set by mortgage lenders that decides the interest rate. The lender bases its SVR on the Bank of England base rate (usually between 2 and 4 per cent higher), so when the base rate changes, the SVR will also change. The upside of an SVR mortgage is that if interest rates fall, so do mortgage repayments, but the obvious disadvantage is if rates rise, so do repayments, and there is no cap on how



high the rates can rise.

Tracker Mortgage

Base rate tracker mortgages mirror exactly any changes to the Bank of England base rate, whereas normal variable-rate mortgages follow the lender's standard variable rate. Lenders can change their standard variable rate (SVR) regardless of changes to the base rate, although most broadly follow it; whereas the Base Rate Tracker cannot be changed by the lender.

Fixed Rate Mortgage

A fixed rate mortgage has a rate fixed at an agreed amount for a limited amount of time – usually between 2 and 10 years. The advantages of a fixed rate are that you know exactly how much your repayment will be each month, and if the base rate goes up, your repayments are not affected. The disadvantage is that if interest rates fall, you may end up paying a lot more than if you had been on a variable rate.

Discounted Mortgage

A discounted rate is based on the mortgage lender's SVR and offers a discount of a certain percentage below

the SVR for an initial period. After this period interest on the mortgage is charged at the lender's SVR. Discount mortgages can offer good deals for those initial periods, with many mortgage providers offering large percentage discounts over their standard rates.

Capped Rate Mortgage

Capped rate mortgages have a set upper value for their interest rates – they cannot go higher than this level, no matter what the changes in the mortgage lender's standard variable rate (SVR). Due to this protection, capped rate mortgages tend to have less favourable rates than other types of mortgage that follow the SVR.

London InterBank Offered Rate Mortgage

The London InterBank Offered Rate (LIBOR) is the rate at which banks lend unsecured amounts to one another. It is compiled by the British Bankers' Association (BBA) in conjunction with Reuters. It is reviewed on a daily basis and released to the market shortly after 11.00am each day. The LIBOR is the widely used "benchmark" or reference rate for short term interest rates.



"A MORTGAGE IS A LOAN SECURED AGAINST YOUR HOME. YOUR HOME MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR MORTGAGE OR ANY OTHER DEBT SECURED ON IT."

THINK CAREFULLY BEFORE SECURING OTHER DEBTS AGAINST YOUR HOME. YOUR HOME MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR MORTGAGE.

Important Information

This factsheet is based upon our understanding of current regulation, law, tax and other legislation at the release date and may be subject to change in the future. Whilst every care has been taken to ensure the accuracy of this information, My Mortgage & Protection Experts can accept no responsibility for any actions taken as a result of this information.



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