A GUIDE TO MORTGAGES

Your mortgage is probably the greatest financial commitment you will ever make so it is important to have an understanding of how a mortgage works and the responsibility that comes with it. This guide aims to explain the basic elements of a mortgage and the process that is involved in arranging one.

What is a Mortgage?

In simple terms a mortgage is a loan but it has two special characteristics. Firstly, it's a loan designed to be paid back with interest over a long period, often 25-30 years. Secondly, and most importantly, unlike a bank loan or a credit card debt, a mortgage is "secured" on your house. What this means is that in return for lending you money, the bank uses the property as security for the mortgage. If you get into problems and can't meet your monthly mortgage payments, the lender has the right to re-possess your house, and sell it, to recover the money you borrowed.

Which type of Mortgage?

There are two main types of Mortgage, or methods of repaying your Mortgage –

Repayment (Capital and Interest)
Interest Only

REPAYMENT MORTGAGES

With this type of mortgage both capital (the amount borrowed) and interest are repaid to the lender over the term of the mortgage. In the early years most of the monthly payment is made up of interest and only a small amount is capital whereas towards the end most of the monthly payment is capital. This means that in the early years the balance owed reduces slowly and most of the capital is repaid in the last few years of the loan. This is the only type of mortgage, which guarantees that the debt will be paid off in full at the end of the term, provided that all payments have been made in full and on time. The majority of mortgages are arranged in this way.

INTEREST ONLY MORTGAGES

Interest Only mortgages are where you repay only interest each month to the lender and the repayment of the capital is left to the very end of the term of the mortgage. This means that **you** must ensure that you have built up sufficient capital to pay off the mortgage at the end.

HOW CAN YOU BUILD UP CAPITAL TO REPAY YOUR INTEREST ONLY MORTGAGE?

A common method of building up capital to repay an Interest Only Mortgage, is to pay monthly into a market linked investment such as:-

A Stocks and Shares ISA
A Personal Pension Plan
An Endowment Policy

As the returns on these investments are linked to the markets, and can fluctuate, there is a possibility that the return may not be sufficient to repay the loan at the end, and as a result, they constitute a greater risk than a Repayment Mortgage. As such, it is important that you take professional advice before considering such an option.

1 4 U Financial Solutions Ltd do not provide advice on investment products. Should you require advice on investment options, we will refer you to an Independent Financial Adviser. Neither 1 4 U Financial Solutions Ltd nor First Complete Ltd accept responsibility for advice supplied by this third party.

Once you have selected how you want to repay your mortgage, the next decision is to decide on the type of interest rate or deal you want to have.

<u>Standard Variable Rate (SVR)</u>

This is the simplest and most straightforward option. Each lender offers a SVR which tends to follow, but is not the same as, the Bank of England interest rate. SVR is generally a percentage point or two higher than base, although at the moment the gap tends to be wider. As the base rate shifts up and down so lenders move their SVR, although not always by the same amount.

Alongside their SVR banks and building societies offer a whole range of other mortgages. Most are introductory offers which last for a set period of time, after which they move borrowers back to the SVR.

<u>Tracker</u>

Unlike an SVR, a tracker is linked to a particular base rate, which it moves up and down with, such as the Bank of England Base Rate. If the Base Rate rises by 1% your mortgage rate rises by 1% , but if it falls by 1% then your mortgage drops by the full 1% as well. Some trackers only run for 2 or 3 years but there are Tracker products available which run for the term of the mortgage.

<u>Discount</u>

This is normally a short-term discount for 2-3 years off the lenders SVR. As all lenders SVRs are not the same it is important to look at the actual interest rate you will pay rather than focusing on the rate of the reduction.

<u>Fixed</u>

Whatever happens to interest rates, your repayments are fixed for as long as the deal lasts - typically 2, 3 or 5 years, but it is possible to fix for 10 years. You are protected against interest rates going up but equally you do not get the benefit if rates reduce.

<u>Cashback</u>

With a Cashback mortgage, your lender gives you a lump sum on completion of the mortgage. Generally the monthly payments on a Cashback mortgages will be higher then an equivalent mortgage, not offering a Cashback, as the interest rate is likely to be higher. In addition an Early Repayment Charge may be incurred (and this may include you repaying the Cashback you have received) if you repay the loan within a set period of time.

ADDITIONAL FEATURES/FLEXIBLE MORTGAGES

All the mortgages we've looked at so far are variations on a pretty simple theme. You borrow a set amount of money, you pay back a certain amount every month, and your debt is the amount you borrowed minus the capital repayments you've made (your monthly payments less the interest element, on a Repayment Mortgage). Over the past number of years a many of the lenders have introduced slightly more complex products:

- **Flexible Mortgages**

A Flexible Mortgage is a basic mortgage but with a couple of additional features. These features generally allow you to overpay on your mortgage, without penalty; take a payment holiday (with the agreement of the lender); or to borrow back money that you have paid off your mortgage. You can normally expect to pay slightly more for the benefits of these features.

- **Offset Mortgages**

An Offset Mortgage is a type of flexible mortgage which offers the facility to reduce the interest charged by *offsetting* a credit balance, (usually your savings) against the mortgage account. Generally the mortgage debt and savings balance will be held in separate accounts and the one offset against the other on a daily basis to calculate the balance that interest is due on.

- **Current Account Mortgage**

This works like an offset mortgage, in that credit balances are offset against the loan, however both the mortgage debt and the credit balance is held within a single account.

OTHER CONSIDERATIONS

Fees and Charges

There are a number of possible charges, which may be incurred with different lenders and products. Some or all may apply, and you need to be aware of them, when comparing different deals and deciding which is most suitable for you.

- Booking Fees
- Valuation Fees
- Arrangement Fees
- Broker Fees
- Legal Fees
- Higher Lending Charge
- Early Repayment Charges*

* Sometimes the period in which Early Repayment Charges can be incurred may be longer than the period that the preferential rate is offered for.

Daily or Annual Interest

With Annual interest, the interest charged on your mortgage balance is only calculated once a year, and only at this point will you receive the benefit of any sums you have paid into the mortgage in the previous 12 months. However with Daily interest, the interest you owe is calculated on a daily basis, and therefore whenever you pay off some of the debt, your interest is re-calculated immediately on the new (lower) balance. You receive this benefit immediately, and this can result in a significant saving on the total amount of interest that you are charged over the term of the loan.

Does my mortgage allow me to move house?

Many mortgages are now portable, so moving house doesn't **necessarily** have to involve a new deal. This can be important if you have an Early Repayment Charge.
However, it is important to note that you still need to meet the criteria of the product and lender to ensure they allow you to port your current product to the new property. This could be very relevant if you need additional borrowing, where you will need to meet the affordability criteria or where the Loan to Value is higher on the new property.

What is Shared Ownership?

You may be eligible for one of the many Shared Ownership schemes available across the country. Under conventional Shared Ownership schemes, run by Housing Associations, borrowers buy a share of a property, usually worth between 25% and 75% and pay rent on the rest, with the right to increase their share in the future. This is an option for First Time Buyers who cannot afford a mortgage for the full cost of the property. The Housing Association normally benefits from their share of any increases in property values but the reverse could apply if house prices drop.

The overall cost for comparison is 4% APR. The actual rate will depend upon your circumstances. Ask for a personalised illustration.

Guarantors
Many first time buyers rely on help from Mum and Dad for their deposit. A number of deals will also take into account parental income as well as the child's income, as along as they can still cover their own mortgage. The Guarantor may be called to meet the full mortgage debt, in the event of the borrowers being unable to do so.
Anyone considering becoming a Guarantor should seek independent legal advice.

BUY TO LET

If you want to buy a property to rent out, you need a special **Buy To Let** Mortgage. In the same way as with a Residential mortgage, you can choose between Fixed and Tracker rates, and whether to pay Interest Only or Capital and Interest. However, when it comes to assessing how much you can borrow, the key factor is not how much you earn, but the likely rental income you will achieve.

Generally, lenders will not let you borrow more than 75% of the property value. Typically, the rental income will need to be around 145% of the Interest Only mortgage payment, based on a notional interest rate of 5.5%. Some lenders will allow surplus personal income to support the loan amount, if the rental calculation is not sufficient.

The majority of lenders will only accept applicants who already own their own home (with a mortgage is acceptable). The criteria on acceptable property types, is generally tighter and the interest rates higher than on standard residential mortgages.

Buy To Let Mortgages are not regulated by the Financial Conduct Authority.

RE-MORTGAGING

Most people can benefit from regular re-mortgage advice. You should seek advice about three months before the end of your current deal. You advisor will be able to review your circumstances, taking on board any changes to income or expenditure and your objectives going forward.

Your review should include

- The term of the mortgage – is it still right for your circumstances?
- The Repayment method -- if you have been paying only interest should you change to a Repayment Mortgage?
- What type of rate suits you best – Variable or Fixed?
- The amount you wish to borrow – affordability
- Do you want to make overpayments?
- Will you need to borrow further funds in the future?
- Is your mortgage adequately protected – against the death or ill health of the borrowers
- Can you make savings in any other area
- Does your existing lender have suitable options

TAKING MORTGAGE ADVICE

Taking advice from a reputable Mortgage advisor can be invaluable. Arranging a mortgage correctly is a complex procedure. There are many factors to consider and care must be taken to ensure that the product selected is the best for your individual circumstances.

YOUR HOME MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR MORTGAGE

We charge a broker fee of £199 on application and £190 on completion of your mortgage.

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