THE MULBERRY MORTGAGE COMPANY

Mortgages: A Guide

Hello, and welcome to our guide to mortgages. We hope it will be a big help to anyone who is thinking about taking out a mortgage, but would stress that this document really is exactly that; a guide, rather than a gospel. There's no substitute for expert advice, and only by sitting with a consultant and discussing your needs in detail can you be sure that you're making the right decision. So we suggest you take a read, then get in touch when you're ready to take the next step.

This guide is broken down into sections as below.

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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.

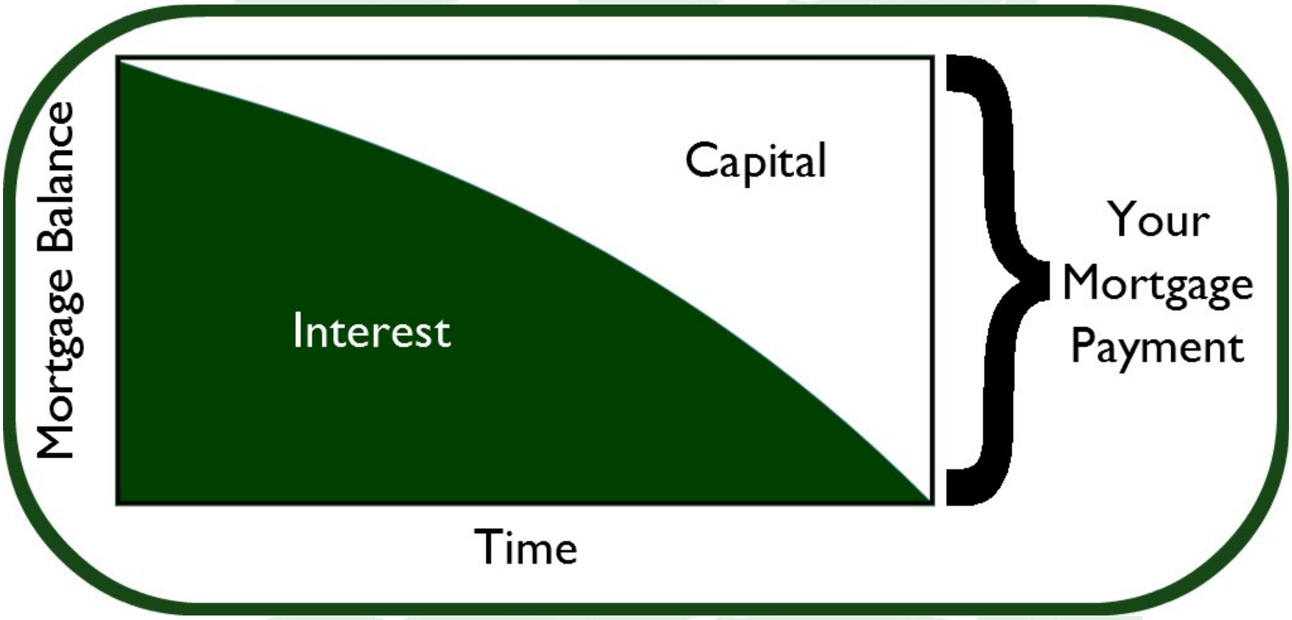
Repayment Types: How to pay back the money you borrow

There are three ways of paying back the money you are borrowing on your mortgage.

(i) Repayment Mortgage

Also know as a "Capital and Interest" mortgage, with a repayment mortgage your monthly payments comprise of both the interest on the amount you have borrowed, and the capital itself. The Mulberry Mortgage Company will always recommend a repayment mortgage for any property you intend to live in yourself, unless there is a compelling reason to do otherwise.

Providing you maintain your monthly mortgage payments, you are assured of paying off all of the money you owe to the lender by the end of your mortgage term. As you can see from the graphic below, in the early years of your mortgage, it will be predominantly interest that you are paying, with the capital reducing slowly. In the later years, the rate at which capital is repaid accelerates. That means your mortgage balance may decrease more slowly than you might expect for those first few years.



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.

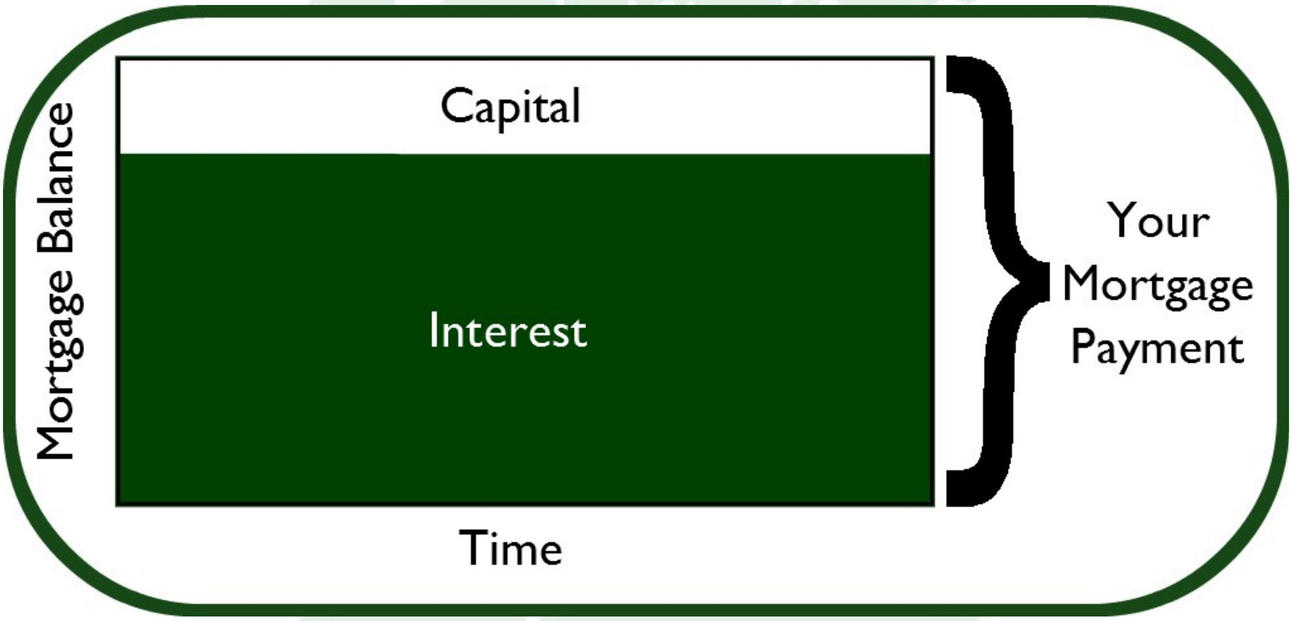
(ii) Interest Only Mortgage

This is widely recognised as being the riskier of the two options, and for this reason lenders have placed tight restrictions on interest only borrowing in recent years. With an interest only mortgage, you pay only the interest on the amount that you have borrowed. While this means your monthly payments are lower than with an equivalent repayment mortgage, you will still owe the lender the same amount you have borrowed when your mortgage comes to an end.

It is the borrower's responsibility to ensure they have the full amount of money they originally borrowed, ready to pay back the lender when their mortgage comes to an end. The risk element comes from having no guarantee that you will have enough to pay off the mortgage at the end of the term. There are many ways of raising capital to pay an interest only mortgage off; a pension, an endowment, an ISA, or equity in the property you are buying or living in are just a few examples. But all of these "repayment strategies", as they are known, come with their own risks, and different lenders accept different repayment strategies. Some lenders will now not lend on an interest-only basis at all.

With an interest-only mortgage, the amount of capital you owe on your mortgage will never change unless you borrow more money or make a voluntary overpayment.

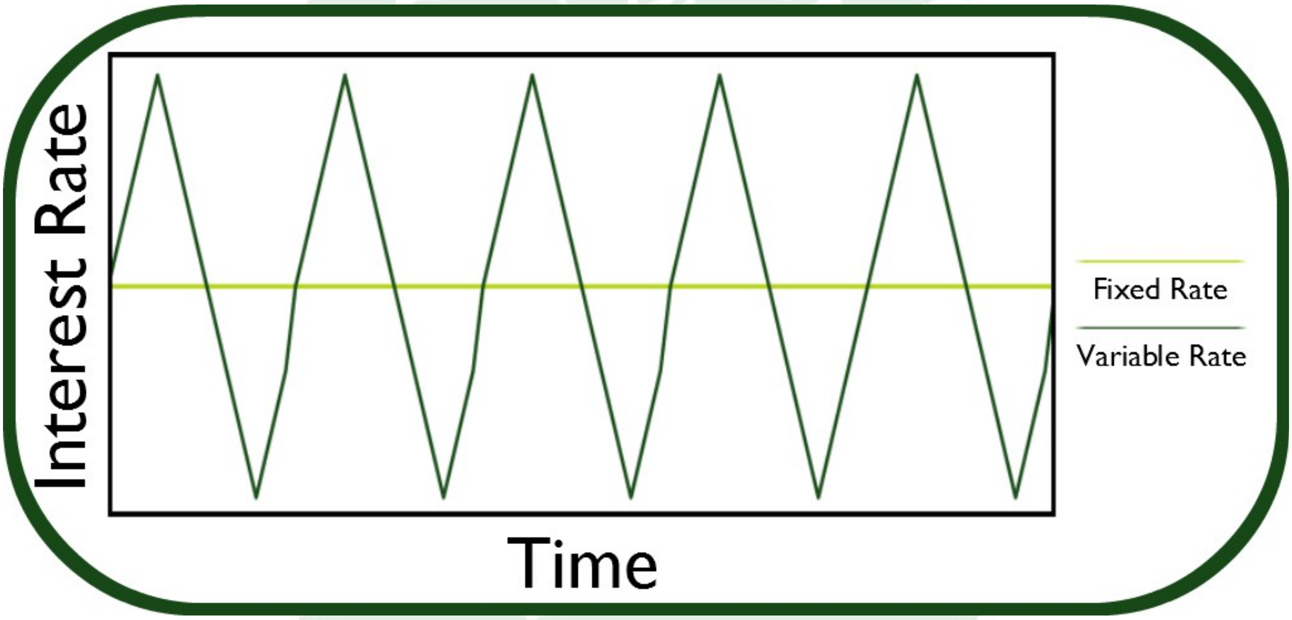
You'll see from the graph below that during an interest-only mortgage, your payments go towards paying the interest on the loan only. The capital balance never decreases. You owe as much at the end of the mortgage as you did at the outset.



(iii) Repayment/Interest Only Split

Subject to the same increasingly strict limitations on interest-only lending, it is possible to split your mortgage between two repayment types. You might choose to have 50% of your mortgage on a repayment basis, for example, and 50% on an interest-only basis. This option may suit those who are expecting to be able raise part but not all of the capital they are borrowing, but there is still the risk of the “repayment vehicle” not delivering as expected.

Mortgage Product Types: What Type of Interest Rate You'll Pay



There are several different “rate” or “product” types, many of which you may be familiar with already. Broadly speaking, they fall into two categories; fixed rate and variable rate mortgages. Within variable rate mortgages, there are several types again. We've outlined them all below.

(i) Fixed rate mortgages

A fixed rate does pretty much what it says on the tin! You pay a predetermined interest rate on your monthly payments for a specified period, usually between 2 and 10 years. Regardless of all other factors, your rate stays the same. Fixed rate mortgages provide certainty with your mortgage payments for a particular number of years which best suits your individual needs and circumstances. For this reason they are a popular mortgage type with our clients. However, there are three potential drawbacks of fixed rate mortgages.

- (i) Most fixed rate mortgages carry hefty penalties if you redeem the mortgage early or repay more than a certain amount of capital, typically 10%, in any one year of the fixed rate term. These penalties, known as *early repayment charges*, (ERCs) can typically range from 1% to 6% of the mortgage balance, although 3% to 5% is the most common. Whatever the percentage, it's unlikely that paying the ERCs will look appealing once you part way through a fixed rate term, so think carefully about committing to a fixed rate mortgage. Historically, the ERCs on some fixed rate mortgages have extended beyond the fixed rate term (e.g. a three year fixed rate period, but a four year ERC period). We rarely see these products nowadays, and would never recommend them unless there is a very specific reason why they would suit you.

- (ii) If interest rates fall while you are on a fixed rate mortgage, you will be unable to benefit from any reduction in rates elsewhere. Many people who took out long-term fixed rates in the late 2000s found this out to their cost. Interest rates plummeted due to the economic downturn, but these borrowers were left paying a relatively high rate of interest until their fixed rate term expired and they were free to renegotiate the interest rate on their mortgage.
- (iii) More often than not you will see that when fixed rate mortgages and variable rate mortgages are compared side by side, based on the initial rate of interest rate payable, the variable rate mortgage will appear the cheaper product. However, while the interest rate payable on variable rate mortgages can change, potentially increasing your payments, the rate payable on a fixed rate mortgage cannot change during the fixed period.

So, despite the popularity of fixed-rate mortgages, consider the following before committing yourself to one:

- The future of interest rates. Will they change, and if so in which direction, and if so to what degree? How we'd all love a crystal ball that would give us that answer! If your view is that rates are likely to fall in the next few years, is now the right time to fix your interest rate?
- How is your income likely to change, if at all? it is likely to fluctuate, remain level or show a small increase then a fixed rate may be a good option. If, on the other hand you are expecting a significant rise in your income (say, a promotion or change of job), bear in mind that most fixed rate products will limit any overpayments you wish to make on the mortgage.
- Whether you will be able to obtain another fixed rate at the end of your proposed fixed rate period. Your existing lender may be prepared to offer you another fixed rate product at the end of your current one, but they are under no obligation to do so. If you need to remortgage to a new lender to get another fixed rate, there are other circumstances that may restrict your ability to remortgage then. These include, but are not limited to: a change in your financial circumstances (e.g loss of employment, long-term sickness), the availability of suitable mortgage products, and changes in industry affordability guidelines or lending criteria.
- Whether you are prepared to commit to a mortgage that carries significant penalties for paying off the loan early.

(ii) Variable Rate Mortgage: Standard Variable rate

The Standard Variable Rate mortgage can be regarded as the standard type of mortgage and all other products are a variation of it. This is the rate that an estimated third of UK mortgage holders are paying (source here). All lenders have a "Standard Variable Rate" (SVR) although some have different names for it. This is the basic lending rate that lenders apply once a customer's fixed or tracker rate period has expired. This rate will fluctuate at the lenders own discretion, and although it tends to move up and down broadly in line with the Bank of England base interest rate which is announced monthly, this is not always the case- a handful of lenders significantly increased their

SVRs in the early 2010s despite a static (and very low) Bank of England base rate.

This means that borrowers on SVR are effectively at the mercy of their lender's decisions regarding monthly rate policy and, by staying on SVR, are probably paying far more than they need to if they are able to switch lenders to find a better deal.. Nearly all lenders will offer a lower introductory rate when you first take out your mortgage, making SVR mortgages largely impractical for most people.

SVR mortgages do, however, offer the borrower the opportunity to make unlimited overpayments without penalty, as early repayment charges do not generally apply to SVR mortgages.

(iii) Variable Rate Mortgage: Tracker Rate

A popular alternative to fixed rates, trackers will quite literally "track" another index rate. This index is usually the the Bank of England (BoE) base interest rate, which is reviewed once a month, and less commonly the LIBOR rate, which is the rate at which banks lend to each other. Trackers run at a fixed percentage above or below the index rate, and change in line with any monthly changes in that rate. So if, for example, you took out a tracker mortgage at 0.25% above the BoE rate, if the BoE rate was 5%, you would pay an interest rate of 5.25%. If the BoE rate were increased the following month to 5.25%, your new mortgage payments would now run at 5.5%. The rate payable on the tracker rate mortgage will usually change within a certain period, typically 15 days, of any change on the index rate Tracker rates suit people who have the financial "slack" to afford their mortgage payments if the BoE rate rises, but want to benefit if the BoE rate falls.

The current Bank of England Base Rate is published on the Bank of England Website. Regulatory restrictions prevent us from providing a direct link to that website, but it's only a search engine click away!

Tracker rates generally carry early repayment charges in the same way that fixed rates do. This is especially important to bear in mind, given the fact that your payments can increase with a tracker rate mortgage.

(iv) Variable Rate Mortgage: Discount Rate

Discount rates work on a similar principle to tracker rates, in that the rate you pay can go up and down and is linked to another interest rate, but with Discount rates your payments are linked to the lender's SVR. Discount rates literally give the borrower a fixed discount off this SVR, but move in line with it. So, for example, if you take out a mortgage at a 1% discount and the lender's SVR is 5%, your mortgage payments run at 4%. If the lender raises their SVR to 5.5%, your new mortgage payments now run at 4.5%. Like tracker mortgages, discount rate mortgages suit people with financial "slack" better than people on a tight budget. Be aware that the rate of interest you pay on a discount rate mortgage is entirely at your lender's discretion, whereas the rate payable on a tracker rate is determined by the Bank of England base rate.

Discount rates generally carry early repayment charges in the same way that fixed rates do, and again, bear in mind that your payments may rise on a discount rate mortgage.

(v) Variable Rate Mortgage: Capped Rate

Capped rates are less common than they once were. Payments will vary with changes in interest rates, but a “ceiling” interest rate is set, and you will never pay more than this, although you could pay less if rates go down. Many capped rate mortgages also come with a “collar”; a lower interest rate limit beyond which your payments cannot fall.

In theory, a capped rate without a collar (that is, a mortgage with an upper limit to the interest rate, but no lower limit) may be more appropriate than a fixed rate, as it would allow you to benefit from any reductions in interest rates, but not suffer if they rose beyond a certain point. However, the reality is that these types of products are not very common.

Capped rates generally carry early repayment charges in the same way that fixed rates do, and again, bear in mind that your payments may rise on a capped rate mortgage.

Options on Your Mortgage: Flexibility

Within the product categories above (fixed, SVR, tracker, discount and capped rates), there are also mortgages that allow you to make larger than normal overpayments, or to use any savings you have to reduce your monthly payments.

(i) Flexible Mortgages

Most mortgages, SVR mortgages aside, will carry early repayment charges if you overpay by more than an agreed amount, typically 10% of the loan, in any given year. However, there are mortgages available that allow you to make unlimited overpayments without penalty. These can be useful if you know you will be receiving a large lump sum in the future which you will want to use to pay down your mortgage balance, or you just want the option of being able to make as many overpayments as you like. Other facilities that flexible mortgages may offer include:

- Being able to pay more than the agreed monthly payment
- Being able to pay less than agreed monthly payment

- Being able to temporarily stop payments (known as a "payment holiday")

The interest rates on flexible mortgages tend to be a little higher than on standard mortgages, however, so we generally only recommend flexible mortgages for very specific reasons.

(ii) Offset Mortgages

This is a feature that a small group of mortgage products offer. The mortgage comes with a banking current account or savings account,as well as the more traditional mortgage account that applies to other mortgage types. Any funds that you keep in this account, whether savings or just spare funds left over from your monthly expenditures, are "offset" against the mortgage, saving the borrower interest. So, for example, if a borrower takes out a £110,000 mortgage but has £10,000 in their mortgage current account, the lender charges them interest only on £100,000 of the loan. The lender will reduce your mortgage term as a result of this reduction in the interest due. Over a period of years, the funds that you keep in the current or savings account can help you pay your mortgage offer earlier.

If you would rather use your spare capital to reduce your mortgage payments, rather than your mortgage term, you can generally choose to make unlimited capital repayments on an offset mortgage. Using the example above, this would mean that the £10,000 in the current or savings account is moved across and paid into the mortgage account. You are free to make unlimited capital repayments of this type, but be aware that the facility to withdraw these funds back out from the mortgage account may be subject to limitations, or may not be available at all.

Some offset mortgage lenders offer a "drawdown" facility. An example of this is where a borrower requires an initial cash advance of £100,000, but the lender pre-approves them for a loan of £110,000. The extra £10,000 remains available in the current or savings account and the borrower is free to remove it from this account, but this will increase their mortgage payments and/or the mortgage term until such time as it is moved back into the current or savings account.

How do I choose?

Most mortgages, standard variable rate excepted, are treated as "special" rates, which the borrower and the lender agree will last for a set period, typically 2-10 years. After this time, the borrower's mortgage will revert to the lender's standard variable rate, unless the borrower chooses to remortgage, which will usually be in your interests (but if not, we'll let you know!). Any "special" rate may attract a booking or arrangement fee to secure the rate for the borrower, as well as early repayment charges if the borrower pays off that mortgage within the initial set period (the aforementioned 2-10 years).

As part of the mortgage application process, the mortgage lender will run an affordability calculation to determine what you can borrow. This will also take into account the impact of likely future interest rate rises on the affordability of the mortgage.

It should be clear by now that as a mortgage borrower, you have a plethora of options when it comes to selecting the right deal for you. We hope this guide has been of use, but to help you make your choice we strongly suggest speaking to one of our consultants to discuss your personal circumstances and get a recommendation that meets your needs. After all, that's what we're here for!

Please note that the information above is for general guidance only and represents our understanding of the commonly available mortgage products in the marketplace. There are other unique products available which we have not mentioned in this guide.

Please also note that under current UK tax laws, additional stamp duty will apply to any purchase of a buy to let property or second home. We will provide you with a full outline of these costs before you proceed with any mortgage application for the purchase of a buy to let or second home property.

Where remortgages are concerned, please also note the following:

YOU MAY HAVE TO PAY AN EARLY REPAYMENT CHARGE TO YOUR EXISTING LENDER IF YOU REMORTGAGE.

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.