

This Fact Sheet outlines the main types of mortgage interest rates.

Part 1 of this Fact Sheet deals with your main choices as far as mortgage advice is concerned and the main mortgage repayment methods.

Introduction

As well as deciding on the most suitable lender and the most suitable way of repaying your mortgage, **you need to decide on the most suitable type of interest rate to use.**

The main types of mortgage interest rate are:

Variable rate mortgages

Fixed rate mortgages

Discounted rate mortgages

Capped rate mortgages

Cash back mortgages

Tracker rate mortgages

Variable Rate Mortgages

This is the most common type of mortgage interest rate in the UK. A variable interest rate mortgage offers you **a mortgage at the lender's basic mortgage interest rate**, commonly known as the Standard Variable Rate (SVR).

This can fluctuate with interest rate changes made by the Bank of England. If the mortgage rate rises you will pay more each month.

Naturally, if the mortgage rate falls so will your mortgage payment.

The **main advantages** of this type of interest rate are that:

- there are usually no penalties for cancellation and for transferring to another mortgage product or to another lender** (known as redemption penalty and lock-in periods). You therefore have the flexibility to change your mortgage type or move to a different lender.
- there are **few, if any, additional fees to pay** such as are often present with fixed rate, discounted rate and capped rate mortgages.

The **main disadvantage** of this type of interest rate is that when interest rates generally increase sharply, **your interest payment instalments are likely to increase substantially.**

Fixed Rate Mortgages

A fixed rate mortgage offers you a mortgage with **an interest rate that is set for a period of time**. The rate then reverts to the lender's basic mortgage interest rate.

The **main advantage** of this type of interest rate is that knowing the interest instalments will not fluctuate during the fixed period **allows you to plan your finances.**

The **main disadvantages** of this type of interest rate are that:

- general interest rates may fall** and you will have to continue paying the higher fixed rate or suffer a large termination penalty.
- these mortgages sometimes have **early cancellation penalties that can lock you into staying with the lender** for a time after the fixed period. This could then tie you into an uncompetitive mortgage.
- application fees** can add to the cost of the mortgage.

Discounted Rate Mortgages

A discounted rate mortgage, as its name suggests, **offers a set discount from the lender's standard variable rate for a set period of time**. Normal terms are between one and five years.

The **main advantage** of this type of interest rate is that you **pay less than the standard mortgage rate**. In addition the initial interest rate you pay can be lower than that of a similar fixed rate or capped rate mortgage. Repayments will reduce further if the interest rate falls.

The **main disadvantages** of this type of interest rate are that:

- when interest rates generally increase sharply, your interest payment instalments are likely to increase substantially.
- these mortgages sometimes have **early cancellation penalties that can lock you into staying with the lender** for a time after the fixed period. This could then tie you into an uncompetitive mortgage.
- the longer the period of discount **the smaller the discount**.
- application fees** can add to the cost of the mortgage.

Capped Rate Mortgages

A capped rate mortgage offers you an interest rate with a **maximum rate for a set period of time**. This means that during the capped period, your interest instalments **will not rise beyond the capped amount even if interest rates increase sharply**.

In other words, the capped rate is the most that you will pay, but if the variable rate falls below the 'cap' you will pay the lower rate.

The **main advantage** of this type of interest rate is that while you are protected from increases in rates, **you will benefit from any falls in interest rates**.

The **main disadvantages** of this type of interest rate are that:

- A** these mortgages sometimes have **early cancellation penalties that can lock you into staying with the lender** for a time after the fixed period. This could then tie you into an uncompetitive mortgage.
- A** **application fees** can add to the cost of the mortgage.
- A** the most competitive capped rates are **normally initially more expensive than the most competitive fixed rates**. Therefore, this type of scheme is most suited to borrowers who believe that interest rates will fall in the foreseeable future.

Cash Back Mortgages

A cash back mortgage is generally a standard variable rate mortgage which can provide you with a **significant cash sum on completion of the mortgage**, typically 5% or 6% of the amount borrowed.

It is possible, also, to combine a cash back with the other types of scheme available, for example fixed and discounted rates, though, in such cases, the level of cash back would usually be lower than normal. This cash may be attractive to first time buyers who need **extra cash for home improvements** or furniture.

The **main advantage** of this type of interest rate is that the **lump sum can be used at your discretion** and can be attractive to those who require the funds to make home improvements or repay a termination penalty on an earlier fixed rate mortgage that now has an uncompetitively high interest rate.

The **main disadvantages** of this type of interest rate are that:

- A** when interest rates generally increase sharply, **your interest payment instalments are likely to increase substantially**.

A rates are usually set at the lender's standard variable rate for a fixed term with **early cancellation penalties that can lock you into staying with the lender**. This could then tie you into an uncompetitive mortgage.

A **application fees** can add to the cost of the mortgage.

Tracker Rate Mortgages

A tracker rate mortgage offers you a variable rate mortgage with **an interest rate that rises and falls in line with a specific benchmark, usually the Bank of England Base Rate**.

The tracker rate would be expressed as a certain percentage rate above the benchmark rate.

The **main advantage** of this type of interest rate is that there are usually **no penalties for cancellation and for transferring to another mortgage product or to another lender** (known as redemption penalty and lock-in periods), giving you the flexibility to change your mortgage type or move to a different lender.

The **main disadvantage** of this type of interest rate is that when interest rates generally increase sharply, your interest payment instalments are likely to increase substantially.

Risk Factors

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

The FSA's information sheet 'You can afford your mortgage now, but what if ...?' will help you consider the risks.

You can obtain a free copy from **www.fsa.gov.uk/consumer** or by calling **0845 456 1555**

For Further Info

If you would like to discuss your mortgage requirements please speak in the first instance to your usual Arch adviser or contact us via one of the following:

Tel: **01483 204600**
Email: **enquiries@arch-fp.co.uk**
Online: **www.arch-fp.co.uk**

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