

Which Mortgage is Suitable for You

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

When you buy your home, you are more than likely entering into the biggest financial commitment that you will ever make. Obtaining a mortgage is normally the first part of the process; the next important step is to decide how you are going to repay the mortgage. In order to reach this decision, you need to know the options open to you. You need sensible unbiased advice on what is best for your particular circumstances. At first glance deciding on the correct mortgage appears complex, but it is really quite simple when one understands the jargon.

No two situations are alike, so the method of repayment should never be contemplated without giving due consideration to your personal circumstances and future financial objectives. There are a wide variety of mortgage repayment plans, so care is needed to make sure you find the most appropriate solution to meet your needs. The following is a guide to help you understand the different types of mortgages available. For advice on the most appropriate option it is imperative that you meet with a suitably qualified adviser.

HOW DO YOU REPAY YOUR LOAN

A mortgage can be divided into two types:

- 1) Interest Only. (Individual Savings Accounts (ISAs) Pensions & Endowments)
- 2) Capital and interest Repayment.

1. Interest Only Mortgage

This type of loan is considered by virtually all the banks and building societies. It is important to realise that only interest is paid on the outstanding loan. At the end of the term the mortgage debt has to be repaid. It is, therefore, necessary to set up some sort of arrangement that is designed to provide you with a sufficient sum from which to repay your loan when it falls due. These investment plans come in various shapes and guises referring to degrees of risk attached. The degree of risk is something of which you acutely need to be aware because your chosen repayment plan could fail to deliver the required amount at the right time. Conversely, the increased risk may potentially mean an increased reward. The majority of repayment vehicles do not provide and guarantee that the proceeds will be sufficient to redeem the loan.

Endowments

Endowment Policies are life assurance contracts. Every month you pay the interest on the loan to your lender and also pay a premium to the endowment provider. This money is invested in their funds, which can include assets such as stocks, shares and securities, such as gilts, which pay fixed amounts of interest and are backed by the Government.

Endowments also include life assurance, therefore, assuming the contract has been set up correctly, should the life assured die prematurely, i.e. before the end of the mortgage term being covered, the mortgage debt will be repaid giving security to the family. It is also possible to insure against the risk of critical illness and sickness or disability preventing you from earning an income.



Virtually all Endowment Mortgage Policies are the low cost version. These offer lower premiums than full endowments. The exact amount you will get back when your endowment matures depends on economic and market conditions coupled with the provider's fund performance during the life of your mortgage.

The low cost endowments do not actually guarantee repayment, but if the investment markets have been strong it is possible that the policy could provide more than required to pay the debt. If this happens during the time the contract has been in force, the policyholder keeps the surplus as a tax-free cash lump sum. Of course, the choice of company is, therefore, very important. There are two main types of endowment.

- (i) Unit Linked - the value can fall, as well as rise
- (ii) With Profits - policies rely upon the insurance company's ability to manage a variety of investments. The profits made from this mix of investments are distributed to the policyholders, either in the form of 'reversionary' bonuses during the life of the policy (which are guaranteed; in that once awarded they cannot be taken away), and a 'terminal' bonus which is normally payable when the endowment matures. You should be aware that during times of consistent poor performance the company does reserve the right to apply at market value adjustment (MVA) thus reducing the policy value.

Individual Savings Accounts (ISAs)

The objective of an ISA (Individual Savings Account) is to invest in a tax-efficient manner over a minimum of 3-5 years and gain the benefits of attractive investment mediums to provide potential long-term gains. One of the attractions of an Individual Savings Account (ISA) is that you may build up a varied portfolio of investments over the years, mixing adventurous and conservative funds, according to your attitude to risk.

Not everybody has the same attitude to risk. The very nature of equity based investment means that you may not get back all of the money you originally invested when you cash in your plan. There are different levels of risk you can take with your investment depending on which underlying fund you choose. Of course we will guide you towards the investment that best suits your current needs, future requirements and risk profile.

Although your ISA is capital gains tax free, the underlying fund itself receives interest net of tax. There is an indefinite tax credit of 20% on the interest received from corporate bonds and gilts, which the ISA Manager is also able to reclaim (please note the current tax legislation may change in the future).

The current Government, when introducing ISAs, stated that the product would remain until at least the year 2009.

There are three separate 'components' to an ISA: Cash, Insurance and Investment; different rules apply to these individual elements. You can elect to have different kinds of ISAs, known as 'maxi' or 'mini' ISAs.

Within a Maxi ISA you are eligible to invest up to £7,000 in the current tax year with one provider only. Up to £3,000 can be invested in a cash environment, £1,000 in an Insurance fund or a mixture of investment as long as the maximum amounts are not exceeded. You may of course invest the full £7,000 in the investment component. These are the present limits, which may be subject to changes in the future.

Within a Mini ISA you are eligible to invest up to £3,000 cash; £1,000 in Insurance based funds or £3,000 in an investment fund, all with different managers if you wish- By opening a 'mini' ISA this tax year, you will have to wait until the next tax year to open a 'maxi' account, as you can only have one type of ISA in any one tax year. These are the present limits, which may be subject to changes in the future.



It is also possible to withdraw your funds at any time, which means that as soon as your investment fund is sufficient to repay the mortgage, you can clear the debt and, therefore, there is no further interest to pay the mortgage lender.

In addition, the ISA allows you to vary your repayment, so that if your ISA has grown quickly over a period you could pay off your mortgage early or reduce your repayments. Should you encounter future financial hardship premiums may also be reduced, however, it would therefore be unlikely that the fund would be sufficient to meet the liability,

If you choose an ISA Mortgage you will not automatically receive life assurance cover to the value of your loan. Even if the lender does not stipulate that such cover is necessary, you should ensure that you have adequate protection in place. An ISA can be used to invest in shares, unit trusts, investment trusts and Open Ended Investment Contracts (OEICS).

Pensions

It is possible to arrange to repay the capital element of an interest only mortgage with proceeds of a Personal Pension. Pension contracts are designed to provide an income in retirement and optional tax free cash lump sum when you retire. It would be this cash element that would be used to repay the mortgage.

It is important to bear in mind that the primary aim of the pension policy is to allow you to make provisions for your retirement. If you are relying on your pension plan to pay off your mortgage as well, you are asking it to carry out two functions and you may therefore have to pay in considerably greater contributions as a result. You should also remember that you cannot access the tax free lump sum until you retire (age 50-75), which may result in you having to pay interest to the lender for longer than would otherwise be the case.

A pension plan is a tax efficient investment because tax relief is obtainable on contributions and the investment fund growth is virtually tax free.

2. Capital & Interest Repayment Loan

Every month you make your payment to the lender; the major part of which pays the interest on the debt, while the balance reduces the debt itself - the capital. As time goes by the outstanding loan is gradually reduced until, at the end of the Term, the property is mortgage free. This type of loan is likely to appeal to the more cautious client who does not wish to rely on investment returns to repay the loan. It is worth bearing in mind, however, that in the early years little of the capital will be repaid. However the capital content of each contribution increases as time goes by resulting in significant reductions to the loan in later years. People often re-mortgage or move several times within 5 to 10 years and usually take another new mortgage again over 25 years as the cost of a shorter term is likely to be more expensive. This results in mostly interest being paid again in the first few years and may therefore delay final repayment of your mortgage for longer than originally expected.

INTEREST CHARGING TYPES

Variable Rate: This is used to describe the variation in mortgage interest payments, it simply means that the interest paid on the loan will go up and down in line with the fluctuation in general interest rates.

Discounted Rates: A discounted rate is offered as an incentive by the lender and is a discount off the general interest rate. With this type of mortgage you do not have to pay back any of the discount, although there may be penalties if you alter your mortgage during the discounted period

Fixed Rate: This is where the rate is fixed for a specific term and, as a rule of thumb, the longer the fixed term of the mortgage,



the higher the interest rate. There may be penalties if you alter your mortgage during the fixed rate term.

Capped Rate: This is where the interest can change when the interest rates fall, but not increase in excess of the pre-determined Capped Rate. There is usually a range of interest rates available from the outset

GENERAL TERMINOLOGY

Early Repayment Charge: Lenders may apply redemption penalties should a mortgage be redeemed early. It is important to make sure that you are aware of any redemption penalties should you wish to switch lenders or pay off the loan. These fees can be anything from 1 to 12 months' interest payments or a set percentage of the original loan.

Higher Lending Charge: This is an insurance premium paid by the borrower usually on loans equating to 90% or more of the value of the property, although in some cases it can be charged on loans over 70% of the property value. This insurance protects the lender against potential loss if, in any event, they have to sell the property. The insurance bridges the gap of any shortfall between what the lender is owed and the sale price. Generally the higher the loan to value the higher the indemnity premium. Depending upon the lender, the premium may either be added to the loan, paid at outset with a one off payment, or spread over the first 12-36 months.

A.P.R (Annual Percentage Rate): This is a true figure that reflects the cost of a mortgage loan. As an example you will often see advertised, say "5-35% Mortgage Lending Rate - (8.40% APR)". The second rate is true Annual Percentage Rate and has taken into consideration the full cost of the loan including application fees, administration costs, and early redemption fees. These factors should be taken into consideration because it may be that the lender offering the lowest monthly payments can be most expensive overall.

RISK WARNING

Please remember that your home is at risk if you do not keep up the repayments on your mortgage or any other loans secured on it.

The ability to repay capital is dependent on investment returns and your monthly contribution. Past performance is no guarantee of future returns. The value of investments and the level of income from them can go down as well as up and the investor may not get back the full amount invested. Any tax assumptions may be subject to future statutory change and the value of tax savings will depend on individual circumstances - this particularly applies to the Individual Savings Account and Pensions. The Endowment in particular is a long-term savings vehicle. If you were to cash the endowment in early it is likely that you will not receive the full benefit of your policy back.

Please ensure that you read the key feature document and product brochure that accompanies the product(s) that will be used.

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