

A fixed-rate or tracker loan? Enjoy the best of both

James Charles Last updated April 23 2010 2:09PM

Homebuyers and homeowners weighing up whether to opt for a fixed-rate or tracker loan face the near-impossible task of predicting the movement of interest rates over the coming years.

Few economists agree when the Bank of England will choose to raise the base rate, still at an historic low of 0.5 per cent.

The debate has been reignited this week by inflation figures showing that prices are rising faster than expected. The consumer prices index measured 3.4 per cent in March, boosted by a surge in fuel costs. If inflation continues to rise, economists fear that the Bank of England will have to increase the cost of borrowing, making the option of a fixed-rate mortgage the best bet for borrowers.

However, others economists caution that the UK's public sector finances are in deeper trouble, leaving the Bank with little choice but to hold the cost of borrowing at 0.5 per cent until at least the middle of next year, making tracker deals pegged to the base rate more attractive.

With this debate in mind, mortgage lenders have introduced new deals aimed at those borrowers who can't make up their mind.

HSBC is bidding to shake up the market with a new "split loan" mortgage, available from Monday. The deal, which is available only directly from the bank either in branch, by phone or online, allows borrowers to get the best of both worlds, pegging part of the loan to a variable-rate lifetime tracker and securing a fixed interest rate for two years on the rest.

The bigger the proportion of the loan that is fixed, the more expensive the interest rate. Borrowers who have a 30 per cent deposit and want to fix a quarter of their loan and leave the remaining three quarters on a tracker will initially be charged 2.49 per cent on both parts of the deal. The tracker rate would be pegged at 1.99 percentage points above base.

However, if the same borrower opts to fix three quarters of the loan and peg the remaining quarter to a variable-rate tracker, he or she would be charged 2.99 per cent on both parts.

The deal is also available to borrowers who have at least a 20 per cent deposit, but with higher rates. At the end of two years the fixed rate reverts to HSBC's standard variable rate, currently 3.94 per cent.

HSBC is not the first lender to allow borrowers to split their loans between a fixed and tracker rate. In fact, a number of lenders allow borrowers to do it.

Andrew Montlake, director of Coreco, the broker, says: "Any decent broker knows that lenders have been able to offer deals like this for years, where part of the loan is taken on a fixed rate and part on a variable tracker rate, with the exact percentage split according to the client's circumstances." Halifax, Birmingham Midshires and Cheltenham & Gloucester (C&G), part of the Lloyds Banking Group, will allow borrowers to divide their loan between fixed-rate and tracker deals. Santander and Alliance & Leicester are also happy to split loans.

David Hollingworth, of London & Country Mortgages, another broker, says: "If you do opt to split your loan, be careful that you are not charged fees twice for each part of the mortgage."

He also points out that cautious borrowers should think carefully before pegging part of their loan to a variable rate. "HSBC is also offering a two-year fix at 2.99 per cent. For borrowers worried about rates increasing, this seems to be a far better option," he says.

Other deals are aimed at borrowers who can't decide between a fix or tracker deal. Yesterday Coventry Building Society, the UK's third-largest mutual, unveiled a new capped tracker. The two-year deal is pegged at 2.49 points above base, giving a pay rate of 2.99 per cent. However, the rate is capped at 3.99 per cent, with the promise that it will never exceed this in the first two years, even if the Bank of England raises the base rate above 1.5 per cent. The deal, which is available only to borrowers with at least a 35 per cent deposit, carries a £999 fee.

Britannia and the Co-operative Bank, which merged last year, also offer a five-year capped tracker pegged at 2.99 points above base for a current pay rate of 3.49 per cent, capped at 6.49 per cent. Borrowers need at least a 15 per cent deposit. It has a £999 fee and free valuation and legal work if the borrower is remortgaging.

ITL Mortgages also offers a broker-only lifetime tracker, pegged at 2.49 points above base for a pay rate of 2.99 per cent, with a cap at 5.99 per cent.

It is available to borrowers with at least a 25 per cent deposit and has a £798 fee.

Mr Hollingworth says: “These capped trackers look attractive. Borrowers get a cheaper tracker rate with the security that their repayments will never rise above a certain level.”

Small lenders show greater flexibility

The biggest high street lenders continue to use automated credit scoring to reject applications from borrowers with even the slightest blip in their credit history.

However, the market is improving among niche players, brokers say. This week Hanley Economic Building Society introduced a new broker-only two-year fix with a rate of 3.35 per cent, available up to 75 per cent of a property’s value, with a £1,499 fee.

The mutual has promised not to credit score applications and brokers can speak directly to underwriters.

Brokers say that a number of other smaller lenders, including the Clydesdale Bank and many regional building societies, also still use staff to underwrite new mortgage applications. These lenders will still consult a borrower’s credit history, but they do not credit score applications.

Aaron Strutt, of Trinity Financial Group, the broker, says: “These lenders are increasingly willing to look at creditworthy borrowers who have one or two missed bill payments on their credit histories or a mark that could be explained. Hopefully, we will see more lenders operating a more flexible approach in the coming months.”