

It's high time now to reduce your mortgage payments

Election result may lead to rate rises, so borrowers should explore options

Elizabeth Colman

Published: 9 May 2010



The Bank of England will come under pressure to increase interest rates. (David Bebber)

Mortgage costs could rise sooner than expected after last week's election failed to deliver an outright majority for the Conservatives.

Economists said the Bank of England may now come under pressure to raise interest rates if sterling remains weak. This increases import prices, which in turn pushes up inflation.

The Centre for Economics and Business Research raised its forecast for Bank rate last week. It previously thought it would remain on hold until August 2011, but now expects a rise of 0.25 points as soon as June.

Most economists expect rates to rise to 0.75% by the end of the year before hitting 1.55% by mid-2010, according to a recent poll by Reuters.

Brokers are coming up with interesting ways to protect mortgages from uncertainty. Largemortgage-loans is offering wealthier borrowers what is believed to be Britain's first multi-currency offset deal.

It allows savings to be offset in other currencies against a sterling loan. This would be useful for people with assets in euros they do not wish to convert into sterling at current rates.

Sterling reached a nine-month high against the euro last week rising to €1.18, but fell back to €1.16 on Friday.

We offer some tips on protecting your mortgage.

Offset mortgages

The multi-currency option from Largemortgageloans requires a minimum £1m loan in sterling on a UK property, with a rate at 2 percentage points above three-month Libor (the rate at which banks lend to each other), or 2.65% at the start of last week. Repayments before offsetting would be £2,208 a month.

Suppose you also had €500,000 in an offshore bank account from the sale of a property on the continent. Rather than bringing the money back into the UK, you could offset it against the sterling loan.

The exchange rate at which you offset is fixed for a month at a time. Exchanging at €1.16 would mean your €500,000 would be worth £430,000. This reduces the amount of the loan that interest is paid on to a notional £570,000, with repayments at only £1,273.

Ordinary borrowers can opt for an offset too

According to research by First Direct, cash Isa savers would have been £3,306 better off putting their savings in a mortgage offset account over the past 10 years, based on average cash Isa rates. The analysis showed that saving the maximum in cash Isas since April 2000 would be worth £38,328.

However, placing the same sum in an offset mortgage could have saved £31,328 and also reduced the mortgage by £10,434, making a total saving of £41,634.

Say you have £10,000 in savings and a £200,000 mortgage. First Direct has an offset lifetime tracker at 2.09 percentage points above Bank rate, currently 2.59%. The mortgage interest payments, based on a 25-year

interest-only deal, would be £5,180 a year, but if you placed the £10,000 in the linked offset account, your mortgage calculations would be based on £190,000 rather than £200,000, saving £259 interest a year.

Switch to a fix

The cost of fixed-rate deals has fallen. The best two-year deal is from Woolwich at 2.98%, with a fee of £1,999, for buyers who can find a 30% deposit. Monthly repayments come to £946 on a £200,000 loan. However, brokers advise fixing for longer than two years as you could come off the deal just when official interest rates — and the cost of new loans — is rising quickly.

The cheapest five-year deal is from Britannia building society at 4.49% with a fee of £999 for those with a 25% deposit. Monthly repayments are £1,111 on a £200,000 loan.

Repayments on the average standard variable rate of 4.67% work out at £1,131 a month — and will, of course, go higher when Bank rate rises.

Mix and match

Tracker deals are cheaper than fixes: First Direct's market-leading deal is 2.39% for those with a 35% deposit, and carries a fee of £499. The repayments are only £886 a month, but borrowers would be vulnerable to rate rises.

One option to keep down cost is a split loan, or hybrid, mortgage. These take advantage of low-cost trackers but provide some security.

Most lenders will allow you to split the loan between a fix and a tracker, although they may charge two arrangement fees. HSBC is heavily marketing its split-loan mortgage, launched last month, which is available on advances up to £500,000 and has a single £999 fee. The size of repayments depends on how much of the loan is fixed.

The lowest rate of 2.49% is for borrowers willing to have 75% of their mortgage on a tracker and 25% on a fix, resulting in monthly repayments of £904.

The rate increases to 2.69% if you are willing to split your mortgage in half, giving repayments at £924 a month, while the highest rate is 2.99% for those who want 75% fixed (£956 a month).

One advantage of this mortgage is that there are no early repayment penalties on the tracker portion, so you can pay down that part of the loan quickly.

Moneysupermarket, the comparison website, said: “You can also transfer to a fix if interest rates start to rise sooner and more quickly than you were expecting and you are worried about your monthly payments.”

A 30% deposit is required for this deal. There are other rates available for buyers with smaller deposits.

For those looking at bigger hybrid loans, Largemortgageloans recently arranged a mortgage with Handelsbanken, the Swedish bank, at a weighted average rate of 3.21% on a £1m advance for a borrower with a 25% deposit.

The broker’s Ian Gray said: “We put £800,000 into a two-year fix at 3.28% and £200,000 on to a penalty-free lifetime tracker at 2.92%. However, this deal was negotiated bespoke and is not available to all borrowers.”

Do not bank on interest-only

Those in the middle of their mortgage term can free up some spare cash by switching from a capital repayment loan to interest-only repayments. Switching could save a borrower with a £200,000 loan at 3% about £450 a month, or £5,400 a year.

Aaron Strutt of Trinity Financial, the broker, said: “Most lenders are not keen to let customers switch to interest-only from repayment, unless they have a method of repaying the loan.”

HSBC, for example, requires borrowers to go to a branch for a meeting before they will allow you to switch, and require you to provide a “repayment plan”.

Cheltenham & Gloucester (C&G) will allow borrowers to switch to interest-only provided the mortgage is 75% of the property value. It charges a fee of £77 for the service.

Strutt said: “With C&G, customers must first explain how they intend to repay the capital part of the loan before it is agreed. However, this bank seems to be more amenable [than others] to switching to interest-only for a short term to help cut your outgoings.”

