Homeowners in fixed-rate dilemma

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Mortgage lenders are continuing to cut their fixed rates, and are seeing increased demand from homeowners keen to protect against rate rises. But brokers have warned that borrowers might still be better off opting for a tracker rate.

Several lenders reduced their fixed rates this week after swap rates – which indicate expectations of future interest rate rises – came down further.

HSBC cut its two-year fix by 0.3 percentage points to 2.69 per cent – the lowest rate on the market – and also reduced its five-year fixed rates by 0.5 percentage points. At the same time, Chelsea Building Society launched a best-buy five-year fix at 3.99 per cent, available on up to 75 per cent loan-to-value with a £495 fee.

“Five-year mortgages do not get much cheaper than this,” said Aaron Strutt of Trinity Financial Group. Chelsea’s rate matches the former market-leading Britannia/Co-op five-year fix of 3.99 per cent, which was withdrawn from the market on Thursday.

Mortgage brokers said fixed rates have become more attractive to borrowers as the gap between the tracker and fixed rates has narrowed. According to John Charcol, the mortgage adviser, this gap has fallen from 2.5 percentage points in March to 1.5 points today – and led more than a quarter of the firm’s clients to take a fixed rate in May, the highest level since October 2009.

“For those who favour a fix, the recent addition of some new, excellent five and 10-year rates is good news and I expect the increase in take-up to continue in the coming months,” said Drew Wotherspoon of John Charcol.

But brokers said it was important for borrowers to take advice based on their personal circumstances as opting for a fix now – in spite of the new low rates – might not work out cheapest for everyone.

“While rates on fixes have fallen in recent weeks, making them extremely attractive, trackers and discounted variable rates are still a cheaper option – at least initially,” said Melanie Bien of Private Finance. Borrowers who do not require the certainty of a fixed rate might therefore find a tracker rate is a better option if interest rates stay at 0.5 per cent for the next couple of years, she argued.

Some wealthy borrowers are instead choosing to hedge their bets by opting for a combination of fixed and variable rates. Nigel Bedford of Largemortgageloans.com has a client who is looking to borrow £1.7m with 60 per cent on a five-year fixed rate and 40 per cent on a penalty-free variable rate.

“This gives him the best of both worlds: medium-term security with the five-year fix but total flexibility with the variable element, matching his plan to reduce the mortgage by £700,000 within the first five years or sooner,” explained Bedford.

Indicative rates for the loan are a variable rate of 2.75 per cent – with an unlimited overpay and redraw facility – and a five-year fixed rate of 4.5 per cent.

Borrowers of larger sums also have the option of capping their existing mortgage rate with an interest rate insurance policy. Mark Harris, managing director of**Savills** Private Finance, said his firm has arranged a number of caps with a private bank. “A lot of our clients have buy-to-let portfolios at rates of around 1.5 per cent over base rate and they want to protect that from future rises,” he said.

For example, a borrower with a £500,000 loan who wants to insure against base rate rising to 3 per cent in the next five years would have to pay an upfront premium of £18,287. The premium reduces as the capped rate increases, so a cap of 4 per cent would require a premium of £14,767.

Similar protection can be provided by RateGuard – a policy from insurer MarketGuard that pays out a monthly sum if rates rise above a certain level. Premiums are set according to the size of the mortgage and the rate insured.