Be wary of mortgage lenders bearing ‘gifts’

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What's this

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If you have received a letter from your mortgage lender recently with a seemingly tempting offer, think twice before taking up the deal.
Mortgage lenders frequently contact borrowers who are part way through a fixed-rate or tracker deal with incentives that could allow them to switch on to new rates, overpay their loan, or get out of a tie-in period without a penalty. Sometimes the offers can bring thousands of pounds of savings, but in other cases signing up to one could be a false economy. Here *Times* Money looks at the offers you could be sent and whether they are worth considering.

Tie-in penalty waivers A number of mortgage lenders have been offering borrowers the opportunity to get out of tie-in periods penalty-free, potentially saving thousands of pounds. This means that borrowers are free to move their mortgage without paying an early repayment charge (ERC) as long as they own a large enough share of their property to qualify for a more competitive rate from another lender. If a borrower is on a variable or tracker rate this might also provide a chance for them to move to a fixed rate.
Bank of Ireland has been writing to certain UK borrowers suggesting they get independent mortgage advice or call the bank to discuss options for moving their

mortgage away or switching on to a new deal. It will not give further details about the incentives it is offering borrowers, but *Times* Money understands that some customers who have responded to the letter have been offered the opportunity to move their mortgage to a new lender without paying ERC, while others have been told they only have to pay a reduced penalty. ERCs can be up to 5 per cent, meaning that a borrower with a £500,000 mortgage could save £25,000 if this was waived.

Borrowers with Northern Rock who were moved into the so-called “bad bank”, Northern Rock (Asset Management), will also soon get the opportunity to remortgage elsewhere without paying an ERC. Bradley & Bingley also offer this waiver. However, borrowers in negative equity or who have little equity will not qualify for other mortgage lenders’ criteria so the initiatives will only help some. Although these deals can provide great savings for borrowers that qualify, it is worth speaking to a mortgage broker to ensure that you have thought through all the implications.

Retention deals Mortgage lenders usually contact borrowers a few months before their fixed-rate or tracker deal comes to an end to warn them that their current rate is due to expire. Often lenders use this opportunity to offer borrowers a new deal in order to retain their business. While borrowers need to prepare for a potential increase in payments if they move on to their lender’s standard variable rate at the end of their tie-in period, they should not feel that they have to immediately accept the new offer put forward by their lender. Even though the rates might be cheaper than what the borrower is paying at that time, it is important to check what rates are available from other lenders and weigh up whether or not it is worth waiting until the end of the tie-in period to get a deal from the open market.

Santander is one lender which frequently tries to catch borrowers before their deals expire, and often the rates it offers are competitive. But brokers say the lender does not offer the best rates to all borrowers. Halifax also contacts borrowers with retention deals. Melanie Bien, of Private Finance, the mortgage brokers, says: “The range of deals offered by lenders to retain existing customers can be limited and are not usually market-leading.”

Standard variable rate tempters Lenders which have low or capped standard variable rates — the rates that borrowers revert to at the end of a tie-in period — frequently offer borrowers tempting deals to try to persuade them to give up their right to this rate. Nationwide Building Society borrowers who took out a mortgage before April 29, 2009, revert to the Bank of England base rate plus 2 per cent at the end of their tie-in periods. Nationwide offers borrowers a £300 cash incentive to switch to a new deal with a higher reversion rate at the end of the tie-in period. Borrowers should consider whether the security of a fixed-rate deal would suit them, but the decision to give up Nationwide’s capped variable rate, which stands at 2.5 per cent, should not be taken lightly.

Aaron Strutt, of mortgage brokers Trinity Financial, says: “Nationwide’s customers would have to be really determined to switch in to a fixed rate, as the vast majority of them would need considerably more than £300 to even consider giving up the capped variable rate.”

Overpayment initiatives You might get a letter from your mortgage lender urging you to take advantage of current low interest rates to overpay your mortgage. This can be a good idea, allowing you to bring down your loan size relative to your property’s value, which will open up cheaper options when you come to remortgage. Borrowers with the Co-operative Bank and Britannia can repay up to 50 per cent of their balance without penalties throughout 2011. But before taking up an overpayment offer, it is important for the borrower to find out whether they will be able to draw down this money again if they need it, as most lenders will not allow this. If not, it is crucial that the borrower doesn't overstretch themselves by trying to pay back too much too quickly. It is also important to have some savings to cover other living costs.

David Hollingworth, of brokers London & Country, says: "As the tide turns and interest rates start to climb, having a smaller mortgage will clearly be beneficial."
Switching from interest-only to repayment Lenders may contact borrowers who have interest-only mortgages to check whether they have a strategy for repaying the capital at the end of the term. Lenders also might suggest moving these borrowers to a repayment mortgage, where payments go towards reducing the balance as well as the interest. Brokers say that while it is important for borrowers to have an effective plan in place for repaying an interest-only mortgage, they should seek advice before switching to a repayment mortgage. (It could be difficult to switch back once you have moved to capital repayment.) Some borrowers may be better off maintaining their interest-only mortgage and speaking to a financial adviser to plan an investment strategy for repaying the capital at the end of the term.

Case study: overpayment wasn't best option

Sarah Harper, 36, from London, received a letter from her bank last month asking if she wanted to pay off her mortgage early.

Ms Harper, who has a Santander Flexible Offset mortgage, works for mortgage brokers John Charcol but is not a qualifed mortgage adviser herself so was not sure what to make of the letter. It suggested she might like to make overpayments on her mortgage or put more money into the offset savings account with which it is linked.

She consulted a qualified broker at her work who suggested that because her mortgage interest rate was just 0.99 per cent, it would be better if Ms Harper and her husband used up their Isa allowances before April and saved this money into a Santander loyalty account paying 3.5 per cent. If they overpayed on the mortgage and the property fell in value Santander could ringfence this money, but keeping it in a separate Isa would provide £300 extra interest over the year without the risk of it being locked into the mortgage.