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Lenders cut rates on two-year deals

By Tanya Powley
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Banks and building societies have been cutting their fixed-rate mortgages and promoting apparently cheap two-year fixes in recent weeks, in an attempt to win new customers.

But mortgage brokers warn that these short-term deals could prove the more expensive option for borrowers in the long run.

In the past fortnight, lenders including Scottish Widows, ING Direct, Santander, Northern Rock and Woolwich have announced lower fixed-rate deals. “Two- and three-year fixes have been lowered typically by 0.2 per cent, but some lenders have made bigger reductions,” said Aaron Strutt of Trinity Financial.

Borrowers can now get a two-year fixed rate of 2.79 per cent from Santander – although this has a fee of £1,995 and a maximum loan-to-value ratio of 60 per cent. As an alternative, Yorkshire Building Society is offering a two-year deal at 2.99 per cent with a £995 fee, available for up to 75 per cent of a property’s value.

Woolwich, the mortgage arm of Barclays, has also launched a two-year fix at 2.99 per cent, available up to 70 per cent loan- to-value, as part of the group’s loyalty mortgage range. To get the cheaper rate, borrowers need to pay at least £800 a month into a current account with the bank.

However, in spite of these cheap headline rates for two-year fixes, brokers believe that most borrowers will be better off with a cheaper variable-rate mortgage or a longer term fix of five years.

“Currently, it does look like interest rates will only start to rise gradually and opinion remains varied on when that climb will commence,” said David Hollingworth of mortgage brokers London & Country. “On that basis and bearing in mind the initially cheaper rates available on tracker deals, there seems to be a strong argument that a short-term fix could prove unnecessary.”

Ray Boulger of John Charcol said two-year fixes only offer security for the period in which it will be least needed and – if rates rose during that period – borrowers would end up having to refix at a higher rate after two years.

Borrowers who want to take advantage of the lower rates initially offered by tracker-rate mortgages have a number of options. The best two-year tracker is from First Direct at 1.99 per cent. It comes with a £999 fee and is available up to 65 per cent loan-to-value.

According to Hollingworth, monthly payments for a £150,000 repayment mortgage over 25 years under First Direct’s tracker deal would be £635, compared with £710 on Yorkshire’s two-year fix – a saving of £75 a month if interest rates remain the same.

Borrowers who want security of payments may be better off opting for a five-year fix, said Melanie Bien of Private Finance. Last week, Chelsea Building Society launched a five-year fix at 3.99 per cent, available up to 75 per cent loan-to-value but with a fee of £1,995. This week, TMW also launched a five-year fix at 3.99 per cent, with a 2 per cent fee. “As long as a borrower is happy with five years of penalties, then a five-year fix looks a better option than two years as there is not much in the rate,” said Bien.

However, borrowers who are considering moving home in a few years’ time may prefer a shorter-term deal so that they do not face any penalty charges or problems transporting their mortgage.

The Financial Ombudsman Service has seen an increase in the number of complaints from customers whose application to move their mortgages had been declined because lenders had tightened their criteria since the deals were granted.