guide: mortgage types

The mortgage market has become more sophisticated, over the years lenders have created more products and schemes to appeal to different people for different needs.

We have asked our mortgage team to put together a handy guide to help explain the differences of each type of mortgage.

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standard variable rate (svr)

The Standard Variable rate mortgage or SVR for short has for years been the most common product available. In truth most lenders will not allow you to apply for a mortgage with them using their SVR but instead when your special deal (such as a fixed rate) comes to an end you would revert to the lenders SVR.

As it says on the tin these rates are variable meaning they can go up and down. Each mortgage lender will have their own SVR and they choose what they feel the interest rate should be. SVR is meant to reflect the Bank of England base rate but this is far from a reality, for example currently Santander SVR is 4.74% and the Base Rate is 0.5%!!

fixed

The easiest to understand of all the mortgage types and currently the most popular. A fixed rate means that your interest rate and therefore your monthly payment are fixed for a certain period of time. Commonly fixed rates last for 2, 3 and 5 years and the current trend is the longer you fix in for the higher the interest rate.

Fixed rates are great for first time buyers to help manage their finances and anyone who wishes to know exactly what they are expected to pay for a given period of time.
The down side to fixed rates are if interest rates start to fall you would not feel the advantage as you are fixed in. Also fixed rates tend to come with an early repayment charge so if you wished to clear your mortgage and you are still within your fixed period this will cost you.

tracker

Tracker rates have their pros and cons like all mortgage types. They are called tracker rates as they track at a fixed amount above/below the Bank of England Base Rate for a certain period of time. The benefit of this is if interest rates start to fall you will feel the benefit as your mortgage payment will start to fall as well. But on the other foot if interest rates start to go up so will your monthly mortgage payment!

Some tracker rates have no early repayment charges so you would be free to repay this mortgage at any time penalty free.

hint - In the mortgage market the word ‘product’ is an umbrella term for what the lender has packaged together. Each lender has a range of products available and they take into consideration interest rates, fees, mortgage type and any freebies, so for example a mortgage product could look like:

“2 year fixed @ 3.99% with a £999 arrangement fee”

“5 year tracker rate @ Bank Base Rate +3% with a £499 arrangement fee”

capped / collar

Because of the volatility of the mortgage market lenders introduced Capped and Collar products. They are exactly the same as trackers but they have the benefit of having a threshold.

Capped – this is the top end, so if you have a cap of 5% but interest rates rocket to 6% your mortgage will not go over the cap of 5%.

Collar – this is the bottom end, so if you have a collar of 3% but interest rate plummet to 0.5% like they have recently your rate will not go any lower than the 3% collar.

discounted

The discounted rate mortgage works in the same way as a tracker but rather than following the Bank of England base rate the discounted mortgage follows the lenders set SVR. Your monthly payment can go up and down but the risk is the mortgage lender has control over their SVR so there is very little that can be done to forecast what the future could bring.

flexible mortgage

Flexible mortgages are recently new to the market and have a number of advantages. For a mortgage to be considered as flexible it must incorporate these three basic features:

- Interest calculated on a daily basis.
- The facility to make overpayments at any time without incurring a penalty and to underpay if your circumstances warrant it.
- The facility to take a payment holiday, again if your circumstances warrant it.

This mortgage also gives you the flexibility to borrow more at a later date without having to apply for further funds so for example you may have only borrowed £100,000 to purchase your property but your flexible mortgage has an agreed limit of £150,000 so if you wanted a new kitchen you can simply write a cheque from your mortgage and the debt will be increased.

current account mortgage

Exactly the same as the flexible mortgage in its set up but has the added benefit that it can be used in the same way as a current account. You can have your pay go in & direct debits going out but with the added bonus that you have a large borrowing facility on hand should you need to raise money quickly.

offset

Seen as the most complicated mortgage for people to get their heads around but is great if you have large savings in which you aren’t planning on spending in a big way. In simple terms an offset mortgage is 2 accounts, your mortgage account and a savings account. The interest you earn on your savings is put into the mortgage to bring the mortgage down.

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