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FINANCIAL SERVICES

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THE AFMS 10 STEP MORTGAGE GUIDE

1. Don’t over-stretch yourself

When you’re arranging a mortgage, you need to be sure that you can keep up your repayments. If arrears begin to pile up, you could end up losing your home. You may have seen this warning on literature from mortgage lenders, ***“Your home is at risk if you do not keep up repayments on a mortgage or other loan secured on it.”***

Of course, the cost of your home doesn’t stop at its price. There are other upfront costs to consider, including stamp duty (an extra 1% to 4% of your purchase price), survey and legal fees (around £1,500 or more). Also, your mortgage repayment is just one of a host of monthly expenses, including insurance policies (life, sickness, buildings and contents, etc.), Council Tax, maintenance costs, utility bills and so on.

Here are three ways to reassure yourself that you’re not going to be over-stretched:

- The first is to put down a large deposit. If you have a 10% deposit, you’re less likely to fall into negative equity (where your home is worth less than your mortgage) than someone who has a 100% mortgage.
- The second way is to limit yourself to borrowing, say, less than 3x times your income (or 2x times a couple’s joint income). People borrowing large multiples of their salary (say, four times or greater) have come a cropper in the past.
- Thirdly, if your mortgage repayments go up and down when interest rates change, budget for a 2% increase in rates. That way, you won’t suffer ‘payment shock’ when interest rates eventually start to climb.
- In addition, double-check your figures by listing all your income and outgoings so that you know how much income you have spare to meet your mortgage repayments.
- One rule of thumb is not to spend more than a third of your disposable income on your mortgage. If your mortgage is costing you more than half of your spare income, you don’t have much room for manoeuvre if things take a turn for the worse!

2. Loyalty costs you plenty

Although faithfulness is to be prized in other relationships, it’s positively harmful when it comes to your mortgage and other financial products! Why limit yourself to dealing with a

single mortgage lender, when there are around 150 lenders eager to do business with you? In fact, being loyal can cost you a fortune. If you don't have a special-rate deal with your lender, you're likely to be paying its standard variable rate (SVR). Generally, big lenders charge an SVR around 2% above the Bank of England's base rate. However, Best Buy variable-rate loans come in below the base rate, which means a saving of 2%+ a year. On a £100,000 interest-only loan, this means an extra £2,000 a year in your pocket. One great strategy is to become a 'rate tart', finding a better deal whenever you can do so without penalty. This approach should save you tens of thousands of pounds over the life of your mortgage.

3. Get the best mortgage

As the UK's once hyperactive housing market really slows down, lenders are cutting each other's throats to tempt homeowners away from the competition. Re-mortgaging is big business and can account for up to half of total lending. Nevertheless, before going elsewhere, talk to your current mortgage lender. All the major UK lenders have a 'turnaround' team, whose job it is to hang onto your custom. If you have a good payment history, you should be able to squeeze a much better deal from your lender by threatening to take your business elsewhere. Ask for a settlement figure or redemption statement - that'll grab their attention! Before you switch loan or lender, find out what incentives are on offer. Many lenders provide 'fee-free switching deals' by paying (or making a contribution towards) your valuation and legal fees. Others offer cashback when you draw down your loan. Typically, these perks are worth £500 to £1,500, which you should factor into your calculations.

If your existing lender won't come up with a winning deal, it's time to try the opposition. You could try the Best Buy tables in the weekend papers, Teletext or the website of independent financial researcher Moneyfacts. However for truly independent advice, contact our Financial Adviser Dianne, she will find the deal that's right for you by searching through 8,000 or more home loans. You'd get several quotes from tradesmen before choosing one, so do the same with your home loan!

4. Interest-only or repayment?

In the Eighties and Nineties, the vast majority of mortgages were interest-only loans. This means that borrowers only paid interest on the money they owed, without chipping away at their debt. In order to pay off the debt after 25 years, they would invest money to produce a lump sum. Most people in this situation were sold an endowment, which combines life insurance with an investment plan. However, in recent years, a combination of high charges and depressed investment returns has all but destroyed the credibility that endowments once had.

Nowadays, most people choose to have a repayment mortgage, where part of each monthly repayment goes towards paying off their loan. With a repayment mortgage, you are guaranteed to pay off your home loan, assuming that you make all your repayments on time. If you're worried about future investment returns, or have an endowment that won't clear your mortgage, you could convert all or part of your mortgage into a repayment loan. Some lenders will charge you a fee of around £150 to do this, but this may be worth paying if you want to play it safe.

5. The joys of over-paying

Taxpayers who save money in taxable savings accounts have to pay tax on their interest: a fifth (20%) for basic-rate taxpayers and two-fifths (40%) for the UK's three million higher-rate taxpayers. So, a gross (pretax) rate of 5%, would fall to 4% or 3% after taxis deducted. On the other hand, if you overpay your mortgage, you effectively 'earn' tax-free interest at your mortgage rate. So, if your mortgage rate is, say, 6.75%, your tax-free return is also 6.75%. To earn 6.75% in a taxed savings account, you'd need to earn 8.44% before tax (11.25% if you're a higherrate taxpayer). Since no safe investment offers this kind of return, 'saving' into your mortgage can be a good idea. In fact, multi-billionaire investment guru Warren Buffett has remarked that, for most people, overpaying their mortgage is the best financial move they can make.

What's more, a borrower with a £100,000 repayment mortgage, paying a discounted rate of 4.75%, could cut his/her interest bill by £11,396 by overpaying £50 a month. Even better, this overpayment means that the mortgage term falls from 25 years to 21 years, which means 3 years more fun in later life! Before setting up a standing order or dropping a lump sum into your mortgage, check with your lender to make sure that you won't be punished for doing so. If you will be penalised, put the money into a Best Buy savings account and whack it into your mortgage when you're free to do so without penalty.

6. Watch out for overpriced insurance

UK banks make billions of pounds a year from mortgage borrowers, thanks to the interest on over £850 billion of mortgage debt. However, they also make enormous sums from selling high-priced protection to their borrowers. Mortgage lenders make it 'easy and convenient' for you to buy their own cover, often collecting the premiums with your monthly mortgage repayments. But this is simply a cunning trick to make you forget that you're over-paying for this protection! For example, your mortgage lender may have 'encouraged' you to buy one or more of these policies:

Life insurance.

If you bought this from your mortgage lender, your premiums are probably three times as high as they could be. Getting cheaper cover will save you thousands over the life of your mortgage. Also, you don't need this cover if you're young, free and single, but it's essential if you have a partner and/or dependent children.

Income protection.

(Long-term sickness cover) and critical illness insurance (protection against cancer, heart attack, stroke and other serious conditions). As above.

Home insurance.

(Buildings and contents).Another nice little earner for mortgage lenders. Ignore any sales patter, such as "our tailor-made policy makes it easier to claim". Instead, switch and save.

Mortgage payment protection insurance.

This optional accident, sickness and unemployment cover is a right royal rip-off. Lenders and insurers make around £800 million a year from selling this over-priced protection. Shop around for it (or call a reputable insurance broker) - you could cut your monthly premiums by two-thirds, saving you £250 a year.

Investments.
You'd be mad to buy any investment plans from your mortgage lender. Most have super-high charges and inferior investment returns. For long-term investing over the long term, we recommend an index tracker wrapped up in a tax-free ISA, which is a simple, low-cost way to grow your money in the stock market.
Find lower premiums in our Insurance Centre.

The AFFS financial adviser can answer your questions on any of the above insurance policies, just ask.

7. Beware of ultra-low rates

Always be suspicious of financial offers that look too good to be true, because they're sure to have a sting in the tail. For example, take fixed rate mortgages that offer ultra-low introductory interest rates. The only way that a mortgage lender is going to give you a fixed-rate deal that's way below the Bank of England's base rate is if it knows that it'll make its money back somehow. For example, if you take out a mortgage with a low fixed rate of, say, under 3% for two years, you can bet that you'll be locked in for a long time after your sweet deal ends. Typically, heavy penalties will keep you tied in to a lender's standard variable rate for, say, five years longer. So, your repayments will rocket and, if you want to buy your freedom, you'll have to hand over a huge chunk of cash (known as an 'Early Repayment Charge'). Ouch!

So, beware of home loans that have fines that still apply after your special-rate deal has ended. If you want to escape to a cheaper deal, these extended Early Repayment Charges usually end up costing you an arm and a leg. Think "short-term bargain, long-term misery" and don't be handcuffed to a horrible home loan. Jam today often means trouble tomorrow, so look for hidden horrors in the small print!

8. Sleep easier with a fixed or capped rate

Although interest rates are exceedingly low at the moment, if they increase this can still cause some discomfort. In 2004 for example, the base rate rose from 3.75% to 4.75% effectively increasing the cost of a £100,000 interest-only mortgage by £83a month. If you don't fancy a ride on the interest-rate roller coaster, plump for an affordable fixed or capped rate over, say, two to five years. Just watch out for extended Early Repayment Charges (see tip seven). Note that a fixed rate is guaranteed not to change over a set period. However, a capped rate means that your rate is variable, but will not rise about a pre-set ceiling (the 'cap') over an agreed period. With a fix or cap, at least you know that you can afford to meet your repayments for the foreseeable future - and you don't have to worry about interest-rate rises for some time.

Many borrowers take great comfort from the security of knowing exactly what their repayments will be for a while. Many first-time buyers choose fixed or capped rates to guarantee their payments in the early years, when they are adjusting to life as homeowners.

9. The horror of hidden fees

When it comes to being a homeowner, there are far more bills and costs than just your monthly mortgage repayments! For example, there are upfront and exit costs, including:

Solicitor's fees Arrangement fees
(for legal work, known as conveyancing)
(also known as application or booking fees), which can be £500 or more
Completion fees Valuation or survey fees
(paid when you draw down your home loan)
(from the surveyor who values and inspects your home)
Sealing and deeds fees
(which you cough up when you pay off your loan or switch to another lender)
And, of course, Early Repayment Charges(see tip seven).

Another gruesome charge to watch out for is a mortgage indemnity premium (MIP), also known as a mortgage indemnity guarantee (MIG) or higher lending charge (HLC). If you want to borrow more than three quarters of the value of your home, some lenders will charge you a MIG. This is an insurance premium that protects your lender if you default on your mortgage, but has absolutely no financial value to you. So, you pay the premium, but the policy only protects the lender! These days, decent lenders don't charge MIPs on mortgages of up to nine-tenths (90%) of the value of a property, referred to as "90% LTV (loan to value)". So, if you have a 10% deposit or own at least a tenth of your current home, you should be able to avoid paying a MIP. And they are worth avoiding, because they can amount to thousands of pounds. Skip the MIG, because MIGs are pigs! So, be warned: lenders advertise headline rates prominently, while tucking away any chunky charges in the small print. Make sure you look beyond the advertised rate to find those extra fees!

10. The benefits of a flexible mortgage

Modern 'flexible' mortgages are seriously cool. They allow you to overpay, underpay, take repayment holidays, skip repayments, and withdraw or deposit lump sums. Of course, making regular overpayments or dropping in the occasional lump sum can seriously reduce your interest bill and shorten the life of your mortgage (see tip five). Nice! What's more, with a flexible mortgage, your debt falls as soon as repayments hit your account. In other words, these loans calculate and charge interest daily. On the other hand, millions of borrowers have outdated 'annual interest' mortgages (also known as 'annual rest' loans). With these old chestnuts, repayments (and most overpayments) are only knocked off your loan at the end of each year. So, your January repayment isn't credited until, say, December. Hence, when you make a repayment, you're also giving your lender a tidy interest-free loan! So, be sure to ask any lender how it charges interest - and avoid any annual-interest mortgages that look like a bad deal.

Finally, current account mortgages (CAMs) combine your mortgage, current and savings accounts under one roof. By offsetting the credit balances in your current and savings accounts against your mortgage, your debt is reduced and you pay less interest. CAMs are the pinnacle of mortgage evolution, but they aren't suitable for everyone. This is because their rates are higher than, say, Best Buy discounted, fixed, capped or tracker rates. However, if you're financially disciplined and have substantial savings, they can be a great way to bring forward your mortgage-free date.

If you have any questions please get in touch with AFFS
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