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The essential guide to **mortgages**

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Most people who buy property will use some form of mortgage. Indeed, according to the Financial Conduct Authority (FCA), in the final quarter of 2023, the total amount borrowed through residential mortgages was £1,657.6 billion.

While buying a property is an exciting time, the mortgage market may seem confusing. It can feel like there are an overwhelming number of options, whether you're a first-time buyer or are expanding your property portfolio.

Read on to discover the essentials you need to know about mortgages and how your decisions could affect your finances.

In basic terms, a mortgage is a type of loan that you can use to purchase a home, plot of land, or other type of real estate. It will normally be secured against a property or land, and you'll usually make monthly payments to your mortgage lender to service the loan.

There are several different types of mortgages, and the decisions you make could affect your finances now and in the future. Here are some key questions you might want to consider if you're looking for a mortgage.

How much can I borrow?

Before you start searching for a property, you need to understand how much you can borrow through a mortgage.

Many factors will influence a lender's decision. A general rule of thumb is that you can borrow up to 4.5 times your annual income. However, the actual amount will vary from lender to lender and be based on factors such as:

- Your employment status – whether you are employed or self-employed
- Whether you receive any other sources of income, such as bonuses or commission
- If you have any regular commitments, such as loans or credit cards
- Your credit status.

Obtaining a mortgage in principle (or "agreement in principle") is one way to get a clearer idea. A mortgage in principle indicates the amount a lender will offer you based on the details you've provided. The lender may conduct a soft credit check, but this will typically not affect your credit score.

Potential rental yield could affect how much you can borrow with a buy-to-let mortgage

If you're looking for a buy-to-let mortgage, the amount you can borrow will likely depend on the rental income the property generates. The rent will normally need to be around 25% to 45% higher than your mortgage repayment.

Lenders may also require you to prove your non-property income to show that you could afford to maintain the payments if, for example, you don't have a tenant.

The Financial Conduct Authority does not regulate some buy-to-let and commercial mortgages.

You can often complete the application online and receive a response in just a few minutes. Some estate agents will want to see a mortgage in principle when you make an offer, so it's a step worth taking. Most agreements in principle will last for three months.

While useful, keep in mind a mortgage in principle is not a guarantee. Nor do you have to take out a mortgage with the same lender you have a mortgage in principle from.

While a lender will complete affordability checks, it's worth reviewing your own finances to provide peace of mind too. Make sure you're comfortable with the potential outgoing and the impact it will have on your budget.

Should you choose a repayment or interest-only mortgage?

With a repayment mortgage, your monthly repayment will cover the accrued interest and a portion of the loan. Assuming you keep up with the repayments, you'd own your property outright at the end of the mortgage term.

Interest-only mortgages are less common – in 2023, the FCA reported that interest-only mortgages made up 9% of the total number of regulated mortgages, and many of these are due to mature in the next decade.

As the name suggests, your monthly payments will only cover the accrued interest if you choose an interest-only option. This usually means your outgoings are lower – however, as your repayments don't include any of the money you borrowed, you'll still owe this amount at the end of the term.

Let's say you have borrowed £200,000 through a mortgage with an interest rate of 4.5% and a term of 25 years. With a:

- Repayment mortgage, your monthly repayment would be around £1,111
- Interest-only mortgage, your monthly payment would be around £749.

So, an interest-only mortgage could be useful if you want to manage your outgoings.

However, you'll still owe the amount you initially borrowed if you don't make any additional payments. As a result, you may want to consider your long-term plan. For example, will you use other assets to pay off the outstanding debt when the mortgage ends? Or do you plan to sell the property?

When you're deciding which type of mortgage suits your needs, you may want to consider both your short- and long-term finances.

How long do you want your mortgage term to be?

The mortgage term determines how long you'll make mortgage repayments.

Traditionally, first-time buyers would take out a mortgage with a 25-year term. However, affordability challenges mean more families are choosing longer mortgage terms. In fact, a report from UK Finance found that almost 1 in 5 first-time buyers were borrowing with a term of more than 35 years at the end of 2023.

Mortgage terms often range from two to more than 40 years. A variety of factors could affect your options, including your age, as lenders will often want the mortgage to end before you retire.

A longer mortgage term would mean your monthly payments are lower, but the cost of borrowing is likely to be higher when you consider the total interest paid.

The table on the right shows how changing the mortgage term on a £250,000 repayment mortgage with an interest rate of 4.5% could affect your finances.

Mortgage term	Monthly repayment	Total interest paid over the full term
20 years	£1,581	£129,466
25 years	£1,389	£166,711
30 years	£1,266	£205,811

Source: MoneySavingExpert

As the example highlights, choosing a shorter mortgage term may save you a substantial amount when you calculate the total interest you could pay.

You can often change your mortgage term in the future. You may choose to shorten the mortgage term if your finances improve, such as after you've received a pay rise. Alternatively, you might be able to extend the term if you'd like to reduce your outgoings.

Would you prefer a fixed- or tracker-/variable-rate mortgage?

Your mortgage interest rate will have a direct effect on your monthly payments. So, understanding whether a fixed- or tracker-/variable-rate option is right for you could be important.

Fixed-rate mortgages

With a fixed-rate mortgage, your interest rate is fixed for a defined period, often between two and 10 years.

The key advantage is that your payments will stay the same throughout your mortgage deal, which could help you budget.

The downside is that if interest rates fall, you won't benefit. In addition, fixed-rate deals often have a slightly higher initial interest rate than comparable variable-rate options.

Tracker- and variable-rate mortgages

If you choose a tracker- or a variable-rate mortgage, the interest rate and your payments could change at any time. This normally happens when the Bank of England (BoE) alters the base interest rate.

On one hand, you could benefit if interest rates fall. But your outgoings could rise if interest rates increase. For some households, this could make budgeting difficult.

The effect rising interest rates could have on mortgage holders has made headlines recently. To tackle high inflation, the BoE has increased its base rate from 0.1% in November 2021 to 5.25% as of April 2024, which has affected millions of households.

Interest rates may be an important factor when you're deciding which mortgage to choose. However, there could be other areas you want to consider too, such as the application fee or whether you can make overpayments without facing a charge.

The BoE's December 2023 Financial Stability report estimates that around 5 million households will be affected by higher interest rates between the second quarter of 2023 and the end of 2026. The average monthly mortgage repayment is projected to increase by around £240 – around a 39% increase.

So, if you choose a variable-rate mortgage, you might want to consider how you'd cope financially if interest rates increased further.

Whether you choose a fixed- or variable-rate mortgage, keeping the length of the deal in mind could be useful. When your current deal expires, you'll usually be moved on to your lender's standard variable rate (SVR), which isn't typically competitive, and searching for a new deal could make financial sense.

Other fees and costs you might want to weigh up when taking out a mortgage

While the interest rate of mortgage deals is important, you need to consider other factors when selecting a mortgage product too. Depending on your circumstances and plans, they could have a significant impact and save you money.

Some of the other areas to consider are:

Application and arrangement fees

Some mortgage products will charge you an initial cost when applying, or once the mortgage is in place. These costs can vary and add to the cost of buying or remortgaging a property. They may be a flat fee or a percentage of the mortgage's value, such as 1.5%.

The fees may be higher for buy-to-let mortgages.

There are many products available that don't include these fees, but they often have a higher interest rate, meaning your monthly repayments will be higher. You should take some time to calculate if you'll save money in the long run by paying an arrangement or application fee.

Valuation fee

All lenders will carry out a valuation on the property you want to buy. This is where the lender checks that the property is worth the money you're paying, and this report may identify any significant issues with the property.

In some cases, a valuation is conducted through online research. In others, it will be a physical visit to the property.

Some lenders will charge you a fee for this work, or offer you a chance to upgrade to a homebuyer report, which will highlight potential problems with the property.

Keep in mind that a basic valuation is not a survey. A homebuyer report looks at some of these issues, but only those that are easily visible. A building survey will be more comprehensive and could be valuable, especially if you're buying an older or unconventional property.

Early repayment charges (ERCs)

Overpaying your mortgage can help you pay off the debt quicker and reduce the amount of interest you pay. If you're in a position to do so, overpaying your mortgage might be beneficial. However, some lenders will levy an "early repayment charge" (ERC) for making overpayments, so it doesn't always make financial sense.

Usually, you can pay up to 10% of the remaining mortgage each year without incurring an ERC. However, make sure you check before agreeing to a mortgage or making any overpayments.

If overpaying your mortgage is part if your short- or long-term plan, you might want to review potential ERCs when comparing mortgage deals.

What will your loan-to-value ratio be?

The loan-to-value (LTV) is the ratio of what you borrow through a mortgage against the value of your property. It's important as the interest rate a lender will offer will usually fall if you borrow a lower percentage of the value of your property.

If you purchase a property for £200,000 with a 10% deposit of £20,000, your LTV is 90%. As you make repayments or the value of your property increases, your LTV will fall.

It's not just first-time buyers that might consider the LTV. It's a factor that could affect the terms of your mortgage when you're remortgaging or moving home too.

It can also determine the level of buy-to-let mortgage you can secure. Usually, if you're taking out a buy-to-let mortgage, you'll need a higher deposit, typically at least 25%.

According to Moneyfacts, in March 2024, the average two-year fixed-rate deal for a 95% LTV residential mortgage was 5.99%. The average comparable deal if your LTV was 60% was 5.23%.

It might seem like a small difference, but it could really add up over the full term of your mortgage. Moving into a lower LTV band could cut your monthly outgoings and the amount of interest you pay overall.

In some cases, you could find that boosting your deposit or making an overpayment to move into the next LTV band is financially savvy. If you already own your home, getting it revalued before you apply for a new mortgage deal could also be useful.

LISA: Helping first-time buyers

First-time buyers struggling to save a deposit may want to consider using a Lifetime ISA (LISA).

You can contribute up to £4,000 (2024/25) and receive a 25% bonus from the government.

You must be aged between 18 and 39 to open a LISA, but keep in mind that if the money is used before the age of 60 for a purpose other than buying your first home, you could face a 25% withdrawal penalty, which would mean you lose the bonus and a portion of your own savings.

It's not just the LTV that will affect the interest rate a lender offers you. They'll also consider the risk you pose. A lender will carry out affordability tests and review your credit report when assessing your mortgage application.

Taking some time to review your credit report so you're aware of potential issues could give you a chance to rectify them or approach a specialist lender if necessary.

6 savvy reasons you might want to work with a mortgage professional

While you can search for a mortgage and complete the application yourself, working with a professional mortgage adviser could be useful. Here are six reasons why you might choose to engage the services of a mortgage adviser.

1. You'll have someone to direct your questions to

Even if you feel confident about the different types of mortgages available, searching for a deal that's right for you can still seem complicated. You might be unsure about which options suit your needs or what fees you could face.

Working with a mortgage adviser means you have someone on hand to answer your questions and provide tailored advice.

2. A mortgage adviser could identify the right lender for you

There are a lot of lenders to choose from, and many don't have a high street presence so you might not be aware of them. In addition, lenders set their own criteria, so it can be difficult to know which ones are most likely to accept your application.

A mortgage adviser may help you identify which lender could be right for you.

This could be particularly valuable if your circumstances aren't straightforward. For example, if you are self-employed, have a poor credit history, or receive a complex income, approaching a specialist lender could improve your chances of securing a mortgage.

The mortgage market can change quickly too. Indeed, according to Moneyfacts, in March 2024, the average mortgage had a shelf-life of just 15 days. A mortgage adviser could prove valuable and alert you if a new deal could be better suited to you.

3. They can offer support during the application process

When completing a mortgage application, you'll need to fill in paperwork and provide evidence, such as payslips or accounts detailing your income. Mistakes could lead to delays or might even mean your application is rejected.

A mortgage adviser may review your application before it goes to the lender to make the process as smooth as possible.

4. A mortgage adviser could help you access a more competitive interest rate

The interest rate applied to your mortgage can have a huge effect on your day-to-day outgoings. So, securing a lower rate could save you thousands of pounds over the full mortgage term.

By working with a mortgage adviser, you might be able to access more competitive deals from lenders who only deal with mortgage professionals.

5. They might remind you when your mortgage deal expires

Usually, when your current mortgage deal ends, you'll move on to your lender's SVR, which could lead to your repayments rising and might not be the best option for you.

Often, you can lock in a new mortgage deal six months before your existing one expires. By establishing a relationship with a mortgage adviser, they could remind you when it's time to review your options and provide assistance if you decide to search for a new deal.

6. A mortgage adviser could offer guidance about financial protection

A mortgage is often the largest loan you'll take out, so it might be a trigger for reviewing your financial resilience.

If you face a financial shock, such as your income stopping because you're unable to work due to an illness, appropriate protection could provide you with a vital safety net that allows you to continue meeting financial commitments.

If you're taking out a mortgage with a partner or have dependent children, you may also want to consider how they'd cope if you passed away. Taking out life insurance could provide your loved ones with a way to pay off the mortgage and offer some security if the worst happens.

Thinking about the circumstances you'd need to make a financial protection claim can be difficult, but it could also provide peace of mind. A mortgage adviser could offer you guidance about which types of financial protection may be appropriate for you.

Financial protection plans typically have no cash in value at any time and cover will cease at the end of the term. If premiums stop, then cover will lapse.

Contact us to talk about your mortgage needs

With so much to consider, finding the right lender and mortgage product for you can be challenging.

A mortgage broker understands the market and will be in a position to offer you advice and guidance throughout the process.

Working with a mortgage broker can help you save money in the long run, through securing a mortgage with a lower interest rate, as well as helping you to handle the paperwork and other aspects of applying for a mortgage.

If you have any questions about your current mortgage arrangement or need to take out a new deal, we could help you. Please contact us to arrange a meeting:

020 8286 3609

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Your home may be repossessed if you do not keep up repayments on a mortgage or other loans secured on it.