Understanding mortgages

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Contents

Introduction

Welcome to this free Open University course on mortgages – loans used for buying homes.

The course explores the mortgage products available in the UK market – their interest rate and other characteristics – and examines the factors involved in making good choices from the product range. It explains why and how mortgages can be actively managed by borrowers through such options as overpaying, offsetting and remortgaging.

The course also examines the mortgages from the viewpoint of the lenders, including the factors that affect their decisions about making mortgage advances.

By completing the course you will not only become more knowledgeable about the mortgage market, but also more confident in making smart decisions about one of most important areas of personal finance.

You will find activities, animations and audio material as well as quizzes to enable you to assess your understanding of the content. You will also be provided with a series of links to explore further the subjects and issues that you will explore in this course.

Understanding mortgages is a free, short course produced in collaboration with MoneySavingExpert.com.

The Open University would really appreciate a few minutes of your time to tell us about yourself and your expectations for the course before you begin, in our optional start-of-course survey. Participation will be completely confidential and we will not pass on your details to others.

Learning Outcomes

After studying this course, you should:

- be able to understand how banks and other lenders like building societies make decisions about providing mortgages
- know the different types of mortgage products available and the interest rates that apply to them
- know the benefits in proactively managing your mortgage – for example by periodically moving from one product to another
- be able to understand the various costs involved in buying property
- know the risks involved in having a mortgage and how to manage these.

The first section will look at the factors that determine how much lenders will provide when you apply for a mortgage.

1 Getting a mortgage: how much can I borrow?

Before making an offer to buy a property you need to know how much your lender will be prepared to advance you and on what terms. Getting at least an indication of what you can borrow makes sense before you make an offer. Subsequently you can return with details of the specific property you want to buy.

Figure 1

Before making a mortgage offer your lender will:

- Check your credit file and your credit score to ensure you're financially attractive. Lenders are very interested in your track record when paying back any money you have previously borrowed.
- Assess the amount of money the lender (not you!) thinks you can afford to pay back (the 'affordability test'). This involves the lender reviewing your income and spending – typically aided by studying your bank statements for the past three months. When it comes to your spending the focus will be on your regular and contractual expenditure (e.g. mobile phone contract, school fees, and home insurance) rather than one-off discretionary spending. They will also take into account the number of dependents you have.
- Stress test your finances. This includes looking at the factors that could change the amount you spend each month and seeing if your budget can cope with the interest rate on your mortgage rising sharply (normally by assessing the impact of a 3% hike in the mortgage rate you pay).

So ahead of talking to your lender there are some things you should do to help present your best financial profile to your lender:

- Check your credit files and ensure that there is no incorrect information. A link is provided at the end of this course to help you do this.
- Ensure that the income details provided include those of your partner if you are both to be parties to the mortgage contract.
- Review your spending – ideally at least three months before approaching your lender and, perhaps, cut out some non-essential regular spending (for example gym membership if you are not making use of this). This will improve the outcome of the affordability test.

- Be careful about your job status when applying. If you are on a temporary contract or even on a probationary period for a permanent contract this may count against you when the lender assesses your financial position.
- Think about the term of the mortgage. Typically, the first time people take out a mortgage the repayment term is 25 years. But if you stretch this to, say, 30 years, the *annual* cost will be lower – although the *total* amount you eventually pay in interest will be higher given the extended term. Additionally, a longer term may stretch into your planned retirement at which point you are likely to have a lower income to cover mortgage repayments.
- Be prepared to approach more than one lender. The affordability tests do vary from one lender to another thereby impacting the size of mortgage you could obtain.
- Make sure you are aware of the costs involved in completing the purchase of your property – like legal and removal costs as well as any fees payable to secure a mortgage. (This is covered in more detail later in the course.)
- Consider using a mortgage advisor (also known as a broker) to help with your application for your choice of mortgage. The advisor's expertise can help – particularly if you are a first-time buyer. Do, though, check that their advice covers the whole mortgage market (as opposed to the products provided by a few lenders). And check the fee payable – typically this is around £500 or a small percentage (less than 1%) of the sum you want to borrow.

The next step is to present your chosen lender with details of the property you want to buy.

1.1 The property in question and the importance of 'loan-to-value'

In addition to undertaking the credit, affordability and stress tests, your lender will want details of the property you want to buy.

Figure 2

This is because most mortgages are 'secured' on the value of the property or land the mortgage has been used to buy. This means that if the borrower fails to make the required mortgage repayments, the bank can repossess the property and sell it to recover the money originally lent.

Three things your lender will want to know about the property are:

- Are you buying a **freehold** or **leasehold** property? The difference between the two is that leaseholders do not own the land on which their property is built and only own the property for the term of the lease. Many lenders are unwilling to lend on leasehold properties, particularly where the residual term of the lease is short (70 years or less). This is because such properties may become difficult to sell unless the lease is extended. Note that owners of leasehold properties also incur certain property related costs including maintenance costs (to cover, for example, repairs to the exterior of buildings, particularly when living in a block of flats) and **ground rent** – a fee paid to the owner of the freehold land on which the leasehold property has been built.
- Are you buying a property to live in (your 'prime' residence) or to rent out ('buy-to-let')? For the latter, lenders will usually charge a higher mortgage rate.
- Is there anything about the property that could make it risky to provide a mortgage for? For example, is it a very old property, or does it have an unusual construction (e.g. built with straw rather than bricks)? Is the property in an unusual location (e.g. above a shop, which may result in issues about access and responsibilities for maintenance)?

Before agreeing to a mortgage, the lender will then get a valuation of the property you want to buy. For most lenders the maximum mortgage they will provide is 95% of the property's value – or 95% 'loan-to-value' (LTV). This is provided that the size of this mortgage does not exceed the maximum the lender is prepared to advance you under the affordability test.

So, for a property costing £200,000, a 95% LTV mortgage would enable you to borrow £190,000 (£200,000 x 95%) leaving you to provide the other £10,000.

The interest rate charged on your mortgage is usually linked to the loan-to-value (LTV). Lower LTVs attract (slightly) lower mortgage interest rates. So it may well make sense to take action to reduce the LTV of your mortgage.

Since lenders tend not to provide 100% LTV mortgages, there is usually a need to use other funds to supplement the mortgage in order to meet the agreed price for purchasing the property. For first-time buyers these could come from using the proceeds from a **Help-to-Buy ISA** or a **Lifetime ISA (LISA)**.

Activity 1 Cutting the mortgage LTV

Allow approximately 5 minutes

What can I do to reduce the LTV on my mortgage?

Enter your comments here and then select 'reveal'.

Provide your answer...

Discussion

Pushing down the LTV – a particular challenge for first-time buyers – means finding other sources of money to help fund your purchase. This reduces the size of the mortgage you'll need. Some options include drawing on your savings or perhaps seeking help from your friends or family (for example the so-called 'Bank of Mum & Dad'). Your lender will, in any case, need details of the other funds that you use to supplement the mortgage to buy a property. If you do use the 'Bank of Mum & Dad' –

or similar sources of funds – the providers will need to confirm in writing that such money is a gift. Without this the lender may assume the money is a loan and include it in the affordability testing (with the risk that this will end up cutting the size of the mortgage they will advance to you).

Over time you may move on to a new home (and therefore a new mortgage). Keeping down the LTV will then become easier. This is because the general trend in house prices for decades has been upwards. So when you sell your first home – particularly if you have lived in it for several years – it is likely (but not definite) that you will receive more than you paid for it. This money or 'equity' that you extract from the property sale can then be used as the deposit on your next property, thereby helping to keep down the LTV of the new mortgage. In fact you may be able to lower your LTV without moving home by simply repaying your existing mortgage after a number of years and taking out a new mortgage (known as 'remortgaging').

Why do lenders charge lower mortgage interest rates on lower LTV mortgages?

Enter your comments in the box below and save to reveal the discussion.

Provide your answer...

Discussion

The banks charge lower interest rates on lower LTV mortgages because more of the house value has been paid for, thereby reducing the risk of losing money on the mortgage provided. If they have to repossess a property and sell it during a period of falling house prices, there is less risk of losing money if the original LTV was 60% than if it was 95%.

OK – you've (hopefully!) now been approved a mortgage to complete your property purchase. But which type of mortgage product should you go for?

1.2 Repayment or interest-only

The first major choice to be made about a mortgage is how to repay it. The options are a 'repayment' mortgage or an 'interest-only' mortgage. These days many lenders only offer the former, making the decision simple!

Figure 3

With a repayment mortgage, the capital or principal sum (the original amount of debt) is paid off in stages throughout the life of the loan. Look at the Table 1 below to see the pattern of payments on a repayment mortgage. The typical structure is a reducing balance loan with a set amount paid each month throughout the mortgage term unless the interest rate changes.

Table 1 Annual Payments on a Repayment Mortgage (£)

In year	Interest paid	Capital repaid	Total Mortgage Payment
1	3957	2379	6336
5	3546	2790	6336
10	2930	3406	6336
15	2177	4159	6336
20	1412	4924	6336
25	142	6194	6336

The effect of this is that the amount of the principal sum repaid accelerates over the term of the mortgage – initially the majority of annual mortgage costs are made up of interest payments, and then towards the end of the mortgage term these costs are mainly repayments of the principal sum.

One consequence is that a borrower who wishes to repay early might be surprised at how much of the principal sum remains. Table 1 shows a £100,000 repayment mortgage payable over 25 years, at a mortgage rate of 4%. For this illustration it is assumed that the mortgage rate stays the same throughout the life of the mortgage.

With an interest-only mortgage, the principal sum outstanding is unchanged throughout the life of the loan and only interest payments are made to the lender until the end of the loan period. At the end of the period the borrower must have the means to repay the lender the principal sum (the amount outstanding).

With interest-only mortgages, repayment of the principal is typically achieved by putting money into a savings or an investment scheme (such as an **ISA** or **unit trusts**) throughout the life of the mortgage. To determine how much to save each month, the investment is projected to grow at an assumed rate in order to produce a lump sum large enough to repay the principal sum in full on the maturity of the mortgage.

Activity 2 Using investment schemes to repay a mortgage

Allow approximately 5 minutes

What could go wrong with using an investment scheme to build up the funds to repay a mortgage?

Enter your comments in the box below and save to reveal the discussion.

Provide your answer...

Discussion

The risk is that the investment scheme builds up insufficient funds to repay the mortgage. In such cases the borrower has to find other funds to complete repayment or borrow money for a further term. This risk means that interest-only mortgages are unpopular these days and indeed many lenders do not offer them. Lenders that do need to be convinced that a credible and robust scheme is in place to pay off the mortgage at the end of its term.

Those on interest-only mortgages are strongly advised by the **Financial Conduct Authority (FCA)** to check whether their investment schemes are on track to repay their mortgage. Those with such schemes set up years ago when interest-only mortgages were more prevalent are, in any case, very likely to be contacted by their lender to ask how they intend to repay their mortgage at the end of the interest-only term!

As mentioned above you may not have any choice but a repayment mortgage. However, the next choice about your mortgage product is one you will certainly have to make: fixed-rate mortgage or variable rate?

1.3 Fixed-rate or variable rate?

It is now time to make the decision about your mortgage – should you go for a fixed-rate or a variable rate mortgage product? Over the typical 25-year life of a mortgage this is a decision you may choose to make several times, switching from fixed-rate to variable or vice versa as you seek out the product that is best for you.

Watch Video 1 and explore the different interest rate features of mortgages, the fees that are associated with them and the pros and cons of different products. You will see that variable rate products take a number of slightly different forms.

Once you have watched the video, there are a couple of questions for you to answer below.

Video content is not available in this format.

Video 1 Understanding mortgages

Activity 3 Fixed-rate mortgages: benefits and risks

Allow approximately 5 minutes

What are the pros and cons of fixed-rate mortgages?

Enter your comments in the box below and save to reveal the discussion.

Provide your answer...

Discussion

Fixed-rate mortgages provide certainty about your monthly mortgage payments as these will not rise during the fixed-rate term. They are a sensible choice for households on tight budgets with only a limited capacity to afford an increase in the costs of a mortgage, or for those who simply prefer certainty about what their mortgage will cost.

Note that these fixed-rate products are commonly for 2 to 5 year terms, with a limited market for 10 year fixed-rate terms. Fixed-rate terms for longer periods have never caught on in the UK. So the likelihood is that any fixed-rate deal will only cover the first part of your mortgage term, and not the full term, unless you're in the final years of a mortgage and remortgaging for the last time.

Fixed-rate mortgages often come with the cost of an upfront 'arrangement' fee. Those on fixed-rate mortgages do not benefit from falling interest rates. Also, usually you will have to pay an early repayment charge if you repay the mortgage before the end of its fixed-rate term. At the end of the fixed-rate term the mortgage will normally revert to the lender's standard variable rate unless action is taken to move to an alternative mortgage product.

What are the pros and cons of variable rate mortgages (including 'trackers')?

Enter your comments in the box below and save to reveal the discussion.

Provide your answer...

Discussion

Variable rate mortgages will move up or down as interest rates in the economy alter – specifically when the Bank of England moves its ‘Bank Rate’. Those with these mortgages benefit when interest rates fall and lose out when rates rise. This lack of certainty can cause problems with household budgets. On the other hand, arrangement fees are less common and there are normally no prepayment fees if you repay your mortgage early.

OK, it’s time for a short quiz to check how much you have learned so far. The section after that will look at the other options which may be available to you to customise your mortgage product.

2 Half-time quiz

A lot of ground has been covered and it’s now time for a short quiz to see how much you’ve learned.

Have a go at these three questions.

Half-time quiz

Open the quiz in a new tab or window then come back here when you’ve finished.

3 Mortgage choices: offset, flexible, discounted/low start and portable mortgages?

The pros and cons of fixed-rate and variable rate mortgages (including trackers) have been covered. But your lender is likely to offer some further choices about your mortgage product. These can, in a sense, customize your mortgage to meet your financial circumstances and even your lifestyle.

Listen to the audio and learn more about these special mortgage features.

Audio content is not available in this format.

Audio 1 The pros and cons of fixed-rate and variable mortgages.

The next section looks further at how you can be proactive in managing the mortgage you have chosen.

4 Managing your mortgage: overpaying

The previous section covered how paying off your mortgage can be accelerated by using 'offset' and 'flexible' mortgage products. It was also noted how conventional mortgages can offer the ability to make overpayments, pushing down the balance left to pay off.

Figure 4

The maths behind this is quite simple – it comes down to a comparison between the mortgage rate and interest rate you could get if, instead of overpaying, you placed the money into a savings account. If the mortgage rate is higher than what you can get on a savings product the answer appears to be a 'no brainer': pay down the mortgage rather than save the money.

There are, though, a few things you need to be aware of before opting to overpay:

- Does your mortgage contract allow overpayments and, if so, by how much? If you go beyond any limits for overpayments you could incur early repayment charges particularly if you're on a fixed-rate mortgage.
- Are there any charges for withdrawing your money from your savings account to make the overpayment? These commonly apply to early withdrawal from '**notice accounts**' and fixed-rate bond accounts. These charges might make mortgage overpayment a costly move – although a key mitigating factor is that the withdrawal charge is a one-off cost and not an annual loss of interests. As such the charge can be spread out across the rest of the term of the mortgage.
- There are complications too if you use money from a variable rate savings account to overpay on a fixed-rate mortgage – interest rates could rise subsequently meaning that you lose out on higher earnings from your savings.
- If you use money from an **ISA** set up in an earlier tax year, you will not be able to use future savings to take advantage of that previous year's **ISA allowance**.
- Do you have other debts (e.g. a bank loan) with a higher interest rate than the mortgage rate you are paying? If so, using your savings to reduce or pay off these debts would make more sense than reducing your mortgage balance.

Activity 4 Should I overpay my mortgage?

Allow approximately 5 minutes

Your mortgage has three years left before you complete repayments. The mortgage rate is 3.2% per annum and you earn 1.8% per annum on your savings in a fixed-rate ISA account. If you withdraw money from the bond account before **maturity**, you pay a charge of 6 months interest. Leaving aside any other considerations, is it worth using money from your bond account to overpay your mortgage?

Enter your comments in the box below and save to reveal the discussion.

Provide your answer...

Discussion

Yes, it's still wise to overpay the mortgage. The loss of earnings on the fixed-rate ISA account is interest. The one-off charge of (= 6 months, or one half, of the annual interest of). But this cost can be spread over the remaining 3-year life of the mortgage and so equates to per year. That totals of lost earnings per year against the of interest that will be saved by reducing the mortgage balance.

Note that these calculations ignore the very small amounts of interest earned on previous interest paid (known as '**compounding**'). However this does not affect the conclusion that overpayment makes sense.

Even if the maths points to overpaying your mortgage, should you use all your savings to reduce your mortgage balance?

Enter your comments in the box below and save to reveal the discussion.

Provide your answer...

Discussion

This would be unwise unless your mortgage has an easily accessible borrow back feature. Everyone should retain some savings to cover life's emergencies and uncertainties. One recommendation is that these savings should be at least £500 per person in the household. If you've used all of your savings, you may have to borrow money at short notice if something unexpected happens – like if your car breaks down or if your washing machine needs replacing.

The next section looks at when and why it makes sense to change your mortgage product and maybe your mortgage provider too.

4.1 Moving to another deal

Around 4 in 10 mortgage transactions relate to people remortgaging their existing property without moving home at the same time. Moving home is very likely to trigger a new mortgage deal as well – certainly when the existing mortgage is not portable from one property to another. But it is the volume of remortgages which highlights the fact that periodically it makes sense to switch to a new mortgage deal, and maybe a new lender too.

Figure 5

One trigger point for remortgaging is when the initial mortgage deal – particularly a fixed-rate deal – comes to an end. It is normal for the mortgage rate to then default to the lender's Standard Variable Rate (SVR) unless action is taken by the borrower. And commonly, action should be taken, as SVR mortgages tend not to be attractive – certainly when compared with 'tracker' rate mortgages.

All borrowers on SVRs should really review whether they could find something better. A mortgage should not be seen as a product you have to stick with until its term is completed and the money repaid to the lender. Since it represents to many households the largest regular monthly outgoing, every opportunity should be made to switch to a new deal if it makes financial sense. Since interest rates do change over time, opportunities are likely to rise to cut the cost of your mortgage.

4.2 Ditching a fixed-rate mortgage

One trigger for remortgaging that arises under certain interest rate conditions is when making an **early repayment** of an existing fixed-rate deal and moving to a new mortgage makes financial sense.

Now look at repaying a fixed-rate mortgage early.

The calculations required to make good decisions are not daunting. Basically, you need to work out the costs of getting out of your current mortgage deal – there may be none if you are on a variable rate or tracker product. Add on the costs of a new deal (possibly an arrangement fee and perhaps legal costs, although the new lender will sometimes cover these). Then compare these costs with the savings you expect to make by moving to a new product with a lower mortgage rate than you are currently on.

Figure 6

In a period of falling interest rates, prepaying a fixed-rate mortgage and moving to one with a lower rate can make sound financial sense.

Here is an example:

The Sharp family have 3 years left on a 5-year fixed-rate (interest-only) mortgage of £100,000.

The current mortgage rate is 6% per annum but they could move to a new 3-year fixed-rate mortgage at 4% per annum. To do this they have to pay an early repayment charge of 6 months' interest and also pay an arrangement fee of £500 for the new mortgage.

What should the Sharps do?

The costs of moving to the new product are:

- The early repayment charge: 3% × £100,000 = £3000. (3% is 6 months of interest when the annual rate is 6%)
- The arrangement fee: £500
- Total £3500

But the benefits are the interest savings of 2% (that is, 6% less 4%) for three years:

That saves the Sharps £100,000 × 2% x 3 years = £6000.

So, the net saving is £2500.

The Sharps will have to dip into their savings to pay those upfront costs. But even if they are earning 4% per annum on their savings, the loss of interest earnings over the three years is only £3500 × 4% × 3 = £420

So, the Sharps should move to the new fixed-rate deal.

Activity 5 Does ditching this fixed-rate mortgage make sense?

Allow approximately 10 minutes

Try the maths of moving to a new fixed-rate deal.

This time the existing fixed rate is running at 4% per annum and has two years left.

The interest-only mortgage is for £100,000.

A new 2-year fixed-rate mortgage can be secured at 2% per annum.

The arrangement fee is £750 and the prepayment fee is 3 months interest.

Enter your comments in the box below and save to reveal the discussion.

Provide your answer...

Discussion

The costs of moving to the new product are:

- The prepayment fee: 1% × £100,000 = £1000 (1% is 3 months of interest when the annual rate is 4%)
- The arrangement fee: £750
- Total: £1750

But the benefits are the interest savings of 2% (that is, 4% less 2%) for two years.

That saves £100,000 × 2% x 2 years = £4000.

So the net saving is £2250.

The costs have to be upfront out of savings (assuming these are available), but even if these are earning 2% per annum, the loss of interest earnings over the two years is only £1750 × 2% × 2 = £70.

For these reasons, it would make sense to move to the new fixed-rate deal.

If you struggled with the maths, you can access the link at the end of the course to guide you on whether it makes financial sense to pay off your fixed-rate deal.

The next section looks at how you have to cover several different costs when buying a property. Your financial outgoings will certainly start, even before that first mortgage repayment.

5 The other costs of buying a property

It's not just about getting the mortgage and being able to pay it. There are a number of costs that you will additionally incur as you take ownership of your new home.

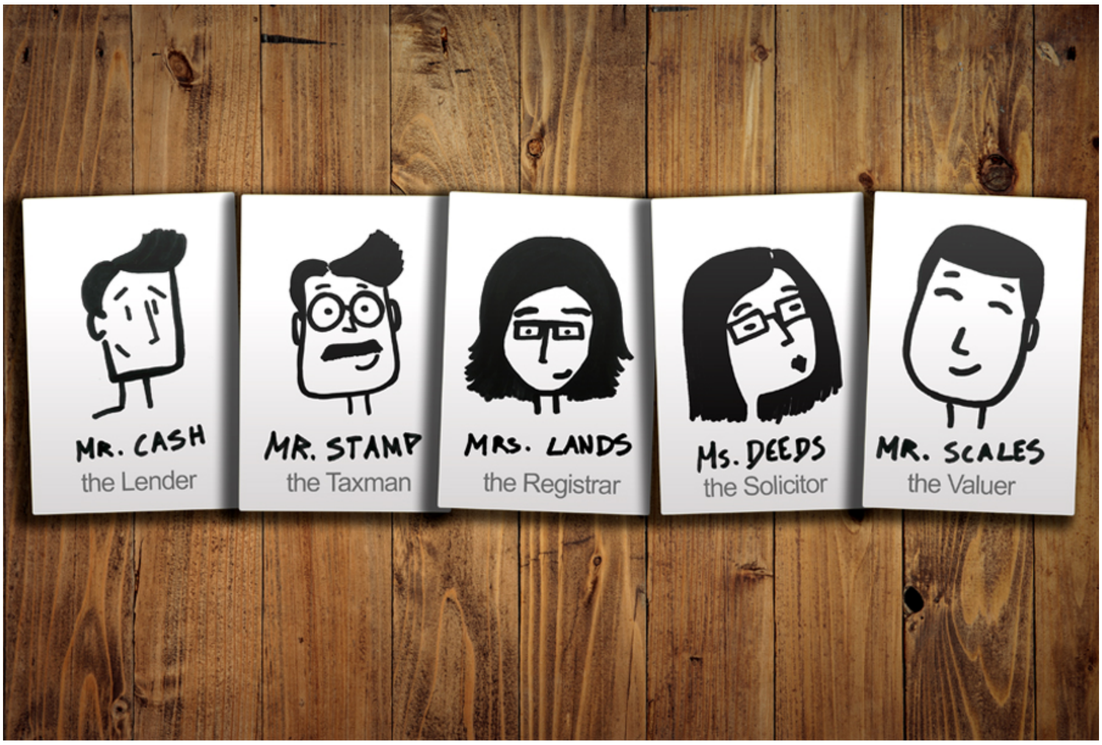

Figure 7

To show you how these costs may add up, let's suppose you're buying a property for £220,000 in England – which is close to the average cost of a property in the UK.

What costs do you incur if you are not a first-time buyer and the property is to be your home (your 'prime residence')?

- Mortgage arrangement fee (common with fixed-rate mortgages and some other products): say, £500.
- Legal costs including local searches and Land Registry fee: £800.
- Survey and valuation: £350.
- Stamp Duty Land Tax (SDLT): £1900.
- Removal costs: say, £700.
- GRAND TOTAL: £4250.

There may also be a fee to the mortgage broker if you've used one to help choose and organise the mortgage. Some costs arising from getting a mortgage – specifically the arrangement fee – can, subject to the lender's approval, be added to the mortgage. The other costs will, though, have to be met upfront.

Box 1 explains Stamp Duty Land Tax in a little more detail.

Box 1 Stamp Duty Land Tax (SDLT)

The marginal rates of Stamp Duty Land Tax on residential property purchase are:

- up to £125,000, 0%
- £125,001 to £250,000, 2%
- £250,001 to £925,000, 5%
- £925,001 to £1.5 million, 10%
- above £1.5 million, 12%.

Note that first-time buyers are exempt from SDLT for properties up to £300,000 and at a reduced rate of 5% for the amount in excess of £300,000 up to a maximum of £500,000. Purchases above £500,000 do not qualify for any SDLT relief. Also note that a surcharge of 3% applies if the property is not acquired as a ‘prime residence’. In Scotland the equivalent tax to SDLT is Land and Buildings Transactions Tax (LBTT) and in Wales it is Land Transaction Tax (LTT). The Scottish Parliament and Welsh Assembly have the power to apply their own rates for these equivalents of SDLT.

The next section reviews the range of risks and challenges that come with a mortgage. It will look at how coping with the costs of a mortgage needs to be embedded into wider household financial management.

6 Mortgages: understanding and managing the risks

It is important to reflect on the risks that arise from home ownership and having a mortgage. Being alive to these risks means that even when you cannot take action to eliminate them, you are at least better prepared to handle the consequences of them.

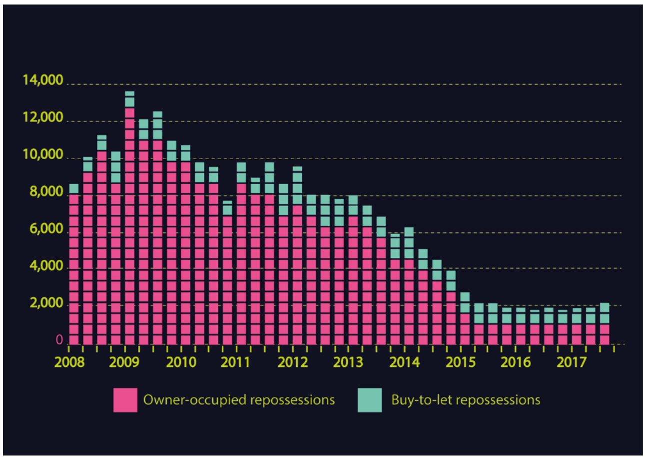

Figure 8 Repossessions, buy-to-let and owner-occupied markets. Source: CML (2017).

Mortgages are secured loans, so there is the risk of losing your home (via repossession by lender) if you default on repayments.

In recent years, mortgages have been very affordable due to the historic low levels of interest rates. But future years will virtually inevitably see higher interest rates return.

Also, mortgage lenders are required by their regulators to work with borrowers who get into financial trouble with their mortgages. But they could eventually repossess the property of a defaulter if it doesn't get resolved.

Then there is the reality that house prices do go up and down over periods of time – although admittedly the trend line since the 1970s has clearly remained upwards. The future is, though, uncertain. There is the risk of finding yourself in negative equity (where the market value of your property is less than the remaining mortgage on it) if you buy at times just prior to one of those periodic falls in property prices. Provided you can still afford to meet your mortgage repayments, being in negative equity by itself is not a problem, though, unless you have to move home. In these circumstances you may need to find the difference between the market value of your property and the mortgage amount you have to repay.

Another risk seen very recently is that those who obtained mortgages under old affordability testing rules cannot obtain the same size of mortgage under the rules that have applied since 2014. These people are at risk of being 'mortgage prisoners', unable to take advantage of better mortgage deals as it means submitting themselves for a re-appraisal of the size of mortgage they can afford.

Interest rate risk is pervasive for all mortgages – you may lose out by taking a fixed-rate deal only for interest rates to fall. Or you take out a variable rate deal and interest rates rise.

And there is always the risk of inertia – for example, not taking action (or at least reviewing the mortgage market) when your initial mortgage deal ends and you are placed on your lender's **reversion rate** (usually its unattractive SVR).

The other risk is not looking ahead and planning for life's uncertainties – those events which will affect your household budget and put pressure on your ability to make your mortgage repayments. These could include breaks in employment, marital breakdown, illness or simply unexpected repair bills on your property.

This may sound like home ownership brings doom and gloom – far from it, as most people repay their mortgages without issues. But being forewarned and planning accordingly can minimise the risk of these issues causing you a problem.

So now it's time for you to assess how you feel about the risks associated with mortgages and home ownership with this final activity.

Activity 6 Your perspective on the risks of home ownership and mortgages

Allow approximately 10 minutes

In Table 2 below are the risks relating to home ownership and having a mortgage.

In each case select whether you have no concern, some concern or great concern about these risks and what you think you can do to manage these risks.

If you don't have a mortgage right now, imagine you've bought a home and think how you'd feel in these scenarios.

Enter your comments in the boxes in the table and save to reveal the discussion.

Table 2 Home ownership risks

Risk	Concern and comments
Having my own home forces me to have expenses – like repairs – that I may find difficult to afford.	None Some Great
My income could make it difficult to keep up with my mortgage repayments.	None Some Great
House prices could fall, pushing me into negative equity.	None Some Great
The rules on affordability may change making it difficult for me to remortgage to a new deal – leaving me on a bad mortgage deal.	None Some Great
I could make a poor choice of mortgage product, for example a fixed-rate deal when interest rates fall or a variable rate deal when interest rates rise.	None Some Great
After my existing mortgage deal ends the reversion rate is the SVR which is unattractively high.	None Some Great

I'm falling behind with my payments and I'm worried that my home will be repossessed by my lender.	None Some Great

Discussion

Table 2 Home ownership risks (with comments)

Risk	Comment
Having my own home forces me to have expenses – like repairs – that I may find difficult to afford.	Preparing for this means drawing up and managing a household budget and building in some financial room for manoeuvre to cover contingencies. Set up a 'rainy day' savings account too.
My income could make it difficult to keep up with my mortgage repayments.	Are there ways of increasing income (a part-time job, maybe?). Talk to your lender too to see if you can take steps to reduce your monthly mortgage payments – e.g. by extending the term of your mortgage or switching to a better deal. Note that there may be administration fees involved in doing this. This will depend on the policy of the lender.
House prices could fall, pushing me into negative equity.	If you can afford your mortgage payments, then you are OK unless you have to remortgage, for example if you have to move home due to a job move etc. If you do have to move, then you may need access to other funds to repay the mortgage outstanding after the proceeds from the sale of your home.
The rules on affordability may change making it difficult for me to remortgage to a new deal – leaving me on a bad mortgage deal.	A tricky one. Campaigning is taking place to help people caught by the affordability rules change. Maintaining an unimpaired repayment record with your current mortgage could help if you find that you do have to submit yourself to a new affordability test under the new rules.
I could choose the wrong mortgage option, for example a fixed-rate deal when interest rates fall or a variable rate deal when interest rates rise.	This happens to most people at some point in the years of having a mortgage. No one has a crystal ball when it comes to interest rates. Just be prepared to switch to a new mortgage deal if it looks as though it will save you money. Be proactive and keep an eye on the media and what is being said about the likely future direction of interest rates.
After my existing mortgage deal ends the reversion rate is the SVR which is unattractively high.	Don't just sit there, do something! Check out the market and move to a better deal, and if that is with a new lender then so be it! Again, there could be administration fees but your current mortgage paperwork will confirm this.
I'm falling behind with my payments and I'm worried that my home will be repossessed by my lender.	Start a dialogue with your lender – they are required to work with you at times like this to avoid matters getting worse. Be prepared to seek advice from organisations like Citizens Advice and StepChange

It is now time to check what you have learned in the end-of-course quiz.

After that it is time to wrap up the course!

7 End-of-course quiz

Now it's time to complete the end-of-course quiz. It is similar to the previous quiz, but this time instead of answering three questions there will be five.

End-of-course quiz

Open the quiz in a new tab or window then come back here when you've finished.

8 End of course round-up

A lot of detail has been covered in this course. The information and skills provided will help you make good decisions when selecting and managing you mortgage.

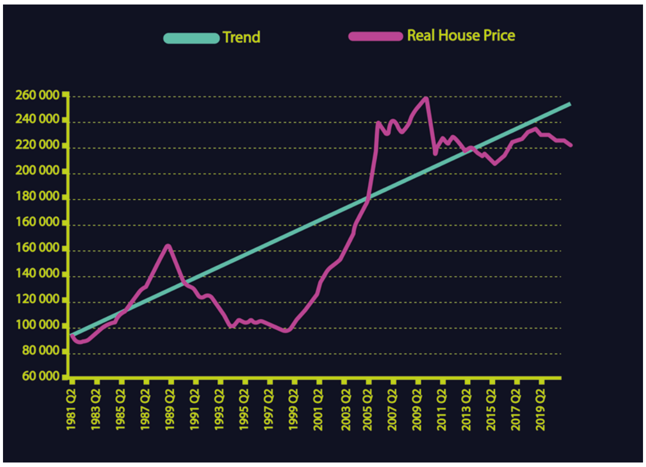

Figure 9 Average house prices in the UK (in real terms) 1981–2019. Source: Nationwide Building Society (2019).

To sum things up, here are five key tips:

- Always search for the best deal.
- Keep your eye on the market and monitor how mortgage rates are moving.
- Be prepared to remortgage – and not just once!
- Don't end up with a Standard Variable Rate (SVR) product. Other variable rate products (trackers) are usually better. SVR products are the equivalent of energy companies' standard tariffs!
- Don't feel obliged to stay with the first mortgage provider just because they lend you a load of money for 25 years – it's a commercial relationship, not a marriage!

The good news is that the trend over many decades has been rising house prices in both cash and **real** terms (see the graph above) – so your mortgage not only provides a home but also a sound investment too!

Well done, you have now completed the course! Now you've come to the end of the course, we would appreciate a few minutes of your time to complete this short end-of-course survey.

Further reading

To learn more about certain of the issues covered in this course you can follow these links to the MoneySavingExpert site:

- To learn more about credit scoring, follow: https://www.moneysavingexpert.com/creditclub/
- To learn more about the early repayment of fixed rate mortgages, follow https://www.moneysavingexpert.com/mortgages/fixed-mortgage-calculator/

- To learn more about Stamp Duty Land Tax costs, follow: https://www.moneysavingexpert.com/mortgages/stamp-duty/

The housing market is an important part of the economy. Understanding how it works can help you make better-informed decisions about your finances. To find out more, MoneySavingExpert recommends you visit the Bank of England's Knowledge Bank site, which includes sections on:

- What is the economy?
- What are interest rates?
- What is inflation?
- Who sets exchange rates?

Glossary

Compounding (of interest)

The process of receiving interest on previous interest earned (on savings accounts) or paying interest on previous interest paid (on loans).

Early repayment charges

A charge that your lender will make if you leave your mortgage before the allotted term. This usually applies to fixed-rate mortgages but can be a feature of tracker mortgages too.

Financial Conduct Authority (FCA)

The UK financial services regulatory body that has responsibility for consumer protection. https://www.fca.org.uk

Freehold

Outright ownership of a property and the land it stands on.

Ground rent

A payment made by the leaseholder of a property to the freeholder of the land on which the property is built.

Help-to-Buy ISA

An Individual Savings Account that provides a bonus from the government when used by first-time buyers to help buy a property.

ISA

A savings account where the interest or other earnings are tax-free.

ISA Allowance

The maximum amount each UK adult can deposit into an ISA account in each tax year. This allowance is set by the government.

Leasehold

Ownership of property for a defined term (the term of the lease, e.g. 99 years) but not of the land it stands on.

Lifetime ISA (LISA)

An Individual Savings Account that provides an annual bonus from the government. LISAs must be used either to help buy a property (if you are a first-time buyer) or to help set up a pension plan.

Maturity (of a bond or savings account)

The point in time when an investment – like a fixed-rate bond – reaches the end of its life and at which the investor is returned the sum invested and any remaining earnings (e.g. interest) on that investment.

Nominal

Not adjusted to take account of price inflation. Often alternatively called 'in cash terms'. See Real.

Notice Accounts

Savings accounts that require a period of notice – typically of between 1 and 6 months – in order to access the funds in the account without a charge. Such accounts offer slightly higher interest rates than those with no notice periods.

Real

Adjusted to take account of price inflation. See Nominal.

Reversion rate

The mortgage interest rate applied by the lender at the end of the term of a mortgage deal – e.g. when a fixed-rate term comes to an end.

Stamp Duty Land Tax (SDLT)

A tax on the cost of property or land purchased in England and Northern Ireland. In Scotland the equivalent tax to SDLT is Land and Buildings Transactions Tax (LBTT) and in Wales it is Land Transaction Tax (LTT). The Scottish Parliament and Welsh Assembly have the power to apply their own rates for these equivalents of SDLT.

Unit trusts

Pooled investment schemes – typically in company shares – managed by fund managers.

References

Council of Mortgage Lenders (CML) (2017) 'Mortgage arears fell in third quarter' [Online]. Available at https://www.cml.org.uk/news/press-releases/mortgage-arrears-fell-in-third-quarter/ (Accessed 21 August 2019)

Nationwide Building Society (2019) 'UK House Prices Adjusted for Inflation' [Online]. Available at https://www.nationwide.co.uk/about/house-price-index/download-data#xtab:uk-series (Accessed 9 September 2019).

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Figure 9: adapted from Nationwide Building Society (2019) 'UK House Prices Adjusted for Inflation'.
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