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A beginners guide to mortgages

Financial Planning & Advice
Your Finances in Focus

Buying a home is the largest purchase you're likely to make. Before you arrange your mortgage, make sure you know what you can afford to borrow. Find out where to get a mortgage, the different types and how the process works.

What is a mortgage?

A mortgage is a loan taken out to buy property or land. Most run for 25 years but the term can be shorter or longer.

The loan is 'secured' against the value of your home until it's paid off. If you can't keep up your repayments the lender can repossess (take back) your home and sell it so they get their money back.

Working out what you can afford

Don't stretch yourself if you think you'll struggle to keep up repayments. Also, think about the running costs of owning a home such as household bills, council tax, insurance and maintenance.

Lenders will want to see proof of your income and certain expenditure, and if you have any debts. They might ask for information about household bills, child maintenance and personal expenses.

Lenders want proof that you will be able to keep up repayments if interest rates rise. They might refuse to offer you a mortgage if they don't think you'll be able to afford it.

Where to get a mortgage

You can apply for a mortgage directly from a bank or building society, choosing from their product range. You can also use a mortgage broker or independent financial adviser (IFA) who can compare different mortgages on the market. As well as mortgages which are not offered directly to customers. Some brokers look at mortgages from the 'whole market' while others look at products from a number of lenders. They'll tell you all about this, and whether they have any charges, when you first contact them.

Taking advice will almost certainly be best unless you are very experienced in financial matters in general, and mortgages in particular.

It is sometimes possible to choose a mortgage without receiving advice, this is called an execution-only mortgage.

These are offered under limited circumstances.

You'd be expected to know

- What type of mortgage you want
- Exactly what property you want to buy
- How much you want to borrow and for how long
- The type of interest and rate that you want to borrow at

The lender will write to confirm that you haven't received any advice and that the mortgage hasn't been assessed to see if it's suitable for you.

In some cases you might need to confirm that you are aware of the consequences of taking out a mortgage without receiving advice, and that you're happy to go ahead. If for some reason the mortgage turns out to be unsuitable for you later on, it will be very difficult for you to make a complaint.

If you go down the execution-only route, the lender will still carry out detailed affordability checks of your finances and assess your ability to continue to make repayments in certain circumstances.

Applying for a mortgage

Applying for a mortgage is often a two-stage process. The first stage usually involves a basic fact find to help you work out how much you can afford, and which type of mortgage(s) you might need. The second stage is where the mortgage lender will conduct a more detailed affordability check, and if they haven't already requested it, evidence of income.

Stage 1

Generally, the lender or mortgage broker will ask you a series of questions to work out what kind of mortgage you want, and how long you want it for. They'll also try to work out, without going into too much detail, your financial situation. This is generally used to provide an indication of how much a lender might be prepared to lend you. They should also give you key information about the product, their service and any fees or charges if applicable.

Stage 2

This is usually where you begin your application. The lender or mortgage broker will begin a full 'fact find' and a detailed affordability assessment, for which you'll need to provide evidence of your income and specific expenditure, and 'stress tests' of your finances. This could involve some detailed questioning of your finances and future plans that could impact your future income. They'll also assess the impact on your repayments should interest rates rise in the future.

If your application has been accepted, the lender will provide you with a 'binding offer' and a Mortgage illustration document(s) explaining terms of your mortgage. This will come along with a 'reflection period' of at least 7 days, which will give you the opportunity to make comparisons and assess the implications of accepting your lender's offer. Some lenders might give you more than 7 days to do this.

You have the right to waive this reflection period to speed up your home purchase if you need to. During this reflection period, the lender usually can't change or withdraw their offer except in some limited circumstances. For example, if the information you've provided was found to be false.

Your deposit – size matters

When buying a property, you will need to pay a deposit. This is a chunk of money that goes towards the cost of the property you're buying. The more deposit you have, the lower your interest rate could be. When talking about mortgages, you might hear people mentioning "Loan to Value" or LTV. This might sound complicated, but it's simply the amount of your home you own outright, compared to the amount that is secured against a mortgage.

For example, with a £20,000 deposit on a £200,000 property, the deposit is 10% of the price of the property, and the LTV is the remaining 90%. The mortgage is secured against this 90% portion. The lower the LTV, the lower your interest rate is likely to be. This is because the lender takes less risk with a smaller loan. The cheapest rates are typically available for people with a 40% deposit.

How does a mortgage work?

The money you borrow is called the capital and the lender then charges you interest on it until it is repaid. The type of mortgage you are able to apply for will depend on whether you want to repay interest only or interest and capital.

Repayment mortgage

With repayment mortgages, you pay the interest and part of the capital off every month. At the end of the term, typically 25 years, you should manage to have paid it all off and own your home.

Interest only mortgage

With interest-only mortgages, you pay only the interest on the loan and nothing off the capital (the amount you borrowed). These mortgages are becoming much harder to come by as lenders and regulators are worried about homeowners being left with a huge debt and no way of repaying it.

You will have to have a separate plan for how you will repay the original loan at the end of the mortgage term.

Combination of repayment and interest-only mortgages

You can ask your lender if you can combine both options, splitting your mortgage loan between a repayment and interest-only mortgage.

Different types of mortgage

Once you've decided how to pay back the capital and interest, you need to think about the mortgage type. Mortgages come with fixed or variable interest rates.

With a fixed-rate mortgage, your repayments will be the same for a certain period of time – typically two to five years, regardless of what interest rates are doing in the wider market.

If you have a variable rate mortgage, the rate you pay could move up or down, in line with the Bank of England base rate.

Let us help you put your finances in focus

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