



YOUNG FINANCE[®]

A Young Group Company

Advice Guide 3:
Repaying Your
Mortgage

Repaying Your Mortgage

Interest Only or Repayment Mortgage?

When you take out your mortgage, the bank or building society will expect you to repay them the full amount of the loan, plus all the interest at the end of the mortgage term. There are a number of options, and each will have its advantages and disadvantages. You will need to think about these carefully before you decide which route to take.

Repayment Mortgages

This is the simplest of all mortgages and the only type where you are guaranteed to have repaid all that you have borrowed at the end of the term, assuming you have made all of the monthly payments.

Repayment mortgages work in a very similar way to simple bank loans in that your monthly payments go towards paying both a percentage of capital (the amount you owe) and a percentage of Interest that the lender charges you for borrowing the money.

When you first take out your mortgage your monthly payments are set at a level, which will exactly pay off the loan at the end of the agreed term. At the beginning of your mortgage term a high proportion of your monthly payment goes towards paying the interest and a small amount pays off the capital. As you make more payments, the capital is gradually reduced so the proportion of your payments going towards paying off the capital increases and the amount of interest decreases.

This means that if you move house and cancel your mortgage during the early years you may not have repaid a significant amount of the loan because a large portion of your payments will have gone towards paying interest.

Points to consider:

- A repayment mortgage guarantees repayment of the loan in full.
- There's no reliance on the performance of an investment product to pay off the capital at the end of the mortgage term; it's paid as you go along.
- You can see your loan gradually reducing over time.
- There is no chance of paying off your loan early without a further injection of funds.
- A high proportion of your payments in the early years go towards paying interest, not the capital.



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Interest Only Mortgages

With this type of mortgage the amount you owe remains the same throughout the loan period. You can only reduce the amount borrowed if you pay off part or all of the loan in a lump sum. The intention is that the capital amount is repaid by profits from a separate investment (typically a PEP/ISA/Endowment or Pension), calculated to accumulate to the same level as your mortgage by the end of the loan period.

FSA guidelines now recommend that all first time buyers take out repayment mortgages and anyone taking an interest only mortgage should be able to provide evidence that a repayment vehicle is in place. It should be noted that the onus of repaying the mortgage at the end of the term falls on the borrower's shoulders.

Interest only mortgages carry an additional risk over repayment mortgages; the performance of the investment intended to pay off the capital is not guaranteed and therefore repayment of the mortgage is also not guaranteed. Borrowers should be aware that any shortfall is always their responsibility and will need to be paid at the end of the mortgage term.

Points to consider:

- FSA guidelines recommend that all first time buyers take repayment mortgages rather than interest only.
- Monthly payments for interest only mortgages will seem lower as none of the capital is being paid off.
- A separate investment vehicle is required to pay off the capital of the mortgage loan and evidence may be required by the lender.
- The investment vehicle is portable so it can be used again and again if you move house and change your mortgage.
- The investment does not guarantee to pay off the loan at end of term - particularly relevant in today's economic climate.