PFP independent financial advice

PREMIER FINANCIAL PLANNING LTD

CONSUMER GUIDE TO MORTGAGES

SOLD

Read this guide and you will discover...

- How to improve your chances of getting the mortgage you want
- The myth about mortgage term
- A useful guide on how much you could borrow
- 12 ways of saving time, stop nasty surprises and get a decision quicker
- A good understanding of what buying a house will cost you
- Your options in plain English
- The secrets of the mortgage decision process

FOR SALE

FOR SALE

Provided as an educational service by Premier Financial Planning Ltd. Specialists in providing Mortgage Advice

Dear Homebuyer,

Choosing a mortgage and moving home isn't easy as you are bombarded with confusing information and high-pressure sales. It can be a very stressful time and not being able to get the right information can leave you feeling distressed and not in control.

We wrote this to help you make an informed intelligent decision and if you have any questions you are invited to call on 07468 610324 and we will be very happy to help.

We have dedicated our business to helping educate you in financial matters.

James Thorne
Premier Financial Planning Ltd.
Specialist in providing Mortgage Advice

CONTENTS

4	Income
5	Deposit
6, 7	The Secrets of the Mortgage Making Decision Process
7	Types of Mortgage
8	Mortgage Term
9, 10	Types of Interest Rate
11, 12	Costs
13	Mortgage Advice
14, 15	Mortgage Related Policies
15, 16	Other Mortgage Features
17, 18, 19	12 Ways to Save Time, Stop Nasty Surprises and Get a Decision Quicker

INCOME ALLOWED AND THE USUAL AMOUNTS YOU CAN BORROW

This will give you an idea of what income sources can be used when applying for a mortgage:

- Salary from an employed permanent contract (full time or part time)
- Income and salary from a ‘fixed term’ contract can be used, but it depends on the length of the contract and also how long you have worked with the company
- Guaranteed overtime
- Regular overtime (usually 50% of the yearly amount is taken into consideration)
- Income from self-employment (lenders usually require 3 years accounts; however some lenders are more flexible on this rule)
- Dividends from directors of a company (these are usually treated in the same way as self-employed income)
- Commission (usually 50% of the yearly amount is taken into consideration)
- Bonuses (usually treated in the same way as commission)
- Child Benefit
- Other state benefits
- Income from pensions
- Investment income (varies a great deal from lender to lender but can be up to 50%)

It should be reinforced that each lender has different criteria and the list is not exhaustive, however the above is a good general guide to use.

The calculation used to work out the maximum you can borrow does vary and factors affecting this will be talked about later. The multiples also change depending on the ‘level’ of your income, however as a rule of thumb most lenders will consider 4 x joint income.

DEPOSIT - WHAT DO I NEED TO SAVE?

The days of 100% mortgages have long since passed us and with the credit crunch lenders require more security from their customers.

It is still possible to have a mortgage with only a 5% deposit with schemes such as help to buy, ***HOWEVER!*** In order to gain a respectable rate of interest the minimum deposit to look at is 10%.

The more deposit you have then there is less risk of negative equity (where the current market value of the property drops below the mortgage amount) and therefore considered less risk by the lender. This means that they will usually be willing to provide you with a more attractive rate.

The term Loan To Value (LTV) is the amount of the mortgage against what you paid for the property. Therefore, if you have a 10% deposit, your LTV is 90%.

SECRETS OF THE MORTGAGE DECISION PROCESS

There are several factors the lender will take into account when deciding what they will lend you. This will give you an idea of how they do this so that you can apply the general principles to your own life.

Credit Score - this is an online search looking at your previous credit arrangements and your ability to meet your commitments, if there has been any missed payments, breaching your overdraft, etc. The score is done as part of the initial mortgage application and will tell you (usually right then and there) if you have been successful. This is often called a Decision In Principle (DIP).

Level of Income - The level of income is a very important factor when considering your maximum borrowing, however the other factors such as debts, nursery fees, maintenance, etc should also be taken into account as many lenders are using affordability calculations instead of the traditional income multiple calculations. It should also be stated that with many lenders the level of your income dictates the multiples they are prepared to use when considering your maximum lending. As a general rule the higher the level of income the higher the amount the lender is likely to lend and vice versa. The maximum considered by many lenders is up to 5 x income (this does vary, and some lenders are less than this).

Debts - if you have existing debts that will continue alongside the mortgage then these will be taken into account when working out how much you can borrow. As always, all companies are different, however as a rule of thumb guide to work this out, minus off the annual payments from your annual income before applying the income multiples.

Example

Brad has an income of £30,000 per annum

His loan payments are £4,000 per annum

£30,000 - £4,000 = £26,000 x 4 = £104,000 that he can borrow

This is a basic example as a rule of thumb and real live calculations should be obtained from a professional mortgage adviser

Maintenance and Childcare Costs - this is generally treated in the same way as debts for calculations.

Children and Other Dependents - Many mortgage lenders are also taking into account how many children and financial dependents you have when working out the maximum you can lend. There is no rule of thumb on this, however most companies have an affordability calculator online that you can use.

TYPES OF MORTGAGE - THE START OF FIGURING OUT WHAT YOU WANT

Not to be confused with the interest rate. The type of mortgage defines how your payments to the lender to ultimately repay the loan are set.

The main two types of mortgage are interest only and capital repayment:

Interest Only - This is where you are only paying the interest of the mortgage each month and making no capital payments to lower the value of the loan. This of course means that the monthly cost is less, however it also means that you will still owe the same amount to the mortgage company at the end of the term as you did at the start.

People generally take out some type of investment vehicle to pay off the capital at the mortgage end date (such as an Individual Savings Accounts, Pension, Endowment, etc.). These have fallen out of favor with the consumers, this is due to poor performance on such vehicles as endowments in recent years meaning that consumers have shortfalls on their mortgage.

Capital Repayment - This is where you pay the interest, but also portions of capital each month that is calculated over the set term (e.g. 25 years) to ensure that the mortgage is paid on at the end. This means that your mortgage will gradually come down over the course of its term. It is only guaranteed to pay off the mortgage providing you keep up your repayments.

TERM OF THE MORTGAGE - HOW DO I CHOOSE IT AND HOW DOES IT IMPACT ME?

It is a common misconception that a mortgage has to be 25 years at the start.

In fact, there is no rhyme or reason to why this term has always been used. The important factors with choosing the term of the mortgage:

It has to make the monthly payments realistic and affordable for you. The longer the term of the mortgage the more interest you will pay (therefore making it more expensive).

Some lenders do have maximum terms allowable and if the term of the mortgage takes you past retirement age then they will want to know what retirement income you have to continue to make the payments.

TYPES OF INTEREST RATE - TAILORING THE MORTGAGE TO YOUR REQUIREMENTS

There are many types of deals and interest rates and cost is only one consideration when selecting a mortgage as the type you choose defines how the rate may change and how that may affect your lifestyle. Clever marketing can make it feel like there are hundreds of mortgage deals, however they are all based on similar structures behind the marketing, I will focus on the main types:

Standard Variable Rate (SVR) - You usually enter a standard variable rate after the end of a deal period (e.g. 2-year fixed rate) and is the companies default rate. These are very loosely based around what the Bank of England Base Rate is set at, HOWEVER, the rate is completely at the mortgage companies discretion and reserves the right to alter this as they see fit. The advantage of the SVR is that there are no early repayment charges and therefore you can pay chunks off of your mortgage, repay it completely as you see fit or move to another lender.

Fixed Rate - This is where you set in a fixed rate for a certain period of time (eg. 4.5% over 3 years). The advantage of this is that you have set costs and regardless of what interest rates do during that time you know your budget each month. A very useful tool for first time buyers or those with low disposable income. During the fixed period there is an early repayment charge (a typical rate is 3% of the mortgage amount). This is payable if you want to pay the mortgage off or pay chunks off the mortgage amount. Many mortgage providers will allow you to over pay up to 10% of the mortgage off each year without penalty and if a charge does apply it is generally only on the proportion above the 10% that you pay off. Once the fixed rate ends it reverts to the lenders SVR.

Discounted Rates - This is where the mortgage company applies a discount for a period of time on their SVR (e.g. 1% discount over two years on an SVR of 5% would provide a rate of 4%). On the main these also have early repayment charges, as described in the fixed rate section. After the rate finishes they also change to the SVR. It must be stated that being that the rate is only a discount on the SVR, if that changes then so will your mortgage rate.
Tracker Rates - This is where the mortgage rate usually tracks the Bank Of England Base rate at a certain rate above it (e.g. 3% above base for 5 years, if base rate was 1% then your rate would be 4%). As this tracks the base rate then it is interest rate movements that will change your rate up or down and not the mortgage companies' internal decision. On the main these also have early repayment charges, as described in the fixed rate section. After the rate finishes they also change to the SVR.

Generally fixed rates are set at a slightly higher rate than variable rates such as discounts or trackers to reflect the extra risk the mortgage company is taking to lock it in for you.

There are always deals in the market that have different terms and conditions to those above. The types of rates above are an indication of the main mortgage deals used.

Suitability of what type of interest rate and the period of that deal should be discussed with an adviser so that you are put in an informed position to make an intelligent decision.

WHAT IF I WANT TO ENTER A NEW DEAL AFTER MY EXISTING ONE HAS FINISHED?

This is called remortgaging and can be done with your existing provider or transferring the mortgage to another lender.

You could find a more attractive rate than your existing provider by moving your mortgage to another lender and this is common practice. It is important to take the full costs into account (the interest rate + any fees to move the mortgage).

You may wish to enter into another fixed rate so that you have set payments for another set period of time, rather than payments that could change due to either the lenders decision or interest rates.

WHAT OTHER COSTS ARE INVOLVED?

There is more to it when buying a house than just the mortgage. This will show you what other costs are applied.

Solicitors Costs

These are costs to provide all the legal work of transferring the title of the property to you, ensuring that everything is correct, transferring of money between the relevant parties including the mortgage company and searches to ensure there are no other problems effecting the property (such as a public footpath through your back garden or land disputes). Every solicitor is different in cost and buying, selling and remortgaging have their own individual costs, however to put an estimate on these, budget for around £600 for a remortgage, £1,500 for a purchase and £800 for the sale of a property.

Stamp Duty

This is a tax on the transferring of ownership of land and is paid when purchasing a property. The price paid for the property will determine what level (if any) of stamp duty you will pay. Also the government sometimes provide incentives such as no stamp duty for first time buyers. To check the rates visit: ***www.hmrc.gov.uk/sdlt/introtrates-thresholds.htm***

Estate Agents Fees

This is a cost to sell your home and the cost is for the marketing and services of the estate agent to find the buyer for you. Costs vary and although cost is important do not underestimate the value of quality over price. How your house is marketed can ultimately mean the difference between selling or still having the property on the market after 18 months! An average cost for this is 1.5% of the value of the property.

Valuation Fee

This is a cost required by the mortgage company (although sometimes they will pay this cost themselves to attract your business) to ensure that the price you are buying the house for is not overvalued. If they consider this to be so it can affect your mortgage offer. This varies from company to company and can be dependent on the value of your house, but an average is £350.

There are other Valuations you can upgrade to or instruct privately. For example a full structural survey, the purpose of this is to get an independent surveyor in the check the house over including the roof and structural soundness of the property. This becomes more relevant with older properties as if the report comes back with problems you may decide to lower your offer to reflect the fact that work needs doing on the house or even pull out all together. Sometimes money well spent! Wouldn't you rather know in advance that you could be buying a 'money pit'!!

Arrangement Fee

This is a fee levied by the mortgage company to set up a specific mortgage rate, for example a 2-year fixed rate. You are paying this to gain a certain set of mortgage terms. This should always be taken into account when looking at the overall cost of a mortgage when comparing mortgage deals. Each rate is different and generally the lower the LTV the lower the cost (some deals don't even charge one) but an average is £1,000.

This fee can either be paid up front or be rolled into the mortgage loan. If it is paid up front and your mortgage application is not successful, then you will lose that money paid. If you decide to roll the fee into the loan then you negate that risk, however you will be paying interest on that fee now in the loan.

Mortgage Advice Fee

Receiving advice on which mortgage is the most suitable for your needs is very important as it not only affects the rate you will be paying, but also the terms and conditions of the ongoing mortgage and how that will impact on your life and changes in interest rates.

MORTGAGE ADVICE - WHO DO I GO TO? WHAT IS THE DIFFERENCE?

It is a misconception that your bank will always provide you with the best rate. In fact, by shopping around you may be able reduce your costs.

Tied Advisers
These are typically mortgage advisers working for a bank or building society. They offer advice of the most suitable product from their companies' range. If you wish to shop around you will need to speak to them individually and this will require more of your time.

Multi-Tied Advisers
These are typically mortgage brokers working for an agency. They work from a 'panel' of selected mortgage providers and can provide advice on the most suitable product from that select range.

Independent Advisers
These are advisers that have no links or ties to any specific company and have the whole market to use when advising on the most suitable product. A major advantage of this is you only have to go to one appointment to do the shopping around. Not only that as they have the advantage that they can provide you with the choice to be paid via a commission from the mortgage lender or a fee directly from you to ensure that the full range is being looked at. These options should always be discussed up front so that you can decide the best option for you.

Financial advice is not just about looking at the interest rate. Generally buying a house is a very stressful time and therefore you want to minimise the risk of you not being accepted by a mortgage company at the outset and not 4 weeks down the line. Part of an adviser's job is to assess your set of circumstances against the different companies lending criteria so that you get the most suitable mortgage for your needs as well as a competitive interest rate.

MORTGAGE RELATED POLICIES - WHAT ARE THEY? WHAT DO THEY DO FOR ME? WHY DO I NEED THEM?

When setting up a mortgage there are other policies you should consider depending on your circumstances. This is just a quick look at the main ones and what they are used for.

Life Assurance - This is a policy designed to pay off your mortgage in the event of your death. The question to ask is on your death can your remaining partner and family continue the mortgage payments? In many cases this would put them in financial difficulty and therefore this protects them against this financial hardship at an already difficult time.

Critical Illness - This is a policy that will pay out a lump sum in the event of a serious illness. The 3 main conditions are heart attack, cancer or a stroke, with many other conditions being covered. Again, this is to help prevent financial hardship. If you are diagnosed with a serious illness this can result in time off work with the illness or due to treatment and the purpose is to help reduce the financial pressure you are under so that you can concentrate on getting better. With most companies when you take a policy it also protects your children up to a certain level (say £25,000) so that if they contract a serious illness such as leukemia then you have the money to take time off work or provide health care.

Buildings & Contents - The buildings part of this is required by the mortgage lender in order to provide you with a mortgage. Buildings and contents is there to protect your home and the contents in the home should anything either damage or steal them.

Income Protection - This type of policy is there to provide income in the event you cannot work due to illness or accident. The question to ask is could you survive financially and continue to keep up with your mortgage payments if you could not work due to accident or illness? If you are the main bread winner or even provide for half of the bills, then this could provide financial problems. This is very useful to self-employed people as their income stops as soon as they can't work! Employed people should check what sick pay arrangements they have as they can be lower and for less time than they actually think. You can then take a policy to tie in with your work sick benefits.

Accident, Sickness and Unemployment (ASU) - This is similar to income protection with its reasons, but extremely different in what it provides and how. The main advantages are that it is usually cheaper than income protection and it can also cover for unemployment. However, where income protection would continue to cover you until a selected retirement age (say 65). ASU policies will only pay out for a set period of time (12 or 24 months). Everyone's circumstances are different and therefore you should seek advice as to what policies are relevant to your situation and at what level.

OTHER FEATURES MORTGAGES CAN HAVE

There are many features that are offered within mortgages, here are some of the more common that are offered.

Lifetime Rates - This is where you set a rate, such as a tracker rate for the lifetime of your mortgage, there are generally different rules applying to early repayment charges with this type of product.

Offset Mortgages - There are different ways of physically doing this however to put it in simple terms, this is where your savings offset your mortgage interest:

Example

You have a mortgage of £100,000 and a savings account linked to the mortgage of £20,000. Unlike in a normal savings account you do not earn any interest on that savings, instead it is set against your mortgage so that you now are only paying interest on £80,000 of your mortgage, not only that you still have instant access to your savings. This can be a massive benefit to people with a large amount of capital and also higher rate tax payers.

An interest only mortgage of £100,000 with an interest rate of 5% (annual interest £5,000)

An interest only mortgage of £100,000 with an interest rate of 5% and £20,000 in an offset account (annual interest £4,000)

Cash Back - Some lenders provide cash back to their clients on completion of the mortgage as an incentive, an example would be £250.

Free Valuation and Free Legal Costs - When you have a large deposit (your LTV is low) then as an incentive to attract your business some lenders may pay for these two costs for you. This is especially beneficial for remortgaging when comparing costs to move to another company.

Overpayments – Many mortgage lenders allow you to make overpayments without an early repayment charge regardless of the type of mortgage deal you have. This is usually up to 10% per annum.

Flexible Mortgages – This allows you to make overpayments of any degree you wish (an offset mortgage is a type of flexible mortgage.

Exchange and Completion - what do those dates mean?
Exchange is the date that the parties involved exchange contracts, this makes things more legally binding and to pull out after this date would be extremely costly!! You do have some legal responsibilities at this point so ensure that your buildings insurance is in place from this date and the solicitor will want to see the documents by then.

Completion is the date that everything is completed, and the house is now yours. Please pick up your keys and enjoy moving in.

12 WAYS TO SAVE TIME, STOP NASTY SURPRISES AND GET A DECISION QUICKER

That is the main facts provided, however here are some important hints and tips to be aware of and use.

Don't get a nasty surprise when your mortgage deal ends

You should keep an eye on what interest rates are. These maybe different from when you originally entered a mortgage deal (say a fixed rate) and therefore your costs could be higher when the rate finishes. If interest rates increase you may want to set up a standing order into a savings account and get use to paying the higher amount (this also has the added benefit of building up some savings). A good starting point is £40 per month per every 0.5% increase on every £100,000 of mortgage.
E.g. £180,000 mortgage would mean you should get used to an extra £72 per month on an increase on interest rates of 0.5%.

Don't forget the VAT!

Both legal costs and estate agents fees are subject to VAT. Ensure that they are giving you the costs with these included.

Apply for your insurances early

Some insurances such as life assurance and critical illness can take a while to be ready to cover you. This is because they are based on your personal health and if the insurance company needs access to your medical records in order to make a decision on offering you the cover it may take longer than expected. Make sure you apply early to get this process completed, you can then place them on hold until the house move happens.

Buildings and Contents

Don't forget to put the house insurance policy live for the exchange date.

Live in the real world

When deciding what size house you can buy, be realistic with yourself as to what you can afford. Speak to a financial adviser about estimated mortgage costs per month. They will gladly help you.

Don’t underestimate the value of quality over price

Buying a house can be a very stressful experience. Although price is important it should not always be the deciding factor when choosing someone to help you with a service like an estate agent, a financial adviser or a solicitor. Cheapest service is very rarely best service, and it can actually save you a lot of time and money to have this in mind, be warned!

Use an independent adviser

This will save your time shopping around and having to repeat the same information and meeting over and over. This will also save your time if the chosen lender declines your application as the adviser will have your information already to reconsider the next suitable mortgage for you.

Timescales

Be realistic with timescales from having your offer accepted to moving into the house. Even if there is no chain to deal with, there are still hoops to jump through. Providing you have all the required documents the lender requests then the mortgage should be ready in plenty of time. The legal work is where it takes the most time. This is mainly due to the searches they have to complete as they are then waiting on local council!! You should allow a minimum of 6 weeks for this to happen, however it is best to get progress reports from the solicitor, so you know where you are with the process.

Find out these documents beforehand:

- Your last P60
- Last 3 months’ pay slips
- Last 3 months bank statements
- Copy of your Passport
- Copy of your Driving License
- Statement of entitlement for any benefits such as child benefit (these can take up to 6 weeks to order)
- Last 3 years accounts (if self-employed)

Not all of these documents are likely to be needed.
But guaranteed, if you don’t find them out then they will be!

Make sure all of your documents have the correct address

If this is not the case they cannot be used and could delay the mortgage, get these up to date as soon as possible.

Get your credit report

If you are worried about any slip ups, then you can access your own credit report. There are several companies that offer these however a well-used one is www.experian.co.uk. This will give you an idea of your credit rating. Some lenders are more flexible than others with credit scores, this can help direct you to the right lender first time.

AS A MORTGAGE IS SECURED AGAINST YOUR HOME IT COULD BE REPOSSESSED IF YOU DO NOT KEEP UP THE MORTGAGE REPAYMENTS.

The information in this guide is general and is designed to help you understand basic principles and estimated costs. You should always seek advice when considering this further and to gain exact costs.

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