June 2006

Your Free Guide to Mortgages

Please find enclosed your free copy of the MoneySavingExpert.com Guide to Mortgages, sponsored by L&C.

A mortgage to suit

The guide provides a great starting point towards understanding how money can be saved by finding the best possible mortgage to suit you. Just as your requirements are different from the next person, so there are multitude of mortgages on the market. It's important to find the right one to suit your circumstances.

A pleasant surprise

Many of our customers phone us thinking that they will be unable to get a mortgage. Perhaps they have a poor credit history, are a first time buyer struggling to get on the ladder, have an unusual buy to let case, need to self-certify as they're self-employed, or have been turned down by another lender or broker. So it is a pleasant surprise when they realise that we can not only help with our expert advice, but that we will not charge a broker fee for our award-winning service.

Another surprise is that mortgage hunting can be surprisingly simple – because we do the work for you. The whole process is conducted quickly over the telephone, with back up and advice provided throughout.

For a free no-obligation review, simply call us on: Freephone **0800 694 0444**. Alternatively, complete the enclosed Freepost enquiry form, return it to us and we will call you.

We look forward to hearing from you – and finding the very best mortgage to suit your needs.

Yours sincerely,

Phillip Cartwright
Managing Director

MoneySavingExpert.com

Guide to Mortgages

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Independence and Integrity

This guide is sponsored by London & Country mortgages, that's the reason it is free. So let me make something very plain.

This guide is written with absolute editorial independence. What's in it is purely dependent on my view of the best ways to save money and the sponsor's view on that is irrelevant. However, the reason I agreed to allow London & Country to be the sponsor, which enables this printed guide to exist, is because after detailed research into those brokers that offer coverage nationwide, London & Country has come out top for each of the last three years.

It's very important that this is understood and no one thinks it is the other way round i.e. that they are being recommended because they sponsor the guide. Like everything with MoneySavingExpert.com, the editorial (what's written) is purely about what's the best deal.

If London & Country no longer offer the deal they currently do, and either start charging fees or stop being whole of market, I'd ditch my recommendation immediately. You can check if that's happened via an up to date article on mortgage brokers on the site. Just go to the Mortgage section of **www.MoneySavingExpert.com** and see the 'sneakily get the best mortgage advice for free' article.

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Martin's Mortgage Moments

Written by Martin Lewis and Jennifer Bailey

Martin's Mortgage Introduction

Getting a mortgage probably scares the pants off you. If not it should do: it's the biggest financial commitment you're likely to make and thus it should be taken seriously. However while it's scary it needn't be difficult. There's a big advantage to getting a mortgage over other financial products. While I'm normally sceptical of financial advisers and believe you can do better going alone, in the mortgage market you can get top notch advice without paying anything (or even getting some money back) and for most people that's exactly what you should do, so you may ask "why bother writing a guide?" and if you did, it'd be a good question.

The answer is simple, because mortgage brokers are advisors not instructors, ultimately it's you who takes the decision and you whom the decision impacts. Even though you're taking advice, understanding exactly how it works is the best weapon possible. And by the end of this guide I hope you'll not only understand how to get a mortgage, but how to get the best MoneySaving mortgage possible.

Who's this guide for?

First Time Buyers

Those who don't own a property and are looking to buy one.

Self-Certs

Those who are self-employed and have difficulty in proving that their earnings are enough to make repayments.

Buy to Let

If you want to buy an investment property for someone else to live in and need a mortgage for it.

Poor Credit History

If your past means lenders are unlikely to lend you money, so you need a higher rate.

Who this guide isn't for?

Remortgagers

If you already have a mortgage and are looking to move, or you simply want to cut the cost of your mortgage, then there's a special guide just for you, go to www.moneysavingexpert.com/remortgageguide to get that one. However if you have some of the issues above, such as self-cert and poor credit history while you remortgage, you may want to read the two together.

What is a mortgage? 1

A mortgage is just a loan, but it has two special characteristics.

Firstly, it's a loan designed to be paid back with interest over a long period, typically 25 years. Secondly, and this is the most important bit, unlike a bank loan or a credit card debt, a mortgage is what's called "secured". In return for lending you money, the bank uses the property as security for the mortgage, meaning if you get into problems and can't repay your debt, the lender has the right to reclaim your house, and sell it to recoup the money you borrowed.

This guide's for anyone who wants to buy a property and needs to persuade a financial institution to lend them the cash to make it happen. The UK mortgage market is one of the most competitive in the world, and whoever you are - first time buyer, someone with a poor credit history or wannabe landlord - there may be a deal out there to suit you. This guide is designed to help you find it.

2 What's on offer?

There are tens of thousands of different mortgages available. Navigating through the plethora of deals on offer can seem bewildering. Think of it as a series of choices.

For starters, do you want an interest-only or a repayment mortgage? With an interest-only mortgage, your monthly payment does not chip away at your actual debt - it just covers the cost of borrowing the money. After 25 years of paying the interest on a £100,000 loan, you would still owe £100,000. Whereas if you'd had a repayment mortgage, while it would've cost more each month, it would have cleared the interest and the loan, meaning you'd owe nothing at the end. Unless you have a compelling reason, repayment is the way forward. It's the only option which guarantees that you are actually paying off some of your debt every month. With an interest only mortgage, you just pay the interest, and should set up an investment to build up enough cash to pay off the actual cost of the house.

There are some mortgages designed for first time buyers which suggest you just pay the interest for the first couple of years and then convert to a repayment later on (N.B. it's worth noting that you don't need a 'special' mortgage to start on interest only – any mortgage will do this). That might work if you're struggling to get on the property ladder, but it's important to make sure you do shift to repayment when you can. The sooner you start paying off your mortgage the sooner you'll finish.

There are a couple of exceptions which we'll get to in good time.

A Martin's Mortgage Moment

Interest only mortgages aren't bad

"Eh … what … that's not what you've said above. That's not the prevailing wisdom in every newspaper, what you going on about Lewis?"

All that's true, but it's over simplistic. While interest only mortgages aren't bad, they are risky. Risk is an important concept in finance; it's about taking a chance. The historic problem with interest only mortgages has been that most people who took them out did so without realising there was a risk. That is bad.

The point is the investment you use to pay off the capital on your interest only mortgage may soar, in which case it'd pay for your house plus more on top, or it may plummet in which case you need make up the shortfall.

It is possible for a detailed rational gamble on an interest only mortgage to pay off. Yet that gamble is beyond the scope of this guide. The reason most people are, and should be, cautioned against these mortgages, is planning, understanding and managing that gamble is complicated, and rarely something to risk your house on.

So, what type of mortgage do you want?

BOG STANDARD

Standard Variable Rate (SVR)

The simplest and most straightforward option. Each lender offers an SVR which tends to follow - but is not the same as - the Bank of England interest rate, known as "base" rate. SVRs are generally a percentage point or so higher than base. As the base rate shifts up and down so lenders move their SVRs, although not always by the same amount; and by not quite making it in-line e.g. they only drop rates by 0.2% when the base rate drops by 0.25%, they increase their profits.

- Pros: Simple (and even that's debatable).
- Cons: If you're on the lenders' SVR you are almost certainly paying much more than you need to, not only that but there's no guarantee you'll get the full benefit of all rate changes.

VARIATIONS

Alongside their SVRs banks and building societies offer a whole range of other mortgages. Most are introductory offers which last for a set period of time, after which lenders shunt customers back to the SVR where they hope you'll stay. Many of these offers can be and are used in combination.

Tracker

Unlike an SVR, a tracker follows the Bank of England base rate absolutely. So if bank rates rise by 1% your mortgage rate rises. But if it falls by 1% then your mortgage drops by the full 1% as well. Tracker rates tend to hover just above or below base. Some also have what's called a "collar" - a minimum level below which the rate will not drop. So in the unlikely event that base rates fell to 2%, if your tracker had a "collar" of 2.5% your rate would not fall below that level. Some trackers only run for a couple of years but you can get one lasting the life of your loan.

- Pros: You get the full benefit of all Bank of England rate falls - subject to any "collar".
- Cons: You get the full cost of all Bank of England rate increases.

Discount

The big question here is 'what is it discounted off?' Usually the answer is a temporary discount (rate decrease) off the lender's Standard Variable Rate (SVR). Yet it is the interrelation of the discount and the SVR that counts. Sounds confusing? Ok let's use an example.

Huddline Bank

This has a huge 2% discount for two years, but the discount is off an SVR of 7%. In other words the rate you actually pay is 5%.

Cansistont Building Society

This has only 1% discount also lasting two years, but it is off an SVR of 6%. So the rate you pay here too is 5%.

So with different discounts the actual rate paid is the same. Therefore it's important to know both how big the discount is and what it's off.

It's also worth noting that you can get a discount off a tracker rate rather than the SVR, e.g. if the tracker is base rate + 0.75%, and it is discounted by 0.5% for the first two years, you will pay base rate + 0.25% during that time.

- Pros: It's cheaper than the SVR.
- Cons: The discount tends to lasts for a relatively short period - typically 2 or 3 years. Plus, as you are linked to the SVR, you could lose out in relation to Bank of England base rate moves.

Fixed

Whatever happens to interest rates, your repayments are fixed for as long as the deal lasts - typically 2, 3 or 5 years. You're effectively taking out an insurance policy against interest rates going up. That protection costs money, so all other things being equal, a 3 year fix will have a higher rate than a 3 year discount. And of course if rates tumble your payments will not fall. It is possible to fix for 10 or even 15 years - but such long term security is expensive.

- Pros: Certainty. You know exactly what your mortgage will cost. Your payments will not go up no matter how high rates go.
- Cons: Rates are usually higher than on discount products. If interest rates fall you will not see your payments drop.

A Martin's Mortgage Moment

Choosing between fixed and discount

There is no right answer here. It depends on your circumstances and your priorities. A fixed rate is like an insurance policy against interest rates going up. That protection costs money, so other things being equal, unless there are exceptional circumstances, a 3 year fix will have a higher initial rate than a 3 year discount. However the rate of the discount deal may go up or down.

It isn't all about what's cheapest

Shock, horror thought from the Money Saving Expert, but choosing a rate isn't purely about which is the very cheapest. Deciding whether to fix is a question of weighing up how important surety is for you. I tend to think of this as a *"how close to the edge are you?"* question.

Someone who can only just afford their mortgage repayments should not be gambling with interest rates, and therefore will benefit much more from a fixed rate as it means they'll never be pushed over the brink by a rate increase.

Those with lots of spare cash over and above the mortgage may choose to head for a discount, and take the gamble that it will work out cheaper in the long run.

Don't look back in anger. If you do decide to go for a fixed rate on the basis of security and afterwards look back with hindsight and realise a discount rate would've been cheaper, this doesn't mean it was the wrong decision. If you needed surety, remember you got it.

As I love m'analogies, let me give you one.

If I asked you to call head or tails on a coin toss and said I'll give you £10 if you win, but you only need pay me £1 if you lose, then you should do it. While the bet itself doesn't increase your chances of winning, the reward for winning is much better than the cost of losing. So if when we actually tossed the coin, you lost, the bet was still worthwhile. It's the same with picking a fixed rate.

Capped

Part variable rate, part fixed. The rate you pay moves in line with the base rate but there is an upper ceiling or "cap" which gives you some protection. Just as a collar sets a minimum rate so a cap sets a maximum rate above which your payments will not go. As you might expect, these mortgages tend to be popular when people are frightened that rates might soar.

- Pros: You benefit from interest rate falls and have some protection from interest rate rises.
- Cons: The "cap" tends to be set quite high, and the starting rate is generally higher than normal variable and fixed rates.

Cashback

With a cashback mortgage, your lender gives you, er, some cash back - typically a lump sum worth 5%, although there have been deals offering to 10% of your loan. Whilst this money is bound to come in handy, as ever, what your lender gives with one hand he takes back with the other. Generally cashback mortgages charge higher rates than standard deals and charge you penalties if you want to repay or switch your loan within a set period, usually 5 years. Basically your lender takes its cash back.

- Pros: You get a nice cash lump sum.
- Cons: You pay for it in other ways. Watch out for higher interest rates and hefty early repayment charges (previously called early redemption penalties).

NEW AND WHIZZY

All the mortgages we've looked at so far are variations on a pretty simple theme. You borrow a set amount of money, you pay back a certain amount every month, and your debt is the amount you borrowed minus the repayments you've made. So far, so straightforward. But the last few years have seen the growth of a completely different type of mortgage. It allows you to use your savings and/or the money which sits in your current account to reduce the amount of money you owe - sometimes in conjunction with the fixed or discount rate offers described above.

Current Account Mortgage (CAM)

As it says on the tin, this combines your mortgage and current account, to give you one balance. So if you have £2,000 in your current account and a mortgage of £90,000, then you are effectively £88,000 overdrawn. Your debt is smallest just after your salary is paid in, and it then creeps up throughout the month.

You make a standard payment every month which is designed to clear your mortgage over the term you have chosen. The extra money floating around in your account is like an overpayment, which should mean you pay the loan off much more quickly. Any extra cash savings can be added to reduce the balance further. Or you can transfer other debts like credit cards or personal loans to the account to take advantage of the lower interest rate.

- Pros: If used correctly, someone who spends less than they earn each month is effectively overpaying their mortgage every month and so should clear it more quickly, potentially saving them thousands of pounds. However this is not unique to CAM mortgages, see 'Martin's Mortgage Moment'.

- Cons: You have to be very organised with your money. Whilst a mortgage is always a debt, when linked to your current account it is more obvious on a day to day basis and can create the feeling of being permanently overdrawn. Plus the interest rates charged on current account mortgages are higher than those on normal deals. To work well you need to have a reasonable amount of money coming into - and floating around - your current account.

Offset Mortgages

An offset keeps your mortgage, savings and current accounts in separate pots. Yet as above, your savings are used to reduce - or “offset” - your mortgage. So, if you’ve a mortgage of £150,000 and savings of £15,000, then you only pay interest on the £135,000 difference.

Again you make a standard payment every month, but your savings act as a permanent overpayment, wiping out more of the capital every month, helping to clear the mortgage early. Plus it’s also a good deal in terms of tax. This is because the interest rate you earned on the £15,000 in a savings account is lower than the interest cost of the mortgage, plus the savings interest is taxed. And you would have to pay tax on the interest you earned. Far better to pay less interest on the mortgage than earn interest on your savings. So these accounts are particularly good value for higher rate tax payers.

Warning! These mortgages are not for the financially disorganised. You also need a reasonable amount of money coming every month or a decent amount of savings to make the most of their features.

- Pros: You are effectively overpaying your mortgage every month and so should clear it more quickly, potentially saving you thousands of pounds. Your savings and debts are kept separate so it’s easier to keep track of your money. Tax efficient, especially for higher rate taxpayers.

- Cons: As with CAMs, the interest rate is higher than on more straightforward mortgages. So you need to have reasonably substantial savings - at least 10% or more of the mortgage amount - to make the sums add up. If you need to spend your savings for any reason, then your mortgage will become more expensive.

A Martin's Mortgage Moment

Flexible facts

Wooooah there. OK offset and current account mortgages sound great. Yet there's a lot of hype mixed in with these flexible friends.

The decision boils down to two questions. Will you use all the extra features? And is the higher interest rate you'll pay off-set (ut hum) by the benefit?

Is it just the ability to overpay you want?

The one facility most people use their flexible feature for is overpaying. This is the ability to pay off your mortgage more quickly in order to reduce the total amount of interest you will pay. Yet these days most bog standard mortgages will also allow you to overpay, and if that's all you're looking for, just get a normal cheap mortgage with an overpayment facility.

Don't believe the marketing

My greatest wrath is saved for some current account mortgage providers. They provide illustrations which show how many tens of thousands 'paying your salary into you mortgage' will save you. Yet this is a myth.

Check the numbers behind those illustrations and you'll see it always includes a fact similar to "you spend all bar £100 a month" – in other words you're overpaying by £100 a month. While of course this overpayment is beneficial, it's not unique to the current account mortgage.

In fact the pure benefit of actually paying your salary into your mortgage account each month (if you take out the overpayment) is roughly equivalent to a 0.1% discount in interest rate, and these type of mortgages are a lot more expensive than that in the first place. Unless there's a very special cheap rate these should most often be avoided.

OTHER THINGS TO THINK ABOUT

Does the lender charge daily interest?

Daily interest means the amount you owe is recalculated every time you pay money off. This means you pay less interest over the life of the loan. With annual interest you don't get the benefit of 12 months' payments until the end of the year. It can make a huge difference to what you pay. If you had 10 years to go on your £115,000 mortgage, a 5.35% deal charging daily interest would actually be better value than a rate of 5% where interest was calculated annually.

Are there any extended redemption penalties?

What happens at the end of any special deal? While most people accept they will be penalised for shifting mortgage or repaying during the initial period, some lenders continue to charge redemption penalties even after this - hence "extended". Thankfully these are gradually dying out, but check anyway.

What happens if I need to move house within the term of the mortgage?

Many mortgages are now portable, so moving house doesn't have to involve a new deal which can be important if you have redemption penalties. However if you need additional funding, be careful to choose the right product so that the end dates of your exiting scheme and new scheme are similar, enabling you to move both mortgages if necessary to secure a better rate - having no penalties on the top up sum can often be good policy.

Can I overpay….?

Many mortgages restrict the amount of money you can overpay - typically a maximum of £500 a month or 10% of the outstanding mortgage per year. Penalties if you go over these limits can be steep. In some cases, although the extra money you pay is knocked off your outstanding debt for the purposes of calculating the interest you owe, in fact the lender keeps the money in a separate pot. You can draw on this in the future either by taking back a lump sum, or using the surplus to cover your monthly payments.

…or take payment holidays?

Be careful. Lenders don't let you take play hooky from the goodness of their hearts. You will pay for it. Typically borrowers arrange to miss one or two payments, and their monthly payments are recalculated to spread the cost of the payment you missed over the rest of the life of your loan. There could also be an extra penalty or administration charge on top.

How to get a mortgage

3

Most people go direct to banks and building societies to get a mortgage. Nightmare. They simply flog you their own, usually uncompetitive, products. Yet it's possible to get top one-on-one mortgage advice for free, plus possibly get some of the broker's commission paid to you.

The right mortgage broker can quickly source a top product, offer an extra layer of protection if things go wrong and carry extra clout with lenders, easing the acceptance of otherwise unobtainable mortgages.

The first step is to inform yourself. Remember they're mortgage 'advisors' not 'instructors', this is one of the biggest financial decisions you'll make, so arm yourself with an understanding of mortgages in order to make an educated decision. Have a good read of this guide before going to a broker. The following websites are also worth a look to get an idea about best buys at the start of the process: moneysupermarket.com, moneyextra.com and moneynet.co.uk.

Warning! Unless you're very savvy I simply would not transact a mortgage online, far better to speak to a broker. If you are savvy, see later for how to go online to get your commission rebated.

There are two key questions you need to ask before using a broker.

"Are you whole of market?"

This means 'will it look at all the UK's mortgage lenders to pick the best for you?'. Some brokers are whole of market, others operate off a small panel of lenders as that way their commission rates tend to be higher. If a broker isn't whole of market, walk away.

Unfortunately when the Financial Services Authority started regulating brokers in Oct '04, it left a loophole allowing some to claim 'whole of market' status while offering only a panel of lenders, providing they review the top deals every two months, simply not frequent enough in the fast moving mortgage market. To be more advanced ask, ***"Could you, right now, source a mortgage for me from any available UK mortgage lender?"***

"How will you make your money?"

Brokers have two sources of income.

Commission. Lenders pay brokers a 'procuration fee', a whopping 0.25% to 0.5% of the mortgage's value, rising up to 1% for mortgages for those with poor credit. That means on a £150,000 mortgage brokers typically earn £375 to £1,500.

Fees. Brokers may also charge you a fee directly. No reputable broker will charge more than 1.5%, even for 'sub-prime' customers. If any charge more, walk away. Fees can be charged at any point in the process, providing they inform you initially. Yet avoid using any broker which will charge you before completion, it can cause problems if things change later.

The answer to hope for…

You want a fees-free, whole-of-market broker. This means it only earns commission, however as it's whole-of-market, it must give you best advice anyway. There are many great local, small, fees-free, whole-of-market brokers in the UK. Find one in the phone book, give them a call, asking the questions and then go face to face that way.

Obviously it's impossible for me to review every one of them, so I've concentrated on the four predominant UK-wide mortgage brokers; Charcol, Savills, Chase de Vere Mortgages and London & Country. All are true 'whole of market' operators, the difference is in their charges.

The first three primarily operate face to face and while the fourth, London & Country provides a telephone-only service, which is cheaper to operate, so it can afford to be fees free. Charcol too is starting to concentrate more on a phone based service, but it chooses to charge a fee for it. Therefore it's a bit of a no-brainer. If you want a national mortgage broker London & Country wins on price and has good customer service feedback.

Playing brokers off against each other

All the national brokers above only charge upon completion of the mortgage, so as it's always good practice to seek more than one opinion why not try a few, especially as big brokers often have exclusive deals with lenders. Remember that most charge you a fee, so so only take that deal if it saves you more than the fee.

A Martin's Mortgage Moment

Some the brokers miss

A small number of mortgage lenders don't offer their products through mortgage brokers. Under the regulations, 'whole of market' is technically defined as the whole of the 'available' market, therefore these don't have to be included in the comparison. At the time of writing, the only major players who this effects are HSBC, Egg and Yorkshire Building Society so it may be worth going separately to them as well as the brokers to be double assured of the very best deal.

Another option for the financially savvy

MortgageGenie.co.uk is a new website with an interesting proposition. It doesn't give any advice, but process the mortgage you choose through it and it'll give you some of the commission it earns as cashback, usually £100-£200 per £100,000 of mortgage.

Simply request the mortgage you want from its ready made best buy list and you'll get cashback. It'll also try and source cashback on other requested mortgages too. This route's only for the very money savvy, so be extremely careful, better to get the right mortgage and no cashback than the wrong mortgage with cashback; but know what you want, and it's better than going direct.

A Martin's Mortgage Moment

Independence and integrity

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4 Other costs

Make sure when you do your sums that you take into account the full costs of buying a house and taking out a mortgage. You can try and minimise these - and some lenders will give you help towards them - but you can't magic them away.

If you can, keep back some of the money from your deposit to cover these costs. Realistically you might have to add them to your mortgage. But remember that means you'll be paying interest on the money for the length of the loan.

If you've followed the info so far your **broker's advice** should have been free.

But you should expect to pay your lender an **arrangement fee**. These have risen sharply over the last 12 months. They vary enormously but reckon on £300 - £500. In some cases this is non-refundable even if the house purchase falls through. A couple of lenders also charge a separate reservation fee to secure a fixed-rate. This is always non-refundable and generally costs around £100 - £200.

You should also expect to pay a **valuation fee** for a survey. This is to check a) the property exists and b) it offers the lender sufficient security for the loan. The cost depends on property value and your lender but assume around £250.

Then there are **legal fees**. Many lenders will contribute - although generally not in Scotland where the process is different - although in that case you would have to use a solicitor approved by your lender. If you have to pay for your conveyancing, you're looking at around £500 - £750.

You will also have to pay **stamp duty land tax** to the government, which won't be included even if your lender will cover legal fees. There's none on properties worth less than £125,000 but you'll have to pay 1% for properties worth between £125,000 and £250,000, 3% for those between £250,000 and £500,000 and 4% for those worth more. The limits are more generous if you're buying property in what the government deems "Disadvantaged" areas.

First time buyers 5

Congratulations - you're taking your first steps onto the property ladder. Commiserations - soaring property prices make it harder than ever to make the leap. Harder, but not impossible. There are a whole heap of mortgages which have been designed with first time buyers in mind.

First things first. This is a numbers game so before you do anything else, have a good look at your finances. Use the free Moneysavingexpert budget calculator at **www.moneysavingexpert.com/budget**. Make sure you're clear about how much you can realistically afford to pay every month. Do your homework to find out what's available. A broker can be very useful here. But again, make sure they're "whole of market" - don't just use the salesman based at your estate agents. He may not offer you the best advice. And just like any borrower, you will need to decide whether you want a fixed, discount or offset mortgage.

Historically lenders simply multiplied your income to work out how much to lend you. Typically a single person could borrow 3.5 times their single salary while a couple would be offered 2.5 times their joint salary. However, increasingly lenders use "affordability" criteria, considering your outgoings as well as your income to work out what you can afford to pay back.

Having a deposit of at least 5% of the purchase price will also help in a number of ways. It demonstrates financial discipline which lenders like. But it can also make it cheaper to borrow. Some lenders impose a "Higher Lending Charge", which used to be called a "Mortgage Indemnity Guarantee", when you borrow more than 90% of the property value. This 90% figure is known as the Loan to Value ratio or LTV. Even where there isn't a specific charge, many lenders offer cheaper interest rates if your LTV is below 90% and even better deals if it's below 80% or 75%. If you do borrow at a high LTV, 90% or more, you should be looking at a lender who doesn't charge a higher lending charge as this will add to your costs.

Given what you can save, it might even be worth taking out a cheap unsecured loan in order to give you a deposit or even a carefully used 0% credit card (see www.moneysavingexpert.com for details). But make sure you take into account the loan repayments when you're calculating what you can afford to pay towards your mortgage each month.

Special deals

There are some mortgages available which will let you borrow 100% of the property value. Some Graduate Mortgages will even let you borrow 110% to allow you to cover your costs. One UK lender offers up to 130%. But it's important to understand this will mean that you will owe more than your house is worth - what's called "negative equity". As your LTV is so high, you can expect to pay a higher rate, and it's a risky strategy.

Most mortgages should be on a repayment basis, as this is the only guaranteed way to reduce your debt. But there are some First Time Buyer mortgages which have been designed to be interest-only for a set period, typically 3 years. This reduces the initial monthly payments but again means that you're only servicing the debt - no capital is actually being repaid during this time. So you still owe the same amount after 3 years. The hope is that by the end of the period, your salary and the value of your property will both have increased, meaning you can afford to switch to a repayment deal.

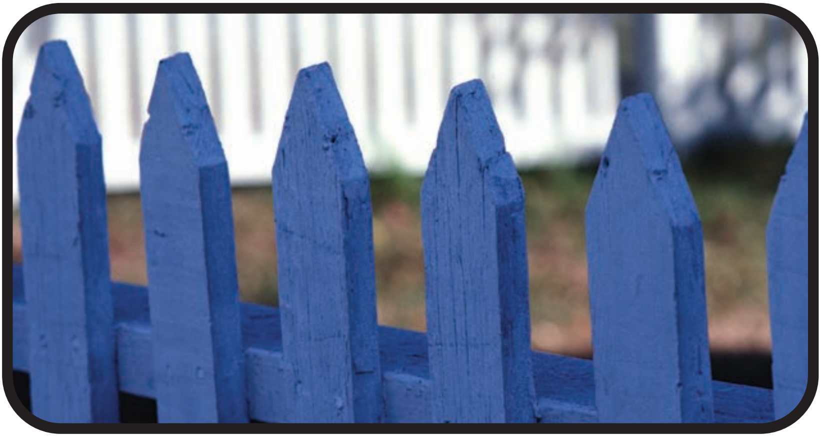
Parent power

Many first time buyers rely on help from Mum and Dad for their deposit. But parents can be much more directly involved. A number of deals will also take into account parental income as well as the child's income, as along as they can still cover their own mortgage. To avoid tax complications the parents are not listed as owners, but they are liable for repayments and arrears. It's also possible for parents to guarantee just the extra portion of the mortgage above the amount covered by their child's income, or to undertake to cover repayments should the child default.

Parents can also help their children without surrendering their cash. There are a number of offset mortgages which will use parental savings to reduce the child's mortgage, while still allowing access to the cash if necessary.

Alternatives

Another route could be to buy a property with a mate. Many lenders will allow up to 4 people to get a joint mortgage although some are more generous than others with regard to lending multiples. Clearly the pooled salaries increase your buying power, but remember you'll need a bigger property, which could take you into a higher stamp duty bracket. You also need to consider what would happen if one of you lost your job - or wanted to sell their share. It's not something to be done lightly. You will need specialist legal advice if you're going down this route.



You may also be eligible for one of the many Shared Ownership schemes available across the country. Under conventional Shared Ownership schemes, run by Housing Associations, borrowers buy a share of a property worth between 25% and 75% and pay rent on the rest, with the right to increase their share in the future. Under the Homebuy scheme, Local Authority and Registered Social Landlord tenants can also apply for an interest free loan equivalent to 25% of the property purchase price.

And there is additional help for “key workers” like nurses, teachers and policemen who live in London, the South East and the East of England, although the eligibility criteria varies according to local recruitment and retention priorities.

The government has also teamed up with Halifax, Nationwide and the Yorkshire Building Society to launch the Open Market Home Buy scheme which aims to help 20,000 first time buyers by 2010. It’s a new shared equity scheme under which the government and lender each contribute 12.5% of the cost of a property for qualifying purchases, though it’s only initially a pilot scheme.

Competition for all these schemes is and will be fierce but they’re worth exploring. However just because it’s available doesn’t mean it’s the best route, compare it to going it alone. For more information go to http://www.communities.gov.uk or contact the Housing Corporation, your Local Authority and/or Housing Association.

A Martin's Mortgage Moment

Don't be too keen to get on the housing ladder

It's become a mantra of our age "must own, must own, must own". I remember meeting a 21 year old couple while filming a ***Tonight with Trevor MacDonald*** who were upset that they weren't on the housing ladder yet.

Let's make this plain. Owning a house is great, but no necessity. Contrary to popular perception house prices could go down both in the short term and the long term. True over the very long term it's not likely, but no one can predict the future.

If you're buying a house to live in, the fact you won't need to pay rent really does help the equation. Yet don't starve to do it. Your overall finances are more important, make sure you can afford the house and definitely don't overstretch yourself – if you think it may be a little much, take a step back and pause, don't hurt yourself to get a house. Better to wait a little until you're secure.

Remember renting isn't a crime. In some circumstances it's worse, but if house prices drop it's better. No one really knows, so don't panic.

Buy to let 6

The explosion in property prices coupled with a crisis of confidence in traditional share investments over the last few years has led to a buy to let boom. Lots of people have been tempted to get involved because they feel comfortable with property. But just because you own your own home doesn't give you the skills to make buy to let work. Ultimately the point of buy to let is to structure your finances such that you maximise your borrowing at the lowest possible cost. The stakes are high - and it's not for the faint-hearted.

If you want to buy a property to let out, you need a special buy to let mortgage. As with a residential mortgage you can chose between fixed and discount and so on, but when it comes to assessing how much you can borrow, the key factor is not how much you earn, but the likely rental income.

Borrowing limits

As a general rule lenders will not let you borrow more than 85% of the property value, and typically the rental income will need to be around 130% of the mortgage payment. So if your mortgage will cost you £600 a month, your expected rental income will need to be £780.

Certain lenders have relaxed these terms for some investors - especially those with multiple buy to let properties and therefore other sources of income - but the surplus gives an important cushion against empty periods or "voids", and helps cover maintenance and other costs.

As well as a hefty deposit, applicants are expected to own their own property. In addition some lenders are unhappy providing buy to let mortgages on ex-council property, flats above a shop or in a high-rise block.

But for mainstream properties, the fierce competition in the buy to let market means that provided you meet the borrowing criteria, you can expect to get a mortgage at or only slightly above residential rates. Again a broker can help you source the best deal for your circumstances. All the major whole of market brokers offer buy to let mortgages. As before, you need to make sure the terms of the mortgage will suit your needs and you need to budget for the cost of taking it out.

Interest only

For most buy to let investors, the goal is to produce a rental income and not necessarily to own their property/ies outright. For that reason, the majority of buy to let mortgages are interest-only loans. This has two benefits. The monthly payment is much lower - making it easier to meet the stringent borrowing rules set out above. And it's also tax efficient because you can deduct the interest part of your mortgage payment from your rental income before you pay tax on it. This perk does not apply to the repayment element of mortgage payments.

Gearing

However just because you are not paying off your mortgage debt does not mean that you cannot exploit the value of your share. Remember you typically need to provide a 15% deposit for a buy to let property. If house prices increase then the bit you own is worth more too. Provided you are meeting your mortgage payments, lenders will let you use your portion of the property, or "equity", to borrow more money.

Say you borrowed £85,000 to buy a £100,000 flat. If that flat is now worth £110,000, you can remortgage it to release the extra equity. As long as the rental income sums add up you could use that newly released money as deposit on another buy to let property. And if it also increases in value, you can remortgage and release money again and buy a third property. In this way, in a rising market, it is possible to finance a string of buy to let properties without risking more of your own money than the first deposit. Increasing the size of your investment through borrowing is called "gearing".

Clearly gearing allows you to buy much more than you can "afford" in pure cash terms. In that way it allows you to make a large return on a small stake. Take the example above where you put down a 15% deposit to buy the £100,000 flat. If it increases in value to £110,000, then your stake has increased from £15,000 to £25,000, a return of 50%. Compare this to the situation if you had bought the house with £100,000 cash. That £10,000 increase would represent a return of only 10%. So in theory you have done much better by spending less.

But beware. It's not just profits which are magnified - but losses too. If the same property fell by £10,000 then with the same gearing ratio, you'd have lost 50% of your money instead of the 10% lost by the cash buyer. These kinds of complicated deals should only be risked by experienced investors who understand the risk they are taking.

A Martin's Mortgage Moment

Is buy to let worth it?

Buy to let worries me. It's not wrong, but years of house price boom have left everyone thinking 'invest in property and you can't lose'. Wrong! Property is a risk-based asset class like any other, or to paraphrase, house prices can drop like a stone.

This doesn't mean they will, it means they can. So consider the worse case scenario. You buy a house, no one rents it, and house prices crash. That is a dire situation, especially because of the gearing impact as explained above, which accelerates the loss.

Now that doesn't mean you shouldn't do it, just like buying shares investing in property is about risk.... You are trading the potential to make substantial gains with the potential to make substantial loses.

What really scares me is people who are highly geared (i.e. lots of mortgage and little actual cash invested) and only have property investments. e.g, if your only asset is the house you live in and then you decide to do a buy to let on top, I won't say 'don't go for it', but be very aware of the massive dangers of this all eggs in one basket scenario.

7 Poor credit history

In general lenders are a competitive bunch and there are excellent deals available if you're prepared to look for them. But they're a lot less interested in people with a poor credit history. Those who've got into arrears in the past, perhaps had a County Court Judgment against them or even the self-employed can all find themselves excluded from the mainstream mortgage market.

If you're in this category, it doesn't mean you won't be able to get a mortgage, but because you present a higher risk, you can expect to be charged extra for your loan. How much extra depends on your individual circumstances.

It may be possible to get a more expensive deal from a high street lender but it's more likely that you'll have to borrow from a company which specialises in "sub-prime" or "adverse credit" lending. They're likely to charge around 2% or 3% more than the best deals on the high street, but if you can demonstrate a couple of years of good behaviour on one of these deals, you'll increase your chances of getting a "prime" deal next time round.

Before you start, read the MoneySavingExpert.com guide to how credit scoring works, it's very important you understand it. Go to **www.moneysavingexpert.com/creditscore**.

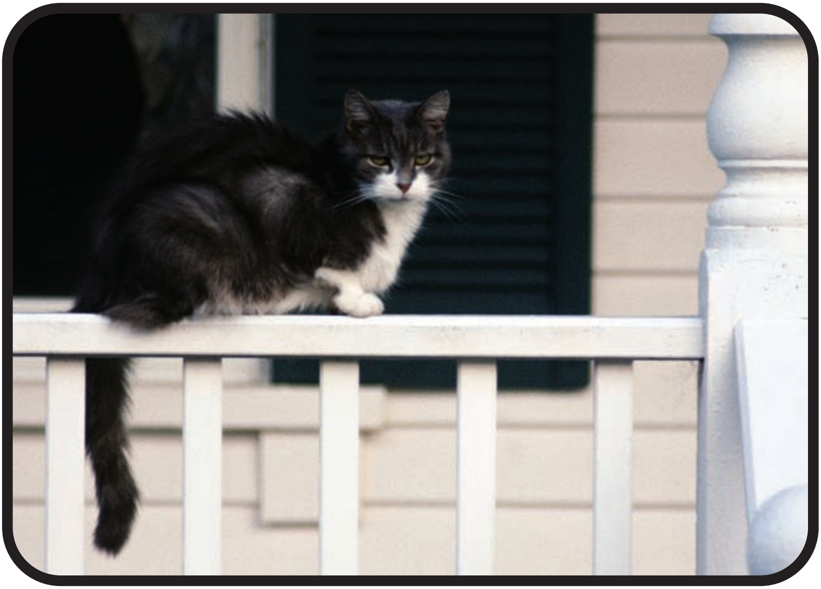
Have a good look at your finances. Use the MSE budget calculator. Be honest with yourself. How much can you afford in repayments? Can you afford to commit to a mortgage? It might be worth waiting a year before trying, but it's crucial that you make all your other loan repayments during that time to help boost your credit score. Having a good deposit will also make you a better candidate.

Even though most high street banks are not interested in sub-prime borrowers, if your problems are historic and you have a reasonable relationship with a bank or building society now, it's worth asking them first to set a benchmark. These days a lot of high street banks offer normal mortgages to those who've had a little trouble.

The expertise of a mortgage broker can be invaluable. All lenders look at potential borrowers differently - a good broker should be able to target those who are more likely to consider your application. Beware of brokers who specialise in the sub-prime market - in some cases they will charge you more than 3% to find you a deal. That's 3 times the standard broker's fee. The same brokers that are good for normal mortgages are good for poor credit history mortgages too (see page 14).

Don't just accept the first sub-prime mortgage you're offered. Just as in the mainstream market, all deals are not equal.

Look at the **interest rate**. It will be higher than high street deals because you're deemed a greater risk. But there's high and there's astronomical. You shouldn't be paying more than 2-3% above base and even this is hideous. If possible go for a deal where the rate is set in relationship to the base rate - that way it cannot spiral - or a fixed rate so that payments are guaranteed during the fixed term.



Consider the **redemption penalties** you'll face if you pay the loan off early or switch to another lender. They're unavoidable in the sub-prime market, but ensure they don't last for more than three years as they would prevent you remortgaging once you've rehabilitated your credit status.

If the purpose of taking a sub-prime deal is to help restore your credit score and allow you to move to a better deal at a later date, then it's worth considering taking out an interest-only mortgage. Your payments will be smaller, making them easier to meet. But you must make sure that you switch to a repayment mortgage as soon as you can. Whichever option you chose, it's essential that you don't miss any payments or you risk damaging your credit history further.

A Martin's Mortgage Moment

Is it really worth it?

If you're pushing to get a mortgage and you've had a bad time in the past, please genuinely consider whether you should be taking on such a big commitment. If your finances are fine and you've done a budget, then go for it. If it's looking dodgy, you could grind your credit history into the dust by over committing on a mortgage.

The likelihood is you're going to have to pay a higher rate because of your past. Often it really is worth waiting, becoming a good repayer and improving your credit score (see moneysavingexpert.com/creditscore) then getting a cheaper mortgage in a year or too. Don't force yourself into a mortgage, consider it rationally, and decide if it really is for you, and if it really is for right now.

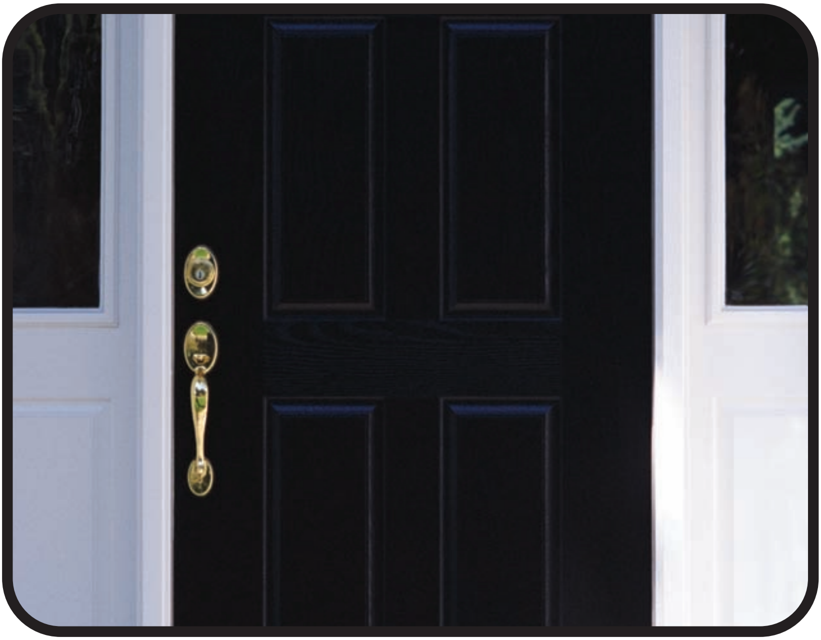
Self-cert

There is another option available for people who struggle to get a "prime" deal. Self-certified mortgages were designed for people who are self-employed and have difficulty in proving that their earnings are enough to make repayments. This may be because they have not been trading for long enough, have more than one job, or rely on bonuses for a large part of their total pay.

Borrowers who go down the self-cert route assess their own income and decide how much they can afford to repay. In recognition of the higher risk involved the rates charged tend to be a percent or so higher than on standard deals. The arrangement fees tend to be bigger too, and the proportion of the value of the property which can be borrowed (the LTV) can be lower.

Self-cert mortgages are controversial though, and the Financial Services Authority has expressed concern about the potential for fraudulent applications. It is essential that borrowers do not overstate their income in order to get a larger loan than they can afford, which could put their property at risk and damage their credit history yet further. They would also be committing a fraud and could end up with a criminal record.

However for some, especially the self employed this is a good route for a bigger mortgage. Deals for self-certs are getting cheaper these days, and the stigma of self-employment is gradually going.



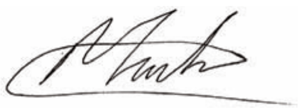
Happy hunting 8

Getting your first mortgage - or even your second or third - is not the end of the story. Your circumstances may change - the deals available will certainly not stay the same. It's perfectly possible that today's perfect fit mortgage will be woefully out of shape in 2 or 3 years time.

So, it's important to keep your eye on the ball - especially if you've chosen a deal which runs for a set period of time. You might even want to put a note in your diary a couple of months before your time is up. Don't ignore it. Use it as a prompt to look again at your situation and research the market. And make sure that once you've tracked down the best deal, you take it. But don't forget to put another reminder in your calendar for the next time…

Happy Hunting.

I hope you save some money.



If you want more information, there are further articles at **www.MoneySavingExpert.com** and you can chat about the subject in the Mortgage section of the site's Chat Forum.

Notes

A word from the sponsor

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MLGM

PRIORITY ENQUIRY FORM

I have received the MoneySavingExpert.com Guide to Mortgages and would now like FREE mortgage advice

Name: ....

2nd name on mortgage (if applicable): ....

Address: ....

.... Postcode: ....

Contact details:

Whom do you wish us to contact?: Applicant 1 ❑ Applicant 2 ❑ (pls tick)

Daytime Tel no: .... Evening Tel no: ....

Your current mortgage:

Value of property: £ .... Amount owed on mortgage: £ ....

Current lender: ....

Interest rate: ....% Monthly payment amount: £ ....

Do you have an early repayment charge? Yes ❑ No ❑ (pls tick)

If yes - how much is it? £ .... When does it end?: / /

Your new mortgage:

Are you: Purchasing ❑ Remortgaging ❑ (pls tick)

Is your property: Residential ❑ Buy to Let ❑ (pls tick)

Amount you wish to borrow: £ .... For a term of: ....yrs

Simply fold and seal this Freepost enquiry form and return to L&C. Alternatively, you can fax the form on 01225 442622 or call Freephone 0800 694 0444.

Thank you
A L&C adviser will be in touch with you shortly

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