Section 2

Mortgage products and schemes

Section 2 describes the different mortgage interest rate options available; and explains the different mortgage products available.

Section 2 covers parts 2 and 3 of the syllabus for Unit 5.

2.1 Mortgage products

The variety of mortgage products now on offer to the public is undoubtedly beneficial because it enables every prospective borrower to find at least one product that matches his needs – but the wide choice available also serves to confuse many people and it essential, in most cases, that a borrower seeks good quality advice.

2.1.1 The standard variable rate mortgage

The **standard variable rate (SVR) mortgage** has, for years, been the most common product available. In recent years it has been challenged by a variety of options and is now less popular. Even borrowers who have had this type of mortgage for many years with the same lender have often remortgaged to take advantage of the benefits offered by new products.

The variable rate mortgage does exactly what its title suggests. The interest rate varies with market rates in general. For example, an increase in the Bank of England base rate will usually lead to lenders increasing their own standard variable rate, which in turn means that borrowers with a variable rate mortgage will see their payments increase. If the rates decrease, so will the

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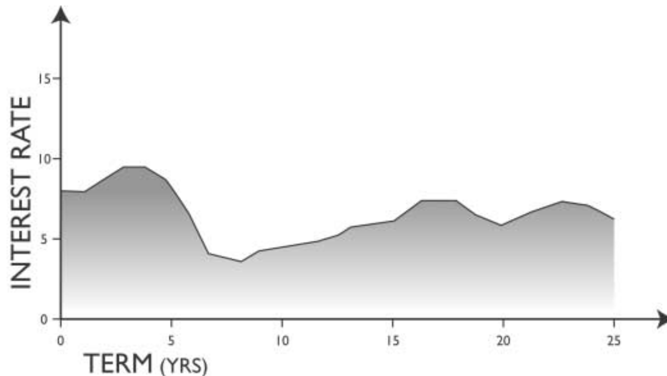
borrower's payments. The Bank of England base rate is reviewed by the Monetary Policy Committee of the Bank on a monthly basis.

Figure 2.1 The variable rate mortgage



The person who wants a straightforward mortgage that is easy to understand may well still opt for this product, whether on a capital repayment or interest-only basis. No protection is offered against steep interest rate increases and generally the monthly payment must be amended in line with each change in the interest rate charged. Some borrowers in the mid 1970s went through a period of monthly rate changes when the economy hit a rocky patch.

2.1.2 The fixed-rate mortgage

A **fixed-rate mortgage** does exactly what it says on the label; the rate of interest, and so the payment, is fixed for an agreed period, typically from one to five years, although even longer terms are becoming more common. The market for fixed-rate mortgages is highly competitive. Very attractive fixed rates are usually on offer to tempt borrowers to remortgage from their existing lenders – but how can lenders afford to offer these competitive fixed-rate products? There seems little or no profit to be gained, although a substantial number of new mortgage applications may well be received, encouraging asset growth.

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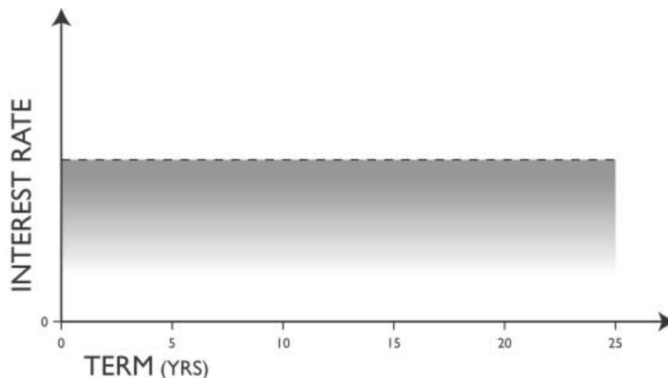
The answer is that the rate to be charged is linked to the rate paid by the lender on a tranche of funds raised on the wholesale money markets. If a lender raises £100m from the market at a fixed rate of 4.8% over a four-year period, then this amount may be made available to new borrowers in the form of a four-year fixed-rate mortgage at 5.2%. Once the £100m has been lent, the product will be withdrawn and possibly replaced with a new product at an interest rate linked to the prevailing money market rates at that time.

Figure 2.2 The fixed-rate mortgage



The main benefits of a fixed-rate mortgage to the borrower are that it helps him to budget. He will know exactly what his monthly payment will be for a given period of time and will be protected against interest rate increases during that period. There are, however, other matters that need to be considered:

- he cannot take advantage of any reductions in the lender's standard variable rate during the fixed rate period;
- an arrangement fee may be payable at the time the application is made – this may be as low as £100 or as high as £500, or it may be a set percentage of the advance. The purpose of the fee is simply to boost the profit margins of the lender on fixed-rate mortgages. It is not usually refundable if the application is subsequently cancelled;

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- an early repayment charge will almost certainly be applied if the loan is either partly or fully redeemed during the fixed rate period. This penalty may be calculated either as:
  - a fixed percentage of the amount redeemed; *or*
  - a number of months interest on the amount redeemed.

  At one time it was quite common for the early repayment charge to apply beyond the end of the fixed rate period. These 'overhang' penalties are now rarely found, although they do still exist.

  The reason for the early repayment charge is to deter the borrower from redeeming his fixed-rate mortgage to take advantage of a cheaper interest rate with another lender. The funds would then have to be lent to another borrower, possibly at a lower rate of interest, and the lender's profit margin would be reduced. Alternatively, if the standard variable rate offered by the existing lender falls below the fixed rate being paid, the borrower may decide to switch to the variable rate and be content to pay any early repayment charge;
- the loan may be subject to the compulsory purchase of an associated product such as buildings and contents insurance, buildings insurance only, or mortgage payment protection insurance. This enables the lender to generate commission income from insurers. Occasionally, the lender may be prepared to waive a compulsory purchase in return for charging a slightly higher rate of interest.

In considering whether to choose a fixed-rate mortgage, the applicant must also bear in mind the possibility that interest rates will rise during the fixed rate period, resulting in a substantial increase in monthly repayments when that period ends.

2.1.3 The discounted rate mortgage

The **discounted rate mortgage** simply offers a discount off the lender's standard variable rate for a given period and is designed to attract new mortgage business in the same way as a fixed-rate product.

Some discounted mortgage products offer what is known as a ***stepped discount***: the discount may be 1.0% in the first year, 1.25% in the second year and 1.5% in the third year. This is designed to give further encouragement to

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the borrower not to move his mortgage elsewhere before the discounted period ends.

As with the fixed-rate mortgage, there are certain things to consider when thinking about a discounted rate mortgage:

- an arrangement fee may be payable, usually between £100 and £500, and is generally non-refundable;
- an early repayment charge is likely to apply to deter part or full redemption of the loan during the discounted period. This may be calculated as either:
  - a fixed percentage of the amount redeemed; *or*
  - a number so many months' interest on the amount redeemed;
  - the actual amount of discount obtained received by the borrower up to the date of the part or full redemption.
- there is not usually quite the same need to consider switching to another product because a discounted mortgage enables the borrower to take advantage of reductions in the lender's standard variable rate, unlike a fixed rate product. The early repayment charge, however, acts as a deterrent;
- the loan may be subject to the compulsory purchase of an associated product such as buildings and contents insurance, buildings insurance only or mortgage payment protection insurance, thus providing the lender with commission income;
- there is no protection against increases in the lender's standard variable rate.

Although a discounted rate mortgage is a variable rate product, the borrower does have an assurance that, for a given period, he will be paying less than the lender's standard variable rate. In choosing a suitable product, therefore, the individual needs to be aware of the different standard variable rates charged by lenders. Generally, lower rates are charged by building societies than by banks.

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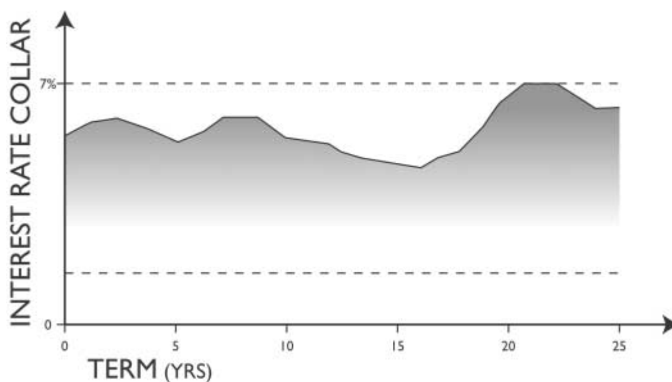
2.1.4 The capped-rate mortgage

The **capped-rate mortgage** is a variable rate mortgage that benefits the borrower in two ways:

- ♦ the borrower's mortgage will follow the lender's variable rate up to a certain level (the *capped rate*) for a specified period. The payable rate may include a small premium over the lender's standard variable rate – it might, for example, be the SVR plus 0.25%;
- ♦ where the lender's rate moves above the cap, the borrower will pay the capped rate. In other words, there is a limit (cap) on the rate the borrower will pay. This means the borrower can take advantage of all reductions in the lender's standard variable rate while at the same time the borrower knows the maximum he will pay;

Figure 2.3 The capped-rate mortgage



Other factors to consider:

- ♦ there is likely to be an arrangement fee payable;
- ♦ there will probably be an early repayment charge on redemption during the capped period (and sometimes for a period afterwards);
- ♦ there may be a requirement for the compulsory purchase of an associated insurance product.

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Although not common at the moment due to low interest rates, some capped mortgages come with a 'collar'. This represents the minimum interest rate payable during the term. In this way, the lender sets an upper and lower limit to the interest payable: a mortgage with a 7% cap and a 3% collar will allow the rate to vary within those limits but, if rates were to go above 7%, the borrower would pay 7%, and if they were to drop below 3%, he would pay 3%.

A capped mortgage will be suitable for somebody who feels that interest rates are about to rise, but still wants the security of knowing the maximum payment, although the differential between the lender's standard variable rate and the capped rate will be an important consideration.

2.1.5 The base rate tracker mortgage

The **base rate tracker mortgage**. This is also a variable rate mortgage. The rate charged follows the Bank of England base rate (BOEBR) for a given period that may be up to ten years. The BOEBR is reviewed and set by the Monetary Policy Committee every month.

The rate charged may be a fixed percentage above the BOEBR for the entire period or may actually be a fixed discount off the BOEBR for a given period, followed by a fixed percentage above for the remaining term: the interest rate charged on a five-year Base Rate tracker mortgage might be BOEBR – 0.25% for the first year, then BOEBR + 0.5% for the remaining four years.

The main advantages of a base rate tracker mortgage are:

- ♦ there is a guarantee that the interest rate charged will be reduced immediately following a reduction in the BOEBR, irrespective of whether the lender reduces its standard variable rate – lenders do not always reduce their standard variable rate in response to a cut in the BOEBR;
- ♦ the interest rate charged is likely to be substantially lower than the lender's standard variable rate simply because the BOEBR is usually between 1% to 1.5% lower than the average standard variable rate charged by lenders.

There may be occasions when a lender will make a small reduction in its standard variable rate even though the BOEBR has not been reduced. In these circumstances, borrowers with a base rate tracker mortgage with that lender are unlikely to have their rate reduced.

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Many base rate tracker mortgages require an arrangement fee to be paid and impose an early repayment charge on full or part redemption within a specified period. In addition, the compulsory purchase of an associated insurance product may also be required.

2.1.6 The LIBOR mortgage

LIBOR is the London Inter-Bank Offered Rate. It is set by the Bank of England and represents the rate at which banks borrow from each other. It is usual for several rates to be quoted, ie for three, six and nine months. Sub-prime lenders, who specialise in lending to those with an impaired credit rating, are increasingly offering mortgages on which the interest rate charged is linked to the three-month LIBOR rate.

A **LIBOR mortgage** works in much the same way as a standard variable rate product, although the rate charged to the borrower is usually reviewed quarterly at the same time as the three-month LIBOR rate is determined. One advantage to the borrower is that the lender cannot arbitrarily increase the interest rate unless the relevant LIBOR rate has been increased. He is therefore protected against interest rate increases that may apply to other variable rate borrowers.

2.1.7 The low-start mortgage

Low-start mortgages are products designed to enable the borrower to reduce the initial monthly outlay in mortgage repayments so that pressure on the household budget is reduced in the early years.

With a low-start mortgage, a loan is arranged as usual on a repayment basis. However, taking a typical 25-year low-start mortgage as an example, the first three years' payments are made on an interest-only basis. This reduces the cost for those early years. No investment vehicle is required, which means that, at the end of the first three years, the repayments are recalculated to ensure that the capital and interest is repaid by the end of the original 25 years' term. In effect, the borrower now has a 22-year repayment mortgage, monthly payments for which will increase significantly over those in the first three years.

These schemes have the benefit of reducing the monthly repayment in the early years but do have drawbacks: payments will increase significantly at the end of the low start period and no capital will have been repaid. These schemes

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are especially useful for those on an upward career path or those who anticipate an increase in other income in the foreseeable future. For those whose circumstances change for the worse, they can compound financial problems, especially if interest rates rise when the low-start element expires.

2.1.7.1 Deferred interest mortgages

An alternative low-start mortgage is the **deferred interest mortgage**. Deferred interest mortgages were introduced during the 1980s as a way of enabling those with limited income but future greater earning potential to obtain mortgage finance during a period of rocketing house values.

These schemes defer some of the interest for an initial period – typically three years – after which the rate reverts to normal. Interest deferred in the initial period is added to the mortgage at the end of that period, and future payments will be based on the larger amount. As a consequence, the borrower pays less at the outset but more later on.

During the housing slump of the 1990s, deferred interest mortgages received bad press and were blamed by many for the problems faced by some borrowers. Many were faced with larger mortgages, increased payments and houses worth less. Following the lessons of the early 1990s, deferred interest mortgages are now very uncommon. Any borrower considering such a mortgage should be confident that increased payments will still be affordable and that they will be able to cope with the double blow of increases in future interest rates.

2.1.8 The flexible mortgage

The **flexible mortgage** is a recent innovation in the UK. It is difficult actually to define a flexible mortgage because it can be almost anything a particular lender wants it to be.

To be classed as a flexible mortgage, however, a product must incorporate the following three basic features:

- interest calculated on a daily basis;
- the facility to make overpayments at any time without incurring a penalty and to underpay if the borrower's circumstances warrant it;
- the facility to take a payment holiday, again if circumstances warrant it.

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The lender would normally set parameters for underpayments and repayment holidays, although these can sometimes be renegotiated.

Many flexible mortgages offer far more than the basic features described above. It is common for the borrower to be provided with a chequebook to take advantage of a drawdown facility. This enables additional amounts to be borrowed and debited to the mortgage account as further advances.

The lender will set a limit on the total borrowing and, if this is exceeded, cheques are likely to be refused for payment, with no further chequebook being issued until the outstanding balance has been reduced to the required level. Typical lending limits will not usually exceed 75% LTV.

This facility is much easier, administratively, than the normal method of dealing with further advances. The wording of the mortgage deed used for this type of product is such that all further advances will automatically take priority over any other charges registered against the property; the need for a subsequent mortgagee to postpone its charge in favour of the further advance is eliminated.

In addition to the drawdown facility, some lenders now offer a range of other benefits that has resulted in a particular kind of flexible mortgage, popularly called a *current account mortgage*.

The most important feature of a current account mortgage is the ability for it to receive salary payments and pay direct debits and standing orders in exactly the same way as a current bank account.

The borrower can also use his chequebook in the normal way and the lender is also likely to provide a debit/cheque guarantee card and, possibly, a credit card.

The main advantages of a current account mortgage are:

- all personal financial transactions can be carried out under one account;
- the combination of salary credits and the calculation of interest on a daily basis considerably reduces the amount of interest paid over the term of the mortgage.

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2.1.9 Offset mortgages

An **offset mortgage** is similar, in most ways, to a flexible mortgage. The main difference is that the account-holder's mortgage and savings are held in the one account. The savings held in the account are offset against the mortgage, which means that interest is only paid on the balance. The savings are not tied into the account and can be taken out at any time.

Example

- The mortgage is £100,000.
- Savings are £10,000.
- Interest rates are 6% on the mortgage and 3.5% on a 'normal' savings account.

The savings of £10,000 will be offset against the mortgage of £100,000, leaving a balance of £90,000 on which interest will be charged. Interest will be £450 per month.

While no interest will be paid on the £10,000 savings, the borrower will have saved £50 each month on the mortgage. Had the savings been held in a savings account at 3.5% gross, the account-holder would have received £29 before tax; after basic rate tax, it would be worth £23.20. Offsetting the savings against the mortgage has saved £27 a month.

While an offset mortgage sounds like a good idea, it is really of value only to those who will be able to maintain a significant and consistent level of savings in the account.

Even more sophisticated and complex offset mortgages are now becoming available. These enable a borrower to offset interest payable on various savings accounts against the interest charged on his mortgage and other secured and unsecured loans held with the lender.

The flexibility afforded by these mortgages often comes at a price: the interest rate charged may be slightly higher that the lender's standard variable rate. It is, however, becoming increasingly common for lenders to offer flexible mortgages with a fixed, discounted or capped rate for an initial period. Early repayment charges are likely to apply and some products may incorporate an

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arrangement fee and/or the requirement to purchase an insurance product from the lender.

Although the number of people arranging flexible mortgages is increasing rapidly, lenders tend to regard these products as being more suitable for those who are perhaps at the higher end of the market in terms of financial awareness. At this stage in the development of flexible mortgages, it is probably true to say that they are not appropriate for all borrowers.

2.1.10 The foreign currency mortgage

Foreign currency mortgages were introduced when UK interest rates were very high compared to other countries. They were seen as a way of reducing mortgage costs. Now that rates in the UK, Europe, the USA and Japan are more closely aligned, they are less attractive because the savings may not be enough to justify the risks for most people. We are talking here about mortgages secured on UK property; many Britons now own second homes abroad financed with mortgages in that country. Not only is that a sensible move, it is often the only choice they have if they need to raise money to buy such a property.

The key points relating to a foreign currency mortgage are:

- the mortgage is arranged in a foreign currency and secured on the UK property;
- the capital owed is denoted in that currency;
- each repayment is made in that currency – which means converting from sterling;
- the interest rate will be that applicable to the country;
- there is usually a very high minimum loan – at least £250,000 in most cases;
- loans are usually only available on a repayment basis.

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Example

- £250,000 is borrowed in euros at an exchange rate of €1.45 to the pound.
- The interest rate charged is 4%; UK interest rates are 6.5%.

This gives a euro debt of €362,500 (£250,000 x €1.45) and a monthly repayment of €1,932. This equates to £1,332 per month.

If the euro improves against the pound to €1.30,

debt owing will increase to £278,846 (€362,500/€1.30); the monthly payment will rise to £1,486.

Movement in the exchange rates has increased both the debt and the repayments, and the benefit of the lower interest rate has been eroded.

It is possible to insure against currency fluctuations, but this is expensive and will reduce savings. Some companies offer managed currency loans, where the debt is switched between currencies to gain advantage of better rates. These are still risky and cost a lot to run, again reducing the savings.

2.1.11 Sub-prime and non-status mortgages

2.1.11.1 Sub-prime mortgages

As well as more generalist providers, the mortgage market is home to a number of specialist businesses that have made a niche in lending to, or arranging loans for, people who might not fit neatly into standard lending criteria.

The mortgages offered by *sub-prime* lenders reflect the risk taken and interest rates are usually higher than those applying to conventional mortgages. The borrower will also have a more limited range of options to choose from, although choice is improving.

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As lenders develop more expertise in underwriting **sub-prime mortgages**, the products have evolved, to the extent that it is now possible to select from a range of products similar in structure to those in the general market. So, for example, it is now possible to arrange sub-prime mortgages on a variable, tracker, fixed, capped or discount basis. The essential difference lies in the rate charged and the underwriting process. It is even possible for borrowers with extreme credit problems to arrange a sub-prime mortgage – at a price.

The essential features that differentiate sub-prime mortgages from the mainstream are:

- previous bad credit can be accommodated. On occasion, those within weeks of repossession have been able to arrange remortgages;
- arrangement fees tend to be higher than those for equivalent prime products;
- interest rates are higher than those for prime borrowers. Many lenders set the interest rates in broad bands depending on the credit history of the borrowers: the rate might be 1–2% higher than the prime rate, for those with one or two county court judgments (CCJs), and 2–3% higher for those with more against them. It is not unknown for fixed rates as high as 11% to be offered to those with severe problems;
- some lenders will include certain state benefits as part of assessable income;
- early repayment charges can be considerably higher than on conventional mortgages, and overhanging penalties are not unusual;
- maximum loan-to-value ratios may also be lower.

2.1.11.2 Non-status (or self-certified) mortgages

The **self-certification mortgage** is designed for those who have difficulty producing evidence of income. In principle, the applicant states their true income but the lender does not seek validation, allowing the mortgage to be underwritten on the basis of the income declared. This has led to some applicants exaggerating, or even falsifying, their income in an attempt to obtain a higher mortgage, working on the basis that low interest rates will cushion the impact of higher borrowing.

Many self-certification products have been withdrawn from the market following evidence of relatively large scale 'cheating', often encouraged by

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lenders and intermediaries, and the scandal that followed. It should be remembered that overstating income is fraud, even if the lender will not seek to verify the figures given. In general, the products available are similar to those in the general market, although arrangement fees and the interest rate charged will usually be higher. In many cases, the loan-to-value ratio before additional security is required, will also be lower.

2.1.12 The Sharia mortgage

Muslims wishing to buy property are faced with a religious dilemma because Sharia law forbids the payment or receipt of interest. This is because one party would gain at the expense of another without regard to the value of the goods traded – a concept that conflicts with the Islamic principle of equality. Sharia law does allow the sharing of risk and profit.

Sharia (or Muslim) mortgages have been developed to allow Muslims to raise the finance to buy property without compromising religious principles. There are two types of arrangement available: the Ijara method and the Murabaha mortgage.

With both methods, Stamp Duty Land Tax is paid once, when the property is initially purchased by the lender.

2.1.11.1 Ijara

With the *Ijara (lease to own) method,* the bank buys the client's selected property. The bank then sells the property to the client for the same price under a *promise to purchase agreement*, with the repayment spread over a term of up to 25 years. The bank is the registered owner during the repayment term. The client occupies the property under a lease during the payment term, paying a monthly amount that combines capital repayment and rent for the lease. The monthly payment is fixed for 12 months at a time and is then reviewed to allow for adjustments to the rental element as appropriate; these adjustments will usually reflect changes in external interest rates.

Under Sharia law, the rent is seen as a fair price for using the property and so there is no conflict of principle. At the end of the payment term, the property is transferred to the client, although early repayment is possible during the term. The bank makes its profit from the rent paid over the term. In comparison with a conventional mortgage, the Ijara is more expensive – the monthly payments tend to be higher.

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2.1.12.2 Murabaha

With a *Murabaha mortgage* the bank buys the property at an agreed price and then sells it immediately to the client at a higher price. The exact price depends on the repayment term, which can be up to 15 years. A first payment, typically of around 20% of the property value, is required and then the client will then make monthly fixed payments to the bank during the term. As the property has been transferred to the client, the property is registered in his name rather than that of the bank. Properties purchased under local authority 'right to buy' schemes cannot qualify.

The Murabaha is less popular than the Ijara as it is more expensive overall and less flexible in terms of early repayment.

2.1.13 Product incentives

From time to time, lenders offer other incentives to prospective borrowers and these may be added to any of the products previously described. These incentives include:

- no valuation payable by the applicant, although sometimes a fee is charged when the application is made and then refunded in full on completion of the mortgage;
- no early repayment charge payable if the loan-to-value ratio is below a certain level;
- all legal fees paid by the lender;
- free insurance cover for a given period, normally 12 months – this usually applies to mortgage payment protection insurance, permanent health insurance or critical illness insurance;
- a cashback facility, ie a lump sum paid to the borrower when the mortgage is completed – this may be either a fixed amount, perhaps of between £200 and £500, or a percentage of the advance. In the latter case, the cashback payable will be smaller the higher the loan-to-value ratio, but where this method is used to calculate the cashback, the amount payable may be as much as £8,000 to £10,000.

It will usually be a condition of the mortgage that some or all of the cashback must be repaid if the loan is redeemed within a given period. This facility is particularly useful for first-time buyers who may have limited savings and can

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therefore use the money to help meet the costs involved in the purchase or in furnishing the property.

Lenders sometimes advertise their fixed, discounted and capped rate products as being portable. This means that they can be transferred to another property when a new mortgage is taken out with the lender, but any early repayment charges are waived.

2.1.14 Hybrid arrangement products

Hybrid arrangement products are a very recent innovation in the UK and offer increased protection to borrowers against future interest rate changes: a borrower who has a five-year fixed-rate mortgage at 5.5% is reassuranced that his monthly payment will not increase for that period, enabling him to budget his finances with confidence; if his lender's standard variable rate is reduced on several occasions during the early stages of the five-year fixed period, then it is quite likely that his fixed-rate will be rather higher than the standard variable rate and also higher than that charged on new fixed rate products offered by that lender. He may be able to transfer to one of these new products subject, of course, to an early repayment charge being payable.

With a hybrid mortgage product, the borrower may be able, for instance, to arrange half of his loan on a fixed-rate basis and half on a discounted basis. He will be protected against interest rate increases on the fixed-rate element but he will also be able to take advantage of any reduction in the standard variable rate on the discounted rate element. He is still exposed to increases in the standard variable rate to which the discounted rate is linked.

A number of combinations are possible with a hybrid mortgage, for example:

- fixed rate/discounted rate;
- fixed rate/capped rate;
- discounted rate/tracker;
- fixed rate/tracker.

Some lenders may specify the ratio of each element, while others may be more flexible. Arrangement fees and early repayment charges are likely to apply to most hybrid mortgages, although different criteria may apply to each element. A borrower with a hybrid mortgage who is contemplating making a part-

redemption payment can choose to apply this to the element that will incur the lowest early repayment charge.

2.1.15 Self-build mortgages

Some potential homeowners feel that building a home to their own design and specifications is a better option than buying from a developer or on the general market. This option can result in significant cost savings when compared to the traditional route but can pose problems, in particular relating to finance, although the situation has improved over recent years. Self-builders can either build from traditional materials or use modern timber-framed technology, which is both flexible and speedy in comparison.

A number of lenders provide finance for such people, generically termed 'self-build' mortgages. The self-build mortgage allows the borrower to purchase the land and finance the building as well. Once the land has been purchased, the self-builder will need finance in stages, to pay for each phase of the building project.

Until relatively recently, lenders advanced finance as each phase was completed, usually limiting the lending to 75% of the land costs and 75% of the build costs. This left the self-builder with cash flow challenges as each phase was built, sometimes requiring expensive short-term borrowing to keep the work on track. Modern self-build mortgages are more flexible, and provide advance funding for each phase. Lenders vary in their attitude and approach to underwriting, but it is now possible to obtain self-build finance for up to 95% of the land costs, 95% of the cost of a timber-framed house kit and 95% of the build costs. In addition, most self-build lenders allow the borrower access to all or most of the normal products – variable, fixed and so on.

2.1.16 Shared appreciation mortgages

Shared appreciation mortgages (SAMs) were introduced in the early 1990s but have now all but disappeared from the market. They were introduced primarily as a means for older homeowners to release equity in their home. Basically, a mortgage advance was arranged up to a given percentage of the value of the property. The proceeds were taken as cash, of which some could be used to provide an income through the purchase of an annuity.

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The rate of interest charged was reduced from the standard rate and, in some cases, no interest was charged at all. The lender would take a share in the future increase in the value of the property. For example, a 25% mortgage advance would result in the lender taking a 25% share in any increase in the value of the property.

Naturally, where property values rise at a fast rate, as they did in the late 1990s onwards, there is a risk to the borrower that the lender's share of the increased value in the property might result in a large sum being repaid. The fulfillment of this risk has led to the withdrawal of virtually all SAMs from the market.

2.2 CAT-standard mortgages

CAT-standard mortgages were introduced to give clear guarantees in respect of the *charges, access and terms* that are applied. They can give a degree of peace of mind to the more cautious prospective borrower.

A mortgage adviser should always point out to a client who is adamant that he wants a CAT-standard mortgage that such a product may not necessarily be the most appropriate. This is in no way related to the fact that a mortgage intermediary is not permitted to charge his client a fee if a CAT-standard product is being recommended.

The criteria in respect of charges, access and terms vary slightly between different mortgage products, but can be summarised as follows.

2.2.1 Charges

For all variable, fixed and capped rate mortgages, the standards relating to charges are:

- interest must be calculated on a daily basis;
- full credit must be given for all payments as soon as they are made;
- there must be no separate charge for a mortgage indemnity guarantee;
- any other fees to be charged must be disclosed at the outset;
- intermediaries cannot charge fees to their clients.

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The following criteria relating to charges apply **only** to variable rate loans:

- there must be no arrangement fee payable;
- the interest rate charged must never be more than 2% above the Bank of England base rate;
- there must be no early repayment charge levied at any time.

Other charges criteria applicable only to fixed and capped rate loans are:

- any arrangement fee payable must not exceed £150;
- the maximum early repayment charge that can be levied is 1% of the outstanding balance for each remaining year of the fixed or capped rate period;
- there must be no early repayment charge payable after the end of the fixed or capped rate period;
- no early redemption charge must be levied if the borrower stays with the same mortgage lender when moving home.

2.2.2 Access

The following criteria in respect of access apply to the full range of mortgage products:

- the minimum loan that can qualify for CAT-standard status must not be more than £10,000;
- any customer must be allowed to apply;
- the lender's normal lending criteria must apply;
- the borrower must be allowed to continue with his CAT-standard mortgage with his lender if he moves home;
- the applicant must be allowed to choose on which day of the month he will make his payment;
- early repayments can be made at any time.

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2.2.3 Terms

The following criteria in respect of *terms* apply to the full range of mortgage products:

- all advertising and documentation must be clear and straightforward;
- the applicant must not be required to purchase any other mortgage-related product from the lender;
- the lender must give the borrower at least six months' notice if he intends to withdraw the CAT-standard status of his mortgage;
- if the borrower is in arrears he must not be charged more than the normal rate of interest on the outstanding debt.

2.3 Other mortgage schemes

Apart from the mortgage products already described, there are a number of other mortgage schemes that are also widely available. These include:

- equity share;
- shared ownership;
- 100/125% mortgages;
- purchases under right-to-buy legislation;
- buy-to-let;
- lifetime mortgages;
- home income plans;
- home reversion schemes.

2.3.1 Equity share schemes

An **equity share scheme** enables the borrower to buy a share in the property with the remaining share held by the lender, a developer or another provider.

A number of different schemes have been introduced during the past 20 years but a typical scheme arranged in conjunction with a lender might involve the borrower paying the standard variable interest rate on 70% of the agreed loan and either a reduced rate, or even no interest at all, on the remainder of the loan.

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In return for this concession, the lender might take a 20% share of the equity in the property when it is sold.

Where the property is purchased in conjunction with a developer, a conventional mortgage is arranged on the purchaser's share and the developer takes a second charge on the rest of the property, making him a part-owner.

Equity share appeals mainly to first-time buyers who may be borrowing at the maximum and who wish to keep their monthly payments to a minimum, or who may not be able to arrange a mortgage large enough to purchase in the conventional way.

There are drawbacks: if the original loan-to-value ratio was high and property price inflation has remained low for some time since the purchase was completed, it may make it difficult for the borrower to trade up in the property market because the already limited equity will be further reduced when the lender takes its share.

2.3.1.1 The Homebuy scheme

As a result of concern over housing affordability for those unable to afford their own home, the government developed the *Homebuy scheme*, which started in April 2006. The target is to help 100,000 households to own their own property by 2010, 20,000 of whom will be helped through an agreement between the government and three major lenders announced in December 2005.

The scheme is targeted at three groups:

- *social tenants and those on the housing register*, waiting for accommodation;
- *key workers* – those in the public sector in health, education and public safety; such as teachers, nurses and police officers;
- *first-time buyers* – those who cannot afford their own home and have been identified as eligible for the scheme and have been prioritised for assistance in the region by the Regional Housing Board.

The Homebuy scheme is based on the principle of equity share and there are three types of Homebuy product.

2.3.1.1.1 Social Homebuy

The ***Social Homebuy scheme*** is available to those 'social' tenants who do not have the right to buy or who cannot afford to exercise their right to buy. To

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qualify, the applicant must be in rented accommodation provided by a registered social landlord or local authority, or on an official waiting list and nominated by the local authority as being in need. Those on a temporary tenancy do not qualify and the social landlord can decline an application if it feels the tenant could afford to buy without help. From the landlord's perspective, the scheme is voluntary; it does not have to be offered to tenants.

Tenants will be able to buy a share in the equity of their local authority or housing association property, with a discount on the purchase price. In order to encourage landlords to participate, the government will meet the cost of the discount offered.

The tenant is able to purchase a minimum initial share of 25%, with the landlord holding the remaining equity. The landlord can charge up to 3% per annum of the retained equity. When the new owner sells the property, the landlord will be entitled to its share of the equity.

2.3.1.1.2 New Build Homebuy

The ***New Build Homebuy scheme*** is designed to allow the buyer to acquire a minimum of 25% of the equity in a new property built with public subsidy. The remaining equity will be held by the provider, who is able to charge up to 3% of the remaining equity each year.

The ***first-time buyer initiative*** is a variant of the New Build scheme, through first-time buyers will be able to buy property built on land owned in the public sector at less than the full market price. 50% of these houses will be available to key public sector workers, with the remainder available to other first-time buyers identified as a priority for assistance by the regional housing boards.

2.3.1.1.3 Open Market Homebuy

The ***Open Market Homebuy scheme*** allows a buyer to purchase an equity share of up to 75% in a property sold on the open market. The balance of the purchase price will be covered by a loan from a housing provider on an equity share basis. The maximum loan for the equity share is £50,000; certain teachers in London, identified as future leaders, will be able to receive up to £100,000. From October 2006, a number of lenders will provide equity loans in a two-year pilot scheme; the loan will be split between the lender and the government.

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2.3.1.1.4 Homebuy rules

In all of the above cases, buyers will be able to buy further portions of the property, with a minimum of 10% bought each time (based on the property value at the time), until they own the whole property: this is known as *staircasing*. In exceptional circumstances the buyer may be able to sell a portion back to the provider.

On selling the property, the owner will receive a share of the proceeds in proportion to the equity he owns: if the property is worth £150,000 and he owns 75%, the owner will receive £112,500 and the provider/landlord will keep £37,500. The provider may retain the right to buy back the property or to sell it to a prospective buyer from a waiting list. If this is not the case, the property can be sold on the open market. The new buyer will buy a share of the property, with the provider retaining the balance.

Any money received by a housing provider on resale of the property must be put back into the scheme to provide more housing.

2.3.2 Shared ownership schemes

Shared ownership schemes were first developed in the late 1970s as a result of co-operation between housing associations, local authorities and mortgage lenders.

They are designed to help people on a low income who are not able to obtain a conventional mortgage elsewhere. The scheme combines rental payments to a housing association or local authority with mortgage payments to the lender. The total outgoings are less than for a standard mortgage.

An applicant is carefully vetted by the housing association or local authority to ensure that he fulfils all the relevant criteria. He is then referred to the lender with which the housing association or local authority is working, who also assesses the applicant in the normal way before agreeing to consider a mortgage application. In some instances, a local authority may put forward applicants who have been on the housing waiting list for more than a specified period.

Typically, the individual will purchase a 50% share of the property and rent the remainder from the housing association or local authority. A process of *staircasing* enables further shares in the property to be bought when income is sufficient to meet the increased payments.

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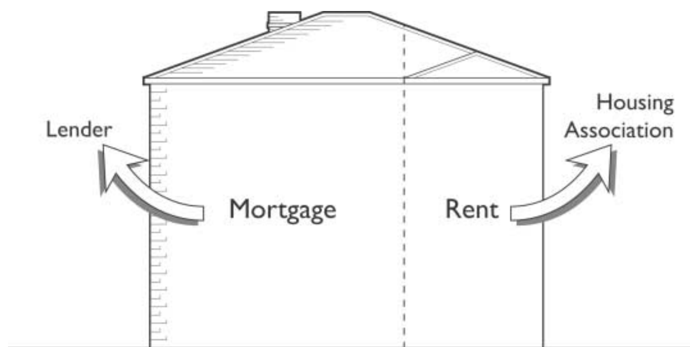
The staircasing process can work in reverse. Some *mortgage rescue schemes* operate by enabling owner-occupiers with serious payment difficulties to sell a share in their property to a housing association.

The rent charged is kept as low as possible so that the total outgoings are not much more than they would be for renting a property in the normal way. The borrower is responsible for all property maintenance, apart from common areas in a block of flats. Stamp duty is payable on the full price of the property, not just on the share being purchased.

The situation may then be reached where the borrower owns 75% of the property and makes rental payments on the remaining 25%. Some schemes will eventually allow the property to be purchased outright, while others may impose a limit of 75% on the share that can be owned.

When the property is eventually sold, the equity is split between the vendor and the housing association or local authority according to the share of the property that is owned and the proportion that is rented. If the property is not owned outright by the vendor, then he may be required to offer it back to the housing association or local authority, which will then find a suitable purchaser from its own list. In many instances, however, the vendor may be allowed to sell the property on the open market.

Figure 2.4 Shared ownership



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2.3.3 100% and 125% mortgages

In recognition of increases in house prices and the difficulty some borrowers have in putting together a large enough deposit, many lenders offer *100% and even 125% mortgages.*

The mortgage will be based on the lender's normal income multiples, perhaps with a little more generosity, because it is important that the borrower is not overstretched financially. There will usually be some form of higher lending fee or mortgage indemnity guarantee required; this can often be added to the loan.

The range of options available may be limited, although borrowers have relaxed their approach in view of the competitive marketplace.

Some lenders have even developed mortgages where up to 125% of the property value is available.

This is achieved by arranging a package with a 95% mortgage and an additional 30% on an unsecured basis. The whole loan will be at the relevant mortgage rate and repayable over the standard mortgage term. Many lenders will allow partial repayment without penalty.

Borrowers considering 100% and 125% mortgages should bear in mind that they will have no equity in the property for a period, and that falls in property prices will leave them with negative equity. Those who can put down a deposit of at least 5% will usually have a wider range of mortgage options.

2.3.4 Right-to-buy legislation

Right-to-buy legislation is included in the Housing Act 1985, revised in the Housing Act 2004, and enables a secure tenant of a district council, a London Borough Council or a registered social landlord to purchase his property at a discounted price. For the purposes of the right-to-buy legislation, there are two categories of tenant: those whose secure tenancy started before 18 January 2005, who we will refer to as *existing tenants*; those whose tenancy started on or after 18 January 2005; these are called new tenants.

The basic rules for existing tenants are:

- those who were in a secure tenancy before 18 January 2005 have the right to buy their property after two years of that tenancy;

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- the purchase discount after two years is 32% for houses and 44% for flats;
- those buying houses qualify for a further 1% for every additional year of tenancy, up to a maximum of 60%;
- those buying a flat qualify for a further 2% for every additional year of tenancy, up to a maximum of 70%.

The rules for new tenants are that:

- those whose secure tenancy started on or after 18 January 2005 acquire the right to buy after five years;
- the purchase discount after five years is 35% for houses and 50% for flats;
- those buying houses qualify for a further 1% for every additional year of tenancy, up to a maximum of 60%;
- those buying a flat qualify for a further 2% for every additional year of tenancy, up to a maximum of 70%.

2.3.4.1 Discounts

In addition to the limit of 60% or 70% discount, the government imposes a monetary limit on the actual amount of discount that can be given by the landlord. This amount varies from region to region and means that a tenant may not necessarily be able to claim the full discount to which he thought he was entitled. At present, the maximum discount in monetary terms ranges from £16,000 in the London area to £38,000 in some other parts of the UK. The limits are intended to reflect the level of housing stock available in the region.

If the tenant sells the property within a certain period, some or all of the discount may be repayable. The amount depends on when the right to buy was exercised.

Where the right to buy was exercised before 18 January 2005:

- 100% of the discount must be repaid if the property is *sold during the first year after exercising the right*;
- two-thirds of the discount must be repaid if *selling during the second year after exercising the right*;

- one-third of the discount must be repaid if *selling during the third year after exercising the right*;
- *after three years* there is no repayment necessary.

The amount repayable will be a percentage of the actual discount received.

If the right to buy was exercised on, or after, 18 January 2005:

- 100% of the discount must be repaid if the property is *sold during the first year after exercising the right*;.
- 80% of the discount must be repaid if *sold during the second year after exercising the right*;
- 60% of the discount must be repaid *sold during the third year after exercising the right;*
- 40% of the discount must be repaid *sold during the fourth year after exercising the right*;
- 20% of the discount must be repaid *sold during the fifth year after exercising the right.*
- *After five years* there will be no repayment necessary.

The amount repayable will be a percentage of the resale value (less any improvements made).

Additionally, those who exercised the right on, or after, 18 January 2005 who wish to sell within ten years of exercising the right must offer it first to their former landlord or another social landlord at full market price.

Most lenders will consider mortgage applications from tenants wishing to purchase under the right-to-buy legislation. Lenders' attitudes vary – some will lend based on the market value of the property, while others will base lending on the discounted price.

The valuer will also look carefully at the location of the property and how, in particular, this might affect its resaleability. An owner-occupied property that is situated in a road or area where almost all other properties are still tenanted may have limited appeal.

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2.3.5 Buy-to-let mortgages

A **buy-to-let mortgage** is designed to enable an individual to purchase a property for investment purposes, ie for letting rather than for owner-occupation. Consequently, such schemes are not regulated by the Financial Services Authority.

These schemes have grown considerably in popularity over the past few years. This is due mainly to an increasing number of people wishing to take advantage of the continuing rise in property prices and the shortage of property for rent in the private sector.

In addition, the rental income and possible capital gain that can be realised when the property is sold represent an alternative investment to equities, which have fallen markedly over the past few years.

A buy-to-let mortgage presents a greater risk to the lender because:

- there is no guarantee that the property will be permanently tenanted – lengthy periods during which no rental income is received may affect the borrower's ability to maintain monthly repayments;
- the borrower may treat the commitment less seriously than if the property were his own home;
- the value and saleability of the property may be adversely affected if it is badly treated by tenants and not adequately maintained by the borrower.

Initially, lenders offset this increased risk by charging a higher rate of interest than for conventional mortgages; as the demand for these schemes has grown, interest rates have fallen. There are now many buy-to-let mortgages available on a fixed or discounted basis. These products usually incorporate an arrangement fee and an early repayment charge.

Lenders do not usually employ income multiples when deciding how much to lend a buy-to-let applicant. The amount of the advance is usually calculated on the basis of the anticipated monthly rental income being around 125% of the monthly payment on the loan. If the applicant owns his main residence outright, however, and has no other mortgages, then affordability may be assessed in the conventional way by applying a prescribed multiple to his income.

The lender will also want to ensure that a suitable form of tenancy agreement is used so that it is not prevented from obtaining a possession order in the event of default. It is usual for an *assured shorthold tenancy agreement* to be

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drawn up because this also gives the landlord the right to take possession of the property when the lease expires.

Before deciding to proceed with a buy-to-let application, the individual needs to assess the proposition carefully. Information on the local rental market should be sought and a reputable letting agent should be appointed to manage the tenancy.

The rapid growth in the buy-to-let market is beginning to cause some concern. In some areas of the country, it is becoming increasingly difficult to find suitable tenants and properties are now remaining empty for longer periods. The situation will be made worse if property prices start to fall following the lengthy period during which they have risen dramatically.

2.3.6 Lifetime mortgages

There are a number of specialist plans designed to release capital or income for elderly homeowners. Some of these schemes involve mortgages – known as **lifetime mortgages** – and some involve the sale of the property to a provider in exchange for a benefit.

The FSA has established a special mortgage category, known as lifetime mortgages, that it defines as mortgages where:

- they are available only to borrowers over a certain age;
- no capital or interest payments are required during the life of the mortgage, although interest accrued can be rolled up and added to the debt;
- the mortgage is repaid only in the event of the borrower's death, a move into residential care or sheltered accommodation, the borrower moving to another property or the borrower choosing to repay the loan.

These plans are designed mainly to enable elderly homeowners who do not have a mortgage on their property to release some of the equity in order to provide capital or supplement their retirement income. Most of the schemes are available only to property owners over the age of 60 and many have a minimum age of 70. While aimed at those who do not have a mortgage, these schemes are also available to those with small mortgages, although the prior mortgage would have to be paid off as part of the arrangement.

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2.3.6.1 Mortgage-based schemes

2.3.6.1.1 Home income plans

The term **home income plan (HIP)** is a misnomer: such a plan does not have to provide income at all. With a home income plan, the homeowner takes out a lifetime mortgage on their home. The lender will restrict the lending, usually to between 25% and 55% of the property value, depending on the borrower's age. Because the property is being remortgaged, the loan is covered by mortgage regulations.

The capital released in this way can be used to provide an annuity or it can be invested in an income-producing vehicle, or it can be used as capital to meet the borrower's needs.

Before the abolition of mortgage interest relief in 1999, many of these schemes used the capital raised to buy a lifetime annuity for the borrower to provide a guaranteed level of income for life. The mortgage interest rate was fixed and monthly interest payments were deducted from the annuity income. The effect of mortgage interest relief meant that the borrower was still able to receive a reasonable surplus income from the arrangement and no interest was rolled up – the debt remained the same. The abolition of tax relief and reductions in annuity rates changed the maths and the surplus income levels became unattractive or, in many cases, non-existent. (Those who entered a HIP on or before 8 March 1999 still qualify for interest relief at 23% on the first £30,000 of the loan.)

Earlier versions of the plan, marketed in the late 1980s and early 1990s did not arrange an annuity but instead encouraged the borrower to buy an investment bond with the capital raised, using the growth on the bond to provide an income. Unfortunately, further problems occurred:

- interest rates were usually variable and increased considerably during that period;
- property values started to fall at about the same time;
- growth and income from equity-based investments fell.

People who found themselves in this situation did not have the benefit of regulation to protect them, as HIPs did not come under the remit of the regulator; neither did they benefit from the safeguards and protection offered by the Safe Home Income Plans (SHIP) trade association (a later development). The result was that many borrowers found themselves with either negative

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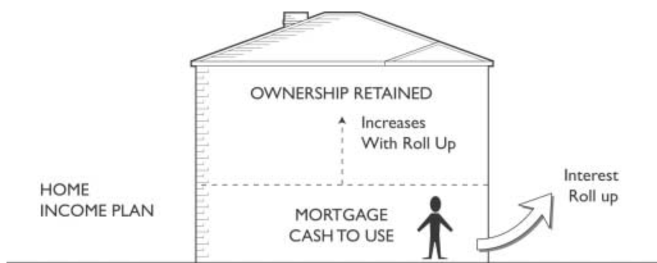
equity or insufficient income to meet the loan payments – or both. A number of court cases resulted in some lenders paying compensation to borrowers for selling an unsuitable product.

On the vast majority of modern HIPs, the borrower makes no interest payments to the lender during his lifetime. Instead, interest is allowed to roll up and is repaid, along with the original loan, when the property is sold on the death of the borrower or when the borrower decides to move. A 60-year-old borrower is likely to accumulate considerably more unpaid interest over the rest of his life than a 70-year-old and the younger one will not be able to borrow such a high percentage of the value of his property as his senior.

Figure 2.5 Home income plans



In recent years, the main providers of home income plans have joined together and formed a trade association called **Safe Home Income Plans (SHIP)**. This has established a code of practice designed to safeguard the interests of borrowers.

The main safeguards are:

- the applicant must be encouraged to seek independent legal advice to ensure that he fully understands the risks involved and the fact that any children and other beneficiaries will receive a reduced inheritance;

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- the provider will give a *non-negative equity guarantee*. This means that the amount that has to be repaid will not be more than the price that is obtained when the property is sold;
- the borrower will be entitled to remain in his home for the rest of his life – in the case of joint borrowers, this applies to each of them;
- the plan must be *portable* – the borrower must be allowed to transfer the loan to another property, although part of it may have to be repaid if the value of the new property is insufficient to cover it.

2.3.6.1.2 Drawdown mortgages

On a **drawdown mortgage**, a maximum lending limit is agreed by the lender. The borrower is then able to draw from the available funds as and when he chooses. Interest is charged on the amount outstanding, but is rolled up rather than paid each month. The benefit of this type of loan over a Home Income Plan is that interest only accrues on the amount actually borrowed, so the borrower has a degree of control and the debt is unlikely to increase as rapidly.

2.3.6.2 Non-mortgage-based schemes

2.3.6.2.1 Home reversion schemes

Home reversion schemes are an alternative to home income plans and involve the homeowner selling all, or part, of his property to the lender in return for a capital sum. The original owner(s) then enters into a lifetime lease agreement with the provider, usually at a nominal annual rent that guarantees him (them) lifetime occupation. No interest is charged because there has actually been a change of owner rather than a mortgage created.

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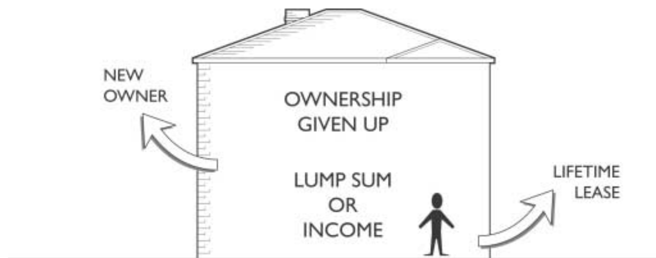
Figure 2.6 Home reversion schemes



The provider decides how much to give the homeowner in return for the property (or share); this is based on estimates of life expectancy. The provider will take a higher proportion of the property value than that represented by the cash released – for example, on a house worth £100,000, £35,000–40,000 might be released. If the same homeowner wishes to sell 50% of the property, £17,000–20,000 might be available. This is to allow for the fact that no interest will be charged and the provider will have to wait for the death of the borrower(s) to receive most of the profit.

The capital can be used as the homeowner wishes. As an alternative, some schemes use the cash released to buy an annuity, thereby increasing the individual's income.

As no mortgage is created, these schemes are not covered by mortgage regulations. There is a strong lobby for the regulation of these schemes because they do not currently fall under any regulatory regime; regulation appears likely in the near future.

As the provider takes full ownership of the property (or part of the property), no interest payments are made by the 'tenant'. The provider eventually sells the property and retains all the proceeds from the percentage of the property it owns. Where only part of the property is held in the plan, the provider will retain that percentage of the property value when it is sold: if 50% of the

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property is sold to the provider, 50% of the final proceeds will be retained by the provider and 50% passed on to the estate.

Most home reversion schemes are covered by the SHIP code of practice and offer the same safeguards as home income plans.

2.3.6.3 Points to consider

There are potential pitfalls with all the schemes described above. There are many happy pensioners who have taken advantage of the schemes – they have seen their living standards improve and have money to spend – but the problems only surface if they decide to move or when they die:

- the family's inheritance is gone;
- the individual is either unable to move or finds that he has less capital than he wanted.

For these reasons, it is important that the homeowners and their families know exactly what they are doing and exactly what the scheme involves. The adviser should always ensure that members of the family are involved in the process. If all are clear on the advantages and disadvantages of such schemes, problems will be avoided.

Those intending to give advice on lifetime mortgages should be suitably qualified.

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Test your knowledge and understanding with these questions

Take a break before using these questions to assess your learning across Section 2. Review the text if necessary.

Answers can be found on page [5] 83.

1. Ellen is considering a mortgage that has a fixed rate for three years and an early redemption penalty of 1% for redemption during the first three years, reducing to 0.5% for the next two years. The arrangement fee is £250. Does this mortgage meet CAT standards? Explain your answer.

2. The Prudent Building Society are offering a flexible mortgage, with a maximum loan-to-value lending limit of 80%. Will and Grace are looking to borrow an initial £130,000 on a property valued at £220,000; this figure is well within their income multiples. One of the attractions of this mortgage is that Will and Grace can drawdown further funds to finance a holiday home later on. How much can they draw down?

3. Bob and Luka have an offset mortgage, with an interest rate of 6.25%. The outstanding mortgage is for £120,000 and they have £20,000 in an investment account with a local building society, earning 4.2% gross. Their financial adviser has suggested they move their savings into the offset account. Comment on this advice, giving facts and figures to support your position.

4. Explain the differences between a 'home income plan' and a 'home reversion scheme'.

5. Peter and Nicky are considering a 125% mortgage to buy their first home. What words of warning would you give them?

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Answer true or false to the following statements.

6. The maximum permitted arrangement fee on a CAT-standard fixed-rate mortgage is £100.

7. One feature of most flexible mortgages is that interest is calculated on a daily basis.

8. An offset mortgage is one in which a repayment mortgage is linked to a savings account.

9. 'Deferred interest mortgage' is another name for a discounted mortgage.

10. Discount mortgages usually have an early repayment charge.

11. A shared ownership mortgage is one on which part of the loan attracts zero or very low rate of interest.

12. In an equity share mortgage arrangement, the borrower pays rent for a portion of the property while owning the remainder.

13. Interest rates on a base rate tracker mortgage remain equal to the Bank of England's base rate, and must change within 30 days of the base rate changing.

14. Sharia mortgages reflect the principle that Muslims must not enter into transactions where interest is paid.

15. Foreign currency mortgages can be secured on UK properties.

16. Under FSA rules, lifetime mortgages are available to borrowers of all ages.

17. Under the Safe Home Income Plans code of practice, borrowers must be permitted to transfer their loan to a different property if they wish to move.

18. Home reversion schemes require the customer to pay interest based on the value of the property.

19. Buy-to-let mortgages are available only to property companies.

20. Under the 'right to buy' scheme, those who bought in 2004 should be aware that the authority will claim back some of the discount if they sell again within three years.

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Answers

1. No, it does not meet CAT standards, because it has a redemption penalty after the end of the fixed period and the arrangement fee is £250, which is £100 more than the CAT maximum.

2. They can draw down a further £46,000, which will take them up to the 80% limit. Of course, they will need to make sure they can afford the increased payments if they do take extra funds.

3. They should seriously consider doing so. If they move the £20,000 into the offset account, they will pay mortgage interest on £100,000. This will save them £104.17 a month. Their £20,000 is currently earning £70 per month gross, £56 net of basic rate tax.

4. A ***home income plan*** involves the property owner taking out an interest-only mortgage on the property. The capital released is used to buy an annuity or to invest in an income-producing vehicle, or as capital to meet the owner's needs. Interest on the mortgage is rolled up and repaid when the borrower moves or dies. The amount that can be borrowed is usually 25% to 50% of the property value, depending on the individual's age (usual minimum 60) and will be lower for younger people.

   A ***home reversion scheme*** involves the owner selling part, or all, of the property to the provider in return for a capital sum, or sometimes an income through an annuity; it is not mortgage-based and no interest is payable. The owner(s) will have a legal agreement to remain in the property for the rest of their life (lives). The amount paid for the property will depend on the age of the owner but will be a low percentage of the market value to allow for the fact that no interest is payable. On death, the provider will sell the property and take a percentage of the sale proceeds equal to the proportion it bought.

5. They will have no equity in the property for quite a while. If house prices fall, they could find themselves in a negative equity situation. They will have a wider choice of mortgages if they can keep their borrowing to 95% of loan-to-value (or less).

6. ***False***: the maximum fee permitted on a CAT-standard fixed-rate mortgage is £150.

7. ***True***: the benefit of the daily interest calculation is that any early payments or overpayments immediately reduce the interest charged.

8. ***True***: the two accounts in an offset mortgage are kept separate and can be dealt with independently.

9. ***False***: a deferred interest mortgage adds the outstanding interest to the mortgage at the end of the initial period.

10. ***True***: discount mortgages usually do have an early repayment charge.

11. ***False***: the low rate part of the loan is a feature of the equity share mortgage.

12. ***False***: rent paid for a portion of the property is a feature of a shared ownership mortgage.

13. ***False***: interest rates on a base rate tracker mortgage are not usually equal to the base rate but are a specified amount above it.

14. ***True***: the most popular method of Sharia mortgage sees the lender owning the property and the customer paying rent.

15. ***True***: the capital owed on a foreign currency mortgage is denoted in the foreign currency.

16. ***False***: lifetime mortgages are available only to people over a specified age, typically 65 or 70 years.

17. ***True***: part of the home income plan may have to be repaid if transferred to a property with a lower value.

18. ***False***: with a home reversion scheme, all, or part, of the property is sold to the finance company, who get no interest or rent, but get the property value when the customer dies.

19. ***False***: buy-to-let mortgages are for individuals wishing to buy property to rent out.

20. ***True***: the discount repayment necessary if selling after exercising right to buy may cause problems if the buyer has taken a large mortgage to assist with improvements. Had they bought the property on or after 18 January 2005, the period would be five years.

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