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Which interest rate deal?

Mortgage lenders offer different interest rates and also different types of interest rate deals. We explain how the most common types work to help you narrow down your choice. Bear in mind that mortgage rates tend to move in line with the Bank of England base rate, which is reviewed monthly.

You have two important decisions when choosing an interest rate deal: whether to choose a fixed or variable rate mortgage, and whether to choose a short-term deal or one over a longer term.

Both have advantages and disadvantages and the most appropriate for you will depend on your particular needs and circumstances.

Don't choose an interest rate deal solely based on the cheapest initial monthly payments. Consider what the mortgage is actually going to cost you over the longer term and whether it is the most suitable for you.

What looks like a more expensive mortgage today, because it has a higher monthly repayment, may end up being more suitable for you. For example, it might have a long-term fixed rate, which protects you against rises in interest rates. Or it might provide a cap or ceiling on monthly repayments, even if interest rates rise unexpectedly. It might have lower initial charges or no early repayment charges if you want to repay early or make overpayments.

Ask for a key facts illustration (KFI) for each of the products you're interested in. This will help you compare products and prices and will tell you exactly how much the mortgage will cost you. See also *Step 2 Shop around* and use the FSA's comparative tables at www.fsa.gov.uk/tables to help narrow your choices.

Some points to consider

If you want to know exactly how much your mortgage payments will be for a given period of time, consider *a fixed rate*.

If you don't think you could cope with increased mortgage payments if interest rates rise, consider *a fixed or capped rate*.

If you need a payment which is as cheap as possible now but will get more expensive later when you can afford it (possibly because your salary will increase), consider *a discounted rate or short-term fixed rate*.

If you want to be able to repay all or part of your mortgage without paying an early repayment charge, choose *a rate that allows you to repay early or allows you to make overpayments*.

What are the risks?

You can't be sure that your income will remain as it is or that interest rates won't change drastically.

Variable rates rise, so you have the risk that you may not be able to meet your mortgage payments; but other deals, such as fixed rates, mean that you may lose out if interest rates fall. See the table overleaf for more detail.

Section 7 of the KFI will give you an example of how much your mortgage payment will go up if interest rates rise by 1%, so you can work out how much your mortgage payments will rise if the rates increase by more than this.

You can also use the FSA's mortgage calculator at www.fsa.gov.uk/consumer to see what the effect of interest rate rises would be on the amount you wish to borrow.

Take time to assess the risks and choose a mortgage deal that's right for you.

Interest rate deals – how do they work and which is right for you?

Type of interest rate	How it works	Early-repayment charges		Is it for you?
		During the special deal period	For some time after the end of the special deal	
Standard variable rate	Your payments go up or down when the lender's mortgage rate changes. (Mortgage rates tend to move in line with the Bank of England base rate but there is sometimes a delay.)	Not usually, except when offered with a large cashback deal		<p>√ Yes, if you can afford to pay more when interest rates go up and like having the flexibility to make overpayments without penalty (assuming there are no restrictions on making such payments and no early-repayment charges apply).</p> <p>X No, if you would be unable to afford the increased payments.</p>
A 'tracker' (changes in line with a specified rate)	A variable rate loan where the interest rate is a set amount above or below the Bank of England or some other base rate and so always 'tracks' changes in that rate.	Yes, with some loans	Yes, with some loans	<p>√ Yes, if you can afford to pay more when interest rates go up and want to be sure that falls in interest rates are passed on to you in full.</p> <p>X No, if you would be unable to afford the increased payments.</p>
Fixed interest rate	Your payments are set at a certain level for a set period of time – for example, two years, five years, ten years or even longer. Unless the rate is fixed for the term of the mortgage, you are usually charged the lender's standard variable rate at the end of the fixed rate period.	Yes, with most loans	Yes, with some loans	<p>√ Yes, if you want to know exactly how much you will pay for a specified period.</p> <p>√ Yes, if you think mortgage rates will rise and you wouldn't be able to afford the increased mortgage payments.</p> <p>X No, if you think mortgage rates will fall (and can afford the increased mortgage payments if you are wrong).</p> <p>? Possibly not if you want to make overpayments or repay the mortgage early without paying an early-repayment charge.</p>
Discounted interest rate	Your payments are variable, but they are set at less than the lender's standard variable rate for a set period of time. At the end of this period, you are usually charged the lender's standard variable rate.	Yes, with most loans	Yes, with some loans	<p>√ Yes, if money is tight when you first take out the mortgage, but are confident your income will increase and you can afford the increased payments when the discount period ends.</p> <p>X No, if you won't be able to afford the mortgage payments when the discount period ends.</p> <p>X No, if you wouldn't be able to afford the mortgage payments following a big rise in interest rates.</p>
Capped rate	Your payments are variable and often linked to a base rate, but fixed not to go above a set level (the 'ceiling' or 'cap') during the period of the deal. At the end of the period, you are usually charged the lender's standard variable rate.	Yes, with most loans	Yes, with some loans	<p>√ Yes, if you like to know the maximum you will pay over a set period.</p> <p>√ Yes, if you think mortgage interest rates might rise above the cap.</p> <p>√ Yes, if you want the security of knowing that your payments can't rise above the set level, but still have the chance of benefiting from any falls in interest rates.</p> <p>X No, if you can find a fixed rate set at a lower rate than the cap and you think rates are unlikely to fall below the level of the fixed rate deal.</p>
Collared rate	May be used in conjunction with a capped rate and/or a tracker. Your payments are variable but will not fall below a set level (the 'collar' or 'floor').	Not applicable	Not applicable	A collared rate may be part of another interest-rate deal which otherwise appears attractive. Understand that if the rate payable is only just above the 'collar' or 'floor' and you think rates will fall, you may not get the full benefit of a reduced payment.
Standard variable rate with cashback	Same as a standard variable rate loan (see above) but you receive a substantial sum (for example, 3-5% of the amount borrowed) shortly after you take up the loan.	Yes, you will normally have to repay some or all of the cashback if you repay the mortgage in the early years.		<p>√ Yes, if you need a large cash sum – for example, to buy furniture.</p> <p>√ Yes, if you expect the cash sum to more than compensate for any interest rate rises during the penalty period.</p> <p>X No, if you would be unable to cope with increased payments due to rising interest rates.</p> <p>X No, if you can manage without the cashback now and can get a better overall deal elsewhere.</p>