

The Mortgage Q Guide to Applying For a Mortgage

Step 1: Think about the type of mortgage you want

Your mortgage will probably be your largest – and longest – financial commitment, so it's important to think about the type of home loan that will suit you best.

There are basically just two types of mortgage – repayment mortgages and interest only mortgages.

What exactly are you borrowing?

When you borrow money from your mortgage lender, you commit to paying back the capital (the amount they lend you) and the interest (the charges for borrowing the money)

For example, if your mortgage is for a total of £100,000, the capital to be repaid would be the sum of £100,000. Each year, a charge for borrowing the money will be applied. Let's say the interest rate is 5% - the annual interest charge will therefore be £5,000 a year.

Repayment Mortgages

With a repayment mortgage, your payments are calculated to ensure that each month you pay the interest you owe and a contribution to the capital you owe, so your overall debt goes down each year. This type of mortgage is also called a capital and interest mortgage – because you are paying off both elements.

Interest-Only mortgages

With an interest-only mortgage your monthly instalments pay off the interest you owe but there is no payment made to the capital that you owe. The capital amount stays the same until the end of the term of the mortgage. So, during the mortgage period, you will need to be sure that you have an investment policy that you save into each month, that is designed to pay off the capital that you owe. This investment could be an ISA (Individual Savings Account) or a range of other investment products.

The benefit of a repayment mortgage is that you have the confidence of knowing that your mortgage will be paid off at the end of the mortgage term, provided that you make all of the payments.

With an interest only mortgage you will need to ensure that you take advice and put an appropriate investment account in place to ensure you have the money to repay the capital.

So, what are Variable Rate, Fixed Rate and Discount Rate mortgages?

Whether you choose a repayment mortgage or an interest only mortgage, you will be paying interest on the money that you borrow.

You can control that interest payment, to suit your current and future circumstances.

Variable rate mortgages

With a variable rate mortgage the amount of interest you pay for your mortgage will go up or down, usually in line with changes to the Bank of England's *base rate*. If rates rise rapidly, you could struggle to keep up your mortgage repayments.

Discounted rate mortgages

With a discounted rate mortgage, your lender gives you the opportunity to pay less than their standard rate, for an agreed period. For example, if their standard rate is 5%, they may offer you a 1% discount for 1 year, after which your mortgage will usually go back to their standard rate.

Most of these schemes require you to stay with your lender on their standard terms for a fixed period after your discount finishes. If you want to move to another lender, you will normally have to pay an early repayment charge.

Fixed rate mortgages

A fixed rate mortgage means that the interest rate you pay will stay the same for a given period, usually between one and five years. You might pay slightly more than the variable rate in the short term but if rates are rising, you are able to budget with confidence and protect yourself against sudden rises in your monthly payment.

As with discounted rate mortgages, you may have to remain with your lender on variable rate, for a given period, once your fixed rate scheme has finished. If you do not your lender may require an early repayment charge.

Different mortgage companies have different offers – so choose a mortgage adviser that can search the market on your behalf and find the best deal for you.

Step 2: Applying for your mortgage

Plan Your Mortgage Early

If you are looking for a new home, it's advisable to understand the type of mortgage you want – and what you're able to afford – before you check out any properties.

Making your mortgage arrangements – if only provisionally – means that you know how much you can borrow and what it will cost. And when you find the home you want and put in an offer, your bid will be taken more seriously if you have already made some initial mortgage arrangements.

Decide how much you can borrow

It's tempting to think that you should simply borrow the maximum amount that a lender is prepared to lend you, but it's important to borrow responsibly.

A series of interest rate rises could make an oversized mortgage difficult if not impossible to repay.

Remember too that your personal and financial circumstances could change in the future and affect your ability to repay your mortgage. Whilst you can insure yourself against the effects of loss of earnings due to accident, sickness and unemployment, it's always best to take a responsible approach to borrowing.

Arrange to see your mortgage adviser who will be able to assess how much you can afford to borrow, and suggest the types of mortgage that could suit your needs and circumstances. Your adviser should also be able to tell you how much a lender would be prepared to lend you.

This is normally directly related to your income. The standard formula used by many lenders is about 3.5 times your annual salary. If you are applying with your partner the income multiples are normally 2.5 times your joint annual income or 3 times the higher salary plus 1 times the lower salary.

Many lenders are adopting different multiples to reflect individual circumstances. For example some lenders recognise that your earnings are relatively low now, but if you are in a profession where they will probably improve, they could offer a more generous income multiplier.

Also, lenders are increasingly using affordability ratings to determine how much they are willing to lend you. This takes your salary into account but also includes your outgoings, to give a clearer picture of what is affordable for you. Again, your mortgage adviser can tell you which lenders use this technique.

If you are employed, you'll need to produce proof of your earnings to your chosen lender and if you are self employed, you may need to provide three years' accounts to the lender.

Some lenders offer self certification mortgages for those who are unable to provide proof of income. This is particularly useful to those who are newly self employed and have yet to accumulate three years accounts. Rates for self certification mortgages are often higher than for those products where income can be confirmed.

Step 3: Get a Mortgage Certificate

By now, your mortgage adviser will understand the type of mortgage you're looking for, will know about your financial circumstances and what you can afford.

Your adviser will search the market and find mortgage deals that suit you. More importantly, he or she will work with a lender to find out, in principle, whether they would be willing to provide a mortgage.

Many lenders will provide a certificate or letter to verify this. This is not a formal mortgage offer – simply an indication that you are the type of customer they would accept. However, their certificate is important – and valuable – because it shows estate agents and property sellers that you are committed to organising a mortgage and have begun the process which, in their eyes, makes you a serious buyer rather than a time waster.

Step 4: Make a formal application

Once you have searched the property market and found the perfect house or flat, and had your offer accepted you're ready to make a full application for a mortgage.

There are thousands of mortgages available on the market so making the right choice is really important. Your mortgage adviser will be able to search for the best deal to suit your personal circumstances and financial needs.

Your mortgage adviser can help you with all of the paperwork associated with applying for your mortgage and can answer any questions that you might have.

Don't forget - be prepared!

So, if you're thinking about buying a property – be prepared!

Give yourself time to work out the best mortgage for you, understand what you can afford to borrow, and get your mortgage adviser to arrange proof that a lender is willing to consider your application. All of these efforts will strengthen your buying position and your bargaining power.