REPAYING THE LOAN

There are three main options: a repayment mortgage, or an interest only mortgage, or a combination of a repayment and interest only mortgage. Here is a summary of how they work.

(OPTION 1) A REPAYMENT MORTGAGE

A repayment mortgage works in the same way as most types of loan. You make regular monthly payment to the lender. This payment will be made up of capital (in other words, repaying the ongoing amount you've borrowed) and interest. So long as you always keep up the correct payments, at the end of the term you will have repaid the loan in full.

(OPTION 2) AN INTEREST ONLY MORTGAGE

With an interest only mortgage, you pay only the interest to your lender. This means you need to make a separate payment into some sort of savings plan. The amount you pay into the savings plan aims to build up a lump sum to pay off the mortgage at the end of the term.

The three main types of savings plans are: endowment policies, ISAs and pension plans. You must keep up the payments or you are unlikely to build up enough to repay the loan. The savings plan you use is not guaranteed to pay off the loan and you will have to make up any shortfall.

(OPTION 3) A COMBINATION MORTGAGE

Some lenders may allow you to combine both repayment methods. For example, this may apply if you took out an endowment mortgage for your first home for £100,000 and you are buying your second home at a cost of £150,000. You may want to keep your £100,000 endowment until the policy is due for payment, but borrow the extra £50,000 as a repayment mortgage. If you are a first time buyer, you can use an existing saving policy such as an ISA, to contribute towards a combination mortgage, or an interest only mortgage.

(IN MORE DETAIL)

REPAYMENT MORTGAGE

- In the early years, most of your payments just cover the interest.
- You pay off the capital slowly in the early years.
- You will repay the loan if you keep up the necessary payments.
- No investment or life cover is built into a repayment mortgage.

In the early years of a repayment mortgage, most of what you pay goes in interest. As the loan progresses, more and more of your monthly payment goes towards repaying the capital. This can be a disadvantage if you move home several times and change lenders each time, because the temptation might be to take out a new 25 year loan every time you move. But you can easily avoid this by asking for a shorter repayment period each time, to keep your original repayment date the same. On the plus side, you will definitely repay the mortgage at the end of the term as long as you make all the payments.

Some lenders allow you to make extra payments on your mortgage. Check whether they work out the interest due on the reduced mortgage immediately or at the end of their financial year. This will help you see when the change in your repayments will begin.

Life cover is not automatically included with a repayment mortgage. So, when you're buying a home with a partner or if you have a family to think about, you need to make sure the loan can be paid off in full if you or your partner dies during the mortgage term.

INTEREST ONLY MORTGAGE

If you choose an interest only mortgage, you'll find there's a choice of 'Invest to repay' plans available to repay the mortgage.

(1 Endowment policies), Endowment policies offer the following:

- Provide a lump sum which aims to pay off the mortgage at the end of the mortgage term.
- The Investment performance is not guaranteed.
- Life cover is built in.
- You can transfer the policy to back a new mortgage so you can keep it going if you move.

You pay a premium (normally monthly) to an insurance company for an endowment policy. An endowment policy is a savings plan with life cover built in. So as long as your endowment policy provides enough cover for the whole of the mortgage, there's no need for extra life assurance in connection with your mortgage. Some endowment policies give you options such as critical illness cover too. The value of the endowment policy can fall as well as rise.

You can arrange life cover just on your own life, or jointly if you're buying with a partner. Both of you will then be covered if either of you die during the mortgage term.

When you move home, your endowment policy can move with you and you can attach it to your new mortgage. So if, for example you have a 25 year term policy, and move home after 10 years, you will only need a new top up policy to cover the increase in the mortgage over the remaining 15 years.

Growth rates: If you take out an endowment policy the insurance company will calculate the premiums you must pay each month. The calculation will estimate the future growth of the endowment policy over its whole term. But the growth rate can't be guaranteed. If the growth rate is higher than estimated, at the end of the term the endowment policy may be worth more than you need to repay the mortgage, any you may have a lump sum left over. Or you may be able to pay off your mortgage early. But if the growth rate is lower than estimated, the endowment policy may not have built up enough savings to repay your entire outstanding mortgage. You may need to pay more each month or at the end of the mortgage term you may have to make up a shortfall by playing a lump sum, or extend the term of your mortgage, if your lender agrees to this.

The maturity values of endowment policies depend upon the growth of the policy during the whole term. It's impossible to predict what that will be. Mortgage related endowment policies have become less popular in recent years and many life companies no longer offer them.

(2 ISAs),

- A tax efficient investment scheme.
- There are 4 types of ISAs: cash, stocks and shares, innovative finance & Lifetime.

Individual Savings Accounts (ISAs) are tax privileged investment schemes. Money is invested in the stocks and shares part of an ISA usually through an investment fund such as a unit trust. The aim is to build up a lump sum to pay off the mortgage at the end of the term. The value of the investment can fall as well as rise.

You can choose either cash ISA, stocks and shares ISA or innovative ISA's. Each ISA can be with a different ISA manager.

Life time ISA's can be used to help build up funds to purchase your first home or saving for later in life.

You may have to take out separate life assurance with an ISA mortgage. ISA limits will apply and can change dependant on the rules for each specific tax year.

(3 Pension Plan),

- It helps you repay your loan when you take your retirement benefits.
- The fund needs to be large enough to give you a good pension too.

The aim of a pension mortgage is to pay off the mortgage by using part or all of the cash available when you reach retirement age (which can currently be any time from age 50 to 75; minimum retirement age increasing to age 55 from 6 April 2010.

There is no guarantee that the Pension Commencement Lump Sum (tax-free cash) will be sufficient enough to repay the mortgage. The mortgage will end on the anticipated retirement date and interest on the mortgage will be payable until retirement date.

It is a very tax efficient way to fund your mortgage. This is because, under current tax laws, you get tax relief on your pension contributions and your pension fund grows virtually tax free. Please note the pension provider cannot reclaim tax credits on dividends. The value of your pension fund can fall as well as rise. Your money is tied up until you take your retirement benefits. However if you use some of your pension fund to pay off your mortgage, less will be available to provide your pension benefits. If you choose a pension mortgage, you must make sure that the pension income you are left with is big enough to meet your needs and that the mortgage term ends when you take retirement benefits.

If you have dependants, you should also take out extra life assurance to cover the loan. Some lenders make this a requirement. If you cease to be in receipt of relevant UK earnings or your contribution exceeds the Annual Allowance, you may also require an alternative vehicle.

IMPORTANT NOTE: Invest to repay products such as endowments, ISAs and pensions are long term commitments. They will not be suitable if you think that you might not be able to keep up your payments until the end of the term. A financial advisor will be able to advise you which products best suit your needs and circumstances. If at any time you stop making regular payments, your home could be at risk at the end of the mortgage term. You will need to arrange to repay the mortgage amount in some other way. If your circumstances change and you have to cash in the policy during the early years, you are unlikely to get back as much as you have put in.

Please note, you cannot cash in a pension plan.

The favourable tax treatment of these products may change in the future.