Philip Clark Financial Services

Interest Only Mortgages – Are they still available? Are they a good idea?

Many people associate an interest only mortgage with the term 'endowment mortgage'. It's true that the most popular method of repaying the capital portion of an interest only mortgage in the 80s & 90s was with an endowment policy. Mortgage advice was limited or non-existent at the time however. The scandal of mis-selling of endowments and other investments was clearly instrumental in the creation of the FSA in December 2001, although mortgages were not regulated until October 31st 2004. Interest only mortgages continued to be popular, mainly because of affordability issues for house buyers but repayment mortgages remain as the preferred option.

Although interest-only mortgages are now very limited, they can still be the most appropriate option, with some switched on borrowers, especially while the interest rates are at a historically low level. Interest only mortgages are cheaper to service, as borrowers only repay the interest on the mortgage, without repaying the actual loan. Although this may seem risky, many older borrowers with a lot of equity in their property may find this the best (or only affordable) route. Most lenders who offer a flexible interest only mortgage insist on a repayment vehicle being in place, e.g. ISA, pension, investment or Buy to Let property. As the alternative is for the borrower to be prepared to sell their home to repay the debt when called upon, it can lead to sleepless nights. This is where independent, impartial and free mortgage advice is essential, as flexibility is the key. One of the options available with flexible mortgages is to overpay whenever finances permit. This means that the outstanding capital will be reduced, whenever an overpayment is made. If the flexible interest only mortgage also has an offset facility, the interest on the outstanding mortgage will be reduced by the interest on the credit balances in linked accounts. (I'll talk more about Offset mortgages in another article.) I mentioned that the current low interest rates are also significant. Regular or one-off overpayments will have a greater effect on reducing the capital balance when the interest rate is low. Most lenders with flexible mortgages permit overpayments of up to 10% of the outstanding balance per year, during the term of the deal (2 year fixed or tracker etc) and unlimited overpayments when the mortgage returns to the standard variable rate.

Borrowers with a flexible interest only mortgage need not panic. Most lenders allow borrowers to switch from interest only to a repayment mortgage, during the term of the mortgage. Take some free mortgage advice – talk to your adviser. It's good to have a choice – it really could make a big difference to your financial plans for the future.