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Cheap rates come with a sting in the tail

By Tanya Powley

Lenders are increasingly offering cheap, so-called "discounted" mortgages to attract more borrowers, but experts warn that these rates could rise at any time, leaving mortgage customers worse off.

Discounted variable rate mortgages differ from standard tracker deals as they are linked to a lender's own standard variable interest rate (SVR), rather than the Bank of England base rate.

As each lender sets its own SVR, there is a greater risk that borrowers on these deals could see their payments increase, even when the official bank rate remains unchanged.

Adrian Anderson of broker Anderson Harris added: "While borrowers know where they stand with the base rate, with a discounted rate there is always the danger of a nasty surprise."

Discounted variable rate deals are largely offered by building societies, though a number of banks have launched deals recently, including HSBC, Clydesdale and Yorkshire Bank.

According to Nigel Bedford of Largemortgageloans. com, 27 lenders offer discounted rates for two, three and four-year mortgage terms. All but four of these are building societies.

Funding for Lending boost

The launch of the Funding for Lending scheme is expected to boost lending to households, with one lender already cutting rates for first-time buyers.

"Linking lending to SVRs gives building societies more control over the cost of borrowing," explained Bedford. If a lender needs to improve their margins, they can do so by increasing their SVR, making them more attractive to lenders. Of the top ten variable rate deals available to borrowers with deposits – or equity – of 40 per cent or more, six are discounted variable rates and just four are

Nigel Bedford of Largemortgageloans.com agreed: "There is evidence that building societies offer better products than banks, especially at high loan-to-values."

For example, three of the five best-buy two-year fixed rates for borrowers with a 25 per cent deposit are from building societies.

They include a rate of 3.19 per cent from West Bromwich Building Society, with a £999 fee, and 3.34 per cent from Furness Building Society, with a £399 fee.

Building societies also dominate the best-buy table for 90 per cent loan-to-value mortgages, offering four out of the five most competitive rates.

Chelsea Building Society has a two-year fix at 4.34 per cent, with a £1,495 fee, while Yorkshire Building Society has a 4.49 per cent rate with a £995 fee.

Building societies can be more flexible on lending criteria as they typically use "human underwriters, rather than the tick-box, computer says 'no' approach" of major banks, said Jonathan Harris.

They are also more likely to offer more innovative products, brokers said. For example, Skipton Building Society this week launched a seven-year fixed-rate deal at 3.99 per cent and a ten-year fix at 4.49 per cent.

However, borrowers have been advised not to discount banks entirely. According to brokers, most of the competitive mortgages for those with larger deposits are still offered by banks, rather than building societies.

Four of the five best-buy two-year fixed-rate deals for borrowers with deposits of 40 per cent or more are offered by banks. They includes a rate of 2.64 per cent from HSBC, with a £1,999 fee, and 3.09 per cent from NatWest/Royal Bank of Scotland, with a £999 fee.

Similarly, for two-year tracker rates, the Post Office – which offers mortgages from Bank of Ireland UK – has the best rate: 2.89 per cent (Bank of England base rate plus 2.39 percentage points) for up to 75 per cent loan-to-value, with a £995 fee.

"You can't write the big banks off," said David Hollingworth of London & Country, the mortgage broker. "The flipside to building societies is that they've got a smaller capacity to lend than the banks, so they are unlikely ever to do the majority of lending in the market," he added.

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