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Money Made Easy: Five-minute guide to... mortgage overpayment

Anna Mikhailova Published: 2 June 2013



NATIONWIDE building society changed the terms of its mortgage deals last week, allowing new customers to overpay by up to 10% of their loans each year.

Previously, the mutual was one of the tightest in the market on overpayments, limiting them to £500 a month. The change will apply only to loans reserved after May 29, and not to existing mortgages.

The move by Nationwide, the country's third-biggest lender, is designed to give borrowers the flexibility to clear more of their debts when it is convenient to them.

Brokers point out that it is wise for some individuals to take into account a mortgage lenders' policy towards overpayments when choosing a deal, rather than focusing on the rate and fee.

Aaron Strutt of Trinity Financial, the broker, said: "This is especially important if you are locking in to a longer-term fixed rate. It is worth confirming how much you can overpay if you receive a large bonus or are planning to make a lump-sum reduction."

What are the rules on overpaying?

Most lenders now allow borrowers to overpay 10% of the outstanding balance each year. Some are even more generous, such as Metro bank, which allows overpayments of up to 20% of the balance each year.

HSBC allows unlimited lump-sum overpayments on its tracker mortgages and has no early repayment charge.

Other lenders charge a higher rate for more flexible rules. Yorkshire building society typically allows a 10% overpayment on its standard deals. It charges a rate 0.2 percentage points higher for the same loans, but with unlimited overpayments. It has a five-year fix at 2.59% with 10% overpayment or 2.79% with unlimited overpayment.

What are the benefits?

Calculations by London & Country, the broker, show that a £200,000 loan over 25 years at a rate of 2.59% would have a monthly repayment of £906. If the borrower overpaid by 10%, they would pay £2,573 a month and clear their loan 17 years and nine months early, saving £52,735 in interest.

What are the other advantages?

Overpaying could help you to get a better deal next time round. Mark Harris of SPF Private Clients, another broker, said: "Overpaying will boost your equity stake more quickly, making you more attractive to lenders, so easier for you to remortgage."

Ian Gray of largemortgageloans.com, the broker, said: "Private banks can be much more flexible than the high street. Even if they want to impose early repayment charges in the first few years, almost all private banks can write in a bespoke overpayment facility as long as it is negotiated upfront."

What are the drawbacks?

Overpaying by more than is permitted in a year could result in an early repayment charge, which could be up to 8% of the loan.

Top tip

Be careful not to overstretch your finances. "Money overpaid is notoriously difficult to get back, so keep some for emergencies," said Adrian Anderson of Anderson Harris, the broker. A more flexible option could be an offset mortgage, which allows savings held in a linked instant-access account to be used to reduce the interest charged.

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