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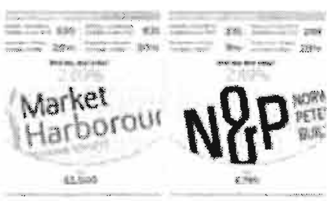
Two-year fixed-rates come at a cost

By Tanya Powley

Banks and building societies are offering a plethora of two-year fixed-rate mortgage deals to homeowners – in spite of the fact that these products do not offer the best value for most borrowers.

New figures released this week show that two-year fixed-rate deals are the most common type of mortgage being offered by lenders, accounting for 30 per cent of all the mortgage deals currently available in the market.



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According to Defaqto, the financial research company, there are now 831 two-year fixed-rate mortgages being offered by banks and building societies, compared with 530 at the peak of the housing market five years ago. Back then, two-year fixes represented just 20 per cent of all available products.

In comparison, the number of lifetime tracker-rate mortgages has plummeted from 231, or 9 per cent of the market, in 2007 to just 69 today – representing 2 per cent of all available deals.

But experts argue that, in the current climate, two-year fixed-rate mortgages offer poor value for borrowers – because the Bank of England base rate is expected to stay at 0.5 per cent for the next few years. As a result, tracker-rate deals are cheaper, and likely to remain so for the next two years.

Ray Boulger of John Charcol, the mortgage broker, said lenders preference for two-year fixes is partly down to demand from brokers, as well as from borrowers.

In the past, brokers have been accused of "churning" short-term mortgage deals to earn regular fees and commissions. "I do think a higher proportion of mortgage deals are sold on a two-year fixed basis than is appropriate," said Boulger.

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However, other brokers argued that two-year fixes have always been popular with borrowers who are attracted by cheap headline rates.

"The mentality is to minimise monthly repayments and refinance in two years' time," explained Aaron Strutt of Trinity Financial. "Extra margins can put borrowers off longer term rates."

But Nigel Bedford of Largemortgageloans.com claimed that two-year fixed rates are favoured by lenders as they make more money out of them.

"The interest rates are higher than variable rates and it gives banks the opportunity to move borrowers to a potentially higher fixed or variable rate in another two years, when the interest rate outlook is likely to be different – and charge them another fee for the privilege," Bedford said.

Brokers said they were more typically recommending that borrowers take out tracker mortgages or five-year fixed-rate deals for longer term security.

"The majority of our clients favour lifetime trackers or five-year fixes," said Adrian Anderson of mortgage broker Anderson Harris. "They would rather not have to remortgage again in two years," he argued. "If property values have decreased, they may not [be eligible for] the same loan-to-value, or their job or family position may have changed so they may not be able to remortgage."

For borrowers with a deposit of 25 per cent or more, a lifetime tracker mortgage from Britannia Building Society at 2.79 per cent would cost only 10 basis points more than the best two-year fixed rate from Market Harborough Building Society.

While two-year fixes can suit some borrowers – particularly those who might be looking to move house within the next five years, and avoid paying redemption penalties on a longer-term fix – brokers said all mortgage applicants should pay closer attention to the lender's "revert to rate" – the interest rate that a customer will be charged when the term of their fixed rate deal expires.

"It is important to check the reversion rate after fixed

Home loans still rising

Lenders have continued to increase the cost of their mortgages in recent weeks, continuing the trend since the start of the year.

This week, Northern Rock and Chelsea Building Society both raised their fixed rates – with the former increasing the cost of its two-year deals by up to 40 basis points. Chelsea increased all of its fixed rate deals for those with deposits of 15 per cent or more by up to 25 basis points.

"The general trend in mortgage rates is slowly upwards, with far more increases than decreases recently," said Nigel Bedford of Largemortgageloans.com.

He noted that some of the rises could be explained by what has happened to interest rates swaps – the derivatives lenders use to price their fixed-rate loans. In the past three months, two-year swap rates have risen by 0.07 percentage points.

However, mortgage rate rises have been much larger than those warranted by fluctuations in the cost of funds, noted Bedford. For example, the best-buy five-year fixed rate in February was 3.19 per cent, but the market-leading rate is now 3.59 per cent.

But while many lenders have raised their rates, some cut the cost of their deals this week.

Coventry Building Society reduced its two-year fixed rates by up to 30 basis points and its five-year rates by up to 10 basis points.

"I think we're coming to an end to the upward movement we've seen in rates in recent months," said Ray Boulger of John Charcol, the mortgage broker. He suggested that mortgage rates could start to come back down in the next few months.

and tracker rates, and to select a deal with a favourable rate to revert on to," noted Strutt of Trinity Financial. "This is a good way of limiting risk after the initial term," he noted.

For example, Chelsea Building Society has some competitive fixed rates – but the standard variable rate (SVR) that its borrowers revert to is 5.79 per cent at present.