Personal Finance

£1m-plus mortgage borrowers pay over the odds

Interest rate disparity could add nearly £2,500 per month to the cost of servicing a £5m mortgage

Large loans pegged to the Libor rate are likely to be paying significantly more than those with base rate-linked trackers © Alamy

James Pickford APRIL 16 2020

Borrowers with £1m-plus tracker mortgages are spending thousands of pounds over the odds on interest payments as a result of a quirk in the way some high-end home loans are structured.

Most trackers are set at a fixed margin above the Bank of England base rate, which fell last month to a record low of 0.1 per cent. However, some larger mortgage loans — typically offered by investment banks and some specialist lenders — are instead linked to the three-month London interbank offered rate (Libor), which is about 0.65 per cent.

The unusually large gap of around 0.55 percentage points that has opened up between the two rates means those with large loans pegged to the Libor rate are likely to be paying significantly more than those with base rate-linked trackers.

Nigel Bedford, senior partner at mortgage broker Largemortgageloans.com, gave the example of two borrowers each with a £5m mortgage, paying a similar margin on trackers tied respectively to the base rate and three-month Libor. A borrower on the latter would pay an extra £2,292 a month in interest.

"If you talk in absolutes the difference is half a per cent, which isn't that big if base rate were at 4 or 5 per cent, as it was in previous years. But when it's so low, it's a massive difference," he said.

The distinction is seldom apparent in the marketing of mortgage deals, which typically promote the tracker rate without specifying whether it is tied to base rate or Libor.

But a base rate-linked tracker with, for example, a margin of 2.25 per cent (a total of 2.35 per cent currently) would be cheaper than another charging 1.9 per cent over three-month Libor — or 2.55 per cent in total.

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"When we get indicative terms from these banks they just quote their margin. They don't say 1.5 per cent above base or Libor," Mr Bedford said. "It can be quite misleading. A broker will know to ask, but a client may not."

The Bank of England base rate was cut to 0.1 per cent on March 19, just a week after it had been reduced from 0.75 per cent to 0.25 per cent. As parts of the economy have been brought to a standstill by the coronavirus crisis, the record low rate is designed primarily to give relief to businesses struggling to stay afloat. As a side effect, though, it may help mortgage borrowers with their monthly payments and those looking to remortgage.

"For the moment and probably for the next year I suspect there's going to be some big savings to be had from base rate lenders as opposed to Libor lenders," Mr Bedford said.

Most private banks, such as Hoare & Co, Coutts, Barclays Private and Investec, use the Bank of England base rate for their tracker mortgages. Libor is more commonly used in the tracker mortgages offered by investment banks, such as Credit Suisse, JPMorgan, Royal Bank of Canada, Citi and Deutsche Bank.

In previous years, the difference between base rate and three-month Libor has been bigger in absolute terms than now, but the proportionate difference — with Libor currently more than six times base rate — is at a decade-long peak. The last time the gap reached 0.55 percentage points was when the Bank of England cut its base rate from 0.5 to 0.25 per cent in August 2016.

The current discrepancy is not expected to last for the long term, as regulators have asked lenders to move away from using Libor — a rate discredited by the fixing scandal that emerged in 2012 — to set rates and other functions. Most are expected to switch their trackers to follow base rate by 2021, the deadline set by regulators for them to relinquish Libor.