Interest and interest rates explained

1. What are they?

Think of interest as being the cost of borrowing money.

The RATE of interest is the size of that cost. The higher the rate, more it costs. Lenders charge different rates.

- Lenders charge different rates.
- Interest can also be applied to your savings.

2. Who decides the interest rates?

The Bank of England sets the Base Rates (reviewed on a regular basis).

- This affects the interest rates set by the lenders. If the Base Rates go up, it’s likely that lenders will charge more and vice versa.

Why is this important?

- \( \% \) \( \rightarrow \) £
- The higher the interest rate the higher the interest paid.

3. How interest rates affect you mortgage?

When you borrow money for a home, you are also charged interest. The rate of interest will affect how much money you pay back overall and each month.

- Capital = The money you have borrowed for the mortgage
- Interest = The cost of borrowing the capital
- Interest rate = The size of the interest cost. This can go up or down

Different lenders charge different rates depending on the amount you borrow

There are two main types of mortgages...

<table>
<thead>
<tr>
<th>1. Repayment mortgage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly payments:</td>
</tr>
<tr>
<td>£ Interest + £ Capital instalment</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2. Interest only mortgage</th>
</tr>
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<tbody>
<tr>
<td>Monthly payments:</td>
</tr>
<tr>
<td>£ Interest</td>
</tr>
<tr>
<td>Full capital is paid at the end of your mortgage term</td>
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</tbody>
</table>
1. Repayment mortgage - monthly payment

- Capital (£252)
- Interest (£625)
- £877 per month

At the end of your mortgage term you don’t have to pay anything.

2. Interest only mortgage - monthly payment

- Capital (£0) paid off at end of term
- Interest (£625)
- £625 per month

At the end of your mortgage term you still have £150,000 (capital) to pay.

4. What types of rates are out there?

Whatever your mortgage option is, you can then choose between...

**Fixed rate**

Your payments stay the same. You pay off the interest at a fixed amount every month for a set period of time.

**Variable rate**

Your payments will go up or down, as the interest rate changes. There are various options such as tracking against the base rate.

5. Things to keep in mind

**Loan to Value (LTV) explained**

The amount you are borrowing in relation to the value of the property. When you buy a property, you put down a deposit. Having a higher deposit means you’ll borrow less of the capital.

If you borrow less, lenders may give you a better (lower) interest rate.

**Example**

<table>
<thead>
<tr>
<th>LTV: 85%</th>
<th>LTV: 70%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage: £150,000</td>
<td>Mortgage: £120,750</td>
</tr>
<tr>
<td>Property value: £172,500</td>
<td>Deposit: 30% (£51,750)</td>
</tr>
<tr>
<td>Deposit: 15% (£22,500)</td>
<td>Interest rate: 5%</td>
</tr>
<tr>
<td>Lower rate: 3.5%</td>
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</tbody>
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