Interest and interest rates explained

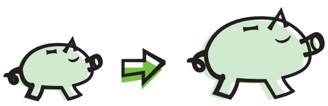
1. What are they?

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.

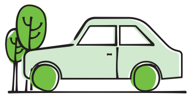
Interest can also be applied to your savings.



Interest is applied to different types of loan. This means you pay back more than you borrowed - the **loan plus the interest.**

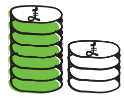
Mortgages

Credit cards



Car loans

Hire-purchases



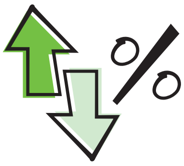
Personal loans

2. Who decides the interest rates?

a

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

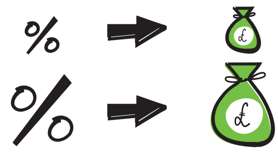
b



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.

c

Why is this important?



The higher the interest rate the higher the interest paid.

3. How do interest rates affect your 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 that cost. Rates can go up as well as down

Different lenders charge different rates depending on the amount you borrow

There are two main types of mortgages...

1. Repayment mortgage

Monthly payments: Interest + Capital instalment

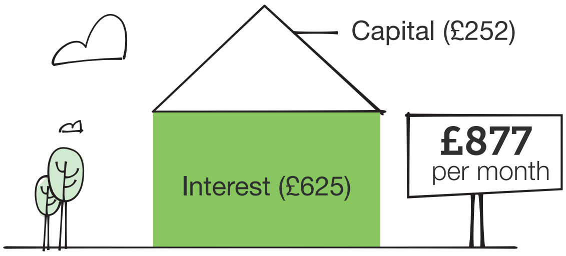
2. Interest only mortgage

Monthly payments: Interest

Full capital is paid at the end of your mortgage term

Example scenario › **Mortgage:** £150,000 | **Interest rate:** 5% | **Term:** 25 years

1. Repayment mortgage - monthly payment	2. Interest only mortgage - monthly payment
Capital (£252) Interest (£625) **£877** per month	Capital (£0) paid off at end of term Interest (£625) **£625** per month
At the end of your mortgage term you don't have to pay anything.	At the end of your mortgage term **you still have £150,000 (capital) to pay.**



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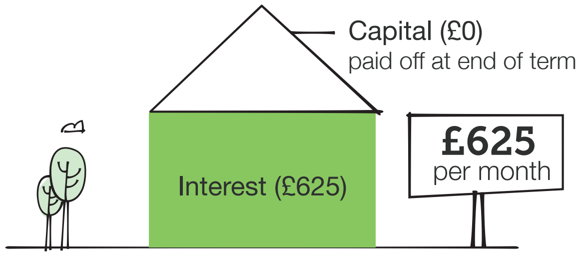


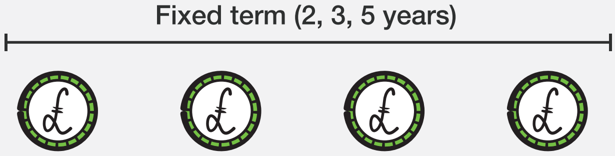
4. What types of rates are out there?

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

Fixed rate

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

Fixed term (2, 3, 5 years)

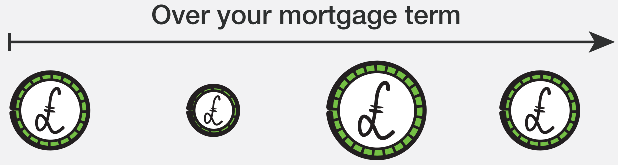


Fixed monthly payments

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.

Over your mortgage term



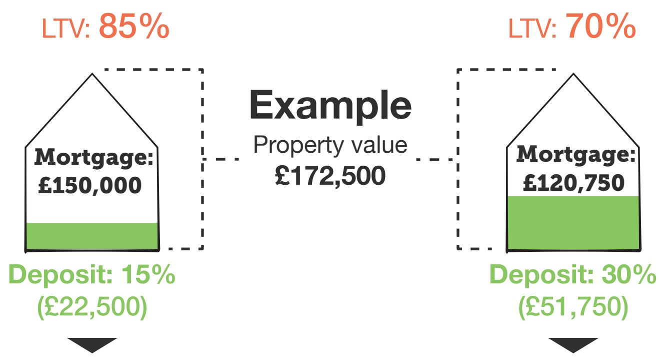
Varied monthly payments

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.

Interest rate: **5%**

Lower rate: **3.5%**

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