Methods of Repaying a mortgage

1) Capital Repayment Mortgage:

Capital repayment or annuity mortgage used to be the traditional way of repaying a loan but they now account for less than one in every five new mortgages. They are available from all building societies, most banks, some centralised or wholesale lenders and partially none of the insurance companies.

Monthly repayments are made up of the interest you pay on the outstanding loan and repayment of the repayment of the loan itself. In the early years most of the repayments consist of interest but as the years go by you pay off more aid more of the capital. Throughout the period of the loan, the capital part of your repayment will increase while interest decrease. Provided the interest rate does not change the period of the loan. In practice this does not happen as interest rates go up and down, but as the years go by the real cost of the repayments will be eroded by inflation.

Advantages of capital repayment mortgage.

- Under this repayment system, when you move house, the mortgage is paid off with the proceeds of the old property and a new mortgage is taken out on the new property. This means that if you move every five years the debts will no significantly decrease through that time because the five year will be spent primarily paying off interest rather than capital.
- It is easier to change the period over which you pay repay loan. If you do not get into which you repay your loan. If you do get into financial difficulties extending the period can make substantial savings in your monthly payments.
- If you come into a lump sum of money that can be use to pay off all or part of the debt outstanding. It is relatively easy to arrange this a capital repayment mortgage.

Disadvantages of capital repayment mortgage

- A disadvantage of this method of repaying mortgage is that, it does not automatically provide your partner or family with protection should you drop dead before paying off the loan.

- The cost of a policy varies enormously. It depends upon, age, sex, whether you smoke, how many people it covers, the amount of your loan and the mortgage term.
- It is suitable for people who do not like to take risks and who one to ten scales, would place themselves around one to three.

Endowment-Linked Repayment mortgage

With an endowment mortgage, two separate payments are made each month; first, and this is the bulk of the repayment, is the money, which goes to the lender towards repaying the interest. The second amount goes into an investment administered by life assurance Company, and also acts as the premium for a life assurance policy.

Monthly payments are made to an insurance company in respect of an endowment policy. At the end of twenty to twenty five years the endowment policy should mature, generating sufficient funds to repay the capital sum outstanding. It is possible that the policy generates funds over and above the capital sum will go to the customer. It should Also be noted the policy may generate than the capital sum outstanding in than the capital sum outstanding in which case the borrower remains liable for short fall. For this reason, the method of repaying mortgage is not very popular today.

Advantages of Endowment –Linked repayment Mortgage

- If you are likely to move house every five years, when the flat is told the same policy can be use for the next endowment mortgage. If a larger loan is needed for the next flat an additional policy is taken out so endowment mortgage give you more flexibility to move more easily.
- If the invest performs well you could end up paying off the capital and have tax-free lump sum left over.

- In practice, the amount of life cover under a low –cost endowment policy start at les than the amount of the loan and generally during the term.

Disadvantages of Endowment Repayment mortgage

- Most of the costs depend upon the value of your property so the advantage of adding to an existing mortgage is minimal. You will save a small amount on your legal fees.
- There is less flexibility if you encounter difficulties with paying them. Most policies do not allow you to stop paying the premium and it is a good deal more difficult to extend the period of the mortgage –which only reduces the cost of the smallest portion of your payments and way, because the interest payment to your lender will remain the same.

Pension Linked Repayment mortgage

In this method of repaying mortgage, payments to the lender is towards interest only and monthly contribution to a pension plan which is designed to repay the mortgage when you retire and to provide you with a regular pension. Many lenders now offer a pension mortgage.

Like the endowment repayment mortgage the capital sum outstanding is not reduce. Upon attaining the age of retirement up to £150,000 can be taken out of the pension fund to repay the capital sum outstanding.

Contributions to pension company are taken out of the individual taxable income thereby ensuring that he pays less tax. Investments in the pension fund are also allowed to grow tax-free. Because of this tax incentive, this is an attractive method of repaying mortgage. However, the payment into the pension fund should commence when the individual is at relatively young age so that sufficient funds are building up to repay the capital sum outstanding and to repay the individual monthly after his retirement.

Advantages of pension Linked Repayment mortgage

- Your payments into the pension plan qualify for tax relief at your top rate. No other of mortgage has this advantage.
- If you need life cover, you can use a term insurance policy linked to the pension plan, which means you get tax relief at the top rate on your premiums.
- Your investments in the pension plan up tax-free.
- The lump sum used to pay off the mortgage is tax-free.

Disadvantage of Pension Linked Repayment

-If you become no longer eligible for the pension plan- because you decide to join a pension scheme at work, for example, or because you become unemployed – you will have to find some other method of building up the sum needed to pay off your mortgage

- Using a pension plan in this way reduces your scope for building up retirement income. Trying to use one financial tool to meet two targets inevitably cause a conflict.