Guide to repayment types

Below we show the different ways you can choose to repay your mortgage and how they compare to one another. Whichever repayment type you choose, you will be paying interest on the money that you have borrowed. Lenders can offer many different interest rate schemes which we will also explain in this guide.

Capital and Interest mortgage:

This is the most common way to repay a mortgage and is sometimes known as a repayment mortgage. A repayment mortgage monthly payment is made up of an element of capital and an element of interest. Capital is the amount that you borrow, and interest is the lender's charge on the amount that you have borrowed. Having a repayment mortgage means that each month the total amount that you borrowed is being reduced. The amount of monthly interest paid is higher in the early part of the borrowing period or term, than it would be later. However, the repayment figure, calculated at the start of the mortgage, is the figure you must pay each month to repay your mortgage, in full, by the end of the term. If the rate changes – either up or down – your monthly payment will be re-worked by your lender, to calculate what you will need to pay monthly at the new rate, in order to repay your mortgage by the end of the original term.

Interest Only mortgage:

With an interest only mortgage, every month you pay just the interest of the amount you originally borrowed. The capital stays the same throughout the life of the mortgage and then when the term comes to an end you will need to repay the capital in full. At the time of application, a mortgage lender will need to know how you are planning to repay the capital at the end of the term, this is called the repayment method or repayment vehicle. Some examples of common repayment methods are:

- Sale and downsize of residential property
- Sale of a second property
- Endowment
- Tax free lump sum from pension
- ISA/Stock Market investments

If you have an interest-only mortgage it's important to know you will be able to repay the capital at the end of the term. Many lenders will check on this throughout the term of the mortgage. If at any time you think you will be unable to pay the capital back, you need to take action straight away because the longer you leave it, the fewer options you will have.

Part and Part mortgage:

This is a much less common way to repay your mortgage. Part and part repayment means some of your mortgage balance is on capital and interest, and some is on Interest Only. So you will be reducing the balance throughout the term of the mortgage but you will also still have a lump sum to pay at term end and therefore will also need a repayment vehicle.

Mortgage Interest Rate Types:

Fixed Rate: The interest rate will be fixed for a given period, typically between 1 and 5 years, although some lenders do offer a lifetime fixed rate. A fixed interest rate means that your monthly mortgage payment will remain the same throughout the term of the rate. If interest rates rise during the time your current rate is fixed, this gives you the security that your monthly payment will not go up. But on the other hand, if interest rates go down, then you will not benefit.

Variable Rate: The lender reserves the right to adjust the rate so it could go up or down at any time and is not fixed. Commonly, interest rates on variable mortgages change when the Bank of England base rate changes, but there doesn't need to be a change in market rate for this to happen.

Tracker Rate: A rate that directly tracks a base rate, for example the Bank of England base rate. When the base rate changes, your interest rate will do so too.

Discount Variable Rate: A discount variable mortgage has a rate which is set a certain percentage lower than the lenders standard variable rate. Similar to a tracker rate, this type of rate tracks the lenders SVR at a discounted rate.

Standard Variable Rate (SVR): Mortgage lenders have their own standard variable rate which they may or may not adjust when the Bank of England base rate rises or falls. The standard variable rate is often the rate in which you will revert to after a certain fixed or discount period has ended.

Offset Mortgages: This is where you have both a mortgage and savings with the same lender and your savings balance is used to reduce the amount of interest you are charged on the mortgage. Offset mortgages are fairly unusual now in the UK but lenders do still offer this option.

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