

Discount versus tracker

Discounted rates are primarily of use to borrowers who are looking to take advantage of a lower initial rate which fits their current circumstances.

For example, first-time buyers looking to get on the property ladder who have other related costs, e.g. furnishing their new property, or applicants who anticipate an increase in wages in the coming years, e.g. professionals who need a lower initial interest rate. Usually these incentives are quite large to capture low 'headline rates'. However it could be argued that the disadvantage to discounted products is that they are not good for budgeting purposes, because payments can often increase dramatically during and after the discounted period ends. In addition to this, some discounts carry extended early

repayment charges after the initial discount period, thus leaving the customer tied in after their discount period has ended and paying a potentially much higher rate.

Trackers may benefit those customers who would be more likely to monitor the Bank of England (BoE) Base Rate as lenders will either track above or below the Base Rate, depending on how they want to sell their product. At the moment trackers are considered to be a good deal because Base Rate is low (currently 4.5 per cent) and is predicted to maintain at this level for the coming months. However, as soon as the Base Rate increases, this will alter monthly payments, which might not be so good for first-time buyers' budgeting. Historically, the BoE Base Rate was controlled by the

government of the day. Today it is set by the BoE's Monetary Policy Committee (MPC), and appears to have settled into greater stability.

Ultimately both discounts and trackers can be set against either Bank Base Rate or a lenders standard variable rate (SVR). A front-loaded heavily discounted rate may have immediate attraction but undoubtedly will carry redemption charges or a large arrangement fee. Both discounts and trackers have to rely very much on what the underlying rates are doing. In simplistic terms they can be viewed as one and the same thing, because they often both have an initial attractive period that will revert to a higher rate at some point. Trackers undoubtedly undercut lenders variable rates – depending on the rate that the lender

chooses to pursue, what the margins on the product are and how long they want the product in the market for.

Both discounts and trackers can be set against Bank Base Rate, lender SVR, or LIBOR (London Interbank Offered Rate).

The UK mortgage market has developed considerably over the last few years, and client's attitude toward risk will have a considerable impact on the option they choose, whether that be discounted or tracker rates. They always need advice on the cost impact of a rise in interest rates and this is usually calculated assuming a 1 per cent increase. This is often entitled 'payment shock'.



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