Fixed vs Variable rates

It's safe to say that there is a fair amount of confusion currently surrounding the mortgage market. Rates have been on the rise as inflation soars, but what does this mean for you? Perhaps you're looking to secure your first mortgage or looking to renew? Either way, it's certainly a confusing time and it can be so difficult to know what type of mortgage best suits your situation. Do you go with a fixed rate mortgage to avoid further rises or a variable rate in the hope that mortgage rates fall again? We've outlined the pros and cons to help you make the best decision.

Fixed rate mortgages

Fixed rate mortgages do exactly what the name suggests. The interest rate on a fixed rate mortgage remains the same throughout the fixed term of your mortgage product – usually between two and five years. With a fixed interest rate, your monthly payments will remain the same for the duration of your product term. Once the product expires, you'll automatically revert to the lender's standard variable rate (SVR).

The biggest positive of a fixed rate mortgage is of course your payment remaining the same. This means that it is much easier for you to budget on a monthly basis as you will always know exactly how much money you'll be paying every month. If you were to take out a fixed rate mortgage today, you would lock in your monthly payments based on today's rates and would not pay any more even if rates rise within your fixed-rate product term – protecting you against your mortgage becoming unaffordable.

The downsides come into consideration when interest rates start to fall. You would then potentially be paying more than the standard variable rate until your product term expires. On top of this, fixed rate mortgages are also less flexible, involving Early Repayment Charges (ERC) during the fixed product term.

Variable rate mortgage

A variable rate mortgage is the exact opposite of a fixed rate. Both the interest rate and monthly payments are dependent on current mortgage rates and can fluctuate at any point throughout the term of your mortgage. The two different types of variable rate mortgages are SVRs (Standard Variable Rate) that is fixed by your lender and a tracker rate that follows the movements of the Bank of England's Base Rate – although the tracker rate will usually be higher than the base rate (e.g., base rate plus 2%).

The main advantage of a variable rate mortgage is felt when rates go down as you could end up paying less as a monthly repayment than you did at the start of your term, (however it could also be more if rates go up). You'll also be able to get a lower rate on a variable rate mortgage than on a fixed as you're taking the risk that rates could increase throughout your term. For those whom flexibility is key, a variable rate or tracker rate mortgage would be preferable than being locked into a product with Early Repayment Charges (ERC) should your circumstances change, and you need to exit your fixed rate mortgage product early.

There is no right answer to this question. It is entirely down to personal preference and your own financial situation. Given the current volatility in the market, it's so important to get in touch with your adviser to discuss your options.

If you'd like to discuss the options available to you, contact your adviser today.

Published November 2022