Client factsheet
Lifetime mortgage early repayment charges
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Lifetime mortgages are designed to be repaid when your home is sold, or when you go into long-term care or pass away (or second event for joint applicants). The early repayment charge is calculated to recover costs that funding providers incur when setting up the lifetime mortgage, in transaction costs incurred in reinvesting the money, or due to changes in long term interest rates. For this reason, lifetime mortgages have early repayment charges, as the provider will want to ensure that they recoup any losses as they had planned to give you the capital until at least an average mortality age.

One of the questions your adviser will ask you when gathering information is whether there is any intention or possibility of repaying your lifetime mortgage early. This is because if there is a likelihood of incurring a charge if you do so, it is important to know your long-term plans so that an appropriate solution can be recommended.

You should be aware that under certain circumstances, you may repay your lifetime mortgage without incurring these charges. These include:

1. If you wish to move home and want to transfer your lifetime mortgage to the new property, you can do so if the new property meets the provider's lending conditions at the time. If the new property is of a lower value, the lender may ask you to repay part of the amount outstanding on the mortgage (however there would be no early repayment charges on the amount that has to be repaid). If you wish to move home and your new property does not meet the provider's lending conditions at the time, you may have to repay the lifetime mortgage in full and you may incur early repayment charges.
2. During a compassionate window, on death or entry into long-term care of the first applicant within a joint application, depending on the provider. Please note that this is an optional feature that may not be included with your lifetime mortgage.
3. If you wish to make a voluntary partial repayment (subject to lender criteria around amounts)
4. And, of course, no early repayment charges are payable when the loan is repaid from the sale proceeds on death or after moving into long-term care (for second applicants if a joint mortgage)

Types of early repayment charges (ERCs)

There are two types of early repayment charge – fixed and variable.

Fixed

Fixed early repayment charges work exactly as you would think. If you repay the lifetime mortgage early, you will be charged a fixed amount which is pre-defined when you setup the lifetime mortgage. Some lenders may charge a fixed percentage of the outstanding balance (including accrued interest) and others may charge a fixed percentage of the initial amount that you release. These fixed percentages usually reduce the longer you have the lifetime mortgage for, for example a penalty of

10% in year one, 9% in year 2, 8% in year three all the way down to 1% in year 10, or perhaps 5% in the first five years, and 3% in years six to ten. Each lender has their own variations of this sliding scale, but you will always know the fixed penalty up front. Your adviser will explain these to you on making a recommendation and will give you precise figures based on your borrowing.

Variable

Variable early repayment charges are usually related to the performance of Government Index Linked Treasury Stocks (GILTS). At the outset, the funder will select a benchmark stock and you will be advised which one this is. A GILT is effectively a “loan” to the Government, which offers a fixed return for a number of years. GILTS are a way in which the Government raises money.

Funders invest in GILTS as part of their costing structures. They know that at the end of the GILT term they will get their investment back along with the interest being paid to them meanwhile. But if you, the client, choose to repay the mortgage early, the funder may fail to get the return they need if they cannot reinvest in a GILT which has the same or higher rate of return.

So, early repayment charges are built into the plan. You are effectively compensating the funder for a possible loss if GILT yields fall during the period from when you start your mortgage to the date at which you repay it. Most lenders have a maximum variable early repayment charge of 25% of the initial loan. Providers differ in how these charges are structured and your adviser will go through these terms before you make an application.

However, this only applies if the GILT yield falls. If the GILT yield rises, the funder would be able to reinvest to obtain a better return than originally planned for. This means they are not out of pocket if you repay. In this situation they would not need you to compensate them, as no loss has been incurred – and no early repayment charge would be payable.

As a rough guide (with a few subtle differences), if the GILT yield decreases, you may incur an early repayment charge for redeeming your mortgage. If the GILT yield increases, you will not incur this charge.

Your adviser will provide you with full information about early repayment charges. But remember that these only come into play on the relatively rare occasions when the loan is repaid outside of the original agreement.