'A Market Full of Mixed Messages' - July 2014

Dear Reader,

It was not so long ago that I wrote a piece titled ‘aligned forces’. It would appear that, at present, we are experiencing the very opposite to this reaction.

It was only recently that our Government was creating stimulus for the property economy to create growth. Now all the focus is on defusing growth as there are fears that the market is overheating - ‘oh the need for foresight’!

The Mortgage Market Review (MMR) that came in to effect at the end of April has indeed impacted the market, as we predicted; where the retail lending sector has been restricted even further, advancing lender caution and therefore reducing activity - activity being the lifeblood of any growing economy.

‘How does this affect me?’ I hear you say.

This has an indirect effect on our business and therefore our clients, as even with unregulated business the lender begins to adopt a similar approach. It all boils down to their interpretation of the regulation, the uncertainty of approach of the bankers in question and the time they need to adjust to the regulatory changes. This may well take a year to shake down but our clients don’t have that time to waste - interest rates are on the rise.

As reported by Mr Carney last week, there are further changes being applied to tighten mortgage regulation. These changes will certainly affect the HNW sector. Restrictions will be imposed on the maximum available borrowing, by applying a cap on income multiples to determine affordability. Many HNW's will have an income subject to performance, in various guises. Typically a lender will only take a percentage of this revenue into consideration, when applying a multiple, assuming that the borrower can show historical analysis of the income sources.

By applying a blanket restriction on income multiples, it removes a lenders ability to show discretion and that has the potential of striking at the heart of what is a very important sector within our economy - one which creates considerable tax revenue.

Is this a prudent move Mr Carney?

Hot on the heels of these proposed restrictions comes the question that still burns on everyone's lips - when will we see an upward interest rate adjustment? We are not here to determine exactly when and by how much but it is obvious that an increase is imminent. That being said, when it does happen, the repercussions will be felt by a large majority of existing and potential clients of ours and so we should cast an eye on whether they should look at fixing, buying forward or staying variable.

There are those borrowers who will look to maximise on their short term position and hold firm before the base rate moves but this isn't always a recipe for success; as we know that the fixed rate deals would have risen sharply before any of us mere mortals would be wise to the increase. Locking into anything short of a five year deal might well be a hindrance rather than a bonus and so, as we've been proposing for a while, we would advise our clients to look at securing the future and, in so doing, buying forward.

This would mean looking at interest rate swaps (IRS) which are a popular and highly liquid financial derivative instrument in which two parties agree to exchange interest rates, based on a specified amount today and a predetermined future date. They are commonly used for both hedging and speculating and as it stands, at the time of writing, 2 year swap rates are at 135 basis points (bps) and 5 year swaps at 222 bps, which have already increased dramatically from their previous March 2013 low of 69 bps and 135 bps respectively.

Following the latest scandals over the miss-sale of swaps, the public are naturally shy of using such hedging instruments but they do have their place in the market. If it wasn't for the hidden commissions charged in the past, many more people would look at these as a viable option; after all they've been used in commercial lending markets since 1981 and give the borrower protection against any unforeseen rise in the interest rate.

Our clients can afford staying on a variable rate for now but in two years time when they might want to fix, the rates will be significantly higher, so they might want to look at protecting themselves. We must caveat however that gambling on the timing and the level of increase suits some people but there are risks, especially if mortgage rates do not rise by the same amount, due to increased competition in the market place.

With all the talk of a real estate bubble in London, we need to be mindful of our clients and their existing deals. Safety of knowledge for the future is key to their continued success.

Best Regards,

Wayne Coleman