

Mortgage
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Once bitten, twice shy



Julien Holmes charts the impact of the recent turbulence in the credit market

The last few weeks have been eventful, both for the credit markets and the mortgage industry. The re-pricing of risk across the board had resulted in many lenders, including established names such as db mortgages, GMAC-RFC and Northern Rock, either withdrawing or amending their product ranges.

The impact of defaulting US borrowers and stagnating house prices has been widespread. Markets have taken fright and there is currently a backlog of circa USD 500 billion of financial deals as bankers wait for market turbulence to die down.

THE IMPACT OF DEFAULTING US BORROWERS AND STAGNATING HOUSE PRICES HAS BEEN WIDESPREAD

The impact on the UK mortgage market has caught many by surprise. Although the US borrower has been showing signs of trouble for some months, many believed that, because of the market differences, such as tighter underwriting criteria and different product design, the UK mortgage market would be sheltered.

So why is this wider market turbulence impacting the UK mortgage market and how much more of an impact is it likely to have on the broker?

A far cry

For many, the world of credit markets and securitisation is a far cry from the home owner looking for a mortgage. But the two are increasingly intertwined, particularly in the non-conforming sector. Securitisation of all assets, from mortgages to credit card debt and commercial loans, such as those for machinery and plants, has grown exponentially in the UK over the last few years; from USD 86 billion to USD 241 billion in 2006. Some 80 per cent of this is mortgage securitisation, or mortgage backed securities (MBS).

The proportion of UK mortgages funded through securitisation is still relatively small, however, the proportion of non-conforming mortgages funded through securitisation is much larger with the non-conforming market now accounting for some 10 per cent of the market.

For the non-conforming borrower, the recent market turbu-

lence and repricing of risk has resulted in two potential outcomes. The withdrawing of products from the market has made it harder to find a suitable product and, secondly, the repricing of risk means that investors who are prepared to lend money to the non-conforming market are only prepared to do so at a higher rate of interest than previously, for some up to 2.5 per cent higher than before. While this may not seem much, for the borrower this can represent a rise in repayments of up to around 40 per cent.

Brokers are also faced with the data protection issues that need addressing; lenders are prevented from informing brokers that their clients are defaulting and that they might well benefit from the broker's advice.

Therefore the re-pricing of credit risk across the markets is likely to impact many non-conforming borrowers more than a rise in the Bank Rate. Those that are highly leveraged are unlikely to be able to absorb such a hike in their monthly outgoings. Indeed, the research by Moore Blatch published earlier this year highlighted borrowers with a high loan-to-value as the most likely to be repossessed. This is supported by the Financial Services Authority's (FSA) comments back in May, where it claimed that non-conforming borrowers were 20 times more likely to fall into arrears than a prime borrower.

Charging order rise

A further cause for concern is the rise in charging orders, that is the tying of an unsecured loan to an asset such as property. These

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have risen sevenfold from 9,207 in 2000 to 66,473 in 2006. Furthermore, the second charge market has grown similarly and currently exceeds £35 billion per year, according to Datamonitor. Concerns regarding excessive lending other than mortgages were also identified by Moore Blatch as the primary cause for people falling into arrears.

Many brokers may now struggle to remortgage a client out of trouble and this, coupled with the FSA's increasing focus on affordability, means brokers must consider all aspects of their client's finances before advising on a mortgage. For some, a debt management plan or Individual Voluntary Arrangement may well be the best way forward, and this need has prompted the rise of specialist companies.

For lenders too, the landscape has changed. Those looking to securitise will face a much greater level of scrutiny from both potential investors and the rating agencies which have been so criticised in the last few weeks. The more information they are able to provide on the portfolio, the more favourably they will be considered by investors.

Those who believe that this is merely a blip and that we shall return to the 'normality' of the last couple of years are misguided. Even when markets stabilise, the era of cheap credit will not return. Investors have had their fingers burnt and they will be much more cautious in future. **mi**

Julien Holmes is managing director of Crown Mortgage Management