PRESS CUTTING

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Mortgage Market

Property Risk – Part 1

Jamie Stewart

Jamie Stewart, a law graduate, has worked in investment banking since 1986, before which he held academic positions in the UK and abroad. Today, Jamie is Head of Institutional Marketing and Research at Eden Financial. His research interests focus on fundamental analysis within the broad field of global equities. He is a director of two companies and on the advisory boards of others. In the past, Jamie has held directorships at Baring Securities, Morgan Grenfell International and Inverlat

Abstract

Although exposure to property is a household concept in the UK, with minimal risk beyond the self-evident downsides of adverse property market and interest rates, this is far from the case as regards portfolio exposure to property. In the first part of this article, the writer seeks to explore the spectrum of property interests and characteristics from private and personal to institutional and portfolio commitment, reflecting the differing characteristics of residential, commercial and industrial tiers of property.

The basis of the analysis emphasizes the essential supply-demand forces governing property market activity, but recent developments and less evident pitfalls in the market place are also exposed and explored.

'We are here,' as preachers proclaim from their pulpits, 'not to re-phrase after-dinner-party boasting about 'I-bought-my property-for-x-and-it's-gone-up-y-times-in-z-nanoseconds-aren't-I-brilliant-and-by-the-way-will-there-be-a-property-crash-soon ...?'. Our mission is rather to make as though we live in a tent, have a disinterested (but certainly not uninterested) stance, and look coolly, reflectively, analytically at specific risks generated by UK property – 'Real Estate', as our US cousins are rapidly leading us to have it (we haven't widely adopted 'Realty' yet – but it'll come soon; mark my sermon ...) – in the sphere of responsibility of those who commit to it in one form or another in their professional capacities.

The difficulty in narrowing down the focus to a laser-beam pin-prick lies in avoiding distraction by myriad factors which are relevant but not core contributors to the cause. The importance is to acknowledge the factors that help establish the context against which risk inevitably crystallises, yet without being led miles astray by exciting visions of palm-tree-shaped artificial island sites off Dubai, or buy-to-let palaces in Mustique ... all stuff of smoke-and-mirrors, for these purposes.

It's easy to overlook the essential truism that property, regardless as to whether one inhabits, trades, insures, lets, rents, builds, converts, refurbishes, securitises or collateralises it, is a commodity – almost a base commodity – with pricing structure driven – you've guessed it – by supply and demand. It's not quite like copper or hog's

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bellies: not only can one scarcely deliver spot-apartment-blocks in a truck, but it is necessary to juggle numerous property pricing parameters between area, capacity, site, age, materials, development potential and ground-plot, whereas a hog's belly is a hog's belly is a hog's belly.

Yes, of course one can research property values on websites, in brokers' analyses and in estate agents' glossy literature, but even there confusion abounds – 'residential' is applied ambiguously and arbitrarily between primary residence and buy-to-let; 'commercial' between buy-to-let, business and, of course, industrial premises; 'value' merges arbitrarily with price, price with payment, and 'yield' with dramatically varying versions of itself.

There are two mainmasts in terms of quality of the UK property market and its segment-structure – one being the integrity and efficiency of the lands registration and conveyancing structures, and the other being the essential liquidity of the market overall. Of course there are critics of each iconic feature of the market, but compare the UK version with numerous overseas equivalent property markets and it quickly becomes clear why it is every prosperous foreigner's goal to own a house and more besides in the UK.

The factors which are currently supportive of property price stability and increases – at the cost of resembling take-away menu listings the while – are these:

UK Physical Geography: 'There's not much of it, and they're not making much more' – a witticism (genuinely and wistfully uttered by a US speculator looking at opportunities over here) which could be enhanced by referring further to the extraordinary rate of erosion of our coastline and expansion of areas vulnerable to flooding. Whoever said that climate change, global warming and The Kyoto Protocol were unimportant?

Affluence profiles: 80 years ago, every Englishman finally owned his own bed; 50 years ago, a watch; 30 years ago, a radio; today, a house ...

Immigration: legal, illegal, asylum-seeking – call it what you will: hotels, hostels and cramped accommodation today, but a house per polyphiloprogenitive family ten years on.

Second homes, holiday homes, Granny flats, Nanny flats: wanton but welcome pluralism.

First-time buyers: A phenomenon to fire the politicians' limited imaginations and the journalists' headlines, but a relevant one. There's always a bottom rung to every ladder which a younger, shorter or poorer climber won't reach easily, but the UK average price to average earnings ratio turns their frustration in to an admirable price-support system. (Is this 'unfair'? Not really: everyone craves but can't yet afford the first motorbike, Caribbean holiday, gigolo, Ferrari – so why not the same for that house, as well?)

Buy-to-Let(-Mania): Yes, but a deceptive supporter. More below, as it slides towards price-risk-factor than support-factor. Apart from the more familiar vulnerabilities of amateur letting, this activity has become a must-have fashion, a designer logo equivalent, rather than staying in the domain of the professional portfolio landlords, as was originally the tendency (not that we should want an encore from Rachmann, of course). The underlying financial picture, to the eyes and calculator of a meticulous private-client accountant, is invariably rather ropey.

Mortgage lending: Yes, but this cuts both ways, too. Industry pressures, competition and targets breed short-cuts and optical illusions: lax criteria, self-certification, higher LTV factors, lower salary multiples, remortgaging, equity release and specialised products drive one to mutter, 'short-term supporter; longer-term traitor'.

Reversion of Freehold 'products': Theoretically supportive of the house-per-head-for-life statistics. However, (a) the quicker the FSA grips it as an alternative form of mortgage, the better: scamsters abound, and where there's scams, there's eventually pricing disease; and (b) marry the house-per-head and house-for-life lures to low population growth, and you see the spectre of most property which falls in to estates of the deceased recycling as even more spares in to unsold housing inventory. What the Chancellor gains from IHT he loses to slower and lower stamp-duty, which he therefore regrettably has to raise…..what goes around, comes around, they say.

REITS (Real Estate Investment Trusts): Well on the way now (2007); hard to predict how they will impact, but at least measured and longer-term support for demand/prices is likely.

The factors overshadowing price reliability, if not presenting outright threats, are these:

Equity Contraction / Excessive Leverage: Call it what you will, but it is worrying that accurate statistics cannot be set up to demonstrate the decline of actual 'owner's share of the freehold' against the increase of the notional lender's share. Economists, systems and the Council of Mortgage Lenders (CML) are gradually recognising the vital value of establishing and publishing rates of contraction. Current patterns suggest that a wave of 'trading down' (perversely, given recent trends) and, worse, stagnation in the shadow of negative equity looms.

Equity Release: A turncoat from the supporters' side. Funds from

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remortgaging and further advances used to go virtuously in to attic conversions, kitchen extensions and a new garage: now they go as often as not to the Seychelles, Bond Street, clubbing and overdosed credit cards. Sinister and subversive shift: beware all.

Demographic trends: What else? – fewer babies per head to compensate for deaths, so the net underlying number of people to house is growing ever more slowly – scarcely at all, in fact. Thank goodness for those immigrants.

Support factors, q.v.: A number of these are maturing and losing impetus.

B2L: Buy-to-Let (see above for an initial salvo) has been getting an increasingly bad press lately. There are too many factors in play to address this segment in any less than a full-blown doctorate. Suffice it to say that dubious yields and net returns are amongst other factors starting to affect values. The Property Clubs saga in the making as well as the endless newbuild flats themselves, constructed to sell off the drawing-board to feed the frenzy (not to mention the compounding effects of the A-Day SIPP bonanza-as-was-to-have-been), begin to look distinctly worrying.

To be continued ...

In the second part of this article, the author will look at affordable housing, re-zoning, SIPP 'A'-day reversal effects, taxation proposals, mortgage procedures, fraud and incompetence, first-time buying and buy-to-let are examined, alongside an assessment of the influences, both benign and pernicious, exerted by each in the market place, together with their attendant risks.