



Perfectly at home with foreign currency loans

Elizabeth Colman says that the strength of the pound presents an opportunity to use exchange rates to reduce your mortgage

MOST people know that it pays to manage your investments to boost the value of your assets, but few realise that it is also possible to manage — and thereby reduce — your debt.

One way to do this is to take advantage of the strengthening pound — at its highest level against the dollar for 26 years — with a managed foreign currency home loan.

HiFX, the foreign currency broker, says that the number of people taking out foreign currency loans has risen 10 per cent in a year. The returns can be fantastic. ECU Group, the currency manager, boasts of reducing loans by as much as 40 per cent over ten years by converting mortgages from and into sterling.

However, brokers caution that foreign currency loans can be high risk. David Alexander, of Alexander Associates Group, the specialist broker, says: "In previous years many borrowers who have adopted a single-currency loan, without the ability to switch into other currencies, have experienced a sizeable increase in their debt."

Mark Bodega, of HiFX, adds: "If the currency of your loan moves against you, you will have to pay more sterling to cover repayments. For example, if you have a euro mortgage of €1,500 a month, your monthly repayment in January would have been £986. However, currency fluctuations mean that the repayment would now be £1,063."

Taking out a mortgage in a foreign currency, such as euros, dollars, yen or Swiss francs, allows borrowers to reduce their interest repayments because base rates tend to be lower outside the UK. Enlisting a currency manager can also help to reduce the size of your debt by converting it back into sterling as other currencies fall against the pound.

For example, a £1 million mortgage converted into US dollars when the exchange rate is \$1.80 to the pound would give a \$1.8 million mortgage. But if the dollar weakened, so that the exchange rate rose to \$2 to the pound, converting the mortgage back into sterling would cut the loan to £900,000, clearing £100,000 off the mortgage.

Mr Alexander says: "Currency managers pick a currency not just because it is at a lower rate than the UK, but because they believe that sterling is undervalued by comparison. For instance, if you had a £1 million mortgage managed by the ECU Group from 1988 to December 2005, you would now owe only £213,165 if you were paying interest only."

He adds: "Debts should be managed as an investment. And because this is on your own home, any reduction in your debt is tax-free money."

To buy your home using a mortgage in a foreign currency, you need

to approach an investment bank. Citigroup, Kleinwort Benson and Singer & Friedlander are among the big names that will underwrite the loan. Unlike the high street banks favoured by mainstream borrowers, investment banks do not have a selection of fixed and tracker rates. Instead, they lend at an amount above the base rate. The rate, which can be as little as 0.9 percentage points above the base rate, or as much as 1.75 points, depends on the size of the loan. A limited number of high street lenders also offer the service.

For loans less than £250,000, a broker can help to negotiate a better rate with the bank. Mr Alexander also recommends using a currency manager, such as ECU Group. He says: "A manager can improve returns, but the risks are still there. You should look at most mortgages being over the long term. Banks tend to tolerate an increase in the debt of up to 15 per cent of the sum borrowed. Above that and they flick you back into sterling. In effect, therefore, your risk is 15 per cent."

There are also significant costs with a foreign currency mortgage. When setting it up you are provided

'YOUR DEBTS SHOULD BE MANAGED AS AN INVESTMENT'

with a current-account facility in the currency of the loan. It is from this account that repayments are collected. When you transfer sterling to the mortgage account, you may incur transfer fees of up to 0.5 per cent.

Investment banks charge up to 1 per cent of the loan amount as an arrangement fee, although the costs fall if you borrow larger sums, while the currency manager takes 20 per cent of your profits. In addition, legal costs are high when using a currency manager, as it is necessary to draw up a power of attorney so that the manager can deal directly with the bank.

Alternatively, you can avoid using a currency manager and instead fix your exchange rate for a minimum of two years to avoid short-term currency fluctuations and cut some costs. Mr Bodega says: "This is a better course of action for a client with a short-term view, who is more risk-averse and does not want to see the monthly repayments rise." However, banks usually charge a penalty if you take the loan off the fixed rate.

Those considering placing their debt in a single foreign currency or with a multi-currency manager should have an income of £100,000 or more and be using the loan to buy a UK property. Foreign properties are considered if valued at £1 million-plus. Generally, the maximum loan-to-value ratio allowed is 70 per cent.

CASE STUDY A COOL HEAD AND A LONG-TERM VIEW

AYESHA VARDAG, left, has a combined mortgage on her home in North London and her office in Central London. The 39-year-old self-employed solicitor has a multi-currency mortgage managed by ECU Group. Her loan, valued at more than £1 million, is currently in pounds and US dollars, with interest rates at about 6 per cent.

Ms Vardag, who had a conventional mortgage until she converted to foreign currency in June, says that the new arrangement has already saved her money.

"Nowadays, when many people have high levels of property-related debt, this kind of solution can be a godsend," she says. "The concept is really very clever; one has the opportunity to have the capital loan reduced while only having to make repayments on the interest. I have had more traditional mortgages on both my properties and this new loan has resulted in a substantial reduction in monthly payments."

However, Ms Vardag says that she is aware that any significant reduction in the size of her loan is likely to occur only over the long

term. Furthermore, her monthly repayments may rise during the term of the mortgage, depending on currency movements.

"There is always an element of fluctuation, so the loan has to be viewed as an investment product," she says. "That is, one may suffer a short-term loss, but one looks at the track record of the organisation and tries to keep a cool head and a long-term view. Given that mortgages are a long-term proposition, this makes sense."

Ms Vardag adds that she preferred to use a broker, Alexander Associates Group, that has a relationship with a currency manager, rather than speculate on her own or agree a fixed exchange rate with the bank.

She says: "To speculate independently, one would require the time and expertise to manage and trade the debt. However, with a managed foreign-currency portfolio you know that this critical debt is being handled by someone with greater buying power and specialist expertise in handling exactly this mechanism."