

# Appeal of multi-currency mortgages is undermined by sterling's frailty

Tom Burroughes

IF YOU are tired of paying high interest rates on a standard sterling mortgage, switching to a special loan denominated in a foreign currency to enjoy lower rates may sound appealing. But be warned: with sterling under pressure, it is a risky strategy.

Although not yet provided by the main high street banks, multi-currency mortgages are available from private banks such as HSBC Private Bank, Investec, Kaupthing Singer & Friedlander and Kleinwort Benson (Channel Islands).

These mortgages, all of them interest-only, run for five years and are initially awarded in sterling. The mortgages are then moved between different currencies to play the currency markets and try to make the most of lower borrowing rates.

With a multi-currency mortgage, the mortgagee can opt to either manage switches into different currencies themselves or else the bank can appoint an external forex manager, such as ECU Group, to switch currencies on a customer's behalf.



**Weakening British economic growth could cause sterling to fall**

If someone borrows £1m (\$1.96m, €1.31m) and the manager shifts it into the dollar when the sterling-dollar exchange rate, say, is \$1.8, the borrower must repay \$1.8m. If sterling rises to \$2, then the value of the loan, converted back into sterling, is £900,000, a saving of £100,000.

Fees are payable: ECU, for example, charges between 0.65% and 1% of the value of the loan

and takes a 20% cut of the profit that a borrower makes on an advantageous exchange rate move.

ECU only manages mortgages worth at least £250,000, where the loan-to-value ratio is no higher than 70% and where the principal income earner named on a mortgage contract earns at least £100,000 a year.

Interest on the loans is payable to the private bank at the prevailing seven-day London Interbank Offered Rate (Libor) for whichever currency the loan is denominated in, plus a lender's margin of up to 2%.

By switching currencies, clients are able to repay loans at cheaper foreign interest rates. Seven-day sterling Libor is currently 5.6% and dollar Libor is just 4.31%. The sterling Libor figure compares with an average British mortgage interest rate, on all types of loan, of 6.1%, according to the Council of Mortgage Lenders.

But if sterling falls – as is now happening because of weakening British economic growth – an investor could be forced to repay a larger loan than originally bargained for.

ECU says if a foreign currency in which the mortgage is held rises by 15% or more against sterling, the mortgage will be switched back into pounds to contain losses. Clients can switch back to sterling at any point without penalty. Most multi-currency mortgages incur early redemption fees, as with any mortgage.

Last year will have tested borrowers' patience to the limit. Total returns, combining forex moves and interest reductions, were -10%; after fees were added, returns were an abysmal -11.15%. In 2006, returns were 1.62% and in 2005 they were 5.7%, not enough to compensate for last year's wipeout.

Cormac Naughten, head of private clients at ECU, stresses this is not a market for rookie, short-termist borrowers.

"This is for fairly sophisticated, high net worth clients," he says. "People in this market need to have a degree of fortitude and hold their nerve."

He is right; but borrowers also need to be confident that sterling will not collapse – these days, a very dangerous assumption to make.