

BETWEEN A 'NORTHERN ROCK' AND A HARD PLACE

By Kim Andrew Lincoln

Now the queues outside Northern Rock branches have disappeared, it may appear to be all quiet on the 'northern' front but are there any more bombshells waiting to go off?

Well, Northern Rock currently owes the Bank of England about £25 billion in loans but when this is combined with other guarantees that the UK taxpayer is underwriting the total figure is nearer £55 billion! Northern Rock are not the only bank in the news and, as the losses from sub prime lending continue to rise, I am sure there will be many more making headlines in the weeks and months to come

Indeed, the big banking story is that four letter word 'debt', or to be more precise bad debt! And, it is the amount and toxicity of this debt that now threatens to destroy the world's towers of finance – if Al Qa'eda, inland flooding and rising sea levels don't do it first!

After the dot.com bubble burst in March 2000, 9/11 brought more market falls and with them the prospect of global recession. So the world's central banks headed off the looming down turn by reducing interest rates. In fact rates fell so far that for a time it was better business to borrow than to save. A credit boom followed and much of this new (borrowed) money – plus some of the cash not lost in the dot.com scam – went into property. And, with this mad rush into property, another bubble was created. Finance companies, mortgage brokers and banks readily accorded mortgages to these buyers. So eager were the banks to lend money that little care was taken to check that borrowers could repay these loans. And now that interest rates have increased sharply much of the 'sub prime' element of these loans will probably have to be written off.

Once the bank obtained the signature of the borrower on the mortgage documents, they sold the mortgages to non - bank secondary mortgage corporations. In order to purchase these mortgages, these secondary mortgage companies later borrowed the money by issuing bonds and derivatives on these bonds.

In essence, through this convoluted maze of borrowing, these non-bank financial institutions own indirectly most properties purchased with a mortgage. In other words if you do not own your property 100%, the mortgage holder is the true owner.

Now that the number of 'sub prime' mortgage defaults has reached epidemic proportions, the US property market is suffering a severe recession which is spreading to the rest of the economy. In the UK property prices have started to fall and the number of personal bankruptcies and house repossessions is accelerating.

As mortgage interest rates have risen the 'buy to let' bubble has burst and landlords are dumping properties because the rent they receive is no longer covering their mortgage payments.

Another problem is that starter homes have become unaffordable for first time buyers, without whom the housing market will simply grind to a halt.

It is, however, in the massive re-mortgage market where the prospect of serious danger to the economy lies because without rising house prices to bail them out people will no longer be able to dip into their house equity every 2 or 3 years to pay for those 'essential' and non - essential items - usually funded with short term loans, credit and store cards. The loss of this large reservoir of 'property cash' will bring about a drought in consumer spending in the months and years ahead.

And if things were not bad enough the introduction of 'Home Information Packs' has significantly reduced the number of new properties for sale!

Something has to give and so house prices will continue to fall. And, as they do consumer spending will drop, the stock market will plummet and the base rate will come rapidly down. This is how a deflationary spiral could begin, if in fact, it has not already begun.

I believe that the Footsie 100 has past its maximum point of recovery (6732 in July 2007) and that the next move in the base rate will be down.

As the world economy deflates, more and more people will lose their jobs, they will default on their mortgage payments and be thrown out onto the streets. These sinister secondary mortgage corporations will take possession of the property. When mortgage defaults reach a critical mass, the secondary mortgage corporations will collapse leaving a wasteland of properties. This will spell the end to the financial grip these organisations have on working people and gradually through this process the towers of finance will fall one by one like dominoes.

I believe that by the end of spring 2008 we will be in no doubt as to the seriousness of this problem and the devastating affects it will have on those who have not prepared for it.

This article was written for the benefit of clients of the 'Safety First Strategy' devised by Kim Andrew Lincoln of MortgageMaude Limited and is part of 'suitability' letters' issued to clients after 14/1/2008.

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