

# METCALF MOAT UPDATE

YOUR FIRST CALL FOR INDEPENDENT FINANCIAL ADVICE

## Pre Retirement

Personal Pension  
Group Pensions  
Pension Life Assurance

## At Retirement

Annuities  
Phased Retirement  
Income Withdrawal  
Lifetime Mortgages

## Investments

ISA's  
Unit Trusts  
Childrens Savings  
Investment Bonds  
Savings Plans  
Fund Reviews

## Tax Planning

Inheritance Tax  
Capital Gains

## Protection

Income  
Life/Critical Illness

## Mortgage

First Time Buyers  
Moving Home  
Remortgaging  
Debt Consolidation  
Buy to Let

## Business

Key Man Cover  
Shareholder Protection  
Commercial Borrowing  
Group Life  
Group Pension  
Employee Benefits

## Advisers

Colin Moat  
John Riley  
Lee Taylor



**METCALF MOAT**

IFA LIMITED

*'Growing by  
recommendation'*

## The Search for Income goes on!

Unsurprisingly, what most clients want to know at the present is where they can get more income from their savings. With the average current account yielding near enough 0%, and, with fixed rates and interest accounts hovering between 2.5%-3% (depending on amounts and terms), they are looking for something to make up the difference from the 5% income they had been enjoying. For some, their only alternative is to eat into their capital. A solution that is proving attractive for those who are prepared to take a degree of risk with some of their money, is to invest into a Corporate Bond Fund. This can be arranged as a Unit Trust/OEIC, and, within a Stocks and Shares ISA, offers tax-free income. The income from these funds can vary, but on average, yield between 5%-7%. If you are prepared for

"The Chinese use two Brush Strokes to write the word 'Crisis'. One Brush Stroke stands for Danger, the other for Opportunity. In a crisis, be aware of the danger, but recognise the opportunity."  
John F. Kennedy.

increased risk, there are High Yield and Strategic Bond funds averaging yields of 8.5%-10%.

So, as an example, if you had £50,000 on deposit and had been used to receiving 4% net (5% gross), you would have received £2000 pa. With the reduction to 2% net (2.5% gross), this has now reduced to £1000 pa. Rather than eating into capital to make up the shortfall (which would also reduce the income over time), you could utilise your ISA allowance of £7200 for this tax year and next, totalling £14400. A fund yielding

7% would offer you £1008 income pa tax free, and with 2% net (2.5% gross) on the remaining £35600 giving you £712 net pa, this would total £1720 pa. A husband and wife (or a civil partnership) would be able to invest a total of £28,800 using the two tax years. If you opted for a higher risk, High Yield Bond, or, Strategic Bond fund yielding say, 9% this would deliver £1296 pa (again tax free if in an ISA). This together with the £712 interest from the deposit account (as in the example above) would make up the total to £2008 pa. Obviously these are just examples, and Corporate Bonds are not for everyone. However, they do offer one solution to the income problem. We would of course recommend you contact your usual adviser before taking any action. To benefit from this years ISA allowance you need to act quickly, before 3<sup>rd</sup> April 2009 latest (5<sup>th</sup> April is a Sunday!)

OLD INCOME		ALTERNATIVE INCOME	
£2,100		£2,100	
£2,000		£2,000	
£1,900		£1,900	
£1,800		£1,800	
£1,700		£1,700	
£1,600		£1,600	
£1,500		£1,500	
£1,400		£1,400	
£1,300		£1,300	
£1,200		£1,200	
£1,100		£1,100	
£1,000		£1,000	
£900		£900	
£800		£800	
£700		£700	
£600		£600	
£500		£500	
£400		£400	
£300		£300	
£200		£200	
£100		£100	
£0		£0	
	<b>Net Return on £50000 is £2000</b>		<b>Net Return on £14400 is £1008</b>
	<b>Net Return on £50000 is £1000</b>		<b>Net Return on £14400 is £1720</b>

"Be fearful when others are greedy, and be greedy when others are fearful."  
Warren Buffet.

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Please note, Buy to Let mortgages and Commercial Borrowing are not regulated by the Financial Services Authority.

Please note that the above investments do not offer the same security of capital as a bank or building society deposit. Past performance is not necessarily a guide to future performance. The value of an investment, and any income from it, is not guaranteed and can go up and down depending on investment performance.

## **A brief guide to Corporate Bonds**

A corporate bond is a loan to a company. In return they pay interest, and, at the end of the term the loan is repaid. In the interim they can be traded on the open market, the price determined by supply and demand. Holders of bonds are mainly concerned that the company has sufficient cash to repay the loan, and service the debt. Profits could halve, ordinary dividends could be slashed, but as long as the company maintains its payments to its bondholders, they continue to enjoy a fixed rate of interest. That said some companies will default, more so in a recession, so a fund with many bonds is preferred (spread of risk). As well as this risk, the price will be affected by other factors such as interest rates, are they offering a competitive rate by comparison?

Bond funds buy and sell corporate bonds on your behalf, effectively a portfolio of bonds. Therefore they do not have a fixed redemption date as individual bonds do, and may not be held to maturity. Different bonds have varying risk profiles. Companies that are perceived to be more financially secure issue investment grade bonds. Alternatively, companies that are viewed as less stable issue 'high yield' or, non-investment grade bonds. As the risk of default is higher, they need to pay more interest to compensate and so attract investors.

## **Never a Borrower or a Lender be!**

Mortgage lending in the UK has and probably always will be, one of the most innovative in the world.

It has evolved over many years, with products such as Base Rate Trackers, Drop-Locks and Offset, becoming mainstream, and terms such as Fast Track, Self-Cert and Sub Prime now widely understood.

That was up until the Spring of 2008.

The last 12 months have been witness to the most rapid change in mortgage lending history. 100% lending was an early and expected casualty, with Gordon Brown recently suggesting it should be banned.

Competitive Fixed Rates started to disappear in the Spring of 2008, only to be replaced by higher rates and higher arrangement fees, despite the Base Rate beginning its historic decline.

Eventually Base Rate Trackers became the "must-haves" as the Base Rate tumbled to the once inconceivable low of 0.5%. However, the most radical change and probably the most damaging, in respect of the housing market, is lenders lack of appetite to lend.

Dominic Williams, of local estate agents Brookbanks, commented on the recent decline in house prices "Whilst a lack of confidence has indeed played its part, it is the complete lack of mortgage funding which has brought about such a sudden and dramatic fall."

While 12 months ago a 25% deposit was seen as positively glorious by lenders, it is now passé.

75% loan to value is the new 90% loan to value.

Most competitive rates require a deposit or equity of 35% to 40%. Dominic went on to say "Sales currently being agreed are about 25% less in value than at the peak, with buyers wanting a discount, not only off the total fall in price to date, but also a further cushion of say 5-10% to allow for further falls."

The mortgages which are available not only require a large deposit to obtain the most competitive rates, lenders also want saint-like credit history.

This presents a widely under-reported problem going forward.

Mortgage lending has always been a devotee of technology. When the Internet first started to gain momentum, mortgages were in the top ten list of requested sites.

Lenders, hastened by FSA Regulation in 2004, moved towards total electronic submission of applications and illustrations.

This has presented lenders with massive cost savings (intermediaries and individuals keying data rather than their own staff!), but has now left us with a legacy of a few and generally inexperienced underwriters.

Previously, flexible products existed to accommodate adverse credit, little or no deposit and so on.

In the good old days, the computer rarely said no!

Unless you have a blemish-free credit and residency history, your path to a competitive rate will be a difficult one.

Dominic summed up the current and future housing market prospects "Most Estate Agents and associated businesses are in agreement, that there has definitely been a ripple of renewed activity over recent weeks.

Whilst it is too early to say how this market correction will pan out, there is one fundamental difference now, to that which we saw during the last downturn and that is a serious lack of properties on the market. With the event of "Home Information Packs (HIP's)," sellers are now having to shell out £350 or more for a HIP, which would be money wasted if the house doesn't sell. Given this, there are significant numbers of potential sellers just not bothering.

This raises some very interesting questions. A lack of supply usually leads to rising prices, and with this in mind, we may find that prices recover quicker this time than during the early 1990's, when there was an over-supply of available unsold properties. Clearly, none of us know how things are going to play out, but given the underlying pent up frustration of those looking to move or get onto the property ladder, once mortgage funding frees up, we are likely, in my view, to see a very favourable return in property sales."

It is the combined hope of both professionals and those wishing to buy or sell a property, that a return to a more balanced approach to mortgage lending returns, and returns quickly.

As I write this article, however, the FSA are gathering to discuss tighter controls on income multiples (amounts lent to individuals governed by income) and maximum loan to values.

Let us hope that the future stability of the housing market is also a topic.