



Another cut to the base rate will not provide a 'magic' fix says property specialist

5 November 2008

Many are expecting the Bank of England's Monetary Policy Committee (MPC) to announce a further base rate cut when it holds its November meeting on Thursday, but this may not bring the relief property owners are hoping for says one analyst.

Neil Young, CEO of property portfolio managers, Young Group, believes that while a cut would be good news for the 30 percent of property owners that currently have tracker mortgages, a reduction in base rate alone will not be the cure-all that many expect.

Young said: "A cut in base rate alone is not a magic bullet. The credit markets rely heavily on the bank's confidence, reflected in the rate of interbank lending. The three month LIBOR rate has not fallen significantly since the Bank of England's surprise half a percent cut in base rate at the beginning of October and remains around 6 per cent.

"Unless LIBOR falls further, the cost of finance to banks and mortgage lenders remains significantly higher than base rate and lenders will not reflect the base rate change in their products because their cost of borrowing hasn't dropped – and consumers taking out new mortgages won't benefit.

"I wouldn't be surprised if lenders begin to offer mortgage products that track LIBOR rather than base rate in the near future."

Since the 0.5 percent base rate cut on 8 October, many lenders have discontinued their tracker products on the assumption that further base rate cuts are in the offing and are now only offering fixed rate products.

A number of lenders have withdrawn tracker products, only to relaunch them with higher interest rates. Abbey, now one of the UK's largest mortgage lenders following their take over of the Alliance & Leicester, raised the interest rate on their two-year tracker products by 0.5 percent immediately after the last base rate cut announcement.

Young also points out that those considering new tracker products should be careful. He said: "A number of well-known high street lenders have imposed collars on their tracker deals, limiting the amount by which the mortgage holder can benefit in the event of substantial base rate reductions. We're looking very closely at the small print of products currently on offer and urge everyone to do the same and understand fully the products that they are signing up to."

Repossession rates have increased according to the Council of Mortgage Lenders' most recent figures, but the situation is by no means dire. Repossession is currently at a level of 0.16 percent of all outstanding mortgages, still less than a quarter of the rate reached in the early 1990s.

Furthermore, the rate of repossession is no higher for buy to let mortgages than for residential mortgages; 1,764 buy to let properties were taken into possession during the first half of 2008.

Long term, prospects remain good with consensus forecasts indicating that the property market will see strong recovery over the medium to long term, particularly in the South East of England and London where the disparity between property supply and demand is expected to drive a relatively rapid recovery of prices, once confidence returns.

"We will find out on 6 November if the MPC believes that the UK economy will benefit in the medium term from a further cut in base rate, but whether the majority of homeowners see any benefit remains to be seen.

"The nation's focus on base rate is becoming less and less relevant as banks protect their positions. It's increasingly clear that a cut in base rate is by no means a quick, easy fix to the current credit market conditions; we need lenders and the Government to work together to inject confidence as well," concluded Young.