MONEY

FRAME ACADEMY
CHARLEY BOORMAN'S WORST BUY WAS A CHILD'S WALKING AID
SUNDAY PAGE 5

The seven deadly sins for young mortgage applicants

PERSONAL FINANCE

It's tough enough for first-timers to borrow money to buy a home without falling into the obvious traps, writes *Linda Daly*

When Niamh Donovan and her fiancé Derek applied for a mortgage last year, they met a serious stumbling block: banks would only give them a 60% mortgage. Derek, the main earner, was working as a project manager in England. Donovan, 31, was on her first-year teaching contract in their home county of Tipperary, so her salary was more or less disregarded in the application.

"Even if I were permanent, we would only get the 60% because one of us was earning outside of the country. They wanted proof of jobs that Derek could apply for over here, in case he decided to come home," she said.

The couple had already found the property they wanted to buy – on sale "for a low price" in Tipperary through Nama. So, instead of going for a mortgage, they applied for a personal loan through the credit union. They were approved and got 90% of the price – at a personal loan rate of about 10%.

"The price of the house was quite low but we couldn't raise the 40% even if it was a 'small' amount," said Donovan. "The interest rate is a lot higher but it is better than not getting the house we wanted."

In March 2017, the number of mortgage approvals jumped by 62.1% on the previous year, according to figures from Banking & Payments Federation Ireland. At least 3,218 mortgages were approved – a big increase on the 1,985 in March 2016.

However, mortgage applicants face tighter regulations and more hurdles to obtain finance. Here we look at the seven deadly sins of mortgage applicants.

Opening a gambling account too close to a mortgage application may up your risk profile with lenders and see your property dreams collapse like a house of cards

Living abroad

Anecdotally, estate agents have reported that Irish emigrants have been busy in the market, especially those who are working abroad and plan to return to Ireland to live eventually. Non-resident mortgages have become increasingly difficult to obtain in the past year, however, with the introduction of the EU Mortgage Credit Directive. This requires banks to allow mortgage applicants to repay their mortgages in the currency in which their salaries are paid. It means the bank takes on the currency risk.

Rachel McGovern, chief operations officer with Professional Insurance Brokers Association (PIBA), said that many mortgage providers would not lend to dual-currency earners. When they do, as in Donovan's case, they require a huge deposit. Any mortgage agreements are on an individual basis.

Not having a permanent job

Your ability to get a home loan will depend on your occupation, whether you are permanent, on probation, contract or self-employed, according to financial adviser Michael Dowling of dowlingfinancial.ie. Contract employment is not a no-no but it depends on your occupation and the length and duration of your contract. Contract employees – especially those who are in the first year of the contract – will find it more difficult to obtain finance.

"If you are a nurse or a teacher, for example, you will be more likely to get a mortgage because there is a shortage of those skill sets," said Dowling.

Self-employed people generally have difficulty in raising mortgages because banks want to see three years' accounts. "Most self-employed people make a loss in their first year. The second year they might make a modest profit and the third year they may start earning some reasonable money," said Dowling. "The problem is that banks take an average of your three years' earnings."

So if you make a loss of €10,000 in year one, a profit of €20,000 in year two and a profit of €50,000 in year three – your average income is €20,000, said Dowling.

Creative accounting will not help as lenders require the past three years' tax returns. They also want confirmation that you have a tax clearance certificate.

Failing to manage your finances

Lenders take a forensic look at bank statements in the current market. "It is not just about the multiples of your income; it's equally about an assessment of your current account," said Dowling. "Are you permanently overdrawn? Do you have referral fees on your accounts on an ongoing basis? Have you had any unpaid direct debits?"

If you are over-reliant on your credit card and make lots of small-ticket purchases or dip into your overdraft on a constant basis, reconsider your spending habits. Payday loans should be avoided at all costs. Make sure that your direct debits and standing orders come out just after payday.

"Don't take out loans or undertake a debt when you're looking to get a mortgage," said Karl Deeter, financial adviser at Irish Mortgage Brokers.

Unless your rent is paid by direct debit or standing order, with the word rent beside it or the landlord's name, the bank will not consider this as rent, he added.

"You could have spent that money on recreation or buying yourself some clothes," he said.

> The price of the house was quite low but we couldn't raise 40% of the cost in cash, even if it was a 'small' amount

Opening an online gambling account

Anthony Hickey's (not his real name) online gambling account almost jeopardised his chances of getting a top-up on his mortgage earlier this year. Hickey said he gambled no more than €10 a week. The value of his home, which he had bought in 2012, had increased and his salary was greater than 3.5 times the new mortgage amount.

"Yet two banks refused the mortgage application as soon as they saw my online account," he said. Hickey deleted his account and returned with his application three months later. This time he was successful.

"Lenders don't like online gambling so you are better off not having an account. My suggestion is cancel it and spend six months without it," said McGovern.

Buying land without planning permission

"A piece of land for sale must have planning," said Piba's McGovern. "Only then will a mortgage provider lend you money to buy the property." If you are building your own home, a mortgage application must be accompanied by a copy of planning permission, the architect's drawings and a building contract.

Failing to cope with interest rate hikes

Usually, the banks do an assessment of your ability to make repayments based upon a two-point hike in interest rates.

"Make sure that you are comfortable not only with the amount you are going to be repaying at that point of time, but also if there is an increase that you will be able to afford that," said McGovern.

"If that increase is something that you don't think you'll be able to endure, look at fixed rates for a longer term."

Not shopping around

Dowling said: "You're going to be paying this mortgage for 20 or 30 years; it is important that you pick the bank that is going to be the best product for you."

According to figures from Longboat Analytics, the best variable rate on the market is KBC, with an APRC of 3%, or a cost of €4.74 per €1,000.

For its three-year fixed term rate, KBC has an APRC of 3.04% at a cost of €4.72 per €1,000. Ulster Bank's APRC is 3.9% at a cost of €4.69 per €1,000.

MARKET MOVER MARK CASLIN

Mark Caslin founded Alder Capital in 2000, an alternative investment manager with €300m assets under management. Caslin has served as the company's chief investment officer since its inception.

Alder's original currency markets implementation has been developed over the years and remains central to the business. This trading strategy is one of the longest running systematic currency programmes available to investors anywhere in the world.

Philosophy

Alder Capital applies a statistical approach to identify persistent and predictable behaviour in financial markets. The currency strategy trades seven leading currencies; 2016 data from the Bank for International Settlements shows daily turnover in these markets was more than $3trillion (€2.7trillion).

Before establishing Alder, Caslin used his mathematical background to develop and trade quantitative investment models at Gaiacorp. He finds efficient solutions to mathematical problems, which is reflected in the Alder approach. "If truly persistent characteristics of predictability are accurately identified through a statistical process, then a strategy will be able to demonstrate an 'edge' in its trading; it is this edge that generates the long-term returns."

Performance

Almost 80% of the rolling three-year periods have seen positive returns, with the average size of the positive returns being more than four times greater than the size of the negative returns, according to Caslin.

"Although the strategy produced very strong returns in the second half of 2014 (almost 30% gross return over six months), the recent past has seen some protracted periods of difficult trading conditions for our approach. The return for the most recent three-year period is lower than the average seen during our trading history but, importantly, it is in line with what we would expect given the markets we have seen."

He said Alder's complex investment strategies are not suitable for every investor. "This is one of the reasons Alder deals only with professional investors. The strategy is also available to retail investors through the Friends First Insight Currency Fund."

Buying and Selling

The Alder currency strategy is actively traded with positions changing on an intra-day basis to reflect the output of the models. Choppy market conditions often lead to increased trading volume; "We continue to spend a lot of time and resources on the trading infrastructure to enable efficient trading in all market conditions," said Caslin.

Outlook

Recent rises in US interest rates and political developments in the US and Europe suggest that the era of ever-increasing globalisation of trade and economic policy may have run its course, said Caslin. Stepping back from the numbers, he added that "a less co-ordinated management of global economies is likely to result in currency markets that behave more independently and in a manner more consistent with their long-term characteristics, this could benefit strategies such as ours".

Gary Connolly

It all adds up to happy returns with Buffett

The 1988 comedy classic Dirty Rotten Scoundrels featured a character called Lady Fanny of Omaha. Watching the film made me aware of Nebraska's largest city for the first time. More recently, Omaha has been known to me as the home of Warren Buffett, the world's best-known and possibly most successful investor.

Earlier this month, 40,000 Buffett acolytes – including me – squeezed into the CenturyLink Centre in Omaha for the annual meeting of his investment vehicle, Berkshire Hathaway.

The format was a Q&A. Buffett and Charlie Munger, the 93-year-old vice-chairman of Berkshire, sat on a stage flanked by three analysts on one side and three reporters on the other, with the board of Berkshire, which includes Bill Gates, at the front.

In a video opening the meeting, Buffett included footage from his testimony to the Senate over the Salomon Brothers' affair. He had invested in the business in 1987 and intervened four years later to step on to the board, following legal issues over fake bids at auctions of US government bonds.

At that hearing, Buffett assured the Senate committee that staff at Salomon were warned: "Lose money for the firm and I will be understanding. Lose even a shred of reputation for the firm and I will be ruthless."

This approach to business ethics and governance permeated the discussion at the CenturyLink Centre. Buffett concluded that many lessons were learnt from the Salomon affair, one being that acting immediately in relation to problems, legal or otherwise, is an imperative. The problem grows exponentially in the absence of action. "An ounce of prevention is worth a pound of cure. And a pound of cure implemented early is worth a ton of cure delayed."

Before the Q&A, Buffett singled out billionaire Jack Bogle, the founder of Vanguard, for special mention. Investors have been done a great service by Bogle, who put billions of dollars back into their pockets through Vanguard's relentless pursuit of costs, Buffett said. It was an interesting juxtaposition because Buffett is the world's poster boy for active management and Vanguard is the pioneer of passive, and the world's second-largest fund management company.

Another interesting point raised at the annual meeting related to Berkshire's patchy track record on technology. Berkshire is the world's seventh most valuable company, but four of the six firms ahead of it are tech stocks: Apple, Microsoft, Amazon and Facebook.

Buffett was candid about missing out on the likes of Amazon: "We blew it. We were smart enough to see it, but we just didn't execute."

Berkshire recently took a sizeable stake in Apple, on the back of an unsuccessful foray with IBM, which the company first invested in six years ago. Buffett gives himself a pass on this, recognising that you can't get them all right. A quick glance at his track record confirms that what counts isn't the frequency with which you are right, but by how much.

Buffett's annual letter to shareholders shows the year-by-year performance of Berkshire shares, relative to the company's book value, and the performance of the S&P 500 with dividends included. It's a remarkable 52-year track record.

A quick tabulation will show there were 17 years when Buffett's return was below that of the market, including 11 negative years.

So, there were annual disappointments for about one-third of the time, when Buffett returned less than the S&P 500. But over this period the gain in aggregate was 1,972,595%, or 20.9% per annum – more than double the annualised return of the market.

Two critical observations of the numbers.

First, if one of the world's best long-term investors can deliver disappointment 33% of the time, we should not hold ourselves, or those who invest on our behalf, to a higher standard.

Second, the power of compounding is writ large in Berkshire shareholder returns. Buffett more than doubled the annual return delivered by the S&P 500 between 1965 and last year. The US stock market's 9.7% per annum over this period delivered a tidy return on investment, equating to 127 times the original capital, turning $1,000 in to $127,170.

Not bad, until you see what Buffett's return has generated. Berkshire's 20.9% per annum return does not give you double the 127 times original investment; through the magic of compounding, it is more than 127 squared.

Buffett turned $1,000 into more than $19m. As Munger says of compounding, try not to get in its way.

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