RESOLVING MARGIN CALLS FOR INTERNATIONAL PROPERTIES

When the bank wants you to top up your repayment due to currency fluctuation, try exploring different options first.

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When investing in overseas property, pay attention to currency movements – it can make a tidy profit for you or burn a hole in your pocket.

When it comes to mortgages for international properties especially the UK and Australia, most agents have been pretty enthusiastic about asking their clients to take out a loan in a different currency such as USD, SGD or even JPY to take advantage of low interest rates. That allows them to present attractive cashflow numbers to their clients and improve their sales proposition. But what they often miss out is the currency risks that comes along when your loan is denoted in a different currency than where your property is based. Investors are then exposed to what is termed as margin calls.

Margin call is a situation when the value of the loan has, due to currency movements, expanded beyond what the bank has agreed to loan you in proportion to the value of the property. For example, if you were to take a 70% loan against a £1 mil UK property in SGD when GBP/SGD was at 2.0, your loan will be S$1.4m.

Consider now when GBP/SGD has fallen to 1.77. Your S$1.4m loan now will be approximately £791k (79.1% of the property value). That will be well above the 70% ratio which the bank agreed to loan you at. Hence you will then be asked to restore the ratio to 70%. In other words, reduce the loan to S$1.239 mil (equivalent of £700k with GBP/SGD at 1.77). That is a whopping S$171k top-up required to resolve the margin call!

Mortgage in SGD taken when GBP/SGD is 2.0	Exchange Rate (GBP/SGD)	GBP equivalent	Loan to Value ratio (LVR)
SGD $1,400,000	2.00	£700,000	70%
SGD $1,400,000	1.77	£791,000	79.1%

We have always advocated that currency is an unavoidable consideration when investing overseas, and investors should always be aware of potential currency movements and understand how such risks can be mitigated.

In this article, we will present some general guidelines to help you navigate through the stresses of a margin call. If you are not familiar with foreign currency instruments, do seek advice from your respective financial consultants. Different situations will require different strategies and this article is not meant to be a comprehensive guide in addressing this fairly complex topic.

The first thing to note when investors are caught in a margin call is never, never ignore your bank. Banks are generally happy to help investors devise solutions for such situations and will only repossess your property as a last resort. In these sensitive times, you should always pick up their calls, explore options with them, and make yourself available to them. Sometimes you might have other investments that you can't liquidate immediately to solve the situation, let them know and work out a compromise. The key here is, the banks need to know that you are on top of things. So stay on top of things!

Here's our 2 cents' worth...

- **It is not the end of the world and you don't have to sell your property!**
  Margin calls can certainly be stressful and for some, very challenging. But they can be managed. Gone are the days when currencies can fall by half or more. Central banks these days are always ready to intervene when there is a sudden and substantial movement of their currency. In fact, currencies are actively managed by the respective central banks these days according to the economic interest of their countries.

- **Have some patience and do not rush into any positions**
  It may be tempting for most investors to address a margin call by pursuing the most convenient solution to remove the stress immediately. However, we strongly urge investors to consider their situation carefully before acting. A major currency adjustment cycle can take anything from a month to 6 months to complete. While the banks would ideally want an immediate resolution of the situation, do feel free to assure them that you have other assets (assuming that you do) to resolve the situation but would like to observe the market a little more. Meanwhile, get input from your trusted advisors to decide how they should move forward.

HERE ARE SOME OF THE MOST COMMON AND DIRECT RESOLUTIONS:

1. **Paying down the loan and switching it back to asset currency**
   This is the most direct resolution that the bank will advocate and you might be tempted to do. But it is often the worst option. We believe that switching is best executed during calculated peaks and troughs, not during desperate moments. To pay down the loan and switch the loan currency to the asset currency is to actualise losses and when the currency recovers, you will end up in a worse-off situation. But of course if you are not adequately prepared for such a situation, switching loans might often be the only course of action available.

2. **Get your property re-valued if it has appreciated**
   If you are confident that your property has appreciated in value, this might be a good time to get it valued. The higher value may mean that the margin call is but a non-event. For example, in the earlier case, if the property has gone up to say £1.1m, the £791k loan would only represent 72% of asset value, well below the usual 5% margin that the bank uses to trigger a margin call. That naturally neutralises the situation.

   However, do always obtain an indicative value first if you are not confident of the price growth. A valuation that comes in lower than the original purchase price can obviously land you in a much more difficult situation.

3. **Top up your assets pledged as collateral for the mortgage**
   While the property itself is the primary collateral for the mortgage, many banks do accept additional security. For example, if you have £100k in cash (or shares, bonds, etc), you can pledge them to the bank as additional security for the mortgage. The bank will hold them as collateral until the situation resolves.

   For the given example, say the investor sets aside some SGD and waits a bit before acting (see option 1), he might get them converted to GBP at say 1.72. Assuming the amount to be SGD200K (converted at 1.72 to £116k), the investor can deposit the amount with the bank as security. Over time as the GBP/SGD restores to 2.0, his GBP will then be released and it can then be converted back to SGD as S$232k, making a tidy profit in the process.

FINAL WORDS

The key to managing currency risks when it comes to mortgages lies in first establishing them at the right currency from the start. A loan is a liability. Hence when taking a loan in a currency different from the asset currency, make sure the loan currency is at a high, not low. Even if that means entering a negative cashflow position. That will minimise your risks in the event the currency moves against you. Secondly, always keep a sum of monies for rainy days. No one can predict the currency market with total accuracy. When things go wrong, have your rainy day funds to tide you over the period (and possibly make some profits in the process).

You may be tempted to think that you are investing in property, not currency, and therefore refuse to understand how currency works, deeming it irrelevant. Let me submit to you that that is certainly not the case. Investors across Indonesia and Malaysia, for example, would know that over the years, despite capital growth, the fall of the Ringgit and Rupiah has resulted in little or negative returns when currency-adjusted. We believe that understanding how currencies work is critical when investing overseas. Investors will do well to learn how to manage it effectively and protect their profits while avoiding unnecessary losses. ■