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## SOMEWHERE, ON THE OTHER SIDE OF THE WORLD...

One of the primary indicators keeping interest rates on hold here in Australia with a consistency never before seen, is the economic standing of countries like America and the UK.

In much of the developed world, as with the local status quo, general fiscal conditions have prevented various monetary policymakers from moving anywhere but down when it comes to interest rates.

Official cash rates have hovered close to zero for more than five years now in the US, while the Bank of England's Monetary Policy Committee has hinted that they will not be raising the current 0.5% cash rate for the remainder of 2014.

In Australia, the RBA has repeatedly referred to the "low probability to any rise in global interest rates...over the period ahead" in its official statements immediately following their decisions to maintain the local 2.5% rate.

This then begs the question, if and when interest rates start to rise in other global economies, will the RBA be forced to follow suit? Although it may not be as black and white as all that, chances are when the financial health of other nations improves enough for their central banks to consider an increase in official cash rates, Australia won't be far behind.

Given that our fortunes increasingly hinge on what is happening elsewhere in the world, it's perhaps timely to take a closer look at where the likes of the US and UK stand around local monetary controls and when fortunes might change.

### Is the US ready for a rate rise?

Reports out of America indicate that a liftoff of policy interest rates is anticipated around mid-2015. However, this is far from set in stone, with the Federal Bank repeatedly emphasizing that timing of such a move hinges on the overall state of the economy.

Should things pick up quicker than expected, rates will begin trending upwards sooner. Conversely, weaker overall data could see rates maintained well into 2015 and possibly beyond.

Analysts in the US suggest that continuing low inflation and a weak labour market will see the Fed continue to sit on its hands well beyond July next year, and say their decision as to when monetary policy shifts depends on two main factors:

#### 1. How much labour market slack is there in the economy?

It's no secret that the labour market in America has been an issue for some time now. And while the unemployment rate has declined much quicker than expected in recent times, sitting at 6.1% in August this year, almost 3 million Americans have remained without work for at least 27 weeks, while close to 2 million have given up the job search entirely.

Experts predict that at the current rates of job growth, it could be another three to four years before the economy has a place for these would-be workers.

#### 2. The extent to which job market slack translates into future wage and price inflation

The Fed's preferred measure of inflation – personal consumption expenditure – is on an upward trajectory (sitting at 1.6% in July). But given one of the ways policymakers are attempting to simulate the local labour market – with many suggesting a possible abolition of minimum wages – chances of this indicator meeting its 2% target anytime soon could be slim.

Much like Australia's regulators though, the Fed Bank finds itself in a bit of a quandary, as lower interest rates create heightened investment activity across some riskier, less liquid credit markets. This has commentators on edge, with concerns over similar financial imbalances that led to the Great Recession.

They suggest an unexpected reassessment of interest rates, or an abrupt unwinding of investors' current high risk tolerance could lead to a sudden surge in asset sell-offs and the re-pricing of same. This, of course, could have serious flow on macroeconomic effects, both in the US and overseas.

Much like here at home, some analysts believe the Fed will be forced to consider macroprudential policies, such as more demanding underwriting standards for banks that extend intermediate leveraged loans and a tightening of limits on larger exposures to riskier assets.

Commentators admit that the timing of an interest rate rise in the US is not the easiest thing to predict right now, but a much-anticipated solid period of economic growth is expected to spur the Federal Bank into action.

### Meanwhile... in the UK

Experts predict that an interest rate rise is on the cards for the UK some time in 2015, giving rise to concerns as to how the many first homebuyers who have been enticed into the British property market by low rates and the government's shared equity scheme, will cope with higher mortgage repayments.

Data reveals that first time buyers spent nearly 20% of their monthly income servicing mortgage debt in July this year, with an increase in first timer market activity of 25% from July 2013.

Additionally, despite stricter lending criteria for UK borrowers, the average loan to value ratio of new mortgages rose from 80% in June to 84% in July this year.

The government's Help to Buy package (similar to our first home owner's grant), pent up demand and an improving economy have all exerted upward pressure on Britain's housing market over the last year. Not to mention cashed up parents who've enjoyed triple digit appreciation on their property assets since 1991, giving their kids a boost onto the property ladder.

Recently though, activity has started to decelerate across London and regional parts of England, with speculation of a looming interest rate rise putting a dampener on buyer enthusiasm.

### Conclusion

It will be interesting to watch proceedings in other parts of the world over coming months, with changes to the status quo in the likes of the US and UK being a relatively good indicator that our own Reserve Bank may feel the need to follow suit. As always, in this increasingly interconnected global economy, it's a case of wait and see as we approach 2015.

# HOUSEHOLD INCOME DOUBLES... BUT SOME ARE LEFT DEEPER IN DEBT.

According to recent data from the Australian Bureau of Statistics (ABS), as taken from the National Accounts, Australian household incomes have more than doubled since last decade. However, it seems we are all feeling the impact of interest payable on overall household debt.

Average growth of 58% was recorded in household incomes between 2003/04 and 2011/12, with the highest household net worth quintile income increasing by 68.2% during that time.

## More income from jobs and property assets

Of the recorded 58% increase in overall income growth, 41.4% was attributable to “compensation of employees”, or wages and salaries in layperson terms, representing the biggest increases overall.

While further rise in household incomes came off the back of “Gross operating surplus – dwellings owned by persons”.

This measures the return to households from tenanted investment property holdings and reflects the relatively significant increase in rents payable over the last decade, with average annual growth of 5.3% - a higher average than that recorded for the previous decade.

Essentially, this means property investors have enjoyed a boost to their household income in recent times as they benefit from the lucrative returns afforded from holding residential dwelling investments.

Additionally, growth in total property income receivable, which includes interest and dividends payable on financial assets, increased substantially during the last decade.

The biggest growth driver in this sector? Perhaps not surprisingly, it was in the form of superannuation fund earnings, spurred on by legislative and policy changes around SMSFs alongside growth in investment income.

## More money, but increasing debt

While Aussie households might be earning more than we were a decade ago, it seems our costs are also increasing and in particular, the interest payable on dwellings.

Use of household income grew by an average 4.4% per annum between 2001/02 and 2012/13, reducing our disposable income by an average of 7.6%. The ABS cites the reason for this as rising interest costs, which have increased at a faster rate than total income received.

Interest payable on dwellings grew by 8.8% per annum between 2001/02 and 2012/13, which is a significant rise compared to the previous period, even though interest rates have been trending lower.

Logically, this is down to the extreme growth in property prices we have witnessed during the same timeframe.

The impact of interest payment debt was most pronounced in the highest income quintile (where not surprisingly a surge in property income was also noted), with income reduced by 10.7% due to interest payments.

This is likely indicative of the higher rate of property investment activity that kicked off early last decade and has continued fairly consistently since, especially off the back of 2008's GFC, when investors turned increasingly to more stable bricks and mortar assets over shares.

# ARE YOU COVERED? 8 WAYS TO ENSURE YOUR INSURANCE IS ENOUGH

When it comes to investing in property with some level of surety and mitigating any associated risk, one of the things that is perhaps least talked about - but really deserves more attention - is insurance coverage.

Many an 'expert' will instruct investors as to sourcing and securing the right kind of property asset and property loan, but rarely is enough attention given to the subject of how you assess and obtain the best possible insurance policies to protect yourself, as well as your property portfolio.

This is a somewhat timely subject to look at right now given the increase in insurance brokerage firms, product options and comparison sites flooding the sector, along with a marked rise in clients turning to financial advisers in a bid to identify the best policy for their needs.

But while these services promise to qualify products currently on the market for your convenience, the question remains; who is actually qualifying the brokers, advisers and comparison sites? And more importantly, how are they assessing and referring business to particular insurance companies?

## Getting paid to point you in “the right direction”

Worryingly, a recent Australian Securities and Investment Commission (ASIC) survey found that

more than one-third of consumers advised on life insurance by financial planners, received guidance that fell short of meeting relevant legal standards. And when advice did comply with regulations, there was significant room for improvement.

Interestingly, of the 202 files surveyed by ASIC, advisers who did not receive upfront remuneration had a far better track record at rendering meaningful assistance to clients, than those paid immediate commissions for converting a prospect, with pass rates of 93% and 55% respectively.

Unfortunately, commissions paid to financial advisers and insurance brokers can be incredibly lucrative, representing anywhere between 100 and 130% of the new business premium.

What does this mean for you and I, the consumer? Well, it seems there's a giant conflict of interest preventing everyday Aussies from securing the correct insurance premiums. You could be receiving inferior policy terms, paying too much for unnecessary coverage or end up making a claim that is denied because of restrictions you were not adequately informed of.

This is a deeply concerning trend for property investors in particular, who often hold numerous assets in their portfolio and may very well rely on these personal insurances to prevent losing everything one day down the track, should their health and wellbeing be compromised in some way.

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Insurance is big business in Australia, with the premium value of individual life risk policies (including life, total and permanent disability, trauma and income protection – all things investors need to consider) totalling \$8.4 billion in 2013.

So how do you ensure you are adequately covered when it comes to protecting your all-important cashflow, without falling victim to a less than scrupulous adviser?

Here are 8 things you should do when exploring insurance options, not just for your assets themselves, but also for you as a high net worth investor.

- 1. Assess your needs and make sure the coverage aligns with them.** This includes careful consideration of your life stage – do you have a family you need to take care of if you lose all or a portion of your income due to an injury or illness? Do you need to maintain loan repayments on a number of assets across your portfolio? Are you covered for all possible events that could impact on your cashflow?

2. **Compare products.** There are so many different companies and products on the market now that it's essential you have some idea as to who offers what. Even if you intend on seeking expert assistance in eventually selecting a policy, you need to know what's out there as an informed consumer. This isn't just about saving money upfront either, but also potentially saving a lot of future heartache by making sure the policy you select is aligned with your requirements.

3. **Qualify an adviser before taking their advice.** Regulatory bodies are considering how to enforce tighter restrictions on things like upfront commissions paid to financial advisers and insurance brokers that can create a conflict of interest for consumers. However, right now, it's most certainly a case of 'buyer beware'. Ask your adviser if (and how much) they are paid by the insurance company they recommend and what process they undertake in qualifying the best product for your needs. If they seem disinterested in finding out as much about your personal circumstances as possible before thrusting a product disclosure statement at you, be wary.

4. **Get it in writing.** Never sign or agree to anything before reading through all related information carefully and critically to ensure the product summary reflects your specific needs.
5. **Read the fine print.** Most insurance product disclosures are more complex than a Year 12 Physics textbook. Always read the 'fine print' and make sure you fully understand what happens in the event of you making a claim and any restrictions or excesses that may apply to your policy.

6. **Ask questions and speak to an adviser from the insurance company.** Don't just rely on a broker or adviser to point you toward the right premium. If they recommend one company and policy over another, speak to a company representative and ask as many questions as possible before signing anything!

7. **Be specific – find out if you are covered for all the little things you might need.** Depending on your career, you might have certain needs that others do not. Insurance is not always a one-size-fits-all prospect, so make sure the policy you end up with is adequate.

8. **Review your policy annually and make any necessary changes.** Never become complacent with your insurance. You should review your coverage annually, in line with your portfolio review. Is the amount of coverage you have still adequate? Have certain circumstances changed that you need to advise your insurer of? Can you find a better deal?

# BANKS MOVE TO MITIGATE RISK, AS INTEREST RATES UP THE ANTE AMONG LENDERS

The Reserve Bank's October decision to maintain interest rates at a low 2.5% has engendered varied responses from property analysts and commentators.

While some agree with the RBA's assessment of "accommodative" monetary policy, others worry that the ongoing low interest rate environment is causing escalating pressure in Australia's housing sector, led predominantly by enthusiastic investors.

In a statement released after its monthly meeting the Board acknowledged that, "Interest rates are very low and have continued to edge lower over recent months as competition to lend has increased."

The RBA said, "Investors continue to look for higher returns in response to low rates on safe instruments," adding, "Credit growth is moderate overall, but with a further pick-up in recent months in lending to investors in housing assets."

The Board is well aware that a more competitive lending arena is enticing increased purchaser activity across capital city property markets, and readily concedes that dwelling prices have grown steadily over the past few months.

However, it cites the probability of long-term interest rates and risk spreads remaining very low, as well as little chance of an increase in global interest rates "or other adverse events" in coming months, as sufficient reason to continue down the current cash rate road.

Too much too soon?

In this competitive lending arena, property investors are vying for reliable bricks and mortar assets, tempted by the promise of lucrative returns that easily outstrip monthly interest repayments and leave them in a relatively comfy cashflow position.

But economists are worried that when this current status quo changes, we could end up with a glut of residential housing stock on the market as the capacity for people to hold their investments over the long term is compromised.

This could, in turn, send Australia's property values into a downward spiral and create further flow-on ramifications for the local economy and banking sector.

Competition heats up

With the Reserve Bank sitting on its hands each month in response to a consistently lacklustre overall rate of inflation, analysts are questioning how the current frenzied market activity will be curbed, so as to avoid the possibility of a property bubble.

Some have suggested the Central Bank and APRA will be forced to put a leash on lenders, who are competing fiercely to secure their share of the current borrowing bevy with low rate and other enticing product offerings.

Six lenders are now tendering cash-back deals of up to \$1000 on selected mortgage products, including the NAB and CBA, while eleven lenders (St George being one) are waiving establishment fees for new home loan customers.

That's on top of the ever-reducing rates on offer for both fixed and variable home loan products, with some dropping by as much as 70 basis points and 30 basis points respectively over the past month.

Are lenders doing enough to mitigate risk?

Talk of macroprudential policy to decrease the prospect of high-risk loans being handed out like the proverbial lollipop has surfaced in recent times, with the RBA said to be keeping a watchful eye on the incidence of higher loan to value ratios being approved.

However lenders seem to be responding to the potential pitfalls of this low interest rate environment with their own actions, as the supply of high-risk loans has been markedly curbed over the past twelve months.

According to RateCity, although the banks might be keenly baying for new business, the number of low-deposit home loans (those requiring a deposit of 5% or less) has decreased to 69% of market share, down from 73% in 2013.

Whether this is enough to stem concerns that continue to float around the property market ether is anyone's guess. But one thing is certain, it's unlikely that in such a favourable lending environment, investors are going to pack up their bat and ball and head home anytime soon. It will certainly be interesting to see how the RBA responds to various macroeconomic indicators as we head into 2015.