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TRILOGY news

"the property investor's mortgage broker"

INVESTORS TO FEEL THE SQUEEZE ON NEXT MONTH'S INTEREST RATE INCREASES

Property investors will soon notice some less than favourable changes to their cashflow and capacity to access capital, as lenders attempt to re-balance their books in line with recent regulatory crackdowns on investment related loans.

Every property investor will be impacted...here's what you need to know...

In December last year, the Australian Prudential and Regulatory Authority (APRA) advised authorized deposit-taking institutions that investor mortgage portfolio growth "materially above a threshold of ten per cent" would be seen as an "important risk indicator" in considering the need for regulatory action.

Despite their continued threats regarding macroprudential intervention however, APRA's analysis of banking statistics from May indicated that the magic 10 per cent margin wasn't being taken as seriously as they'd hoped.

ANZ's residential property loan book grew at an annualised rate of 12 per cent for the month, with all the majors (aside from Westpac) allowing investor loan activity to rise beyond 10 per cent, along with AMP, Macquarie, ME and Teachers Mutual Bank.

APRA took a hard line approach in response to the data, cautioning that lenders who didn't adhere to mandated restrictions on investment borrowing at 10% or less of all loan settlements could force the imposition of formal credit sanctions.

Pulling in the investment mortgage purse strings

The effects of APRA's sterner stance were almost immediate. Prior to May, discretionary loan pricing was readily available to property investors, with competitive deals below carded rates offered pretty much across the board.

These virtually disappeared overnight in a veritable avalanche of changes to property investment mortgage offers.

It began with ANZ contacting brokers to advise they would only extend advertised rates to investor clients, with no further discretionary pricing available. Other lenders quickly followed suit. Then came additional serviceability barriers and the application of loan to value ratio limits.

Since then lending policy revisions have continued, making the acquisition of new property investment mortgages, the settlement of loans on existing contracts and the overall management of cashflow, a lot more challenging for investors.

Here's what we're currently seeing:

1. **ANZ and CBA to apply a RETROSPECTIVE interest rate increase of 0.27%** to all investment property related loans from August 10, impacting cashflow for new AND existing customers.

2. **Negative gearing 'add backs' removed** by most lenders, impacting serviceability and making it more difficult to obtain an investment loan.

3. Bankwest, St George, Advantedge and ING have **lowered their Loan to Value ratios** on investor related borrowing. Notably, ING have capped their LVR at 80% for NSW and 90% for all other states.

4. **Additional discretionary pricing pulled back** on all investment property loans.

5. **Stricter serviceability requirements,** including:

• Additional proof of expenses – NAB requires statements on non-held facilities.

• Rental income capping among the NAB, St George, CBA and ANZ. Some will work to 80% of rental income, others will only allow 4% of the property's value and some consider just 50% of total rent.

• Interest 'add backs' removed.

• CBA, Westpac and St George applying additional buffer, loadings and stressors on existing and non-held facilities.

6. **Fixed rate increases** on investment property loans, with the CBA and ANZ already announcing changes.

You need a Plan B (especially OTP purchasers)!

These measures will no doubt add a few potentially problematic hoops for investor mortgage applicants to jump through, in order to obtain capital for future acquisitions.

Worryingly, a large number of investors are currently locked into OTP loan contracts, having arranged finance months before these industry revisions came about.

This has led to questions regarding the fate of many OTP deals at settlement time, particularly as a large number of transactions would be geared at a 90 to 95% LVR, which may no longer be accessible. All OTP investors are advised to discuss alternate financing options with their broker.

While it certainly isn't the end of the line for those looking to take advantage of our current low rate environment and board the property bandwagon, APRA has undeniably changed the rules of the game.

If you would like some help navigating this new lending landscape, please contact the team here at Trilogy to discuss how these changes might affect you and how you can prepare for what's to come.

We can review established investment loan portfolios, as well as planned ones, to come up with the best solution for your circumstances in any type of credit climate. Call us on 1300 657 132 to connect with one of our specialist investment mortgage brokers.

Special Trilogy Report

If you would like to know more about the changes currently occurring across all lending institutions for property investment mortgages, don't miss the next issue of the Trilogy Report, where our mortgage brokers will provide a comprehensive insight from the coalface.

WILL THE RBA BE FORCED TO REDUCE RATES FURTHER BEFORE THE END OF 2015?

As the world waits to see what effect recent events in China and Greece might have on our vastly inter-connected global economy, local and overseas analysts consider the potential impact on future interest rate decisions here at home.

After the RBA confirmed that the official cash rate would again remain unchanged at 2.00 per cent for July, talk immediately turned to future monetary policymaking prospects for the remainder of 2015; as the central bank works to keep Australia's somewhat vague fiscal fortunes stable in the face of this latest economic upheaval.

No change for now

In a statement regarding their July decision, governor Glenn Stevens said, "Information on economic and financial conditions to be received over the period ahead will inform the board's assessment of the outlook and hence whether the current stance of policy will most effectively foster sustainable growth and inflation consistent with the target."

Essentially the Board is doing much the same as everyone else; waiting to see what the fallout might be as two sizeable and dare I say it, 'unprecedented' economic occurrences play out overseas, in two very different scenarios.

It's almost like tuning in for your favourite daily soap opera fix to see how the (generally drawn out) storyline unfolds…only this is real life and the potential repercussions of all the drama a lot more serious.

"Despite fluctuations in markets associated with the respective developments in China and Greece," says Stevens, "Long term borrowing rates for most sovereigns and creditworthy private borrowers remain remarkably low."

In other words…it doesn't look like our financial sector will be too badly buffeted by the ripples casting their way outwards from Greece and China at this stage, but it's really too soon to tell.

Big trouble in not-so-little China

It's not like this is new ground for Stevens…whose no doubt become accustomed to navigating unchartered waters whilst trying to find an interest rate safe haven for Australia's economy.

But as is the case with all 'unprecedented' economic shifts (think 2008 GFC), including these current occurrences across two highly influential and diverse markets, you have to wonder: what will the fallout be?

If the current stream of Chinese sharemarket losses continues unabated, analysts fear the country's entire economic growth could be stunted as consumer confidence plummets alongside stock prices.

Given Australia is so closely tied to China's economic fortunes through our trade association with the Asian manufacturing juggernaut, this is certainly a concern for local investors.

Not to mention what might happen if the glut of Chinese investors who've bought into residential real estate across our major capital cities were to suddenly pull the pin due to a change in circumstances, such as losing a large sum of invested money.

The impact on iron ore prices was virtually immediate, leading experts to suggest that if this becomes worse case scenario for China, Australia's employment levels and overall confidence could slip into the economic abyss the world's new superpower could leave in its wake.

Will all of these factors combine to force the Reserve's hand? Some believe this will be the case, and are banking on a further rate cut before 2016.

What the experts say

"Even though the RBA decided to leave interest rates on hold at 2 per cent for the second month in a row, and did not provide a clear hint that more cuts lie ahead, we still think that a further weakening in the outlook will prompt it to reduce rates to 1.5 per cent by December," said Capital Economics' chief economist for Australia and New Zealand Paul Dales.

Begging to differ (but only slightly mind you) was, among others, Westpac chief economist Bill Evans. Evans and fellow optimistic forecasters are of the opinion that interest rates have eased sufficiently, although uncertain variables might force the RBA's hand.

"Westpac's current view is that rates will remain on hold through both 2015 and 2016," said Evans. "However, the risks are clearly to the downside and will be dependent upon the bank's confidence in the outlook for the unemployment rate and economic growth."

The 2015 BusinessDay Economic survey invited a veritable 'who's who' panel of globally recognised economic experts and academia to comment on Australia's economic and interest rate outlook.

None of the forecasting panel expects a recession this coming year, but feel Australia's terms of trade will continue to drop and wage growth will be so low it won't match inflation, sending real wages backwards.

The outlook for property markets was sunnier however, with values expected to climb for at least another year. And while business investment is set to slide further, unemployment is anticipated to hold steady.

Ominously for Abbot and co, the general consensus is that the budget deficit will be worse than initially calculated, and that the falling Aussie dollar might prompt a possible further reduction in interest rates over coming months.

More likely though, according to panel consensus, is that the cash rate will remain steady, along with the general status quo.

"It'll be 2014-15 all over again," stated the report. "Another year of drifting, without much of an economic or budget recovery."

Property continues to prop us up

The panel says housing is really the only bright spot in an otherwise bleak outlook for Australia, in the short term at least.

Collectively, industry heavyweights predict acceleration in growth to 7.5 per cent for the overall real estate sector, with Sydney house prices expected to surge a further 10.3 per cent in 2015-16 and Melbourne by a more modest 6.4 per cent.

And what do the experts make of all the housing bubble banter? Well it seems most agree that the hot air will be let out of our currently buoyant inner city markets in a slow, flatlining manner, not an earth-shattering pop!

WHAT DOES THE CHINESE SHARE MARKET MELTDOWN MEAN FOR AUSSIE PROPERTY?

When the extent of China's stockmarket turmoil became apparent earlier this month, our beloved property industry 'Emos' emerged in their droves to profess the imminent bursting of Australia's so-called housing bubble.

They foretold that the recent, steady stream of investment activity from our Asian neighbours – particularly in Melbourne and Sydney's off the plan apartment sectors – was sure to dry up, as many Chinese were rendered poor overnight from life shattering share losses.

But interestingly, it seems the opposite is occurring. As local brokers seize the opportunity presented from a newfound lack of confidence in the Chinese stockmarket, to more widely promote the reliability of Aussie bricks and mortar to overseas buyers.

China crash could hit house prices

In reality, the ripple effects of China's current economic woes and how they might influence our housing markets here in Australia aren't quite so black and white.

Some analysts suggest this is "China's 1929", when the biggest stockmarket crash in history sent the world spiralling into the Great Depression.

One of my personal favourites appeared in the UK's Telegraph and read, "The Chinese economy is like one of those cartoon characters who manages to keep running long after leaving the edge of the cliff, only belatedly to look down and plunge into the abyss."

Let's all pause for a moment to appreciate that visual! (You saw Wile E Coyote didn't you?)

Others however, consider what's happening to our neighbours more of a temporary glitch, not unlike the 1987 crash that saw significant short term falls, but no real lasting fallout.

With regard to the housing sector specifically, the negative implications are twofold…

1. More stock in select markets.

One theory is that if China's economy goes down the proverbial gurgler, so too will its people's banks accounts. This, in turn, would restrict their ability to finance overseas property investments and potentially impact pockets of our housing markets, where foreign buyers have been particularly active.

2. Falling commodity prices will concern overseas wholesale lenders.

With predictions of a much larger crash on the cards for iron ore prices, it's feared overseas wholesale lenders will start to think twice about financing our banks to keep the mortgages rolling out.

"Banks have to get their money from somewhere to be able to lend to homebuyers," explains Lindsay David of LF Economics.

"They've absorbed everyone's deposits – if you put $1 in the bank they go and lend that to someone else. They've exhausted that, so they go into the wholesale lending market to acquire more funds.

"Real estate prices in Australia depend more on what some wholesale lender in New York or London is willing to lend than anything else," reasons David. "House prices in Australia are dependent on debt growth, and if there's no credit out there, house prices will begin to fall."

This would effectively mean a credit crunch that sees competition dry up and house prices come off the boil.

At the coalface

Anecdotal reports from real estate agents in areas where foreign investment has been prevalent for some time, point to an easing in activity from Chinese buyers on the back of the country's almost $US4 trillion share market rout.

A number of younger Chinese investors in particular, who never saw the share market crash coming, have been forced to rethink their Australian property purchases and pull out of pending deals.

Seeking shelter from the sharemarket storm

It's not just Australian real estate that's finding favour with Chinese investors looking for a safe haven from the stormy Shanghai equity markets, but Canada and the UK too.

Pallier's claim that the bulk of 'real money' had already been removed from danger prior to the economic calamity over in China, is supported by reports from Bank of America Merrill Lynch.

It claims that major shareholders in China had already sold 360 billion yuan ($58 billion) in the first five months of 2015, compared to 190 billion yuan for all of 2014 and an average 100 billion yuan in prior years.

"There is anecdotal evidence that Chinese buyers have intensified their interest in 'safe haven' global property markets, including London, as a result of the recent stock market volatility," said Tom Bill, head of London residential research at Knight Frank.

And according to experts, this is only the beginning. With more interest expected from these cashed up and insightful Chinese investors, as Australian made real estate gains more of an international market edge due to a weaker currency exchange.

Of course for local investors with a clear game plan, it's business as usual.

5 INVESTMENT RISKS OF OUR LOW RATE ENVIRONMENT

Not since the decade that saw rock and roll truly emerge as an iconic aspect of American culture have variable interest rates been trending as low as they are right now.

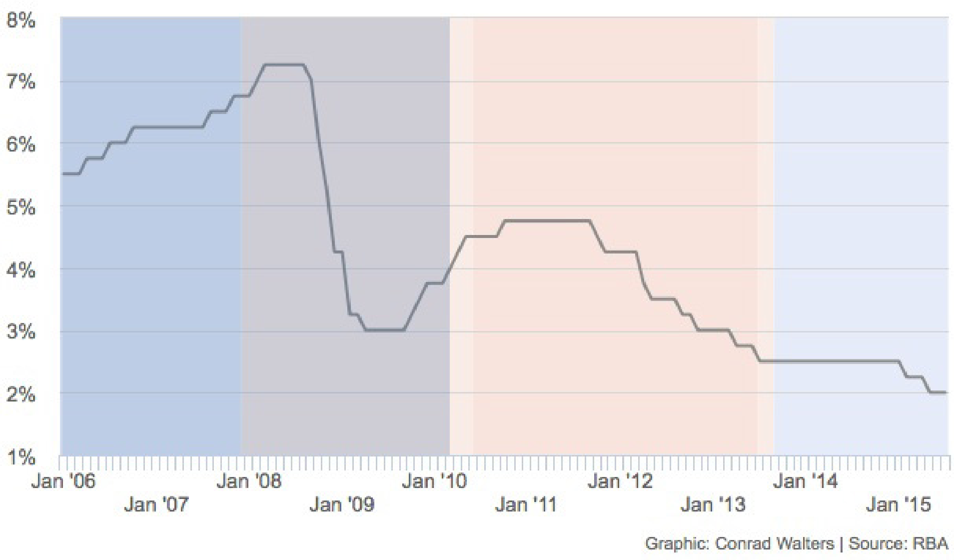
Despite the far more focused regulatory eye APRA is directing at property investment lending activity, many banks are offering enticingly good variable deals at less than 5 per cent – the lowest since the 1950s. With some of the best fixed rates for one to two years under 4 per cent.

Credit is almost going begging. And if the Reserve Bank does indeed maintain rates at their current low level for the remainder of the year, as many anticipate, you can guarantee more punters will jump on the property bandwagon.

Why wouldn't you? Cheap credit, buoyant inner city markets that consistently prove to deliver with strong growth and yields, and a collective shift in how younger generations perceive property ownership that will invariably see real estate become more of a commodity as demand continues to grow…

Seems to be the perfect property investment storm. But is it too perfect?

Interest rate movements 2006 to 2015



The calm before…

Some would argue that we're currently in the eye of the storm, and as with any market in a state of volatile flux (such as a housing bubble about to implode), there could be a few dark clouds on the horizon.

If history teaches us one thing about any type of commodity – housing being no exception – it's that there'll always be swings in fortunes. They could go in favour of the investor, or against, at any given time.

Those who can ride out the storm…bunkering down when things get a little too full on, and sustaining their investment portfolio with airtight asset selection, structuring, finance and management…will soon step back into the sunlight, having survived the chaos.

Then there are those who 'never saw it coming'. The ones who get caught 'out at sea' in a market monsoon, and carried away on a tide of transition that may or may not see them come out with their portfolio intact.

At this present time, low interest rates and constant reports about 'unprecedented' escalations in housing values are encouraging a lot of buyers into real estate.

But neither low interest rates, nor a moment in time when the markets happen to be peaking, mean that the inherent risk associated with real estate (as with any type of investment) is eliminated altogether.

In fact, it could be said that the opposite is true…with many diving in too enthusiastically before checking the forecast, consulting a compass and assessing the potential pitfalls.

Now more than ever, you need to remember that low rates DO NOT equal low risk! Here are five key risks you need to weigh up at this time…

1. Paying too much

Competition is fierce, but that doesn't mean you should join those who end up in frenzied bidding wars, just to say you had a win!

A number of industry experts suggest that in some highly sought after suburbs, where auctions are the standard way of moving homes, stock can currently sell for as much as 20 to 30 per cent over market value at the fall of the hammer.

When you consider many of these are high-end postcodes to begin with, you can see the very obvious issues here.

For starters, if (and when) the market cools, property owners could find themselves in a negative equity position – owing more on their mortgage than what their home is worth.

In other words, the risk is that you end up with a liability rather than an asset and moreover, a liability that you'll either have to sell at a loss, or retain in the hopes of regaining some of that lost capital ground.

Paying too much is particularly problematic for investors making off the plan acquisitions, who could find that when it comes to finalizing your loan contract, the lender decides the security (ie. new apartment) isn't actually worth enough to cover the amount you need to borrow.

2. Failing to research

When buyers start to feel a sense of urgency about getting into the market before there's nothing left (and what is available is completely unaffordable), they tend to make snap decisions.

I guarantee there'll be many a new investor who neglects to do the appropriate research and ends up with a dud, because not all properties are investment grade.

If you're investing based on what everyone else is doing rather than facts and figures, then the wealth you hope to achieve with real estate could elude you indefinitely.

3. Becoming complacent with your finances

Failing to take honest stock of your financial position before borrowing to acquire additional housing assets, when rates are at such an all time low, could see all of your investment dreams unravel down the track.

If your budget suggests that you could afford the mortgage repayments, but things may be a little tight financially, or there might be changes to your income on the back of significant life events like starting a family, then perhaps you need to do a little more number crunching.

Ideally, you should still be able to comfortably afford your mortgage at an interest rate of around 7 to 8 per cent, which is still held as the long-term average. And don't forget to allow for a cashflow buffer in case of emergencies!

4. Thinking anything will do

In tightly held markets when property is moving at a relatively fast pace, it's easy to assume that you can buy any old house and just wait for the revenue to come rolling in.

Optimal asset selection is critical to building a successful, long-term property portfolio. The investment you select must align with your strategy and goals, and demonstrate a history of sound, long-term growth with promising future prospects.

It must be a proven performer over the number of years you plan to hold it, irrespective of market ups and downs.

5. Not following a game plan

This is the most common downfall of investors who start out in overly optimistic markets. They leap without looking carefully at the elements that matter most – where you are right now, where you hope to be and how you plan to get there in between.

If you're investing in a property because you can, not because you necessarily should or even have a clue whether it's right for you, then what exactly is the purpose of the exercise?

If you would like to discuss whether purchasing a property investment at this particular point might suit your investment strategy and current financial position, the Trilogy team can help.

Click here now to connect with us and we can help you to identify and manage the risks, rather than ignoring them at your peril.