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Interest rates, Bank policy tightening, Housing markets and Small Business incentives

It has been an interesting last twelve months where, due to a need to boost the economic growth, the RBA has continues to use the cash rate as a lever to try to achieve that. In 2011 the RBA moved rates down from 4.75% to 2.50% over an 18 month period, held it steady for 2 years at 2.50% and recently dropped it again in 2015 to 2.00%.

Having the cash rate so low (although still comparatively high compared to USA and UK) means that the global and Australian economies are weak and need as much stimulus as possible. Within our political environment, the option of budgetary policy in the way of budget deficits is perceived to be poor government, so it is left to the RBA to use monetary policy.

Within the environment of lowering interest rates there has been a growth in residential housing prices in some markets, notably Sydney followed by a lesser extent Melbourne, however other capital cities and areas have seen little growth at all.

The hysteria surrounding Sydney house prices and its recent growth, has lead politicians and regulators to act or be seen to be acting to contain this. However the means they do is to ignore history or they haven’t understand what history has shown. Sydney median prices rose from just under $300k in March 1999 to around $580k by September 2003, it rose by 19% per annum for that 4 year period then remained flat until 2010 before increasing again briefly before the GFC effect hit, to again rising strongly in the last eighteen months or so. Market forces will determine where prices need to go to satisfy demand and supply, whether it is land supply or finance availability.

With RBA only able to use rhetoric to try to stem demand for Sydney houses (they cannot ignore the rest of Australia and the weak growth and confidence and I do not remember seeing controlling Sydney house prices as a prime component of their role within the Australian economy – it is to control inflation) it has been passed onto APRA (bank regulator) to step in and put some pressure on banks to reign in lending practices. In their wisdom, they have decided investors are the culprit and have directed banks to tighten lending policies to investors. They claim investors are driving the market (although it still seems around the 30% investor and 70% owner-occupier mix) and that the investor market is a higher risk of default (ignoring the RBA research paper of 2014 which states the incidence of default of the two are broadly similar), **so banks have changed lending policies for investors**.

- Some lenders have decreased loan to value ratios (LVR) to 80% for investors.
- Others have increased interest rates for investors, adding 0.15% or more.
- Some are adding a further 0.10% for an interest only facility compared to principal and interest.
- Some are assessing rental income at 60% compared to 80% previously.
- Many have changed how they calculate servicing so instead of taking other lenders debt at actual repayments, they are now assessing all debt at their assessment rates on a principal and interest basis. For instance a $400k interest only investment loan at 4.5%, with a repayment of $1,500 a month, suddenly they are using a $2,800 a month for servicing.

Banks are selling this as prudent lending standards. Does that mean that they did not have prudent standards previously? Has their incidence of defaults risen – NO. Is it a simply further grab for profits - YES. Remember many of the lenders did not pass on the full RBA cash rate cut from May.

Does this make it harder to obtain finance for investors – from the banks – YES it will, not impossible but certainly harder that previously. Other non-bank lenders will start taking market share off banks and it will be interesting to see the banks' actions once they start losing market share and in theory profits.

Does it make sense to blame investors for the rising Sydney market – NO. In theory lower interest rates should change the rent/buy equation for potential owner-occupiers to purchase rather than continuing to rent. It may just be that the uncertainty with the political leaders and the economy is such that renters are not confident to make that commitment to buy as yet and that investors see the volatility in the share market and weakness in the global economy as a reason to buy into the property market for more certainty of bricks and mortar.

What are the interest rate offers available?

With the positioning of lenders to gain or maintain market share, there are some very competitive interest rate pricing available at present. Unfortunately, most lenders do not pass on their offers to existing clients, they gear their better rates to attract new clients, not keep existing ones. If you have not refinanced or requested better pricing in the last five years, almost certainly you are paying more than you need to on your loans.

The following is an example of better rates available for loans.

- $250k loan at <= 80% LVR 4.17% to 4.24%
- $500k loan at <=80% LVR 4.13% to 4.23%
- 3 year fixed interest 3.99% to 4.24%
- 5 year fixed interest 4.29% to 4.49%

Factors that will affect what interest rate is available include – LVR, loan amount, state the lender lends to, type of property in some cases, can you show servicing with that lender and what facilities you require such as 100% offset. The interest rate (and associated loan costs such as monthly or annual fees and establishment costs) is a significant factor in determining what lender you use but it should not be the only factor. Loan structure is important, if you are establishing a line of credit facility (LOC) to extract equity to use for further investing, what the overall cost of the facility is when drawn down, what lender can you service with for the next investment if you are building a property portfolio, are all components into the decision of what lender you should use and perhaps more important what rate.

If you are still paying standard variable rates (ANZ for instance is 5.38%), for every $100k loan amount, you are paying up to $1,210 a year more in interest than you need to. If your current mortgage rates are not in the range shown above, give me a call and we can discuss what you can save off your mortgage.

Small business owners – immediate $20k tax write-off for capital purchases

The federal government announced, as part of the May Budget, a provision that will allow small businesses to be able to write off (tax deduction against income) capital equipment of up to $20k for purchases made in this tax year. This $20k is per item so businesses could purchase multiple items. Cash flow is a critical component to all businesses, so the option of a lease or chattel mortgage should be considered. We have access to a range of finance providers offering some very competitive rates, for cars, trucks and other business assets. Give me a call for a quote.

Our Service to You

We provide a specialised service for investors wanting to create long term wealth for themselves and their families. We are finance strategists, credit advisers and mortgage brokers, helping you achieve your goals. Give us a call when you think it's time to consider your options.

As well as providing a service to investors, we will assist you in purchasing as an owner-occupier, or upgrading to a new property, or simply looking at better pricing or structuring options for your current loans and banking or assisting seniors looking at possible reverse mortgage options.

Our business is built on referrals provided by clients, so please don't keep us a secret, feel free to forward this e-mail to family and friends interested in their own financial future. Give us a call and book an appointment to see if it makes sense for you.

If you have any questions about any of these topics, give me a call.

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