

How to play rising property prices while interest rates stay low

By **STUART WEMYSS**

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Almost everyone is predicting that property prices will surge higher this year. In fact, the newspapers are already full of stories about properties selling well above reserves.

Low stock levels are partly responsible for the exuberant market. That exuberance might cool as more stock becomes available. But the RBA and the government do not want prices to rise too quick as it might create a bubble, and all bubbles pop eventually.

Westpac's chief economist, Bill Evans, predicts that [Australian property prices will rise by 20 per cent](#) over the next two years. Most other economists agree with him.

According to [ABS lending indicators](#), the property market is still dominated by owner-occupiers.

However, as overall sentiment improves, it is likely that investors will return to the market, and that could further fuel price rises. The government could become concerned if it believed growth rates were unsustainable.

Last year the government announced that it would scrap the “responsible lending” rules in order to speed up loan approval times and eliminate the “one-size-fits-all” approach (that is, give banks more discretion).

The practical consequence is that lenders may no longer have to ascertain what you currently spend each month (including discretionary expenses). Instead, they could use a benchmark. In effect, for many borrowers, it would increase their borrowing capacity.

The Senate Committee [recently recommended to the government](#) that these proposed changes become law. The bill will now need to be debated and passed in the Senate and the House of Representatives before it becomes law. If the bill is ultimately successful, this could further fuel property prices.

There are two main reasons why the RBA probably will not increase the cash rate.

First, as highlighted by [governor Philip Lowe in a speech in - October last year](#), the lowest 40 per cent of income earners have been affected by COVID-19 the most. Therefore, an increase in interest rates would adversely affect lower-income earners who can least afford it.

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Second, an increase in interest rates would be very bad news for the federal (and state) budget deficit. The federal government's total borrowings are tipped to reach \$1 trillion. A 1 per cent rise in interest rates would cost the government an additional \$10bn a year. Politically, this is not an attractive prospect.

If the RBA doesn't feel it's appropriate to cool the property market by increasing the cash rate, then the next best method is to change prudential lending standards.

Here's how this might be done:

- Increase interest rates for investor mortgages and leave owner-occupier rates unchanged (investor mortgage rates are already 0.4-0.8 per cent higher than owner-occupier rates).
- Limit the maximum loan to value ratio (LVR) for investment loans. At the moment, investors can borrow up to 90 per cent of a property's value, meaning they only need a 10 per cent deposit plus costs. The government could reduce these LVR limits, like the Reserve Bank of New Zealand [did last month](#).
- Increase the benchmark interest rates for investors. A benchmark interest rate is used when a lender calculates your borrowing capacity. It provides a buffer to provide for future interest rate increases. The higher the benchmark interest rate, the lower your borrowing capacity.

I think it's very likely that the government (through APRA) will tighten borrowings criteria for investors sometime over the next six to 18 months. Of course, this is dependent on property prices. If price rises are considered sustainable, borrowing rules do not need to change.

For property investors, it is time to lock in access to as much capital as possible over the next six months.

Depending on the type and location of your property, I would probably be inclined to wait one to two months before getting your properties revalued. This will allow for some more comparable sales to occur. Then, around April or May, I would ask my mortgage broker to revalue my properties and lock in my borrowing capacity to 80 per cent of those new valuations. The exact timing of this does depend on your circumstances.

Notwithstanding the prospect of future lending rule changes (as discussed above), it is always a good idea to maximise your access to borrowings, even if you have no immediate plans.

Some people worry about the prospect of future property price rises and feel a sense of urgency to buy property now, before they rise further. Don't!

Of course, you shouldn't procrastinate. If you are ready to invest, you should certainly do so. But by the same token, if now is not the right time, do not despair for three reasons:

- Ultimately the price you pay for a property is largely irrelevant. What is far more important (by a factor of 10) is the quality of the asset you buy.

- Property is a long-term investment. You should plan to hold it for many decades. So there's no point getting anxious over a few months.
- Discretionary vendors will be encouraged by recent results. As such, we should expect the supply of properties on the market to increase. This may have a cooling effect on prices, or at least temper price rises. We must remind ourselves that prices are able to move in both directions.

One thing is almost for sure. Interest rates are likely to remain low for an extended period of time, and that's an opportunity.

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