TONY'S VIEW

My aim is to help Kiwis make better decisions for their businesses, investments, home purchases, and people by writing about the economy in an easy-to-understand manner.

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Thursday 26 August 2021

Reasons Why – House Price Inflation Will Slow

As an experiment, for a while I'm going to start each issue of Tony's View by running through a simple list of reasons for why a thing will or has happened. If you've got advice to offer regarding what issue to address or whether its good or a waste of time, let me know.

This week I'm going to start with the big piece of reality I've been trying to get across to people for a while and which the Reserve Bank Governor had a go at last week. But he blew his media message by saying he thought house prices would fall. I don't at the national level.

Why will house prices not keep rising at the 6.7% average pace seen since the end of 1992, once we get beyond the current remaining surge? There are five main reasons.

1. Slower Population growth

Over the 30 years to 2018 New Zealand's population grew about 48%. Statistics New Zealand project that over the next 30 years growth will be 27%.

This results from a fall in the fertility rate in the past ten years from 2.0% to 1.6%. Also, Baby Boomers are aging and starting to depart this mortal coil. The combination of a decrease in the birth rate and increase in the death rate has a powerful impact on population growth.

2. Higher Interest Rates

Mortgage and bank deposit rates have been oscillating downwards since 1992. That process has ended. The natural repricing upward of assets to reflect lower interest rates has ended. Now, some opposite pressure will arise.

3. Greater House Supply Growth

Since 1986 consent numbers for new dwellings have averaged below 0.6% of the population. We are now at almost 0.9% and have been above average for six years after seven years below average.

4. Rules Reducing Returns to Investors

Too numerous to name but including the brightline test, loss of some depreciation allowances and ability to claim interest expenses, Healthy Homes Act, tenant-friendly rules etc. More probably to come.

5. High Household Debt

The ratio of household debt to income now sits at 167% from below 60% in 1990.

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Bank attitudes & policies towards first home buyers

In the monthly survey of mortgage advisors I run with the folk at www.mortgages.co.nz, I invite respondents to make observations regarding bank lending policies towards first home buyers. Here is a selection of this month's insights which young buyers might find useful now that they are returning to the market in greater numbers according to this survey plus my latest survey with REINZ.

First Home Buyers

A key theme to come through is that banks are paying greater attention to short-term debt of young buyers, particularly the likes of Afterpay. There is a general tightening of criteria as banks get ready for the new Credit Contracts and Consumer Finance Act (CCCFA) changes. This legislation requires lenders to be certain the borrower fully understands what they are signing up to.

Where you see letters like "xxx" that is where the respondent has written a bank's name – but I see no reason to provide them with free advertising! Plus, the Aussie banks do tend to be sensitive to criticism.

- Xxx bank is applying a debt-to-income ratio of 6 times.
- Very tough on outside debt, account conduct, deposit amounts and savings history.
- Increasing uncommitted monthly income minimums.
- Just wanting to see affordability, making sure the clients can prove they can afford the mortgage.
- Looking at overall short-term debt levels.
- Deposit funds are still the crux of an application for FHB with 20% deposit still being the ideal and not many lenders are open to over 80% lending for new to bank clients and for Nelson/Tasman region the price caps are too low for being eligible for subsidy grant to assist with deposit funds for purchasing existing home ($525k) with current housing market and $600k for land & build packages - these have been snapped up as soon as mention of new developments coming on within this criteria and nothing ava for FHB at this time for new builds.
- Minimum 10% deposit unless Kainga Ora. No appetite for minor conduct issues at 90% LVR. Significant surplus requirements, although these have reduced quite a bit with

xxx bank and slightly with yyy. Little chance of boarder/flat mate income being considered to support servicing (zzz bank is the exception) if low equity. Not aware of any significant changes at this point, however I expect low equity criteria will tighten considerably and only the best of the best will be approved.

- Employment security is paramount for first home buyers, banks are also focused on Industries that are more effected by potential Covid lockdowns.
- Same employment for 2 years or same industry, IRD earnings 12 months, employer letters, payslips, ID and residency proof (even for Kiwis).
- Harsher on servicing, particularly at over 80%.
- Good servicing and account history.
- No new to bank customers at LVR >80%, pending CCCFA changes tightening approach further.
- xxx bank recently made some very good changes to criteria making it easier including lower servicing threshold and increase in boarder allowance. Well overdue.
- Strong UMI (uncommitted monthly income) if over 80% lending, but these have come down in the last 6 weeks or so. Clients may meet servicing criteria, but for >80% banks choosing which loans to take on board. Previously this was domain of the nonbank lenders. Its no longer, you meet our criteria, you get the loan. Another lender has introduced TDTI (Total debt to total income) voluntarily for FHB over 85% LVR. More scrutiny on the client spending habits, and particularly any unauthorized OD fees - pretty much kills a deal if over 80%.
- Preferring to lend to own customers - some banks not taking on new high LVR clients.
- Lost a deal to a direct bank channel for customers with a bad debt to a finance company that the non-banks refused to write, so it seems the banks are writing subprime lending on their prime products.
- Sounds as if xxx bank are introducing DTI's but being very quiet about it.
- They are restricting the amount people can borrow and being tougher on expenses
- Affordability seems to be front and centre. i.e., Rent + Savings = new mortgage repayment. Also, debt to income no higher than 6 times when >85LVR.
- Xxx bank DTIs are pinching FHBs now. Previously it was really only investors. This is increased prices driving this though, not tighter policy.
- Debt to income ratios strict on low deposit plus large scaling of any self-employed income
- The RB changes around low deposit borrowers haven't hit home yet. Expect more pickup by non-bank lenders when it happens.

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- Account conduct. CCCFA rules have begun and high-level checking of bank statements and client financial behaviour.
- More focus on DTI's and tougher to get across the line.
- Behind the scenes DTI, and micro-examining every current expense with no flexibility around "discretionary spending"
- Banks are warning they will be tightening up on debt servicing evidencing, and requirements for advisers to provide advice commensurate with age and stage.
- Stronger focus on customers individual expenses used for servicing calculations. No longer accepting a general figure for expenses probably in line with cccfa requirements coming.
- They are actively looking at their bank statements with a fine-tooth comb and coming back to us if we have missed any in our applications. Also, the scene will change even more with the CCCFA changes. Some banks are quite rigid in terms of less than 20% deposit which is the case with most FHB's.
- This space is quite competitive amongst the Kainga Ora lenders. Zzz have released some great tools to entice first home buyers to their bank. These include Interest free credit card, reduced fee's, lower interest rate for 12 months and cash backs on insurance policies and Kiwisaver.

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Investors not greatly exposed to higher interest

New Zealand is filled with people who believe that at some stage the great number of people who have sought to provide for their retirement (as advised by our governments for three decades) by investing in houses will come unstuck.

Every forecast of investors somehow getting their comeuppance via a substantial and sustained fall in house prices has been wrong. But at the moment there will be some of these people hoping and perhaps expecting that the increases in interest rates expected to be engineered by the Reserve Bank will cause a lot of investor pain. They are going to be disappointed.

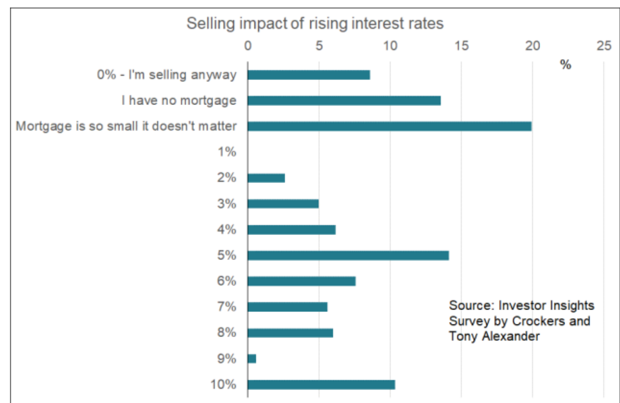
My latest survey of residential property investors undertaken with Crockers Property Management included an extra question at the end. I asked

"How much would your mortgage interest rate need to rise from its current level to force you to sell at least one of your properties?"

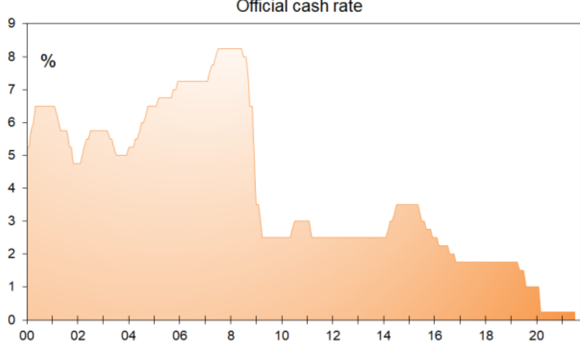
Those who have yet to make a property purchase and those wanting a structural adjustment downward in average NZ house prices will be hoping that a high proportion of investors reported that only a minor rate change would force them to sell. However, the opposite is the case.

For 43% of investors virtually any rate change would have no impact as they either have no mortgage, only have a small debt, or are planning to sell anyway. This is shown by the first three bars in the graph.

If interest rates were to rise by 5% then some 28% of investors would be forced to sell and that would represent an extreme hit to the NZ housing market when taken in conjunction with the fall in demand from virtually all buyers if they faced mortgage rates of 8% rather than near 3% currently.



However, such a large rate rise is very unlikely. The Reserve Bank have pencilled in rate rises adding up to just 1.75%. My personal view is 2.5% may be needed.



If mortgage rates rise 1% no investors say they would need to sell. If they rise 2% only 3% say they would need to reduce their portfolio. And if rates rise by 3% then 8% in total say they would need to sell.

The results allow us to say that the commonly expected cumulative rate rise for this monetary cycle of potentially less than 2% will have an extremely minor impact on the number of properties which investors will bring to the market.

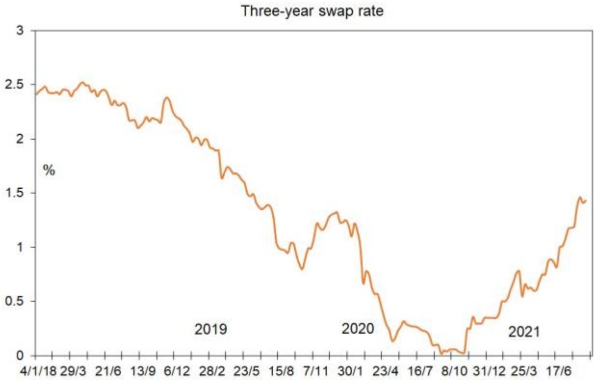
If I were a borrower, what would I do?

Nothing I write here or anywhere else in this publication is intended to be personal advice. You should discuss your financing options with a professional.

I've written quite a bit about interest rates recently, so will keep things short this week. Even though the timing of things in the very short-term has been affected by the new Covid outbreak and lockdown, the direction for rates remains upward.

If anything, the delay in interest rates going up increases their ultimate upside risk because we know the housing market gets a lift when lockdown ends, and people are again getting wage subsidies and building up savings to spend (a new fiscal stimulus is occurring).

This week, swap rates at which banks borrow to lend have largely held the low levels reached last Thursday morning, two days after the lockdown announcement.



The one-year swap rate sits unchanged at 0.94%, the three-year rate which people are now keeping a close eye on sits at 1.43% from 1.41% last week and 1.46% two weeks ago. The five-year rate is at 1.61% from 1.63%.

My expectation for the one-year rate in August each year is shown in the first column of the table here. I focus on that rate because there are many people who have fixed one-year repeatedly since 2009 and the strategy has worked very well.

The second column shows what the one-year rate will average over the next 2-, 3-, 4-, and 5-year periods. The last column shows the current 2 – 5-year fixed rates.

	Forecast 1 year Fixed rates	Rolling average rates	Current fixed	
2021	2.49		2.49	1 yr
2022	3.75	3.12	2.79	2 yr
2023	4.5	3.58	3.15	3 yr
2024	4.5	3.81	3.49	4 yr
2025	4	3.85	3.79	5 yr

If these forecasts prove correct (I'd give that a 10% probability), rolling one-year fixed will deliver an average rate for the next two years of 3.12%, three years 3.58%, four years 3.81%, and five years 3.85%.

Personally, I'd still be looking to lock in 2-3 fixed rate terms in the 2-4-year time periods.

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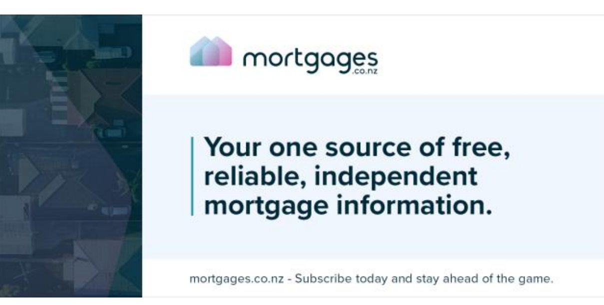

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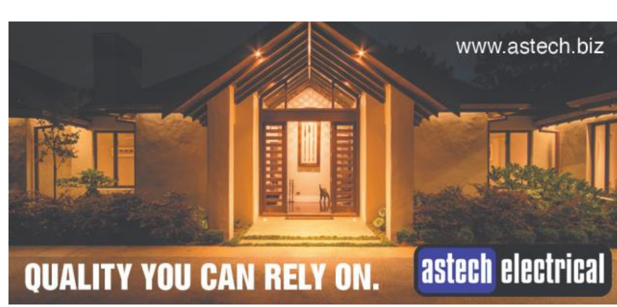

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