If You Want a Safe Investment, Invest in Property

As property commentator David Potts writes: "So the Reserve Bank is worried about property prices, fearing they'll go up instead of new homes. That's its problem. The more it worries, the better property prices look."

As property investors and owner occupiers we should be worried that our property is going to rise in price? Problems like that we all need.

It's true enough that first-home buyers with a $14000-21,000 grant up their sleeves (and even more with top-ups from the State Government) have contributed to price rises in the lower end of the market.

But Potts questions if this same group of buyers is still making that much difference when there has been a sudden and spectacular recovery in the top end of the market. Witness the recent weekend's auction clearance rates topping 74 per cent, the highest figure reached in a long while. And guess what the median price was? Try $706,000.

Another property commentator, Terry Ryder, actually questions the notion that first-home buyers are creating a bubble in the lower end of the market. He says while there have been small rises in prices in first-home owner suburbs, it has been in areas where there has been no growth for five or six years.

"It is hardly a cause for concern," Ryder adds. According to him, first-home buyers have been driven more by low interest rates and softer prices in a lot of areas and less so by the first-home owner incentives.

"Sydney and Melbourne dwelling prices are back at record highs," observes chief economist at CommSec, Craig James. "It is a simple case of supply and demand. Demand for homes is being spurred by improved affordability, the fastest population growth in 40 years and weak returns on other assets. At the same time, Australia continues to experience an undersupply of homes through lack of building over recent years. Demand for homes exceeds supply, pushing prices higher."

Potts points out that it will be worst bidding against other investors than against first-home buyers. The latter are declining in numbers anyway as banks raise the entry bar.

But Potts also sees another group of first-home buyers who are waiting in the wings until the temporary boost to the first-home buyer's grant expires at the end of September. This group looks to save through not having to compete with "swarms of temporarily cashed-up buyers".

Just like Ryder, Potts agrees that when the boost is halved and then eliminated three months later, it won't put a hole in home prices. That's because of the "undisputed housing shortage, rents rising at an average annual rate of 7 per cent and the lowest number of vacant places to let in more than 20 years."

Mortgage Choice and the Real Estate Institute ran a survey on vacancy rates in Sydney. The result? Vacancy rates were not much higher than 1 per cent which is half that needed to keep demand and supply balanced.

Potts further adds that the building slump and still-high immigration have combined to create a huge backlog of demand.

The next consideration is interest rates. The Reserve Bank has flagged an increase in the coming year. Just last week the Commonwealth Bank threatened to lift rates unilaterally if high funding costs (which includes what it pays depositors) persist.

But will a rise in rates deter investors? Not nearly as much as less well off first-home buyers. As Potts writes: "Rates would be coming off an unrealistically low base and besides, interest is tax-deductible."

He goes on to observe that a few rate rises would cleanse the market, but hardly stop it. The bigger threat is rising unemployment, but "higher unemployment than this hasn't stopped property prices from rising spectacularly before."

Sources: 1) "Property prices safe as houses", *The Sun-Herald*, 16 August 2009.
2) "The return of rental property", *The Sydney Morning Herald*, 8 July 2009.

Take Care When Asked to be a Guarantor

Many young buyers need a hand from their parents to take advantage of the first-home owners grant. But be sure to consider all the alternatives and ramifications before making a decision.

Property prices are rising and with that so will interest rates. With growing unemployment, guarantors are putting themselves at risk of losing their own home in bailing out their financially challenged children.

James Sheffield of Commonwealth's Mortgage Wealth Service points out that there are two main types of guarantee. There is "a supported guarantee, where the guarantor's

home or investment property is provided as security for the borrower's home loan and an unsupported guarantee, where the guarantor services the loan if the borrower is unable to meet his or her repayment schedule."

One little known fact is that guarantors can limit their liability by limiting the guaranteed amount to 20 per cent of the purchase price so their children can avoid paying lender's mortgage insurance.

Theoretically, if a divorce or loss of job occurs and the debtor can't meet their obligations, the lender can sell the home to settle the mortgage. Should there be a shortfall, the bank can then call on the guarantor to service the debt. Parents then have one month to come up with the cash before the property they put up as security for the loan is sold to repay the debt.

But consumer advocates point out that the bank doesn't have to sell the children's property first. "If you're a bank, you will sell whichever property will sell the quickest," says Katherine Lane of the NSW Consumer Credit Legal Centre.

"What people think will happen is not what will necessarily happen. Maybe you can convince the bank to be reasonable but they are under no obligation to be reasonable."

Sheffield, however, says enforcements against guarantors are rare and, while no figures are available, anecdotal evidence from consumer groups supports this claim.

Another option is for parents to lend their children the deposit and get a personal loan to do that if they don't have the cash. It's also recommended that buyers take out life and income protection insurance to protect their ability to continue making loan repayments if they are unable to work. This would safeguard mum and dad.

Guarantors should also be aware that they can be released from the arrangement before the end of the loan term. Once a borrower has built up about 30 per cent equity an application to have the guarantor released can be made.

In conclusion, before agreeing to be a loan guarantor be sure to get plenty of legal and financial advice from independent sources. Find out things like whether or not the guarantee is for a fixed amount or "all monies"—that is, amounts owning now and in the future.

Find out the exact fixed amount of the guarantee if it is fixed and make sure the guarantee states this. Do you need to place a mortgage on your property? What type of loan is it? Take care with loans that are not scheduled to be repaid. For example, overdrafts and line of credit loans—where guarantees can go on indefinitely.

Source: "A guarantor's key decisions", website www.domain.com.au, 21 July 2009.