Property Postcard

Ferrier Hodgson

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# BREWING STORMS FOR SYDNEY RESIDENTIAL PROPERTY DEVELOPERS

## As Sydney hits a record $1,000,000 median house price, could a storm be brewing for residential developers?

Sydney's obsession with the residential housing market ensures high level coverage in national and local media. Most Sydneysiders have an opinion or story to share about the sale prices in their neighbourhoods!

Media has focused on affordability, Asian buyers and what is being done to curb 'crazy' property prices in an environment of unprecedented low interest rates.

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Factors which may impact commercial property developers include:

- Home loan risk rate rising from 16 per cent to 25 per cent.
- Investor deposit increases of up to 20 per cent for at least one major bank.
- Interest rate increases of 0.27 to 0.29 per cent for three of the four major banks.
- Foreign capital restrictions.

### APRA's home loan risk rating

Developers have accessed cheap and heavily geared capital for the past few years. The Australian Prudential Regulation Authority (APRA) announced in July that the lending environment for commercial and residential property is likely to change significantly.

From 1 July 2016, APRA will require top tier lenders to increase the average risk rating for home loans from 16 per cent to at least 25 per cent. In line with international standards, banks will be required to fund existing lending with additional equity capital.

The new requirements will effectively reduce the banks' current return on equity which can be mitigated by:

1. Passing on the cost to customers through interest rates; or
2. Lowering interest rates on deposits

Strong competition in the marketplace for development finance may initially limit any increase in interest rates; however this is not the long-term view.

Major banks should expect a re-introduction of non-bank lenders to the market, who may explore methods such as online platforms. Access by developers to credit may change in response to financiers' perceived risks resulting in increased interest rates and lower loan to value ratios (LVR).

### Increased deposit for investment loans

Residential investors make up approximately 41 per cent of the Australian market up from 30 per cent in 2011. The RBA and APRA have been closely monitoring major bank investor lending standards as historically investor residential loans required 10 per cent or less of equity. It is reported that one of Australia's largest lenders has established a new LVR benchmark of 80 per cent.

This will affect developers by reducing the pool of potential property market investors. Furthermore, there may be increased settlement risks associated with existing purchasers who are potentially unable to meet new lending standards.

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### Increased interest rate for investors

Last week, the ANZ and CBA announced an increase of 0.27 per cent for residential investment loans to ensure an appropriate balance of investor to owner-occupied loans. Other major banks are likely to follow this approach. This move may coincide with APRA's objective to slow lending growth to investors to less than 10 per cent a year.

On 28 July 2015, the NAB announced it would increase its interest-only variable rates by 0.29 per cent for both investors and owner-occupiers. This move is likely to have a higher impact on investors due to their preference for interest-only loans.

Increased interest rates will lower residential rental yields with the consequential impact on price.

### Foreign capital

Well before Joe Hockey questioned the appropriateness of his neighbour's purchase, the FIRB have been policing the acquisition of real property by foreign investors. The existing rules allow foreigners to purchase new property only.

Complementing the taskforce and increased resources of FIRB to investigate suspect transactions, the government has flagged the establishment of a register and the introduction of substantial fees relating to acquisitions. An application fee of $5,000 is proposed for property under $1 million (with higher fees on properties exceeding $1 million).

According to the latest NAB Quarterly Australian Residential Property Survey, in the June 15 quarter, foreign buyers bought 16 per cent of new apartments and 15 per cent of new houses in Sydney.

Developers may expect reduced demand by foreign investors if higher fees and greater transparency of purchasers are implemented.

Other potential problems facing developers include:

- Increased building costs and extended construction timetables due to the shortfall of experienced tradespeople.
- Potential increase in GST to 15 per cent.
- Potential legislative changes affecting SMSF borrowing.
- Speculation as to the abolishment of negative gearing.
- Reduced stock / supply of greenfield property and development sites in Sydney.
- Static growth in rents forecast for residential property.
- Rising unemployment and limited wages growth contributing to serviceability concerns.

Whether you are a property developer, financier or other relevant stakeholder, it is vital to be prepared for whatever property storm may be looming. Ferrier Hodgson has a deep understanding of the risks impacting the property sector. If you have any questions or for further information, please contact us.

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Ferrier Hodgson's property specialists regularly send a *Property Postcard* detailing the latest news and trends in the property sector. If you have any comments or suggestions, please contact John Melluish directly at john.melluish@fh.com.au. If you know of others you think would be interested to receive the *Property Postcard*, please send us their details.

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