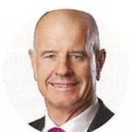
TOUGHER TIMES LOOM

Property investors, especially in the capital cities, have had a great run but that looks like changing



MALCOLM GUNNING

BEN KINGSLEY

PETER KOULIZOS

Q IT HAS BECOME HARDER FOR INVESTORS TO BORROW TO BUY PROPERTY. DO YOU THINK THIS WILL BE A CONTINUING CHALLENGE?

MALCOLM GUNNING, PRESIDENT, REAL ESTATE INSTITUTE OF AUSTRALIA

It will be a continuing challenge because the government is using the regulator, APRA, to control the property market. It is essentially a lever that can be eased on or eased off depending on the state of the nation. In the short term it is going to be tougher for residential investors to borrow as they have such a stronghold in the residential investment market.

BEN KINGSLEY, CHAIR, PROPERTY INVESTMENT PROFESSIONALS OF AUSTRALIA

There is no doubt the macro-prudential measures being actioned by APRA, combined with tightening lending policies and higher interest rates being charged by the banks, are making life more difficult for investors. That's their desired goal and I see it getting even harder and more costly from a lending perspective in the near term to further reduce the appetite to invest in residential property to take the heat out of prices in Sydney and Melbourne.

If I was looking to invest in property in the short term, I would be factoring in higher borrowing costs, say between 7%and 7.50%, to work out if I can comfortably afford to invest now. Also because you are late to the party for this current uplift cycle for capital growth returns in the Sydney and Melbourne markets, you might need to consider other capitals for better short-term returns or maybe pass off buying this time round and wait for these markets to come off their peaks.

PETER KOULIZOS, LECTURER AND AUTHOR

In the short to medium term, investors will continue to find it hard to borrow money to buy investment property. Investors already have to pay a higher interest rate compared with owner-occupiers. There is also a difference in the loan to value ratio (LVR) between investors and owner-occupiers – investors, especially property developers, now need a greater deposit or need to put in more equity. Some banks are also using a lower percentage of the rental income when calculating the investor's capacity to make mortgage repayments.

Q WILL THE BUDGET RESTRICTIONS ON FOREIGN INVESTORS AFFECT THE MARKET?

GUNNING

Yes, they will. They will affect the construction industry because many of the foreign investors underpin the pre-commitment requirements that in turn underpin the value. Currently you need to de-risk your development by 100%. Foreign investors were unafraid to pre-commit to developments where the Australian investors and first-home buyers were unwilling to take a risk.

KINGSLEY

In short, I believe it will have an impact on buyer interest from offshore. Considering foreign investors are only able to purchase new properties, the harder question to answer is, by how much? I personally don't think the federal and state revenue-raising initiatives will dampen too much foreign buyer interest in our marketplace, as the desire to hold property assets in Australia still remains high for our Asian neighbours.

In terms of the so called "ghost tax" on unoccupied property, I don't see this being that much of an incentive for foreigners to release "in bulk" their properties for rental. I suspect they will pay the tax and keep their property for own and their families' enjoyment when they visit.

KOULIZOS

The lower demand from foreign property investors has already started to impact the property markets that they were most active in – Sydney and Melbourne. The property price increases in Sydney and Melbourne have been very subdued this year, compared with their stellar performances in recent years. Growth will continue to slow in our two major capital cities as foreign investors seek other locations to invest. Most other capital cities and regional areas will not be greatly affected by the lower number of foreigners buying in Australia.

Q WHAT IMPACT WILL BUDGET CHANGES TO DEPRECIATION HAVE ON THE PROPERTY MARKET?

GUNNING

These changes are just another disincentive. It isn't a primary disincentive but is another deterrent to the viability and attractiveness of investment in residential property. While curbing of the abuse of deductions is supported, this initiative is contrary to the principles of a good tax system – the tax office already has systems for addressing abuses and excesses.

KINGSLEY

The federal government decision to restrict depreciation claims on existing properties' fixtures and fittings did come out of the blue on budget night. Investors who like to buy existing property will now need to factor into their calculations higher holding costs, requiring them to dig deeper into their own pockets to maintain cash flow in the early stages of ownership. Furthermore, for existing properties they should reduce what they are willing to pay for the property, given they can no longer write off any wear and tear on the fixtures and fittings.

In terms of steering large numbers of investors towards brand-new property, for those investors wedded to the idea of tax and depreciation benefits, this change might sway them in the "new" direction but I still think the smart money should stick with the sound fundamentals of choosing the right location where demand exceeds supply of certain types of properties, as this is where solid long-term capital growth will still win out over tax incentives.

KOULIZOS

The changes should only impact property investors who have bought since the budget on May 9, 2017. All existing property investors will still be able to claim depreciation on plant

and equipment, as well as the depreciation on the building.

However, if investors can clearly demonstrate and itemise the plant and equipment they have purchased as part of the property transaction – for example, through a separate contract – they may still be able to claim the depreciation on plant and equipment.

Investors who build a property and keep it as an investment should still be able to get full tax deductions for depreciation. However, this may not apply to investors who buy brand-new property.

Q WHAT IS THE BIGGEST CHALLENGE FACING PROPERTY INVESTORS?

GUNNING

The lack of capital growth ... those investors who are buying with capital growth in mind rather than yield will be challenged. We may well see small growth, or no growth, which will go against underlying inflation to show negative growth. In the past a big part of the investment market was speculative and that speculative market will disappear, as it has done previously.

KINGSLEY

Over the past couple of decades property investors have been too successful. So much so that we are getting challenged on many fronts, such as:

- **Too many sheep:** There are too many "new" investors coming into a hot marketplace, almost matching owner-occupiers one to one in some markets. This level of interest is unsustainable over the longer term. I do expect the heat to come out of this market cycle soon and we can return to more sustainable levels of investment. I do expect there will be some casualties who will learn that not all property makes for a good investment.
- **Market intervention:** With investors being blamed (incorrectly) for housing affordability and "budget repair" challenges, politics have found their way into this investment arena. As such, investors are now facing policy "thought bubbles" by those who don't understand the market's dynamics. From touted changes to negative gearing and capital gains tax, travel expense bans, higher interest rates for investors and interest-only loans, the list goes on ... property investors face real uncertainty. What they want is a sensible and stable regulatory environment that protects the long-term value of their investments, instead of potentially ruining their goal of being self-funded retirees.

KOULIZOS

The biggest challenge in the current lending environment is having enough equity to buy property. Most investors should still be able to buy one investment property. However, coming up with enough cash or equity to buy any more could be an issue.

In addition to this, the imposition placed on investors through higher interest rates, higher LVRs and the impact of the budgetary measures in relation to not being able to claim travel expenses or depreciation on plant and equipment will all mean there could be fewer investors buying property. This will help first-home buyers get into the market. However, it could have a detrimental effect on rents, as with a lower supply of rental properties rents could increase markedly. M