THE MORTGAGE MONTHLY

RESIDENTIAL

Cash Rate Update | held at 4.10%

An aerial view of a city

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**The outer suburbs are being impacted most by higher rates**

Despite interest rates rising at a record pace, the number of mortgage holders in arrears remains around the long-term average of 1%. However, households in the outer suburbs of the major capital cities are likely to be the ones facing the most pressure from higher rates.

According to new data from S&P Global Ratings mortgages ‘more than 30 days late’, are highest in Sydney’s south-west, with 2.5% of borrowers behind in their repayments followed by borrowers in Perth’s north-west, Melbourne’s north-west and the Blue Mountains.

Director of structured finance ratings at S&P Global Ratings said the areas experiencing the most pressure were typically in locations where there are high proportions of first home buyers who might be highly leveraged. She said that the while the arrears rate had been rising recently, they were still a long way off the peak during the global financial crisis (GFC) when arrears reached 1.8%.

Ms Kitson said that unemployment and the resulting loss of income was a “key cause of mortgage defaults” – but given Australia’s unemployment has remained at record-low levels – this has helped keep arrears low. She also said that many borrowers had also been able to build up a substantial savings buffer over the past few years, while the competitive refinance market has allowed mortgage holders to keep their interest rates manageable.

Despite that, there are still areas that are doing worse than others, led by the outer suburbs of the major capital cities. Ms Kitson said that Sydney’s south-west region had the highest arrears in May of over 2.2%. Perth’s north-east also saw arrears reach around 2%, along with Melbourne’s north-west, Sydney’s Outer West and the Blue Mountains area while other outer ring areas of Melbourne and Perth also had arrears rates of around 2%.

According to Ms Kitson, the outer areas often attract first home buyers, who are more susceptible to rate increases because they are generally on lower incomes. “If we look at arrears rates across our capital cities, the trend that starts to become apparent is that mortgage arrears are certainly higher on the outskirts and fringes of capital cities compared to inner-city areas,” she said.

“If you think about the types of borrowers and why that might be the case, housing is typically more affordable on the cusps on the fringes of capital cities. This is likely going to attract the types of borrowers like first home owners, for example, who – given their stage in life – are often more deposit constrained and therefore need to be more highly leveraged; they need to take on more debt. These types of borrowers are going to be more susceptible to high interest rate rises, given they may not have the saving buffers available to older borrowers,” she added.

She said mortgage arrears tend to be far lower closer to the CBD, where incomes are generally a lot higher than in the outer suburbs. “Those higher income levels and areas where you’ve got borrowers on those high-income levels, they’re, probably not going to be experiencing the same level of debt serviceability pressure, as areas where those income bands and proportions are not as high,” she said.

A building with a pool in the back

Description automatically generated**Pros and cons of building a granny flat on your investment property**

With higher interest rates impacting investors, many buyers are looking at creative ways to boost their rental income.

One popular strategy is building an extra dwelling – like a granny flat – on the property. While it’s not possible in all situations, there are benefits to having a second residence on the property. Here are some advantages and disadvantages of building a granny flat on your investment property.

**Advantages:**

**Cash flow and yield** – One of the main benefits of building a granny flat is the potential for increased cash flow and yield. With a separate living space on the property, investors can generate extra rental income. Even during periods when the main residence is vacant or undergoing renovations, income from the granny flat can continue to flow, providing a reliable source of cash.

**Tax benefits** – Investors may be eligible for certain tax benefits when they build a granny flat. Depreciation on the granny flat can help reduce their overall taxable income. This can result in significant savings, making it an attractive option.

**Equity growth** – Adding a granny flat to the property can lead to an increase in its overall value. While the equity growth may not match that of other dual-occupied properties like duplexes, it still provides some appreciation.

**Appeal to certain buyers** – Granny flats offer flexibility in their usage, making them appealing to a wide range of tenants and potential buyers. They can serve as a teenager's retreat, guest space, home office, or an extra bedroom.

**Development cost** – Compared to extensive renovations, duplex developments, or subdivisions, building a granny flat is relatively cost-effective. The lower development cost allows investors to expand their property portfolio without the huge costs that come with bigger projects.

**Rental demand** – Granny flats provide affordable housing options, making them highly attractive to a specific demographic of tenants, such as singles, retirees, the elderly, and single parents.

**Disadvantages:**

**Approvals and regulations** – Building a granny flat requires adherence to specific council rules and regulations, which can vary from one area to another. Obtaining the necessary approvals may not be quick and there might be additional costs involved.

**Overcapitalisation** – Investors must be careful about spending too much on any type of development. While a granny flat can add value, it may not always translate to a proportional increase in property valuation. Lenders may also be conservative in assessing the added value, limiting potential borrowing capacity.

**Limited buyer appeal** – While granny flats can be attractive to certain tenants and buyers, they may not appeal to everyone. Families seeking larger homes may not find a property with a granny flat suitable, potentially narrowing the target market and reducing the pool of potential buyers when it comes time to sell.

**Opportunity cost** – Before committing to a granny flat development, investors should carefully evaluate the opportunity cost of their investment. Consider whether the money used for the development could find higher returns elsewhere, such as a deposit for another investment property.

**Three reasons property prices are still rising**

Despite the Reserve Bank of Australia (RBA) raising the cash rate at a record pace, property prices have managed to shrug off the higher borrowing costs and again started to increase.

There are several factors as to why property prices rise, but at a national level, it’s clear the supply and demand fundamentals are still bullish for property.

**Tight supply**

One of the common themes we’ve seen over the past few years has been the tight level of supply. During COVID, listings were tight and demand remained strong. As interest rates started to climb, some of the demand started falling away, however, listings didn’t rise.

According to CoreLogic, the number of capital city homes advertised for sale is almost 20%

lower than this time last year and 26.4% below the long-term average. Regional listings are also sharply lower, tracking 32.9% below the previous five-year average.

The tight supply levels have been one of the main factors that has propped up prices over the past few months. Demand for high-quality listings remains higher and is leading to strong competition for properties.

**Record immigration**

Immigration levels fell away dramatically when the government closed the borders. Prior to COVID, the government would typically bring in between 200,000-250,000 migrants every single year.

Since late 2022, the government has increased that number to 400,000-500,000 which is leading to a record increase in demand for property. These numbers have also been inflated by the huge increase in students coming to Australia to study. This has dramatically increased the level of demand for homes, as new arrivals add to the pool of buyers.

**Tight rental markets**

The surge in immigration has also put rental markets under more and more pressure. Across the country, vacancy rates in many states are sitting at or near all-time lows.

The demand from overseas migrants is incredibly high, and these people will typically rent before they buy. This is leading to upward pressure on rents in most locations, with the latest data from CoreLogic showing that rents have surged 11.5% in the past 12 months.

Normally rental growth leads to property price growth. As renters who are having trouble finding a suitable rental property will look to buy if it is more financially viable to do so. This leads to upward pressure on property prices.

For the most part, the surge in property price growth has been led by people simply looking for a home to live in. With few choices on the market and ever-increasing numbers of people in Australia, this will continue to put upward pressure on property values.

A house with trees and grass

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A living room with white furniture

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**Four reasons to buy and sell in winter**

The spring is usually the most active time to buy and sell real estate in Australia, however, buying in the winter months can present some advantages and help you get an early start.

This year, we are already seeing the number of listings and auctions begin to rise as confidence is returning to the market after a period where interest rates have risen sharply. For those looking to buy or sell, here are some reasons why winter might be the perfect time this year.

**Less competition and better deals**

One of the biggest advantages for sellers in winter is the lower supply of properties on the market. With fewer listings available, sellers have the opportunity to attract a more focused and captive audience of buyers. This can lead to less competition for properties and potentially better deals for both parties.

**Timing is not as crucial**

In the past, sellers and buyers may have preferred to wait until spring to make a move. However, the real estate market has evolved, and the seasons are no longer as critical in determining the best time to buy or sell.

In some areas, there may be a continuous demand for properties throughout the year due to factors like population growth and immigration.

Often, the best time to buy a property is when you are ready to do so and have the finances in place. While sellers are most of the time selling for personal reasons such as needing to upgrade or downgrade. This is often more important that trying to market their properties later in the year.

**Increased seller commitment**

Selling in winter can attract more committed sellers. Those who list their properties during the colder months are usually determined to make a sale, which can work to the buyer's advantage. Sellers are more likely to be open to negotiations and meeting the market, which could result in more reasonable prices for potential buyers.

**Seasonal home appeal**

Winter can also be a great time to showcase certain properties in their best light. Homes with features that are particularly attractive during colder months, like a cosy fireplace or inviting interiors, can have a higher emotional appeal to buyers.

On the flip side, properties with features that might be more suitable for warmer weather, such as large outdoor spaces or pool areas, might be better suited to market in spring or summer.

**Is it worth leasing a motorbike?**

With spring just around the corner, motorbike enthusiasts will be getting ready to get back out on the road for some long rides. If you’re in the market for a new motorcycle and don’t have the funds to purchase a bike outright, there is the option to lease the vehicle. Before leasing a bike it’s important to weigh up the advantages and disadvantages.

**Pros of motorcycle leasing**

**Opportunity to 'try before you buy'** - If you’re unsure about what bike you want, then leasing might be a good way to 'try before you buy.' If you're a new rider, leasing allows you to experience the thrill of riding without a hefty price tag. You can get a feel for different models, assess your preferences, and determine if a motorcycle is genuinely for you. If you end up falling in love with the experience, you can explore purchasing a motorcycle later on.

**Lower monthly payments** - When you opt for a motorbike lease, you'll typically have lower monthly repayments compared to financing a bike with a loan. This is beneficial if you're not in a position to make significant financial commitments. Leasing can also include lower upfront costs, as dealers frequently waive down payments making it more accessible for those on a tighter budget.

**Easy to upgrade and maintain** - For motorbike enthusiasts who always want the latest models, leasing is an attractive option. Leases allow you to regularly upgrade to newer models, staying up-to-date with the latest features and technology. Additionally, basic maintenance will typically fall under the lease agreement.

**Cons of motorcycle leasing**

**You never own the motorbike** - If your ultimate goal is to own the motorbike, leasing might not be right for you. One of the best parts of owning a bike is the freedom – knowing that the bike is not technically yours might not sit well with you. At the end of the lease term, you will likely have to give the bike back. Instead, you might be better off directing the money spent on leasing towards repayments on a motorbike loan, allowing you to own the bike outright.

**Driving restrictions and charges** - Motorbike leases often come with mileage limitations, restricting the number of kilometres you can ride per year. Exceeding this limit can result in additional fees you might not be prepared for. On top of that, you might be liable for charges related to excessive wear and tear on the bike. If you plan on taking long rides or extensive trips, these limitations might not suit your adventurous spirit.

**Limitations on customisation** - Leasing a motorbike means you won't have complete control over the bike's customisation. Since you don't technically own the bike, modifications and adjustments may not be allowed. If personalising your bike to suit your preferences is a priority, leasing might not be the best choice.

The back of a motorcycle

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This is general information only and is subject to change at any given time.

Your complete financial situation will need to be assessed before acceptance of any proposal or product.