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Smart Investor

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DEPOSIT SWEETENER COULD TURN SOUR

Election promise First-home buyers may get a better start via existing loans, getting bank-smart or asking for family help, writes **Duncan Hughes**.

Falling property prices, rising supply and a little help from the bank of mum and dad are likely to be more help to first-time buyers trying to bridge the deposit gap than election promises. Only a fraction of eligible home buyers will be selected for the deposit scheme being promised by both major parties and many of the scheme's features are already available in existing loans for borrowers who meet lenders' strict criteria.

There are also fears the proposed scheme could raise the cost of properties in the price range coveted by first-time buyers and even drive up the cost of mortgages.

"It would make a difference, but only a small number will be eligible," says Jashan Gill, 27, who has been saving for nearly eight years to build a 20 per cent deposit for a Sydney home.

Gill, a business analyst, fears both major political parties' promises to help buyers could make it tougher because those just priced out of the market could afford to pay a little more. "I am getting close to 20 per cent and it has been a stretch," says Gill.

But Gill knows the Coalition has capped the scheme at 10,000 loans a year, or about one in every 10 first-time buyers, according to the Grattan Institute.

He is also used to seeing the elusive 20 per cent goal repeatedly made harder as Sydney price growth during the past decade has easily outpaced wage growth and inflation.

Sydney's median residential property price of about $970,000 means a single-income key worker, such as a teacher, nurse or young executive, will take more than 12 years to save a 20 per cent deposit, according to recent analysis by insurer Genworth.

In Melbourne, where the median price is around $746,000, it will take nearly 10 years, according to Genworth.

The proposed scheme is intended to help eligible first-home buyers purchase a house with a deposit as low as 5 per cent by saving them lenders' mortgage insurance, which covers lenders' risk for buyers with less than 20 per cent deposit. It provides a surety for the first 15 per cent of the loan. As the table shows, these costs can be sizeable.

Details of the scheme, which was announced by the Liberal Party last Sunday and then matched by Labor, are sketchy.

What is known is it will target individuals earning up to $125,000 a year or couples with a combined income of $200,000. Properties that can be purchased will be assessed on a regional basis to allow for the big price gap between capital and regional cities.

"The Labor and Liberal promises to help young home buyers has raised hopes high but is unlikely to deliver," warns Cate Bakos, a Melbourne-based buyers agent.

Big bite

Estimated lenders mortgage insurance for first-home buyers with 5% deposit

Property price	$1,052,632	$421,053
Loan amount	$1,000,000	$400,000
Deposit	$52,632	$21,053
LMI*	**$45,100**	**$13,440**

* Inc GST, ex stamp duty. Provided by Genworth as at May 13, 2019. Based on first-home buyer premiums. SOURCE: CANSTAR

These schemes can have the opposite effect and worsen affordability.

Martin North, Digital Finance Analytics

Brendan Coates, a fellow at the Grattan Institute, says: "There is a risk it will go from irrelevant to counterproductive because it tries to fix the housing affordability problem by adding to demand for housing."

Coates says the scheme is likely to squeeze out investors, particularly if Labor wins and abolishes some negative gearing breaks.

Borrowing power is calculated on salary and expenses, not on deposit size. Online comparison site Canstar cites the example of an individual on an annual income of $125,000 with total expenses of $17,630, who would be able to borrow a maximum of $538,000 for a 30-year loan. These expenses are based on government statistics and include food, insurance, transport and general household expenses. They exclude rental, credit card costs and car repayments.

The deposit of 5 per cent takes the total to $566,000, according to Canstar.

Based on the same assumptions a couple could borrow up to $1.3 million.

"Incentives lift all the boats in the harbour," says Martin North, principal of Digital Finance Analytics. He adds those lacking the discipline to save a full deposit are more likely to struggle with ongoing payments, raising the risks of delinquency.

"These schemes can have the opposite effect and worsen affordability," North says.

Other analysts claim loans under the scheme could attract significantly higher capital charges compared to loans in which customers put down a larger deposit or take up lenders mortgage insurance.

The table shows how interest rates are cheaper on loans with a 20 per cent deposit as opposed to a 5 per cent deposit.

10,000 loans a year
Coalition limit is about one in every 10 first buyers.

27% of market
First-time buyers with mortgages in February

But limited details about how the scheme works make it difficult to be specific about potential impacts on loan and insurance costs, analysts claim.

Brokers claim the funding target for many borrowers will be to remain below the first-time-buyer threshold for state government stamp duty exemptions, which is $650,000 in NSW and $600,000 in Victoria.

"LMI is put there for a reason," adds Bakos. "Buyers with a low deposit are a riskier proposition and are put through additional hurdles by lenders, with higher scrutiny and tougher conditions when they opt for loans at this level."

There are plenty of loans below 4 per cent available for borrowers with only a 5 per cent deposit and who meet lenders' rigorous income and spending criteria.

In addition, lender's insurance is usually capitalised on to the loan. That means the typical $10,000 premium on a 4.5 per cent loan adds about $50 a month on a 25-year principal-and-interest loan.

Borrowers with regular income and disciplined saving should be able to knock another 20 basis points off the headline rate, say mortgage brokers.

Most lenders offer family guarantees allowing family members to use their home equity to provide additional security for a portion of the borrowers' loan amount.

It reduces the loan to value ratio and might even avoid the need to pay lender's mortgage insurance or low deposit fee.

But each bank has different fees and conditions. Macquarie Bank insists that where a guarantor's property has an outstanding debt it must be repaid or refinanced across to Macquarie, which does not take second registered mortgages behind other lenders.

Paul Moran, principal financial planner with Moran Howlett Financial Planning, warns that parents are often unwilling – or unable – to keep oversight of the loan.

"Parents are often unwilling to regularly ask for statements on loan status and can find out far too later that their child is in significant financial difficulty. But they are on the hook if there is a default," Moran says.

Nearly half of first home buyers turn to parents for either a deposit or as a loan guarantor, according to analysis by finder.com.au, which monitors prices and rates.

"They provide support in other ways too,"

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Cost overview

Lowest-rate variable owner-occupier home loan with 20% deposit

Lender	Loan	Rate (%)	Comparison rate (%)
Reduce Home Loans	Rate Slasher	3.44	3.44
TicToc Home Loans	Live-in Variable	3.47	3.48
loans.com.au	Smart Home Loan	3.48	3.50
Mortgage House	Advantage HL Essentials	3.48	3.63
Freedom Lend	Freedom Variable	3.49	3.49

Lowest-rate variable owner-occupier home loans with 5% deposit

Lender	Loan	Rate (%)	Comparison rate (%)
G&C Mutual Bank	First Home Premium	3.59	3.62
RACQ Bank	Mortgage Saver	3.69	3.69
BankSA	Basic Promo Variable	3.69	3.70
WAW Credit Union	Back to Basics Home Loan	3.69	3.74
Community First CU	Accelerator Package HL	3.69	4.09

Rates and comparison rates current as of May 15, 2019. Based on variable home loans available for $550,000. Table sorted by nominal rate, followed by comparison rate. Does not include loans with introductory periods. SOURCE: CANSTAR

ILLUSTRATION: SIMON LETCH

Pet spas and massage tables – the future of apartment living

Flat chat

Jimmy Thomson

There is a growing division in the world of apartment living and it's not – for a change – between owners and renters. It's between the haves and the have-nots.

There are plenty of renters who are loaded and lots of apartment owners who don't have two bitcoin to rub together.

Those apartment residents who have cash to splash are spending it on facilities that are possibly just as much status symbols as they are lifestyle essentials.

It's not so long ago that a lap pool and gym (a windowless room equipped with a clapped-out exercise bike and a machine bought off a late-night TV shopping channel) were advertised as "resort facilities".

These days buyers into high-end apartment blocks expect a lot more. The gym equipment has to be top of the line, even in areas with a new commercial gym on every corner.

There is one large apartment block in Sydney that has not one but two music rooms – one of which comes with a baby grand piano.

Others have cinema rooms that you can book for free, libraries for quiet contemplation, table-tennis rooms and heated communal spas.

Saunas and steam rooms may be coming back into fashion after years of bad press about running costs and maintenance, but massage suites and fitness assessment rooms are a more recent trend.

Inside the apartments, timber floors in the main rooms and lush carpets in the bedrooms are de rigueur. Add in a kitchen in which you could stage a heat of *MasterChef* and bathrooms big enough to hold a Roman bacchanalia – you get the picture.

All of this costs money but hey, that keeps the riff-raff out. Nowhere is that principle more vividly illustrated than in Victoria where purchasers of some high-end apartments must sign a legally binding caveat that they will never let their apartment on Airbnb or any other holiday agency.

It's not so long ago that a lap pool and gym ... were advertised as 'resort facilities'.

With yoga rooms and rooftop silent cinemas offered as a selling point in some Australian apartment blocks, you'd think we were ahead of the game here. Not even close. If America now is Australia five years hence, this is what you can expect to be offered in a 2024 luxury apartment block.

There will be a 24-hour gym, a walking trail and outdoor fitness stations all around the scheme. It will be pet-friendly, with a dog run and pet spas.

There will be communal barbecue grills, outdoor TV screens and free Wi-Fi, a heated swimming pool with resort-style sundecks and a fire pit. It will have a virtual golf simulation room, a club room with a pool table and a media room with flat screen TVs. There will be environmentally conscious airconditioning, lighting and appliances, plus a private guest suite for visitors, a 24-hour business centre, home-minding services for while you're away and parcel collection.

There will be online or smartphone rent payment, a residents' intranet, social networking events and 24-hour emergency maintenance.

Various apartment blocks in Australia already have similar facilities, but perhaps not all in the one place. So is this just a pipe dream, a glossy brochure that the reality will never match? No, it exists and a second-floor, 76 square metre one-bedroom apartment with study will cost you from $3435 a month. The place is a build-to-rent called The Parker and it's in Alexandria – Washington DC.

OK, it would be a bit of a commute, but check it out online and see what the future of apartment living looks like – for some. SI

Jimmy Thomson edits the apartment living advice website, flat-chat.com.au. States have different strata laws.

From previous page

Housing turns from threat to opportunity

experienced during the crisis (and may now be higher); home loan prepayment rates dropped like a stone, blowing out the expected life of these bonds; new RMBS supply soared to the largest levels since 2007; and the credit spreads offered on the bonds tightened to the skinniest margins in over a decade.

For the last year and a half we have felt like a lonely voice highlighting these risks, and published novel research to verify them. For example, we developed the world's first "hedonic", or compositionally adjusted, index of RMBS arrears that showed they were climbing in contrast to Standard & Poors' index that implied they were moving sideways (the S&P index was artificially suppressed by the surge in new RMBS issues that are default-free).

Indeed, since almost every bank in Australia is loaded up to the gills with RMBS that they buy for their "liquidity books" and most fund managers have large allocations, often to the riskiest tranches with the highest yields, there has been an enormous amount of "book-talking" defending these positions.

While we tried to get short the sector, or profit from price falls, and were definitely shadow-short relative to peers, we were not able to do so for a bunch of complex reasons that would ruffle far too many feathers were they revealed.

We have, therefore, been one of the few unconflicted participants when it comes to objectively evaluating the pros and cons of RMBS vis-à-vis other alternatives. Pretty much everyone else issues it, buys it, rates it, and/or clips the ticket advising on it.

In 2019 it has been the worst-performing sector in Aussie fixed income with primary, or new issue, credit spreads moving consistently wider since mid-2018.

But if the RBA cuts, the housing market turns and Westpac prevails in its responsible lending case with ASIC in the Federal Court, we will consider buying fresh RMBS pools (not existing issues) over the next one to two years if they are priced correctly.

I generally like the secured (asset-backed) and self-amortising (where principal is constantly repaid) nature of RMBS, and the exposure you typically get to thousands of diversified loans. But these are complex assets to understand and price, and the huge "long-only axe" in the market means most commentary and research tends to be biased and seriously understates the risks.

For example, we have regularly marked to market RMBS deals priced since 2017 with low levels of loan seasoning (ie, low weighted-average loan lives) using CoreLogic's hedonic house price indices. This analysis reveals a striking increase in risk in many recent RMBS portfolios as a function of falling house prices and rising arrears. We can find deals where the share of loans with less than 10 per cent equity protecting them appears to have leapt from below 5 per cent to over 20 per cent.

Indeed, one transaction looks to have 12 per cent of all its assets underwater, or in negative equity. This unambiguously increases the probability of rating downgrades and should, at the very least, demand greater compensation in the form of superior spreads. SI

The author is a portfolio manager with Coolabah Capital Investments, which invests in fixed-income securities including those discussed by this column.

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Deposit sweetener for election could turn sour

says Kate Browne, an analyst for finder. "They could be letting them live at home for free, or charge lower rent," she adds.

Craig Hollett, a director of Solomon Hollett Lawyers, says problems often arise because the original deals have not been properly documented and the courts have to reconcile different accounts.

"The key thing is to document any agreement," says Hollett. "There is nothing worse than to later say this is what was agreed if there is no contemporaneous record."

The document should include whether the loan is registered against the title for the property or if the parents are noted as part owners. Any loan agreement should spell out repayment conditions, interest rates terms and other issues, such as lenders' rights on default. Alternatively, there needs to be a document specifying any gift. Parents also need to specify in their wills whether the debt will be forgiven and ensure other beneficiaries will not be disadvantaged.

Moran recommends gifting money: for example, retired parents can draw down a lump sum from super savings. "Check that it does not have any current or future impact on Centrelink payments," he says. "Don't make promises you can't afford to keep."

Ironically, the scheme is being proposed as first-time buyers are being attracted back to the market by less competition, lower prices and bargain basement lender rates resulting from cheaper funding costs.

In February first-time buyers accounted for more than 27 per cent of the home loan market, the highest since the property price boom started seven years ago. SI

MARCO POLO

Each week, our experts look at a global stock.

Fanuc

Trade tensions between the US and China, along with the weakness in the smartphone sector, mean a more muted outlook for robotics manufacturer Fanuc. But we believe the outlook is reasonably strong despite management's conservative outlook, with orders in China potentially picking up ahead of a prospective resolution on the trade front.

Fanuc has seen a change at the top, with CEO Yoshiharu Inaba, the son of the company's founder, last month passing the baton to president and chief operating officer Kenji Yamaguchi.

Inaba was largely responsible for making Fanuc one of the largest suppliers to the smartphone sector, but has recognised secular shifts and the need for rejuvenation by letting in young blood and a pivot to more lucrative markets.

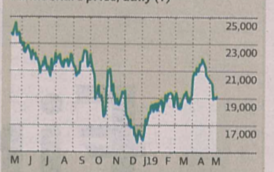
For the end-March financial year, sales came in at ¥635.6 billion, down 12.5 per cent year-on-year. This followed a deceleration in the third quarter culminating in one of its slowest sales results in recent history.

US-Chinese trade negotiations have had a strong impact, with a fifth of sales coming from China and many companies putting off capital spending. Over the long run, though, demand for robotics from China should remain robust as more workers seek employment in white-collar work. On a positive note, orders in the fourth quarter were up 2.6 per cent quarter on quarter after hitting a nadir.

Cost of sales fell at a slower pace than revenues, declining 7.2 per cent to ¥369.8 billion. This meant gross profit margins contracted by 3.4 percentage points to 41.8 per cent. This figure is still much higher than peers where the median is 27.95 per cent, emphasising the significant cost advantages Fanuc enjoys. The company is near the top spot in the industry (97th percentile), largely due to using robots and factory automation in its factories and employing fewer human workers than peers. The viewpoint from management looks far too conservative in our view, especially with the Chinese economy showing some positive signs recently. Indeed, "consensus" net income for this financial year is pegged at ¥100 billion (A$1.31 billion) versus ¥62.3 billion by management.

Better times ahead

Fanuc share price, daily (¥)



SOURCE: BLOOMBERG

We also believe that China and the US (particularly Donald Trump who will want to get re-elected) have a vested interest in not walking away from talks. A trade settlement would boost investor sentiment towards Fanuc.

Overall, Fanuc boasts some of the highest margins in its sector. The company uses robots to build other robots at its factories in the Yamanashi Prefecture, trimming high labour costs. In our view, Fanuc is a well-oiled machine with cost advantages helping maintain solid industry margins even when it endures periodic contractions in demand. W

GREG SMITH

Greg Smith is head of research at investment research and funds management house Fat Prophets. Interests associated with Fat Prophets declare a holding in Fanuc. To try Fat Prophets' daily market commentary, please call 1300 881 177 or email info@fatprophets.com.au.