

THE FINAL WORD - 'ZERO INTEREST'

Welcome to the brave new world of zero percent (benchmark) interest rates.

Wow! What would have still seemed almost inconceivable just a few short years ago and absolutely impossible a few more before that, is today well on the way to becoming a reality in Australia, as we rather belatedly but unsurprisingly catch up with the status quo across the rest of the developed world.

Well, as we've simply never been this far before, what will the new reality mean for the property market?

First and foremost, the heightened affordability that is part and parcel of lower interest rates means people can service a higher mortgage ('buy a more expensive house') without their income changing, something they will be able to do (only) until the weight of additional people able to enter the higher market drives prices up to balance the ledger. In summary, prices rise as interest rates fall!

The same mechanics work for investment property with an additional impetus coming from the fact that as interest rates fall (and their cash deposit equivalents), market forces dictate that investors will (have to) accept lower returns.

To illustrate the point, when borrowing rates were at 8% (not so long ago), a return of 5% on a well-positioned property would hardly have rated a second glance. Today such a property would be snapped up as a return along those lines would make the property almost 'positively geared' from the outset (the term positive gearing almost unheard of in Australia since Negative Gearing was first introduced in the early 1980's).

Lower financing costs also means developing property carries less financing cost risk, hence the current apartment building boom occurring in Brisbane and in other capitals along the Eastern Seaboard.

Heightened availability of investor stock (where we are headed at least at the lower end of the market) means downward pressure on rental yields and thereafter diminished returns, the latter always balanced however by the fact that it has always been (and will likely always be) difficult for any Australian to stomach paying a rental amount higher than the cost to service a loan to buy the same property.

Ultimately low (and soon ultra-low) interest rates positively influence values in all stable residential property markets. I say stable property markets because the same fundamental does not apply were you to buy a house in a mining town in a resources downturn (or bust - which all mining towns have after a boom), where a \$1 million purchase price 'justified' when the property was returning \$5,000 per week in rent can plummet 75% almost overnight when there are no longer tenants for it at any price (as is the case presently).

Like with all property booms regardless of stimulus or stimuli, the latest run in the market is a bottom up affair and just how long it will take to work its way fully through to the middle and upper sectors of the market and how long it endures once there is at question.

It's in question because the further you go upmarket, the more influence do other factors beyond serviceability come to the fore. For the Top End of the market to truly fire normally requires that the economy be on track (which it currently is not).

For the sector to fire in a down economy therefore requires something from left field. Enter the mainland Chinese. They are the current potential saviours for the mid to high end of the market (assuming they can stay the course or are allowed to). Without them, life at the better end of the market may well prove a harder road to Hoe regardless of how far rates fall!

— John Johnston