The POWER of financing

RECORD-LOW MORTGAGE LENDING RATES HELPED RESIDENTIAL VALUES TO HIT NEW HEIGHTS DURING THE PANDEMIC, BUT A NEW SET OF DRIVERS IS NOW IN PLAY, WITH CONSEQUENCES FOR RESIDENTIAL DECISION-MAKING.

ULTRA-LOW MORTGAGE LENDING rates and a sustained programme of fiscal stimulus from the globe's central banks kept economies afloat and owners in homes during the darkest days of the pandemic.

But over the last 18 months, the hard work has really begun as policymakers worldwide battled to close Pandora's inflationary box, with broad effects for borrowers.

Sam Stepney, head of strategic partnerships and activation at financial advisory firm Vega Mortgages, says New Zealand's Official Cash Rate (OCR) is now at the highest level it's been in 14 years, with many Kiwis needing to make some tough choices as the cost-of-living crisis continues.

"Economic uncertainty and the Reserve Bank's (RBNZ) tough talk on inflation have seen Kiwis shy away from residential purchases over the last year, as higher mortgage lending rates remain the most significant drag on market activity.

Though the winds may be shifting on real estate turnover, with wholesale lending rates – which dictate local mortgage rate offerings, and inflation data tracking lower in recent weeks," she says.

THE SWAP RATE TANGO

Determined by supply and demand market forces, wholesale interest rates are the rates at which banks and other financial institutions lend to each other in the wholesale money markets.

In many cases, and particularly in New Zealand, which has a relatively small, open economy, overseas interest rates set the base for our mortgage rates. When global swap rates increase, the cost of international borrowing rises too, which can lead to an uptick in the cost of funding for New Zealand lenders.

This has been a key determinant of recent market activity as central banks raised cash rates internationally to quell inflationary pressures and dampen consumer demand for goods, services and assets like residential property.

However, recent bank failures in the United States and weak domestic growth have contributed to a natural contraction of credit conditions, meaning wholesale interest rates have fallen 50-70 basis points (bps) over the past month.

Stepney says this was a critical factor in the RBNZ's surprise decision to raise the OCR by 50bps (0.50 percent) in its April Monetary Policy Statement (MPS).

"The recent decline in wholesale swap rates was beginning to manifest as downward pressure on mortgage lending rates, which in turn necessitated a larger-than-expected rise in the OCR, for the RBNZ to maintain current lending rates and keep a grip on inflation.

"Essentially, the RBNZ treated this as a way of maintaining interest rates at their current banking levels. But it's been interesting to note that retail rates have shifted only marginally, leading many to surmise that the most popular terms of one and two years may have reached their peaks."

COMPETITION HEATS UP

Despite the still-rising OCR, New Zealand's lending institutions are becoming increasingly competitive as they work harder to win new lending business amid lower real estate turnover.

The some $6.6 billion worth of new mortgage funding advanced in New Zealand during the first two months of 2023 is less than half the nearly $14 billion provided during the same period in 2021 when the housing market was riding high.

> "RETENTION OF CLIENTS WILL REMAIN A FOCUS FOR LENDERS WITH CUSTOMERS LIKELY TO BENEFIT FROM THE DOMESTIC FINANCIAL POWER BATTLE."
>
> SAM STEPNEY, VEGA MORTGAGES HEAD OF STRATEGIC PARTNERSHIPS & ACTIVATION

"Lenders are becoming more competitive to attract new business and retain existing customers, which may well open the door for mortgage lending rate reductions in the not-too-distant future.

The major players are keen to maintain their market share, particularly in the refinance market where approximately 55 percent of fixed mortgage debt is due for refixing within the next year.

This means retention of clients will remain a focus, with customers likely to benefit from the domestic financial power battle," Stepney says.

CHANGING THE RULES

Adding another dimension to the light at the end of the tunnel, particularly for entry-level and leveraged borrowers, the government recently announced a suite of additional reforms to the beleaguered Credit Contracts and Consumer Finance Act (CCCFA).

Tightened legislation at the end of 2021 required lenders to ensure loans were more suitable and affordable for borrowers. However, a lack of transparency and confusion around interpretation saw banks adopt stringent stress-testing measures which drilled down into every budding borrower's money move stretching back three months or longer.

This shut out a significant portion of the market, with unintended consequences, particularly for first home borrowers.

Stepney says the new changes, effective 4 May, are a positive move for the banking environment, as discretionary spending is being removed from affordability testing.

"Living expense benchmarks are being softened, and only expense essentials to the wellbeing of the borrower and families are necessary to include in finance applications – meaning, borrowers will no longer be judged by their daily coffee purchases.

This could mean that potentially, the loan amount you're able to receive approval at is slightly more than previously thought, and, more importantly, a realistic approach to expenditure is being taken into account."

The announcement has seen some commentators anticipate a flush of buyers to the market, encouraged by a more flexible attitude by banks. This aligns with anecdotal evidence that mortgage approvals are being provided quickly and efficiently, easing the backlog that hampered residential sales activity during the recent days of high demand.

For the months ahead, Ms Stepney expects the economic environment will continue to influence residential market activity. However, only a few homeowners are under financial pressure to sell, and several key supportive factors indicate we may well be treading down the path of a residential real estate recovery, driven by greater certainty in the mortgage lending arena.

Sam Stepney is head of strategic partnerships and activation at Vega Mortgages, Bayleys' preferred full financial advisory business, which offers core solutions and expertise in residential mortgage lending, personal insurance, business and commercial lending, KiwiSaver and asset finance.

PROPERTIES FOR SALE

The property featured on the cover at 36 Glanville Terrace, Parnell found on page 26.