First-home buyers could emerge winners as banks put investors offside

JAMES KIRBY
WEALTH EDITOR

Just occasionally our supersized banks can change the terms of finance in Australia.

At a stroke this week the big four banks created the perfect landscape for first-home buyers and pushed property investors to the side.

Seeking to justify an official rate cut while the housing sector is still showing signs of real strength, outgoing RBA governor Glenn Stevens said he believed house prices are stabilising thanks tighter lending standards.

The jury is out on whether Stevens has called it right or not, but the remarkable move by the banks — acting together once more — to hold back on passing on the rate cuts in full and instead lifting deposit rates — instantly pushes investors back to cash and away from property.

Property investors must now contend with a string of negatives which have rarely combined so perfectly in the local market:

1. The rate reduction cycle is being cut off early by banks expressly favouring depositors over investors.

2. Rental yields are falling, worse still rental growth is fading.

3. Foreign buyers, invariably from China, now face new difficulties getting money out of the mainland and then an absence of finance provision within Australia.

4. The prospect of acceptable price growth is slim in most cities with the exception of pockets in Sydney and Brisbane.

But the remarkable aspect of these major changes to the property market is that first-home buyers actually benefit from almost every one of these recent developments. Vincent Turner, chief executive of the recently launched online mortgage broker and comparison site, Unohomeloans.com.au, says lending to first-home buyers is likely to rise.

"We've watched as the first-home buyers shrunk back and investors got the upper hand in recent years. The level of first-home buyers in the wider lending market fell well below 20 per cent — more traditionally it had ranged 30-40 per cent — and I think we will see it lift again from here."

Investors squeezed on two fronts

For the millions of investors who depend on the fully franked yields in bank stocks, there are fears that a battle for depositors among the banks can only bring trouble.

Leading bank analyst Brian Johnson of CLSA has already pointed out the business of offering higher headline deposit rates at banks such as CBA and NAB while the RBA is dropping official rates is going to be expensive.

Johnson indicated the trade-off between holding back on rate cuts and lifting rates is a losing game suggesting all-important bank net interest margins will be "negatively impacted".

In other words bank stocks, which are already struggling with capital demands and maxed out dividend payout ratios, can ill-afford the break out of a battle for cash deposits.

Meanwhile, two groups in the residential property may be heading for a fall. First, "off the plan" purchasers where the termination rates are already rising. A recent BIS Shrapnel report warned almost all the major markets are moving towards an oversupply.

Second, the interest-only brigade — with one in 10 primary home loans now classified as interest-only — a significant portion of the market is going to be very exposed if prices soften in any fashion.

And with a vacuum left by exiting investors, the path is clear for first-home buyers — and perhaps the "downsizers" — to cherry-pick a market where the banks have moved the goalposts.

Hedge funds bankroll boom in gold

There's plenty of hot money from America in the sector that could vanish when US rates rise

TIM TREADGOLD

Gold put the buzz back into Kalgoorlie's annual Diggers & Dealers conference this week, but the biggest story from an event famous for miners behaving badly in Western Australia's isolated mining centre is that this year's stunning gold recovery comes with a number of wealth warnings.

One of those warnings can be found in the share register of gold sector favourite **Evolution Mining (EVN)**, along with the list of shareholders in other equally well-known gold stars, such as **Saracen (SAR)**, **Gold Road (GOR)** and **Northern Star (NST)**.

All of those goldmining companies — which have seen their shares prices more than double across the past six months — have attracted hot money from New York-based funds, which often hunt in packs, keen not to miss a fashionable market trend.

No wonder Evolution Mining chief executive Jake Klein could be found telling the 1800 delegates that there was a risk of the gold industry repeating past mistakes, which could destroy more value than that created by a high price.

Gold, quite correctly, is seen as one of the best performers in a world of super-low (and even negative) yields on most other forms of investment, performing the role of sheet anchor at a time of uncertainty, much like other safe-haven rivals such as the Swiss franc and US dollar.

The problem with gold and goldmining companies is that neither fits comfortably into a financial model because to predict their fates you need to guess the future gold price — and guessing the gold price is impossible, despite what some gold guru may tell you.

Still, even if it is the current focus of hedge funds, gold has an undeniable appeal and can generate rich rewards in good times, which is precisely the message from Klein's attempt to hose down excess exuberance.

Klein, who can take credit for turning Evolution into a top 100 company on the Australian Securities Exchange with a market value of $2.95 billion, is also aware that North American funds have lifted the position in his company from ownership of 15 per cent a year ago to 25 per cent today.

The keynote speaker at Kalgoorlie, John Lipsky, has tipped a rise in US interest rates in the next two months despite the approaching presidential election. A former deputy managing director of the International Monetary Fund and former Salomon Brothers banker, Lipsky is worth listening to.

> The question is: how long will these hedge funds stay?

If he is right about US interest rates rising soon, even if by a tiny amount, there could be a significant knock-on effect on investment markets, including the appeal for those busy New York fund managers to consider their gold exposure against the potential rewards from shifting to other investments that could benefit from an interest-rate rising trend.

In the short term, the arrival of the North Americans in the Australian gold sector is a positive event that has made local investors feel richer. The question — which is as tricky as guessing the gold price — is: how long will these hedge funds stay?

Warnings aside this year's, Diggers & Dealers conference was the breath of fresh air needed by the downtrodden mining sector with regular delegates (I've been making the trek to Kalgoorlie for 25 years) rating it the best since 2011, when the gold price last peaked.

Promoters of other metals, such as lithium, nickel and uranium, tried to spruik their stories, but they were drowned out by the gold companies, which dominated not just the speakers list but the party circuit too.

This is an edited version of a story that first appeared at www.eurekareport.com.au.

TRAVIS ANDERSON

Caption here

North American fund managers, many of them New York-based hedge funds, have suddenly popped up on the share registers of favoured gold stocks with very significant stakes. Here's the percentage of stock held in some outstanding examples

33 per cent Gold Road Resources, the Yarmarna, Western Australia-focused rising favourite among gold stocks

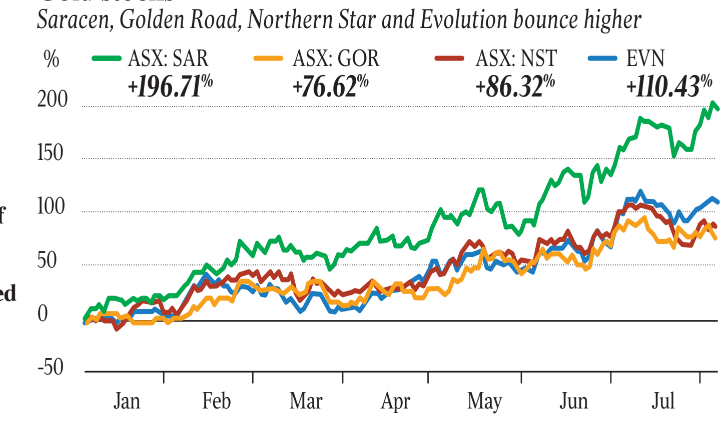
25 per cent Evolution Mining, with a market capitalisation at nearly $3 billion, the ASX 100 company has become one of the new big goldminers

24 per cent Northern Star, another major new play now valued at $3 billion and one of the best known early moves in the latest upswing in the gold sector

25 per cent Saracen, the $1.4 billion mid-tier goldminer has operations in Kalgoorlie and Leinster, Western Australia

Gold stocks

Saracen, Golden Road, Northern Star and Evolution bounce higher



THE COACH

I recently started working part-time for my husband who is a sole trader. Does he need to pay my compulsory 9.5 per cent superannuation contribution? Can he also make non-concessional payments into my superannuation? He plans to contribute the maximum concessional $35,000 into his superannuation this financial year, but can he add more to mine, and if so, what is the maximum he can contribute?

Provided that your husband doesn't derive more than 50 per cent of his business income from his personal skills, labour or expertise, there is nothing stopping you being genuinely employed by your husband in his business. Your husband would be obligated to meet the legal requirements to employ you under the Fair Work Act 2009, which covers the obligations for employers.

If he does derive more than half of his business income from his personal skills, labour or expertise, the income may be considered Personal Services Income (PSI) and as such, there may be restrictions on what he is able to claim for tax deductibility purposes in employing you. Please speak to your accountant to confirm whether you are impacted by this.

If the business income does not count as PSI, he should be eligible to claim a tax deduction for the salary income that is paid to you for the work you do. He should ensure he retains good records evidencing your job description, the type of work you are doing, your remuneration and hours worked. No different to any other employee.

You will need to be registered with the ATO by completing a pay as you go (PAYG) withholding tax declaration. When he pays you income, the net after-tax amount should be paid to your bank account. He will be obligated to withhold the appropriate amount of tax and submit this to the tax office on at least a quarterly basis or more regularly, depending on the amount of income.

He will need to register as an employer with Work Cover and establish Workers Compensation insurance. The premium for Workers Compensation is set by WorkCover, based on your occupation and income. Your husband is free to choose any insurance provider registered with WorkCover.

He will be obligated to pay you the 9.5 per cent superannuation guarantee contribution as required by the SG rules.

Employer contributions and personal contributions made to a superannuation fund (where the contributor is eligible to claim a tax deduction) count against the concessional contribution cap. If you are 49 or older at June 30 this year, the concessional contribution cap for the 2016-17 tax year is $35,000. If you are younger, the cap is $30,000. Please note the government announced changes to the cap to take effect from July next year, reducing this cap to $25,000.

Presuming you qualify by age, he can contribute up to $35,000 to your superannuation as an employer and not exceed the concessional contribution cap.

Please check with your accountant to ensure your husband's income is non-PSI and the tax deductibility of superannuation contributions before embarking on this strategy.

Visit the Wealth section at www.theaustralian.com.au to send your questions to Andrew Heaven, an AMP financial planner at WealthPartners Financial Solutions

SMSFs and unit trusts provide a way to buy a property when you don't have a deposit

JAMES GERRARD
HOW TO DO IT

As a financial adviser, I find the best value I can give is to show people how to do something they did not know about and positively influence their long-term wealth plans.

At the moment, with a lively property market, I am regularly asked how to get started in investment property without a large deposit. One route that is well worth considering is using a non-geared unit trust structure in conjunction with a SMSF. You might look at it as someone doing a joint venture with their SMSF where the person takes the risk (gearing) and the SMSF provides the deposit.

SMSF property loans have exploded in popularity over the past five years as a way for people to use their super to purchase investment property. However, these loans can be expensive to set up, with thousands of dollars in establishment fees and legal costs in addition to the SMSF interest rates typically being around 1 per cent higher than residential home loan rates.

It's surely one of the secrets of the system that you can actually partner with your SMSF to unlock cash that you might not have realised was accessible and jointly purchase property investments in a tax-effective way. For someone who does not have a lot of spare cash but a healthy super balance and — importantly — equity in their home, this strategy can be very appealing.

There are "related parties" super rules that usually prohibit SMSFs from investing more than 5 per cent of their assets in a unit trust with other people. Related parties are defined as people who are super fund members, or associates of the fund members such relatives and business partners. However, if the unit trust is not geared, there is an exemption and up to 100 per cent of the SMSF balance can be invested in the unit trust and used to buy property assets.

Try this for a start

Imagine you decide to purchase a $500,000 investment property and do so jointly with your SMSF via a non-geared unit trust. The SMSF and you would own units in the unit trust depending on how much cash you both contributed. For example, if the unit trust had 500 units and the SMSF invested $200,000 while you invested $300,000, the SMSF would have 200 units and you would have 300 units.

A common situation where this strategy may be considered is where a couple have paid down part of the mortgage on their home and have equity available to redraw in addition to having a few hundred thousand combined in super balances.

- The first step would be to set up a SMSF and combine super balances.
- The next step would be to set up a unit trust and transfer money into it from the SMSF and home loan account.
- The final step would be to purchase the investment property using the combined funds inside the unit trust. By structuring the property purchase inside the unit trust, the key benefit in addition to avoiding costly SMSF loans is that you have flexibility in the future to buy and sell parts of the property.

> Expert advice is recommended so that you structure the trust and SMSF correctly

If you required cash personally, you could sell units in the unit trust to the SMSF, and conversely, if you had excess cash to invest, you could buy units in the unit trust from the SMSF.

Another significant benefit is the potential avoidance of stamp duty — at least in NSW — on the purchase of trust units. CPA SMSF specialist accountant Timothy Ricardo notes that from July in NSW stamp duty has been abolished on non-listed securities but CGT still applies. If over time you purchase the SMSF-owned units, the SMSF would be liable for CGT; however, you would sidestep stamp duty, saving a significant amount of money. Ricardo also notes that "the related party can borrow to acquire their units in the unit trust (generally by offering another asset such as the family home as security) and then claim the interest on the loan as a personal tax deduction because the trust is income-producing".

This effectively allows you to gear your personal share of the ownership.

But like everything, there are rules that must be adhered to, the main one being that you need to have an existing property that you can borrow against or some level of cash savings, as the investment property inside the non-geared unit trust cannot have any charges or loans secured against it.

Using a non-geared unit trust and a SMSF is one little-known way for people to get into the property market with potential fee savings, flexibility, tax savings and stamp duty exemptions, but expert accounting and legal advice is also recommended so that you structure the trust and SMSF correctly.

James Gerrard is the principal and director of independently owned Sydney financial planning firm FinancialAdvisor.com.au

Investors beware, and don't get used to these low interest rates

ROGER MONTGOMERY

When the sun is shining, and it's sparkling off the water, a view of Sydney Harbour is one of the best in the world. The views are so covetable that prices for harbourfront homes will hit $100 million in the not too distant future.

Despite its desirability, many residents literally draw their shades on the view. People quickly become used to the world-class view despite its beauty and its price. Low interest rates are a bit like that. We get used to them and operate as if it's normal. Commentators have labelled this low-return environment the new normal, but it's anything but normal. And getting used to it is a very dangerous plan and a hazard to your wealth.

But getting used to it is exactly what Australian households have done. While household debt in the US, Britain and Germany has fallen materially since the GFC, the reverse is true in Australia. Aussie battlers have leveraged up to chase asset prices higher, particularly property, increasing their debt to 185 per cent from 170 per cent of disposable income since 2008.

As a nation, we are ill-prepared for any reversal of the global bond market rally that is now in its third decade. The inverse relationship between bond prices and yields means that as bond markets decline, long-term interest rates will inevitably rise.

The value of any asset is simply the present value of all its future cash flows discounted back to today. Intuitively, receiving $100 immediately is worth much more than receiving $100 in 10 year's time. In order to work out how much more valuable the $100 is today, we need to discount the future $100 back to today to be able to compare them. If we use a 7 per cent rate to discount the future $100 back to today, we arrive at $50.83. If interest rates fall and we start using a 3 per cent discount rate, the present value of the future $100 becomes $74.40.

In other words, the value of the asset has risen 50 per cent simply because the discount rate we use to value the asset has declined from 7 per cent to 3 per cent. Global sovereign 10-year bond rates have been in decline now for 30 years, but the declines over the most recent decade are not the result of the normal buying and selling activity by rational and sensible long-term investors.

The most recent declines in bond rates, particularly the move to negative interest rates for 30 per cent of the world's sovereign bonds, is the work of central banks and has produced rates that no longer, even reasonably, reflect risk. When Italy can borrow money at negative rates despite non-performing loans in their banking system amounting to 25 per cent of GDP, the bond market has ceased properly signalling risk.

And yet these low rates are what professional investors use to inform the discount rates they use to value assets. And the greater the proportion of cheap debt a company has, compared to relatively more expensive equity, the lower the discount rate. Just think: a company's shares are more valuable because it has more debt!

Of course all this will unwind and we will look back with astonishment that investors were, for example, willing to lend money to the Swiss government for 30 years just to receive 96 per cent of their capital back. Bond king Bill Gross has warned that the $US10 trillion pile of negative-yielding government bonds is a "supernova that will explode one day".

The question we should then be asking is how long will the party continue before the punchbowl is taken away? Or perhaps a better question is, should I simply go home early and not hang around to see the stampede for the narrow exit?

Investors in shares, property and other high-priced assets can, at best, expect only low returns. At worst, violent volatility will accompany those low returns.

Low rates aren't normal and they aren't permanent so don't get used to them. Awareness of that fact should have you beginning to behave very carefully.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund. www.montinvest.com