REDE ADVISERS
PROFESSIONAL FINANCIAL ADVICE

Newsletter
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Is The Perfect Storm Coming?

If we take a cocktail of highly combustible and volatile ingredients and throw them at a fast moving and seemingly unstoppable train, something will happen! Will the explosion be enough to de-rail the train and cause a high speed crash, or will the train just plough through the explosion as if it was not there and continue to build speed on its journey?

We are referring of course to property, Christchurch property in particular. We are beginning to have concerns, grave concerns, about property pricing and the direction of this pricing over the next few years. So first, let's look at the ingredients that make up the property cocktail:

1. **Interest Rates**
   They are low, and could even go lower in coming months. We have had very low borrowing rates, at least compared to our recent history, for 6 years. Even the increases that occurred early last year have all been wound back. Long term fixed rate mortgages of 5.00% are available. This has had an undoubted positive impact on property sales.

2. **Available Credit Supply**
   Not only is money cheap, there is plenty of it. We recently heard of a major bank (yes, Aussie owned) that was able to borrow $500m from offshore at just 0.66% for 5 years! There has never been more credit available, and with banks hell bent on lending it there is no shortage of mortgage money available. This has led to an increase in sub-prime lending.

3. **Supply and Demand**
   The quakes of 2010 and 2011 destroyed 10,000 homes. Many more have been damaged sufficiently for owners/tenants to move out during the repair process. Demand for housing for these people, and the people brought in to repair our broken city, has never been higher. At the same time our supply of housing has never been lower. Years of lack of investment in infrastructure and housing has meant our housing stock could not have been in a worse position when the quakes arrived. This supply/demand equation has supported increased property prices until now, but new supply is coming on stream quickly and this can lead to an oversupply of property.

4. **High Prices**
   The media recently highlighted the very high price of property in this country. Why New Zealand has the second highest average property price per capita (based on average income) in the western world is a topic we will cover in another article. The fact remains we have very expensive housing as measured by any reasonable standards. And this expensive housing keeps going up at rates higher than other assets. How does property keep defying gravity? Why should property go up 10.00% if wages go up only 1.00%? We have always had cycles, cycles where assets out-perform based on normal movements in interest rates, money supply, and demand. However a cycle which ignores fundamentals and continues on up is not a cycle – it is a bubble.

5. **Insurance Pay-outs**
   Due to significant increases in building costs in this city, insurance companies are turning more and more to cash pay-outs as opposed to re-building properties. We have seen many multi-million cash payments being made, and many many more lesser sums as well. This virtual flood of cash has forced up prices on properties in demand, and inevitably flowed through to the whole Christchurch property market. The insurance council has stated that all but a few of the more difficult policies will be settled by the end of 2015 – what happens after that?

6. **Relative Incomes**
   There is no doubt that some parts of our city's work force in this city have been making a lot of money. We certa inly don't blame them, however the average taxable income of a builder, plumber, electrician, engineer, architect or anybody else involved in the rebuild has gone up. Higher incomes mean more funds available, after paying living costs, to service debt. More buyers in certain price brackets have forced up prices dramatically. Good rental properties as investments have been almost impossible to find in recent times. When the re-build slows these incomes will either leave the city or reduce back to more normal levels.

All these ingredients, and we suspect others too, are now all in the cocktail shaker. The train, of course, is the property market. We have no doubt the cocktail is being shaken, and stirred, and is ready to be thrown at the train. How big an explosion, and whether it will de-rail the out of control train, is an unknown. Our fear, or should we say – grave fear, is that if enough of the ingredients listed above get shaken (cease to be a positive factor on property prices), then the explosion will be more than enough to cause all sorts of damage. The last thing our city needs now is a property implosion.

Steve's Soap Box

'Peer-to-Peer' Lending: Rotten Fruit or The Golden Apple?

I wondered how long it would be, as it turned out – not long. In the mail the other day arrived a letter saying I had been pre-approved for a $25,000.00 loan from the new 'Peer-to-Peer' lender on the block. Being an ex lender back in my days with AGC I often debated the criteria required to send pre-approved borrowing limits to the public. Obviously in my case the criteria isn't very high.

Perhaps it's my address which makes me attractive to target? No, it could not be the address because I don't own any property, my family trust does. If it is not my address, then what is it? Is it my job? I'm not sure financial advisers are good credit risks, some I have met certainly wouldn't be. Perhaps it is something to do with the census I filled out last year – is that information publically available? Maybe there are no qualifying criteria, maybe everybody does and my only claim to fame is that at the time I received my pre-approved loan offer I can fog a mirror!

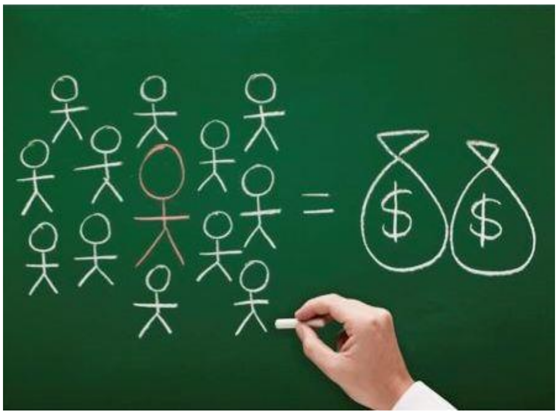
So what is 'Peer-to-Peer' lending? What sort of risks are involved for the borrower and the lender? Firstly, Peer-to-Peer lending is not new. It has been around for centuries and is usually the domain of the 'rich and famous' not the 'mums and dads'. Peer-to-Peer lending is very common in the larger commercial space. In simple terms someone with money to lend will be matched up with someone who needs money. Usually there is a third party in the middle who will receive a fee for 'arranging' the match and usually has a role to play in collecting payments and taking some action if a default occurs.

One obvious example is the old 'solicitor's nominee mortgages' that were common prior to the relaxation of banking lending requirements. So why would a lender or a borrower even bother – after all credit is very easy to obtain from more traditional sources?

The reasons are:

- Peer-to-Peer lending is riskier lending. Usually it is second or third security lending behind banks, or the security offered is minimal or non existent.

- Because the lending is riskier, it commands a higher interest rate. If a bank will lend money on first security at 6.00% then Peer-to-Peer lending will be on second security at rates in excess of the bank's return. The borrower will happily pay a higher interest rate if a second security loan is the only option available to enable a certain project to proceed. Obviously the profits from the project have to be large enough to cover the increased interest costs. The lender will happily advance the extra funding if the interest return received meets their 'risk and return' criteria. After all, the bank currently will offer only 4.00% for a deposit therefore some lending at 8.00% - 10.00% is attractive.



This all seems very easy and straight forward! So what are the concerns around my pre-approved $25,000.00 loan? From the **lenders perspective** the matters of concern are quite obvious.

Firstly you need to have the ability to decide on the risk of your loan yourself. The 'broker' in the middle is being paid a big fee to match borrowers and lenders and receives nothing if the loan doesn't proceed. As a third party they have a strong vested interest for the loan to proceed and as the money invested is not their money this could, and does, lead to some very bad lending.

Secondly you should have only some of your investment funds in this sort of lending. With a bank, or a lending institution such as Mutual Credit, your money is pooled with other lenders and spread around many borrowers. In Peer-to-Peer lending the lenders money is lent to only one borrower, good or bad. Spreading risk is one of the corner stones of successful financial planning.

Thirdly the interest rate offered to lenders can be very attractive however it is attractive for a good reason. Not only is the loan 'riskier' from a security perspective, but it falls outside the many regulatory powers of the Financial Markets Authority (FMA). There is no need for a Prospectus or Investment Statement, and many of the protections that have been put in place since the Global Financial Crisis are sidestepped.

From the **perspective of the borrower** you may think your dangers are less. After all, if you have the money the risks are with the other guy? Because the loss on a bad loan can be total, enforcement action will be quicker and more severe. If you think a bank can be tough to deal with, try dealing with an inexperienced and fearful lender with little or no regulatory rules. It does prompt the imagination somewhat and it is not difficult to perceive the local gang knocking on your door late at night with baseball bats.

In summary, Peer-to-Peer lending is very good in the right place with the right people involved, and for the right reasons. Peer-to-Peer lending can be very bad if the wrong people are involved, and the lending is for the wrong reasons. The fear is that this investment will be attractive for those who only see the return compared to low bank rates, not the very real risk of capital loss. This is not comparing apples to apples, more like apples to pears! As for my $25,000.00 pre-approved loan – the letter is in the rubbish bin – where it belongs.

KiwiSaver Changes – First Home Buyers

While not wanting to inflame the housing market cocktail further, changes have been made to those KiwiSaver members wishing to access funds to purchase a first home. **These changes, effective 1 April, include:**

- Withdrawal - first home buyers can access contributions made by them and their employer, investment growth and now Government member tax credits too. Withdrawals are not subject to any house price or income limits – you only need to be buying a first home to live in.
- Subsidy, now renamed HomeStart Grant and grants doubled for those buying / building new homes. House price limits are now $450,000 in Christchurch and income caps are unchanged.

Getting the right advice in relation to saving for a first home and withdrawing at the right time is key.

Key Indicators and Rates

OCR (official cash rate)	3.50%	UDC Finance Deposit – 1 year	4.40%
90 day Bank Bill	3.62%	Mutual Credit Finance Deposit – 18 mths	6.25%
Enhanced Cash Portfolio	3.75%	Heartland Bank Deposit – 1 year	4.50%
Income Securities Portfolio – Call	4.25%	Income Focus 18 Portfolio *(estimated)*	4.70%
Income Securities Portfolio – 3 & 6 mths	4.50%	Income Focus 28 Portfolio *(estimated)*	5.30%
Income Securities Portfolio – 12 mths	4.50%	Income Focus 50 Portfolio (estimated)	6.60%
Income Securities Portfolio – 24 mths	4.75%	Corporate Bond Portfolio (estimated)	3.90%

Reporting Timetable

We are now entering our usually very busy administrative quarter with the financial and tax year-end:

MID-APRIL

✓ Non-Custodial assets will be updated ahead of preparing six-monthly reports.

LATE-APRIL

✓ Six Month Investment Performance Reports to 31 March 2015 will be prepared and sent.
✓ Tax certificates from financial institutions should have all been received.

MID-MAY

✓ Grosvenor RWT and PIE Tax Certificates will be issued.
✓ We will commence preparation of tax worksheets, compiling all investment income for the year ending 31 March 2015. These will be issued to you unless you have instructed us to send them to your accountant or hold them. This is usually completed by mid-June.

LATE MAY

✓ 2015 Tax Packs and Summary of Earnings are issued by Inland Revenue.
✓ Clients wishing us to prepare their tax returns and Trust financial statements should have forwarded us all information by the end of May.

JUNE

✓ 2015 tax returns & financial statements will be progressively prepared ahead of Inland Revenue's 7th July filing deadline.

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Disclosure Statements are available on request and free of charge.