It's not only rising house prices that affect your purchasing power.
by Greg Carroll www.attitudefinance.com

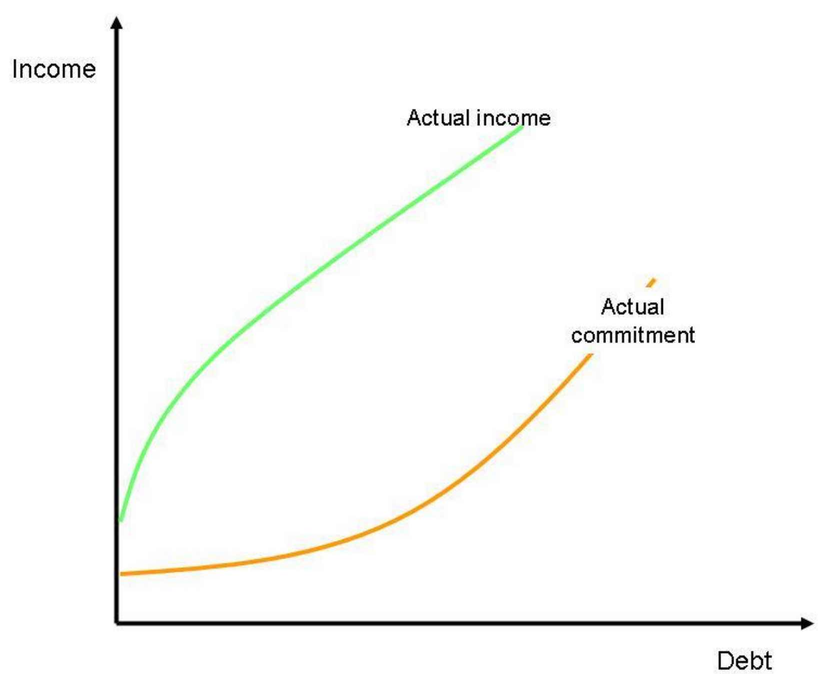
In the current property market the longer you delay, the more the market is likely to move away from you. But something you may not have considered is how delayed action and the movement in interest rates could also affect your borrowing capacity.

To assess a borrowers servicing capacity for a loan (Income less expenses) most lenders use an assessment rate. Usually the lenders standard variable rate plus a margin of between 1% to 1.5%. As rates increase so does the assessment rate. The impact of this increase is a reduction in your borrowing capacity, unless your income increases in line with rates.

Let's look at a very simple example using one lenders calculator. Our applicant has an income of $70,000 pa and no other liabilities. Prior to the rate rise in August she could have borrowed up to $430,000. After the rate rise her capacity has reduced to $421,000. Another 0.25% rise would reduce her capacity to $412,000. That's an $18,000 drop and could be the difference between getting the property you want.

This impact can be amplified when it comes to purchasing investment property. From an investors perspective you will assess your capacity to take on more property based on your expected rental return and the effects of depreciation and other deductibles on your overall tax position. In most cases you will also have your loan set on an interest only basis. Therefore as you increase the number of properties and debt your position may look something like Table 1.

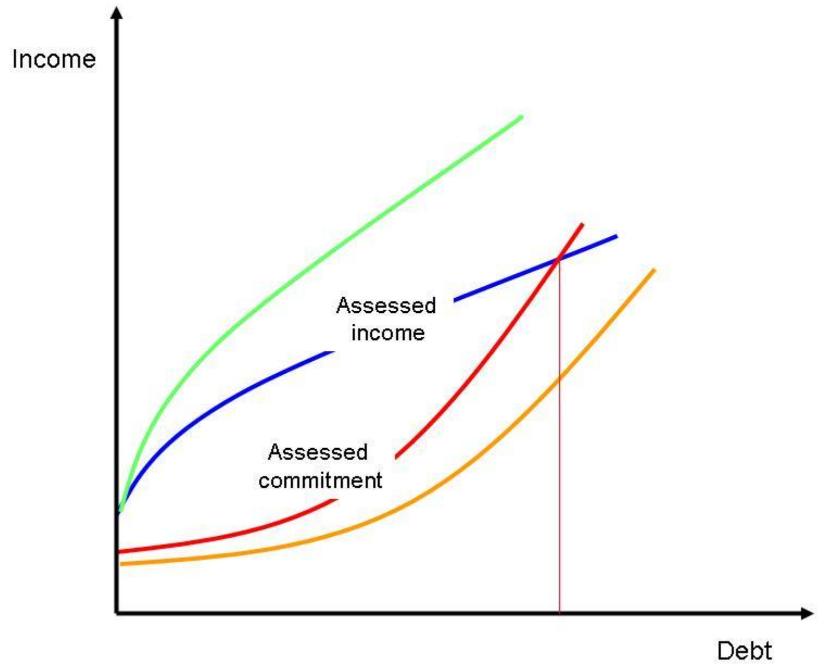
TABLE 1



Lenders however apply tighter assessment criteria to assess the viability of an investment proposal. As mentioned they will load the assessment rate, but many will also assess the debt on a fully amortizing basis. They will also write down the rental income by 20 or 30% even if you are self-managing. Some will allow for negative gearing, but generally won't factor in depreciation.

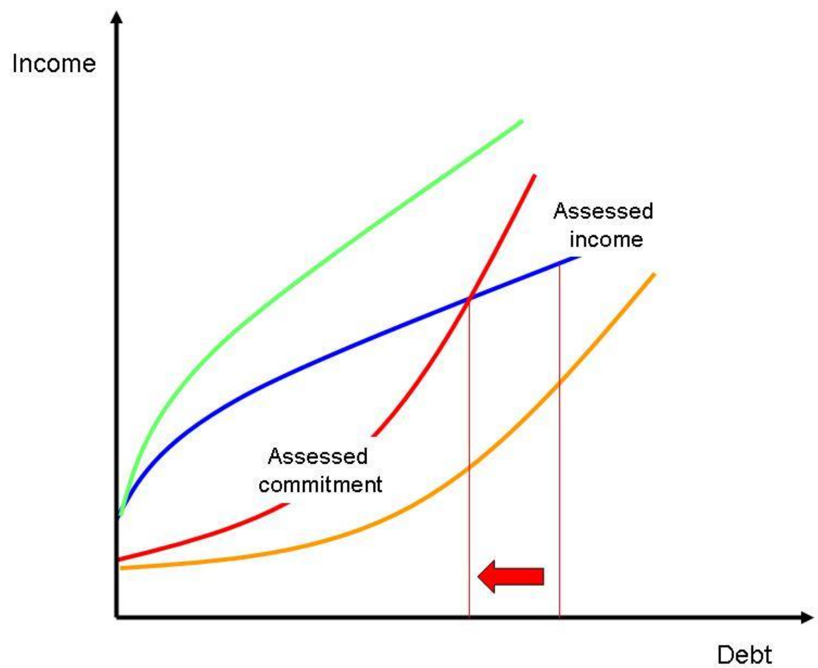
Therefore from a lenders perspective your position will look like TABLE 2

TABLE 2



The red vertical line represents your borrowing capacity from a lender perspective. So if rates increase this will be reduced as shown in TABLE 3.

TABLE 3



So what does this mean for you? It means in a rising market, delay may reduce your capacity and your options.