WHAT GOES UP MUST COME DOWN SO WHAT’S A BORROWER TO DO?

Tony Alexander looks at our rising interest rate environment and a safe course of action for borrowers looking to manage risk.

NOW THAT INTEREST rates have started to rise, after a number of false starts since 2019, the questions borrowers want answering are as follows: How fast will they go up? How high will they get? When will they start going down again? Should I fix or float, and if I fix do I do it now or wait until floating rate costs are a lot higher?

The way in which people react to rising interest rates post-GFC is different from before but we don’t know how different. This entire monetary policy tightening period is a huge experiment which all other central bankers and economists overseas will be keeping an eye on to gauge how their own borrowers and savers may react as their monetary policies are also tightened.

What this means for NZ mortgage holders is that you should not take big risks with your mortgage in terms of borrowing to the hilt or leaving all debt sitting at a floating rate basis. Where interest rates go and how fast they get there is a guessing game this cycle. You need to minimise and spread your risk with the realisation that nothing you can do short of quitting the mortgage altogether will prevent your borrowing costs from going up.

You can either take the increase in cost straight away by fixing your interest rate for a five or seven year period. Or you can take the rises bit by bit over the next two up to maybe four years by sitting away by fixing your interest rate for a five or seven year period. Or you can take the rises bit by bit over the next two up to maybe four years by sitting on a floating rate or just taking short-term fixed rates.

But based on what we think we know now and what we think we will know tomorrow, what are our current answers to the questions posed above? How fast will interest rates go up and how high will they get? We think that rates will rise about another 1% this year, then 1% again over 2021. So come early-2021 floating mortgage rates will be probably at least 8% with our analysis of the risks suggesting rates are more likely to be higher than that than lower. This speed of increase is about standard, though young borrowers who have not lived through tightening cycles over the 1990s and 2010s will not have a feeling for what standard is.

When will interest rates start going down again? My personal response to that is do not be surprised if interest rates fall later than expected. This is the reason why I emphasised the merits of engaging a CA earlier. That’s because Audit Shield is only available to clients of a chartered accountancy firm. Audit Shield recognises the professionalism and care that we offer to our clients.

FEASIBILITY

Keep copies of the file notes retained by architects, surveyors, valuers, property manager, real estate agent and accountants. These documents could help paint the picture that supports your frame of mind and your intent at the time of purchase.

Secondly, know your rights. You do not have to deal with any IRD review or investigation yourself. You are well within your rights to ask IRD to contact your accountant and have them handle the investigation on your behalf.

This is quite important as you could say the wrong thing by being too helpful. Recently IRD contacted one of our clients directly without notifying us. This is not the usual protocol as IRD usually contact the accountant or tax agent first. They were asking all sorts of questions about intent and why the property was sold in a relatively short period. Our client dealt with all the queries themselves without informing us as they thought they have nothing to hide. While the matter was finalised satisfactorily, they regretted it in hindsight as they found the line of questioning quite stressful.

Thirdly, use a professional where possible.

INTRODUCING “AUDIT SHIELD”

Many of you already know that it can be costly to engage professionals to help resolve tax investigation. So this is where Audit Shield comes in handy. It is an insurance policy underwritten by a NZ insurer that covers the professional cost (accountants & lawyers’ fees) in the event of an IRD risk review, audit and tax investigation.

While there is an annual dollar limit on the cover, nevertheless, it offers peace of mind knowing that the professional fees are covered. This enables you to have the best representation to respond and resolve an often stressful tax investigation process.

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