Lending restrictions

There are plenty of hurdles to jump when financing studio apartments and commercial properties converted to strata units. **Peter Cerexhe**

SINCE at least 2004, there has been plenty of investor gossip about increased restrictions placed by mortgage providers on lending for cheaper strata properties. Here's the chat: "*They won't lend on small inner-city studio apartments… You won't get the money if the floor size is less than 50 sqm… Some lenders won't lend for apartments in large complexes… Hotel or motel conversions are out… Student apartments are out… The location of the unit within the complex could count against it.*"

The various 'myths' here are indeed very real. These barriers *all* exist but (and here's the clincher) not for everyone and not everywhere.

You ought to be able to work your way around most of them, with the right lender, *provided* you don't require lender's mortgage insurance (LMI). Once LMI is necessary you'll find yourself dead in the water if you cross their lines.

Says CANNEX, "Lenders are generally willing to lend provided they can pass risk on to an insurer."

I ran through these scenarios with a big bank (Commonwealth), a big mortgage broker (Mortgage Choice) and a mortgage insurer (Genworth Financial).

Scenarios

Postcode. The loan-to-value ratio (LVR) and maximum mortgage amount may vary depending on the location of the property. For example, the maximum loan in New South Wales, Australian Capital Territory, Queensland and Victoria with an LVR no greater than 80 per cent might be $1 million, falling to $900,000 in Western Australia and $750,000 in South Australia, Northern Territory and Tasmania. The areas are determined using Census data on population, sales activity and prices obtained.

Title. Strata/stratum title is normally acceptable, as are 'group' titles. However, community title in Victoria and NSW might be ineligible for LMI if the property is part of a staged development which hasn't been fully completed. Clearly the risk to the lender and insurer is higher on an incomplete project.

Company title apartments mark a curious diversion from the general rule that lenders are more open to atypical securities while mortgage insurers draw the lines. Mortgage insurers aren't afraid of company title and will lend, though they may lower their LVR (to a maximum of 85 per cent for Genworth). As the table shows, many financial institutions are put off by company title before the application even makes it to the insurer. (We'll explain the differences between strata title and company title in next month's API).

Size. While this might not be important to the lender, you can expect the mortgage insurer to place a limit on the minimum floor space. As a general rule aim to avoid an apartment with a floor space of less than 50 sqm. This excludes balconies and car space etc. It must be 50 sqm of 'living area'. In special circumstances this rule might be stretched down to 40 sqm but the property would have to be in a "desirable and high demand capital city metropolitan location" for Genworth.

"The fundamentals of real estate remain important, not necessarily the fact that there's a studio apartment," says Peter Hall, country executive for Genworth Financial.

The Commonwealth Bank doesn't impose a floor-space limit but notes that LMI might fail the application.

Number of properties in a single development. There might be a limit on the number of apartments within the one development that you can put up for mortgage insurance. For Genworth the limit is "four units or 25 per cent of the development, whichever is the lower".

According to the Commonwealth Bank, "to any one borrower, the bank limits lending on six apartments in a development or lending applications for more than 25 per cent of a development".

Warren O'Rourke, national corporate affairs manager for Mortgage Choice, agrees: "It isn't unusual for a lender to cap its exposure within the one residential complex, for example to a limit of 10 per cent of the development. This offers some protection from a downturn in the market by spreading their risk."

Inner-city apartments cause the most concern, particularly in Sydney, Melbourne and Brisbane. Some lenders don't like them *period*: see table.

Location in the complex. When some factors count against a property the decisive issue might be whether it's in a fantastic location within the development or if it's the equivalent of the lowest deck on the Titanic, without a porthole and next to people dancing to Irish jigs all night.

Change of use from commercial or industrial to residential. "Hotel conversions, holiday lettings and serviced apartments are really commercial lettings rather than

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residential proposals so there might be more requirements for the application," notes O'Rourke. "If the conversion meets all council's ordinances and general lenders' requirements, most lenders will proceed but there may be a reduced LVR or restrictions on LMI."

But the Commonwealth Bank doesn't like these things at all.

"The bank doesn't finance for student accommodation, serviced apartments or holiday investment schemes as we're restricted in terms of resale and we're bound by existing management schemes. (For hotel/motel conversions) we'll look at lending on adaptive reuse towards the completion of the conversion," says Steve Batten, a spokesperson for the Commonwealth Bank.

"Serviced or managed apartments are an increased risk, largely due to the fact that you're reliant upon the performance of the management company assigned to the group of apartments," says Hall.

Others. Add the following to your caution list: multiple occupancy (where there are more than two dwellings on the one title); display homes; mobile or temporary homes.

In the end your application – both for finance and LMI – will be considered according to the overall merits of the deal. The last thing you want is to find yourself having to scurry urgently to find an alternative lender or extra cash to complete the purchase.

Be prepared to face hurdles such as:

- More thorough valuation inspections and reports;
- A lower LVR (70 to 80 per cent max, though some, usually non-bank lenders, only go to 60 per cent) – and a higher deposit required;
- Reduced maximum mortgage amount;
- More costly LMI;
- More limits on availability of LMI;
- Reduced consideration of the rental income to allow for longer vacancies;
- A call for additional or cross-collateral security;
- Downright refusal of application.

Having said that, I've seen studio apartments which have doubled their value over 10 years. You might just be right about your instincts, but you'll have to jump higher and think faster to get the deal finished in the time you've been given. ■

TABLE: EXAMPLES OF RESTRICTIONS BY LENDER AND SECURITY

Company	Product	Vacant Land	Acreage /Rural	Comp-any Title	Dual Occu-pancy	Inner City Apart-ments
AIMS Home Loans	AIMS Complete Variable	✔	✘	✘	✔	✔
Alliance One CU	Standard Variable Rate	✔	✘	✘	✔	✔
ANZ Bank	Standard Variable	✔	✔	✔	✔	✔
Aussie Home Loans	Standard Variable Rate	✔	✔	✘	✔	✔
Awesome Mortgages	Homeloan Standard Var	✔	✘	✘	✘	✔
BankWest	Mortgage Shredder	✔	✔	✘	✔	✔
Capricornia CU	Standard Variable	✔	✔	✔	✘	✘
Colonial	Standard Variable	✔	✔	✘	✔	✔
eChoice	Standard Saver	✘	✔	✘	✘	✔
ING Bank	Mortgage Simplifier	✘	✘	✔	✔	✔
Macquarie Bank	Select Classic	✔	✔	✘	✔	✔
Manly Warringah CU	All in One Home Loan	✔	✘	✘	✔	✘
QuickDirect Online Mortgage	Variable Loan	✘	✘	✘	✔	✔
RAMS	Standard Variable	✔	✔	✔	✔	✔
Royal Guardian Mortgage	Royal ProPack	✔	✔	✘	✘	✘
Suncorp	Standard Variable	✔	✔	✘	✘	✔
Uni CU	Educators Package <$500K	✔	✔	✘	✘	✘
Wizard Home Loans	Smart Choice Loan	✘	✘	✘	✔	✔

Source: CANNEX, July 2007