

01/12/2009

Presented by: Tony Sirett, Managing Director, Rodney Gibson Financial Services Pty Ltd

Am I better off to buy or rent?

Many people have been asking me lately am I better off to rent or to buy?

There are many differing situations that you have to consider and the answer really depends on your stage of life and what you are trying to achieve.

The first clients I have been working with are a couple who are 53 and they are planning to work on and off over the next 20 years or so but also travel. They have long held a desire to spend 6 months living in France and then come back and move to the Sunshine Coast. They own their house outright and have a reasonable amount of money in super.

The second couple are Generation Y and are struggling to save up a deposit. They are being told by everyone that renting is dead money and that they should borrow as much as they can to get into a property now at all costs.

The answer to this question of buying vs. renting depends on many factors so I thought it would be worth exploring these.

Financially

Many people are surprised when we tell them most times you are better off financially to rent rather than buy.

We have all heard people say renting is dead money. I don't see it this way because it does provide you a legal right to occupy a property.

Interest on a loan on the other hand could be considered dead money too. However, the reason people are happy to pay this interest is they hope the property will appreciate in value in the future.

Let's look at a home valued at say \$400,000. Most people would agree that you could rent a home like this for approximately \$400 per week or less.

If you were to buy this property you would be well advised to have at least 20% or \$80,000 deposit plus expenses and then you would pay approximately \$360 per week in interest payments on that size loan and more if rates continue to rise. That is even after an initial investment of over \$80,000 you will pay almost the same amount in interest as you would in rent.

If you were lucky enough to have \$400,000 cash to invest into a portfolio of growth assets history has shown us you could achieve a total investment return of around

\$800 per week (capital growth and income) over the long term. Obviously you have to take interest costs into account if you were to borrow the money but if you were to borrow the funds any interest you paid would be fully tax deductible.

So if you were to rent a home for \$400 per week you could theoretically then invest the other \$400 per week into a regular investment or you could use it to service interest on a loan for an investment portfolio.

Investment Returns

There has been much debate as to what delivers the best return – property or shares.

There have been recent media reports suggesting we could see strong price growth in residential property markets due to the undersupply issues.

This undersupply has come about because of many factors. Property developers found the banks less willing to lend on developments during the downturn, interest rates are now rising so less people are investing and there is strong net migration in Brisbane. The theory is this will continue to push rents and property prices higher but it has to stop somewhere.

We may see short term boom periods in property but over the long term shares in most of our major companies have performed better than residential property. We have certainly seen a strong rally in our share market over the last 9 months. The truth is though you can do well with either asset class, if you buy well.

The thing that is difficult to do is to get a reasonable level of diversification when buying property and a lack of diversification increases potential for risk.

There are also the high costs of purchasing property, such as stamp duty, legal costs and land tax. As we know owner-occupied property is capital gains tax free. The interest payments aren't tax deductible though as they would be on an investment property.

First home owners need to consider whether they opt to buy an investment property first because if they do they will not then qualify for the first home owners grant.

Demographic Trends

Reports tell us there has been significant increase in the size of our homes. One theory for this is that this is partly necessary as our children (or possibly parents) need to live with us because they cannot afford to buy property. Some of the younger generations now think differently about home ownership than prior generations did and no longer see it as an essential move.

Discipline

Many people like the discipline of being committed to a mortgage because it becomes forced savings.

The fact is though this is not the best way to build an asset base. Our modelling shows that if you maintain the same discipline whilst renting you should be considerably better off over the long term and be exposed to arguably much less risk.

Establishing an automated regular investment plan is the best way to ensure you do maintain discipline and is easily arranged these days.

The fact remains though that maintaining the discipline of regularly investing the difference between rent and a mortgage proves for many to be very difficult. You have to be true to yourself and be able to resist temptation for this to work. This can be too difficult for many people.

Emotional Factors

For many people the real confronting issue really comes down to the emotional issues. Having a property that you can call your own is a very attractive lure for many.

Providing a stable living environment especially for people with families is also a very strong motivator. Anyone who has had to move house due to the house being sold or the landlord changing their circumstances will appreciate this more than most. Many people fear this greatly.

Being able to alter the property or have your own garden the way you want also weigh heavily on the decision.

On the other side having someone else be responsible for repairs and maintenance to the property can be a big positive. The ability to move easily if there is something you don't like or if your circumstances change is another benefit for the renter.

These emotional factors have to be dealt with before you can know which way is right for you.

How do you determine what is right for you?

As you can probably see by the issues above there is both positives and negatives both ways. An in depth discussion with a good financial planner can be invaluable in determining what is best for you.

If buying is your preferred option try to get that 20% deposit plus costs first. Accept that the high transaction costs such as stamp duty, legal fees and loan application fees will take some time to recoup. Work hard to reduce the debt as quickly as possible by making extra repayments and paying fortnightly or weekly rather than

monthly but then ensure you also implement a mortgage replacement strategy, as this can help you to reduce your debt even more quickly.

If renting and investing is your preferred option ensure you have a plan, set a budget and maintain your discipline. It will pay off for you in the long run.

Disclaimer:

This article is produced for general information purposes only and is provided in good faith. This article does not contain investment or insurance advice and is not to be relied on as a substitute for professional financial advice. Such advice should be sought prior to any implementing any strategies. Whilst the information contained herein is considered reliable, responsibility is not taken for errors, omissions or inaccuracies.