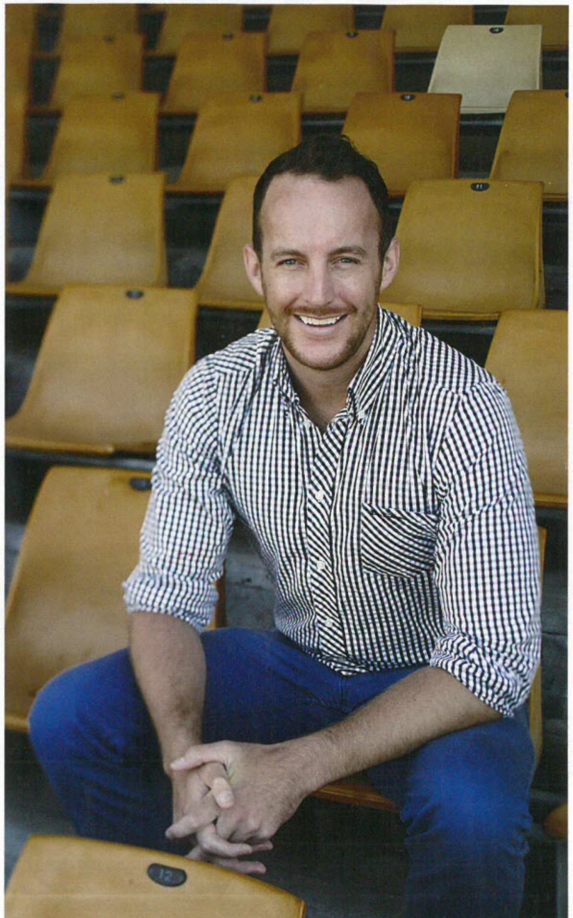
CASE STUDY

Home buyer's big dilemma

Waiting for property prices to fall can be a gamble, writes Susan Hely

NAME: Doug Mann
STATUS: Married, early 30s
QUESTION: Do we buy a house now or wait? What inner-Melbourne suburbs are affordable? Or do we buy in Geelong or on the coast and commute? Should I spread my asset allocation beyond international and Australian shares? What about investing in distressed US property?
ANSWERS: Keep future savings in cash because putting them in shares can be a high-risk strategy when you want to use the money to buy a house. Take profits from shares when there is a market upturn as you don't want to sell at a low point. Don't wait, act now and buy a property. Consider "rentvesting". Look at Yarraville, Seddon, Newport, West Footscray and Kingsville.



EAMON GALLAGHER

It is one of the biggest financial dilemmas: when is the right time to buy a home, particularly if prices may decline in 2016, as some commentators predict for Melbourne and Sydney? Do you wait in case they fall significantly or do you buy now?

Doug Mann has been saving through the now defunct First Home Saver Account scheme and regularly contributes to two managed funds. He rents in inner Melbourne and would like to buy within 10 kilometres of the city. Can he manage this on a budget of $620,000 to $800,000, or should he buy in Geelong or along the coast for $500,000-$650,000 and commute? He is happy to wait if prices continue to soften. "I'm not in a rush to purchase given the high prices," he says.

Doug invests via automatic contributions to Colonial First State's Geared Australian Share Fund and the PM Capital Global Companies Fund. He says he has chosen actively managed funds to achieve a long-term return greater than that from index funds and exchange traded funds. But he wonders whether he would be better off adding exposure to some low-cost funds to save on fees.

Also Doug wants to know if it is time to broaden his investment risk away from shares. Should he add some higher-yielding bonds or hybrids for higher returns than cash but more security than shares? Distressed US property has caught Doug's eye and he would like to know if there are any recommended investment vehicles.

Doug is weighing up buying income protection insurance. When should he start?

Costs are high so think long term

JONATHAN PHILPOT

Jonathan Philpot is a partner of wealth management at HLB Mann Judd. He specialises in financial life stages as well as SMSFs and tax planning.

It is rare to find someone who has lost money on property over the long term, so often the advice from family and friends is to purchase a property once you have the 20% deposit. I am a little more cautious as people can lose on property – usually if they have purchased and sold a property within a short period, say about five years.

If you buy property at a cycle peak you need to wait until the next upward cycle begins before the price moves above the purchase cost. The other factor to consider is the large transaction costs of buying and selling, which are about 5% of the purchase price. This means you need a price rise of at least 5% before you are ahead.

Also to be considered, however, is that the money that is currently being spent on rent could be put towards paying off a mortgage.

In regards to a budget, this is very difficult for couples who are about to commence a family, as for a period of time there will only be one income to pay the mortgage and the bills. It is important not to overcommit to a large loan. A good rule of thumb is to commit no more than 50% of net household income, on average income levels.

It is great that you have established an automatic savings plan for managed funds. I am hopeful the Australian and international sharemarkets will have a good year in 2016. However, for people who are saving for a house deposit, particularly if they wish to purchase within the next two years, having too much of your money in shares and not sufficient in interest-earning cash accounts or term deposits can be a high-risk strategy. Yes, the cash rates are low but it is the amount you are able to save that matters in the short term, not so much the investment returns. It is worthwhile considering putting future savings into cash. With regards to the amount already invested in shares, it is important to plan ahead and take the profits if share prices experience an upturn. You don't want to have to sell your shares at a low point during the year just because you have finally found your dream home.

Distressed US property may in the long term prove a good investment; however, for a short-term savings plan it is probably too risky and is not liquid when it comes time to use the money.

Finally, it is important that Doug has some income protection in place. His future income is his biggest asset, so it is important to ensure it is protected in the event of injury or illness. Given that the premiums are tax deductible, it is a very reasonable insurance to pay compared with car and other property insurances.

Key question needs to be answered first

BEN KINGSLEY

Ben Kingsley is the CEO of Empower Wealth, a property analyst, a qualified property investment adviser, co-author of *The Armchair Guide to Property Investing – How to Retire on $2000 a Week* and co-host of *The Property Couch* podcast.

There are a lot of ideas running through Doug's head by the looks of things, which is understandable for a couple who have saved up a good deposit and want the best outcome for their family. The first question they need to answer is, do they want to own their own home one day?

They have a clear idea of what they want in a property: three or four bedrooms and a yard for the future family, ideally in an inner area of Melbourne with a budget of $800,000; or in the Geelong-Surf Coast region with a budget up to $600,000 but a potential long commute back to Melbourne to contend with.

If owning is important to them, then my recommendation is very clear: three- and four-bedroom properties in inner Melbourne are scarce and getting scarcer. And with scarcity comes higher prices. So, although they might be reading that Melbourne's metropolitan price is currently slowing down, I can inform them that three- and four-bedroom houses within 10 kilometres of the city continue to grow in value, as investors and couples just like themselves fight it out to secure a property in what is becoming a more and more exclusive and highly sought-after market for families. So if owning is a priority, the strategy of playing the waiting game, on balance, isn't a wise one.

Now if owning isn't the be-all and end-all, the curve ball they may wish to consider is to "rentvest", whereby you rent where you want to live – because it is cheaper to rent properties in these prime locations than it is to buy – and then invest the money you are saving in an investment property. Again this is not a strategy for most, because often instead of investing the difference the surplus savings is spent, so you really want to be sure this is the right strategy for you before embarking on it.

If they decide to own, which is the more conservative option, the next question is going to be all about lifestyle choice. Weigh up the pros and cons of inner-city living in terms of convenience, amenity, proximity to infrastructure and the variety of things to see and do, against the realisation that $800,000 doesn't get you into many areas of the inner markets of Melbourne – so they would have to compromise on type of home and land

Up to $800,000 will buy you, at best, only a townhouse

size. Then one needs to compare this with the pros and cons of living in the Geelong-Surf Coast region. And it's also important to note that the combination of lower demand and lower incomes in that area will see lower property price growth compared with the inner city over the medium to long term.

If focusing on the inner city, up to $800,000 is going to buy you, at best, only a townhouse with a courtyard in the eastern areas – and this would be a little further from the CBD, say 10-15km. The inner northern and inner north-west may net you an entry-level home, probably in need of an update to bring it into this century. Finally, the inner west is probably where you will see your price range provide you with more options, with Yarraville, Seddon, Newport, West Footscray and Kingsville being the patch to watch.