

THE TRUE COST OF HOME OWNERSHIP

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A young couple very much in love can be all starry eyed when it comes to the nitty gritty of home ownership. An often heard cry is *we earn damn good incomes, but why don't we have any money left after all the bills?* It seemed a doddle when they could buy a property and service a mortgage for only a little bit more than they were paying in rent. No matter that they had borrowed to the hilt, securing a mortgage at 95% of the properties value. After all, property prices don't go down do they?

Unfortunately, there would be more than a handful of New Zealanders who have mortgages at higher values than their house is worth. They wouldn't even be able to pay the Land Agent fees out of the sale proceeds should they sell. In time the market will correct itself and these people will eventually become happy pixies when they eventually see some capital gain. This of course assumes these same people haven't been victims of the market forces that caused house prices to drop in the first place. Then they may be out of a job, divorced, or income hasn't increased enough to service mortgage on high interest rates. Suddenly for these people, the spectre of being unable to meet their mortgage commitments is very real. Prompt action is then required to minimise any potential losses, should they not be in a position to keep their home. *Oh but the market is down, and it's not a good time to sell,* is a likely response from those reluctant to face a reality that they never contemplated. Grimly, should they not take control themselves; the Bank will do it for them and sell them up on that same market. The likely fetching price will be 10-20% below what they might have obtained and of course that deficit they were worried about will look bigger to them than the effect of a government budget blow out. What's more, if the Bank is left with a deficit after sale, they will still owe the Bank for the mortgage deficit, plus solicitors and land agent expenses.

So, how much does it cost to own?

While we recommend that in this current climate buyers put down at least 10%, we recognise the difficulties to overcome in purchasing your first home. At the present time there isn't a market that is spiralling out of control and if (as in most cases) you are renting cheaper than what it would cost in loan repayments, I would continue to build my deposit bigger. Albeit the first conundrum a buyer faces adopting this policy is the likelihood of increased interest rates in 2012, as the current rates rise to somewhere, from their near all time lows.

Let us take purchasing a home for \$380,000, with a 5% deposit of \$19,000. All loans over 80% attract what is called Lenders Mortgage Insurance. This is an insurance the Lender buys to protect themselves from your possible default on the loan. The lender passes this insurance cost on to you, the borrower. Therefore your \$361,000 loan has just become a loan for \$365,700. This is the effect of the insurance fee of \$4,700 added to the loan, because you are unlikely to have this kind of money if you borrowed at 95%. Now we will string the loan out for as long as possible (30 years) so repayments are more affordable. At say a low 6% repayments would then be \$506 per week. *That's OK,* you might say. First mistake; because interest rates are unlikely to stay at this level and you still have 30 years of loan to run. To redress this and ensure you are not a victim of rising rates you might adopt a repayment programme based on a 7.5% pa interest rate – we recommend 8% pa although 7.5% pa has been an approximate average for the last 30 years. Repayments would now be \$590 pw and therefore if interest rates stayed at 6% for 30 years in this home, you would repay the loan in 21 years. Great, but life and bills have a habit of getting in the way.

Now you own your own home, there is the house insurance to pay (\$10 pw), the rates (\$30 pw), maintenance (\$35 pw), not to mention additional life or mortgage repayment insurance. Perhaps you can cut out the maintenance allowance because you are pretty handy, but you won't be handy enough to be able to obtain materials or services needed to replace the toilet, replace the kitchen, paint or stain for the house and it goes on and on. This means at a bare minimum you need another 15% over and above your original mortgage payments – bigger loans will be bigger homes and commensurably bigger expenses.

Accordingly just because the bank says you can borrow to the hilt, it doesn't necessarily mean you should. After all you can smoke as well, but should you?

What about Capital Gain?

Personally I believe home ownership is the bees knees, both as a way to put a roof over your head and as a way to help you become financially independent through purchase of investment properties. But, it is not the only investment strategy and as the word strategy implies, it should be a well thought out plan, looking at the pros and cons and what is best for you.

Over time, if you buy right, there is handsome capital gain in property, which is one of two major growth assets, the other one being equities or shares. Also your capital gain needs to be viewed against inflation. If inflation is 3% and property price gains are 7%, then you are ahead of the game by 4%. That is of course, without taking into account the interest on your loan and the other expenses mentioned earlier.

Ask any person who has rented all their lives, how easy is it now for them to get into the property market. They will answer that *as the years have gone by the mountain has got even steeper*. Nevertheless, property buyers need to cast their emotions aside, and understand the true cost of home ownership to avoid over-commitment on the 'dream' property. Cash is king and the less of your own in the transaction, the more at risk you are. Above all, when exposed to high levels of debt don't ignore your insurance, particularly if someone else is reliant on your ability to service the debt. Finally understand and know your numbers. Contact a Registered Financial Adviser specialising in mortgages, like ourselves, to help you. They will help provide you with a plan that is properly costed out, and protects you for unforeseen future events.

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