Healthy Housing

Stage 6

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NOW® ACCOUNTING
Your financial potential. Realised.

Freedom Stages

1. Plan your financial freedom
2. Mini emergency fund
3. Protect your income (with insurance)
4. The debt snowball
5. Emergency fund
6. Healthy housing
7. Wealth Creation
8. Generosity

Housing and extremes of fear

FOMO (fear of missing out) is the dominant housing related fear in Australia. If I don’t buy now, someone else will, the price will go up, and I’ll be worse off.

Loss Aversion (where I live!) is the other extreme, although less common it comes from a concern that housing prices will crash and you will be trapped with a mix of emotional and financial pain.

Healthy Housing involves a decision to purchase with a strategy that has in built resilience. It’s a middle ground between two extreme fears.

FOMO in print

The best selling Australian author Scott Pape:

“Our little ploy worked and we found our dream property. But here’s a confession: I played pricing games with the owner, and we almost lost our forever home. Learn from my stupidity.”

“If you find a house that you love and can afford, don’t play games. Put your best offer in writing, straight off. Let them know you’re serious. Get it off the market as quickly as you can. Instruct the real estate agent to present your signed offer to the vendor immediately.”

“Repeat after me: I will not mess around with my forever home.”

Loss aversion on screen

The perpetual housing pessimist

Peter Schiff

Peter Schiff, addressing the American mortgage bankers association before the US housing crash and GFC in 2006.

“I hope it doesn’t get to that worst case scenario, but unfortunately that type of inflation is the only thing that’s going to stop nominal real estate prices from collapsing”.

“[Moderator] Peter, what should I be doing with my mortgage company right now?”

“[Schiff] You should put it on the market, and if you can find someone dumb enough to buy it and someone dumb enough to finance it, you should sell.”

Healthy housing USA

America’s Anti-debt money guy
(who loves debt free real estate investment)
Dave Ramsey’s guidelines to his 15 million American listeners

- No more than 25% of your net (after tax) income should go to a mortgage
- A mortgage should be no more than 15 years and have a fixed interest rate
- Complete the earlier steps before you buy (no debt, emergency fund etc)

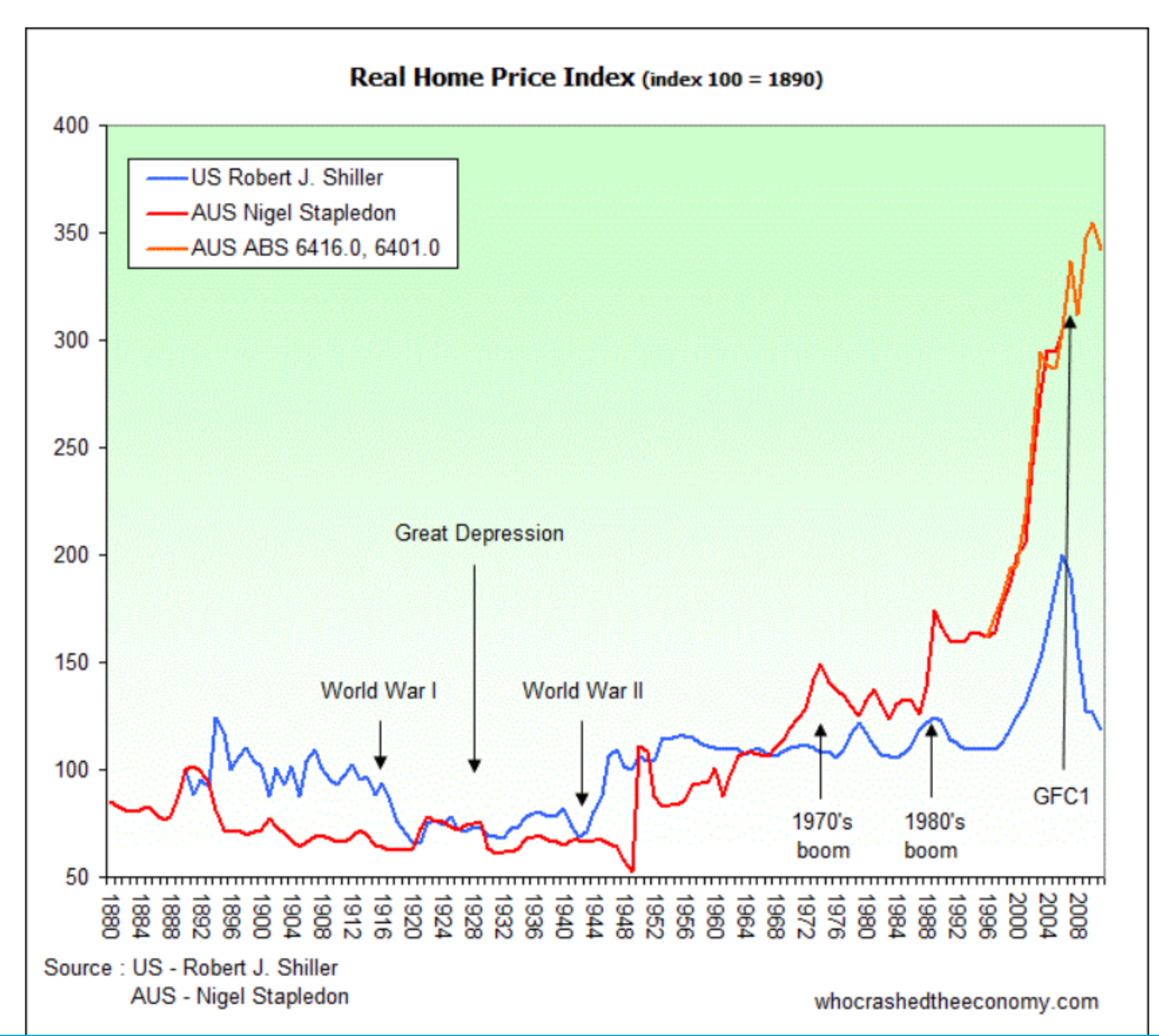
Australia's increasingly expensive houses

Household Sector

* Household disposable income is after tax, before the deduction of interest payments, and includes income of unincorporated enterprises

Sources: ABS; CoreLogic; RBA

Australia's increasingly expensive houses



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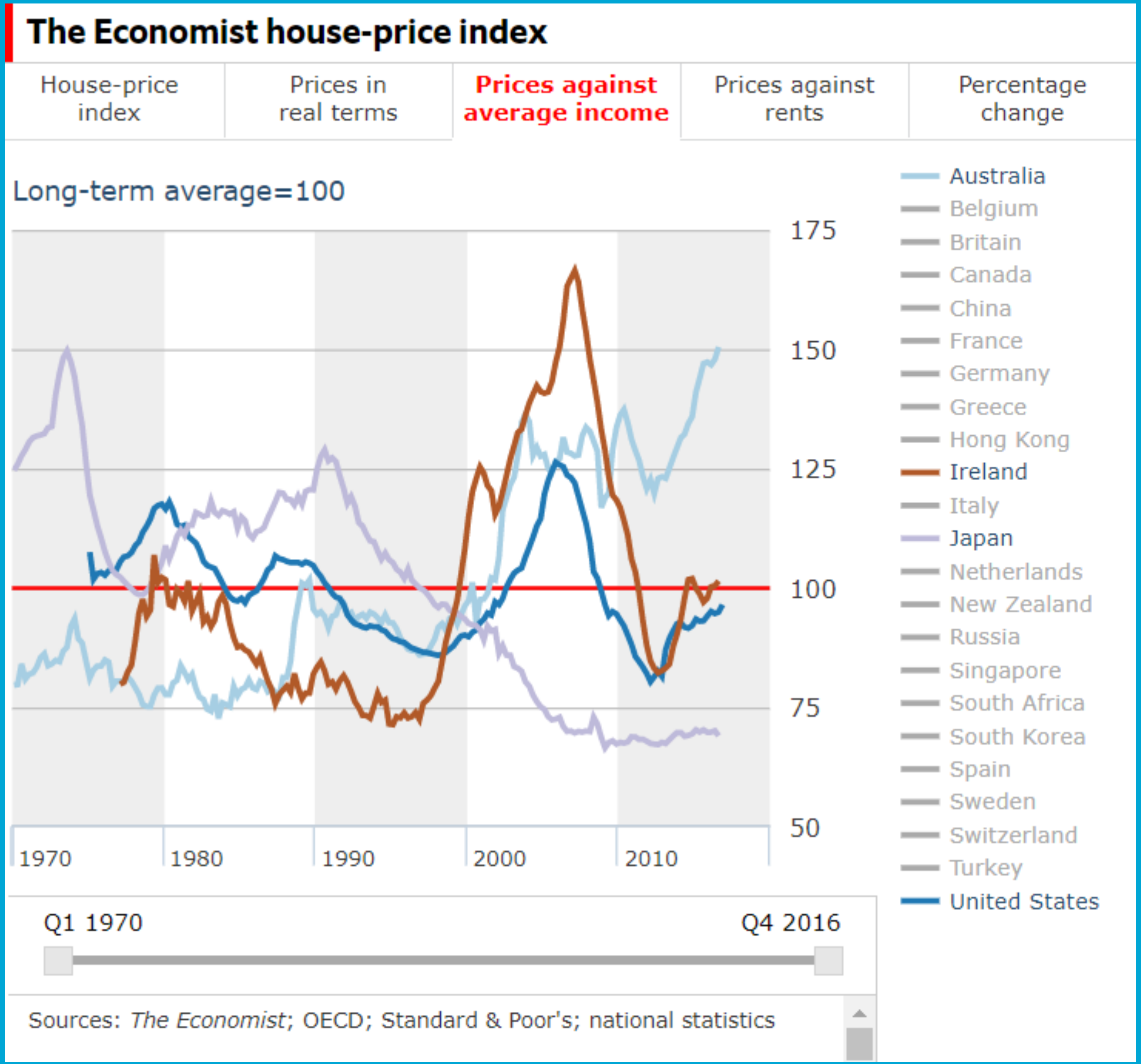

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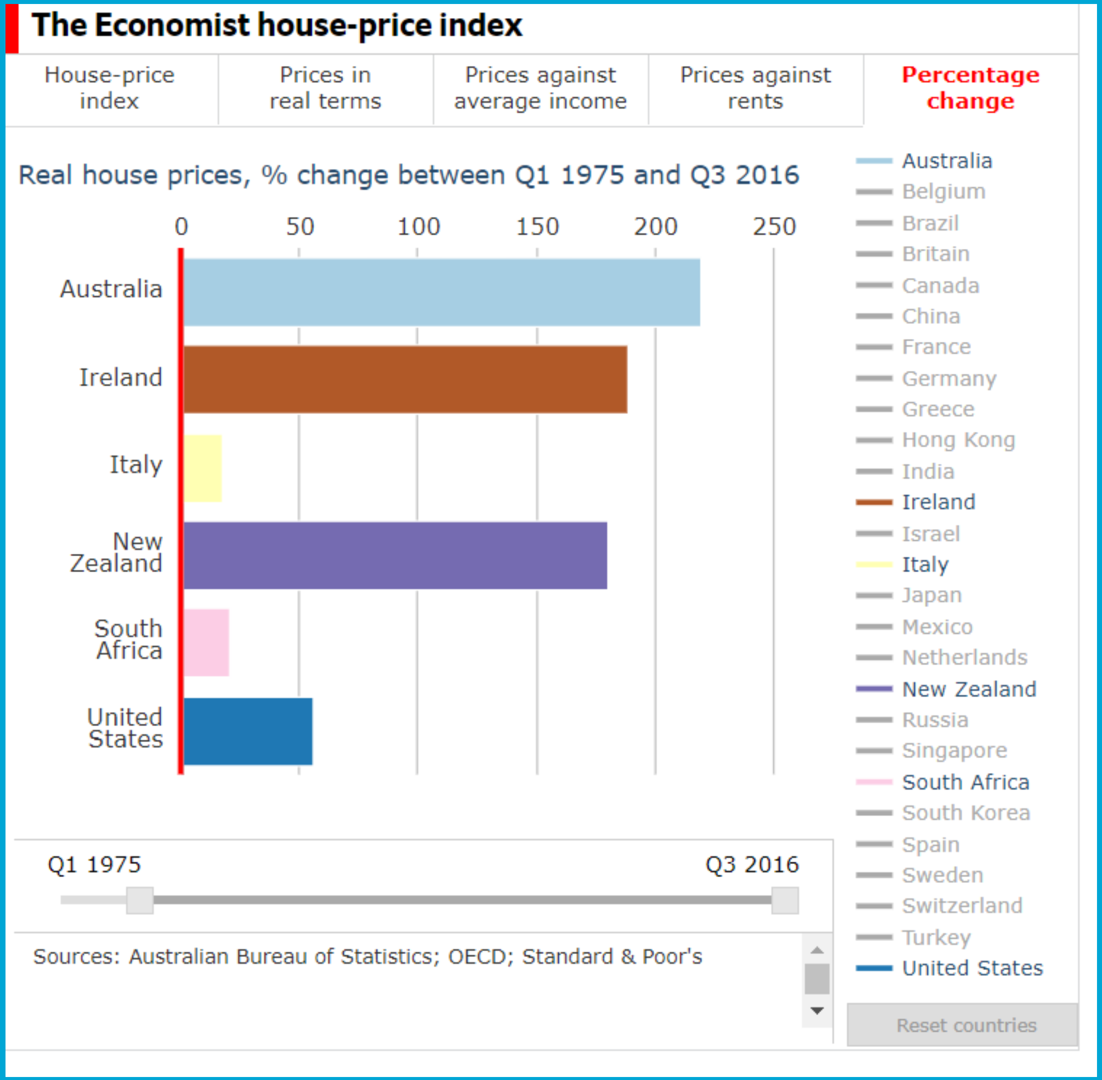

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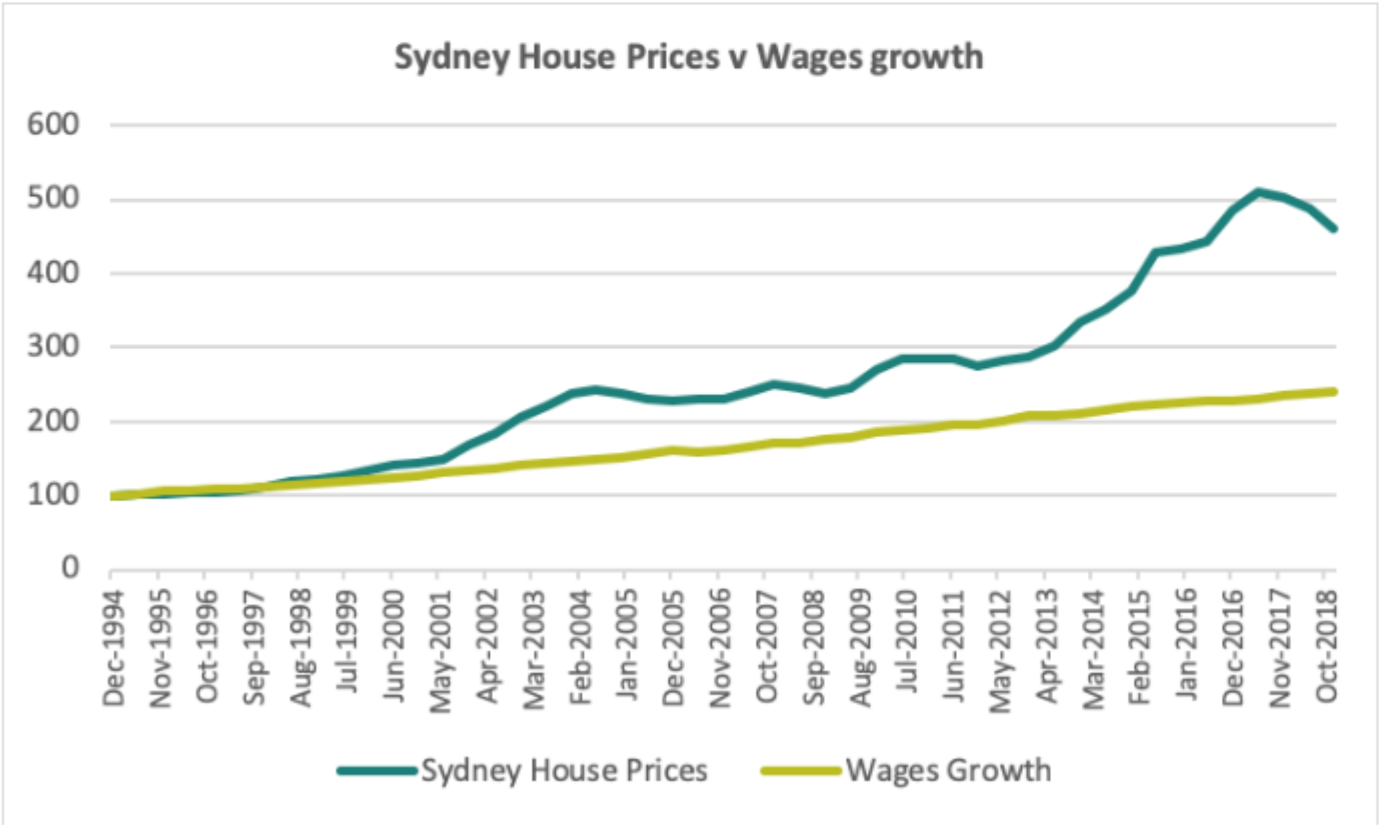

Source: Australian Bureau of Statistics

Keys to freedom in housing

- Know your budget
- Get out of non housing debt before taking on housing debt
- Build an emergency fund on top of your house deposit. It would be very costly to buy a house now and be forced to sell it later in an emergency.
- Save a deposit. Try to avoid stamp duty and LMI.
- Insure your income and your house remembering your income is used to pay off your house.
- Look into the FHSSS & other government programs

Keys to freedom in housing

- Once in mortgage debt, work hard to get out (but not at debt snowball intensity level)
- Do the math on the savings from early mortgage repayments & extra Super contributions, and come up with a plan that works for you
- Balance early mortgage repayment with diversified investment opportunities
- If you can't afford your current house (rented or mortgaged) – make a wise decision.

Rent vs Buy?

Advantages of renting:

- Rent is usually a fraction of a properties value and rental yields are very low
- Renters don’t pay council rates, water rates (only usage)
- Renter don’t insure the building, or pay for repairs and maintenance
- Renters can move if there are problems
- Different life stages might require different size houses
- No stamp duty on renting
- If the market falls, renters gain, they don’t risk negative equity
- Super contributions are tax deductible while mortgage interest repayments are not
- Superannuation is protected in bankruptcy

Rent vs Buy?

Arguments for buying:

- Do what you want with the property
- Pension Assets Test (house you live in is exempt asset)
- Don’t have to move
- Don’t have to deal with a “really annoying” owner
- Forced savings (renters who don’t save and invest end up with nothing)
- Can use property as security for debt
- Avoid getting priced out of a rising market
- Cultural endorsement (most people think it’s the best decision)
- Prices are expected to go up over the long term by most people

Your action steps:

Do the numbers on rent vs buy then decide

Adjusted rent: (Rent + Moving Costs) – (Costs paid by landlord)

How does this rent compare to the purchase price?

EG Adjusted Rent $ _____ House Price $ _____
Net Rent / House Price = % ______
Example: $850 per week adjusted rent for a $3mil house
$44,200 per year / $3,000,000 = 1.47%

Your action steps:

Ask the questions:

How much per week can I afford?

How many years am I prepared to borrow for?

How am I placed if interest rates rise?

Resilience – if borrowing , have a buffer:

Example:

$2000 net per week household income.

$1000 living costs ex house payments.

Mortgage of $500 per week, gives a buffer of $500. 25% of income, 100% of payment.

Mortgage of $750 per week, gives a buffer of $250. 12.5% of income, 33% of payment.

In the event of recession, loss of job, a repayment that looks similar has a very different risk.

You can build resilience into your housing purchase by limiting borrowing.

Re-thinking traditional negative gearing

Negative gearing strategies have worked reasonably well for investors due to the increase in prices in Australian houses.

However, there are serious deficiencies in the competency, qualification, licensing and regulation of property spruikers within Australia. It is the wild west.

Traditional negative gearing means buying a house and then making a loss renting it out.

People assume that this loss is absorbed and recouped by taxes but this is unlikely to be the case since the highest marginal rate of tax is 47%.

Those who buy in individual high income earner names will pay individual high income earner rates of tax when they sell if the strategy works and the sale price is high. Its only a short term tax benefit.

Before investing in property seek taxation advice from a professional who does not earn a commission off your borrowings and is licensed to recommend other investments and be sure to discuss SMSF.

What does it mean to guarantee a mortgage?

When you guarantee a mortgage, you commit to the full amount of the debt.

So if you guarantee your adult children's mortgage, firstly understand that the bank is asking you to do so because they believe your adult children are not a safe investment.

If you choose to do this, get legal advice, and the lawyer will probably recommend against doing so. If you still decide to proceed, have a mechanism in place to sell the property immediately upon default.

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