# RENT VESTING

YOUR GUIDE TO WHY, WHEN, WHERE AND HOW

# Contents

## Before you get started

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We encourage you to seek professional financial advice before making any investment or financial decisions. We would obviously love the opportunity to have that conversation with you, and at the rear of this handbook you will find information about our authorised representative and how to go about booking an appointment.

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# Letter from the Wealth Adviser Library

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**Welcome to the Wealth Adviser Library**

This library was built specifically to facilitate the provision of sound financial information to everyday Australians.

Our mission is to build an accessible, comprehensively supported team of members who share our vision and commitment to providing tailored financial advice and a new foundation of financial understanding and security for everyone.

With a national network of likeminded experts, we have the potential to provide the financial building blocks for future generations.

**Knowledge gives you a huge advantage**

We believe that knowledge gives you a huge advantage in creating and effectively managing wealth; in planning to reach your goals; and in being prepared for whatever unexpected twists and turns life may present.

That's why our team of experts has created this series of digital handbooks and manuals that seek to inform you of not only the benefits but also the potential risks and pitfalls of various strategies and investments.

We trust you enjoy this publication and find it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

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At the rear of this handbook you will find details on how to book an appointment.

**Wealth Adviser Library**

## Introduction – what is rentvesting?

Rentvesting is the strategy of renting at the same time as investing in an investment property. More specifically, it is the strategy of buying an investment property in an affordable area and using the rental income to facilitate mortgage repayments, while renting in a location that suits your lifestyle.

Although it is a term you may not be familiar with, Rentvesting is a rising trend in property buying behaviour both in Australia and other countries.

A classic question in the property market has always been –buy or rent? Rentvesting allows you to do both.

The purpose of this eBook is to provide information to help you understand the Rentvesting strategy. We will explain why, when, where and how you can use it as a financial strategy, as well as the basic advantages and disadvantages of both renting and buying.

As with any financial decision, we recommend you seek professional advice to help you determine if Rentvesting is appropriate for your financial circumstances.

## Why rentvest – the new great Australian dream?

Owning your own home is considered to be every Australian's dream.

House prices in Australian capital cities are among the most expensive in the world. Sydney, Melbourne and Brisbane that now have average prices that are outside the reach of a younger generation (although Brisbane remains the most affordable).

Let's look at 1975 and see how the maths has changed. 1975 is a good year to pick because Baby Boomers were just turning 30, getting married, having kids and buying homes (on average they were marrying about 6 years earlier than they are today).

The average price of a house in Sydney was $34,000 (for a unit it was $26,000). The average income was about $8,000. So, very importantly the house to income multiple was in the low 4s (so four years' income paid for a house, and less for an apartment).

Today the average house price in Sydney is $1 million with average income about $75,000. So, the multiple is in the low 13s (even with two incomes you do not get back to the maths of the 1970s). Put simply, the maths has changed so much that without some help and/or different thinking younger generations will not be able to step onto the inflationary elevator that is Australian property.

While we are on the subject, we cannot help but talk about the cost of university. In 1974, just as a large wave of Baby Boomers were entering university, university fees were abolished and then in 1989 just as the last Baby Boomers were leaving university, the fees were reintroduced again. Today's university student can easily leave university with a $30,000 debt (or much more) compared to the unencumbered Baby Boomer.

Many young Australians (Gen Y and Millennials) are concerned that entering the property market is beyond them.

But there is a way forward –Rentvesting. It provides you with the best of both worlds (owning and renting). It is a strategy that can make it both affordable to enter the property market as well as yielding significant long-term financial benefits.

**Current trends towards Rentvesting**

A 2018 annual investor survey that targets first time property investors, who have either recently purchased, or planning to do so in the next two years has found:

- 63% of investors would consider rentvesting as a property investment strategy
- 36% of investors were first time buyers, a statistic that has been stable since 2016 and significantly higher than the 21.1% recorded in the same survey in 2015.
- One in every four first time buyers

stated they had purchased an investment property before their own home to live in due to affordability.

The survey further revealed that more than 75% of respondents believe that investing in property is the key to setting themselves up for the future.

These buyers want to get their 'foot in the property door' without compromising their current lifestyle. They find an investment property in an area they can afford, rather than where they actually want to live.

More and more first property buyers are now buying investment property rather than a home.

## Pros and cons of rentvesting

Before we discuss when, where and how to Rentvest, we will highlight the relative advantages and disadvantages of both buying and renting at the same time.

**Advantages of Rentvesting**

- Live where you want –Rentvesting allows you to live in a better home than you might afford to buy.
- Live the life you want to live now.
- Flexibility to change where you live offering mobility to suit cash flow and family circumstances; and pursue career opportunities.
- Tax benefits not available on the principal place of residence are available to property investors. – These include mortgage interest, rates, insurance, depreciation, repairs and maintenance. These expenses are not tax deductible for owner-occupiers.
- Entering the property market sooner than if you focused solely on buying a home to live in, provides you with more opportunity for capital growth.
- Greater return potential –By removing the emotional attachment from the purchasing process with an investment property you are more likely to select a location and property that is well researched based on its return potential, rather than your desire to live there yourself.
- Minimise emotional renovations or improvements to the investment property –By not living in the property overspending on bathrooms, kitchens, fences, driveways, landscaping etc. to get the property exactly how you want it (which often don't add the equivalent value) are minimised
- You are generally able to access a larger loan for an investment property than for an owner-occupied residence. This is because an investment property provides you with additional (new) income (i.e. rent). This might enable you to buy properties that might otherwise have been inaccessible to you. It may also increase the extent to which you are able to benefit from the effect of gearing.

**Cons of Rentvesting**

- Renting is temporary and may lack predictability –Being faced with a rent increase or a request to vacate the property at inconvenient times is not ideal.
- You are not living 'in your own space' -Inspections and possible access requests by the landlord real estate agents impinge on your freedom of enjoyment
- Limited changes and usage –Certain permissions maybe required or expense requests to alter or improve the living environment.

  Hanging pictures inside and having pets inside are just two examples of possible restrictions imposed by the landlord or where repairs may- be required on eventual moving out.
- Vacancy of the investment property, which could be minimised if you do your research and purchase in a desirable suburb with good prospects. Structuring your loan

effectively (e.g. taking out an interest-only loan with lower repayments) will also assist.

- Investment properties may attract Capital Gains Tax (CGT) and may be liable for land tax under current legislation.

## The mechanics of renting AND buying

More and more investors are coming up with an interesting answer to the classic 'buy vs. rent' conundrum. They choose to rent as far as their own living arrangements are concerned with a view to maximising their flexibility and mobility whilst at the same time buying a property (or properties) as an investment. 'Rentvesting' is a strategy that can yield significant long-term results.

Following are some of the reasons and benefits behind such a strategy:

**Making Lower 'Cost of Accommodation' Work for You**

We all need a place to lay our heads at night and the cost of such accommodation is obviously a major budget item in most households. When the Cost of Accommodation (COA) for renting and owning is compared it quickly becomes clear that owning is more expensive. Consider the following:

If you own a home the Cost of Accommodation will include:

1. Interest component of the mortgage repayment
2. Rates
3. Insurance
4. Ongoing Maintenance
5. Utilities
6. Regular one-off capital expenditure

When you rent a home the Cost of Accommodation is comprised of:

1. Rent
2. Utilities

Every case is different but the equation above points to the fact that it is much cheaper to get a roof over your head through renting rather than owning. Renting can therefore result in a higher level of disposable income. If you can manage to channel this higher level of disposable income into investment it can greatly strengthen your financial position. Applied to property investment you could say that renting might free up cash to invest in non-owner-occupied property. Possible reasons for doing so will be explained below.

**Combining the Advantages of Renting and Buying**

It should be clear when considering the advantages and disadvantages associated with renting and buying that there are some pretty compelling reasons to choose for either strategy. By opting for 'Rentvesting' you can combine some of the benefits associated with both. You can, for example choose to live in a desirable inner-city area that you might not have been able to afford to own. In this way, you will hopefully be gaining long term capital growth on your unemotionally chosen investment properties while making fewer compromises on your lifestyle and where you live.

**The Tax Implications of Being a 'Renting-Landlord'**

There can be significant tax advantages associated with being a 'renter-landlord' instead of an owner occupier. As an investor, the interest on your loan and other costs associated with holding the asset (e.g. mortgage insurance, repairs and owners and corporation fees) will be tax deductible. Interest on mortgages held by owner occupiers is not tax deductible. The fact of tax-deductibility for investment properties means that you are effectively able to access cheaper debt. This fact may make a significant difference to the bottom line, enabling you to grow your investments at a faster rate.

While the tax deductibility described above is a significant benefit, it should be noted that the tax situation for investors is not necessarily uniformly rosy. The following should be taken into consideration:

- Land Tax is not payable on owner

occupied properties but may be levied on investment properties above certain levels (these vary from state to state). Prospective property investors are therefore strongly urged to do their homework in order to avoid nasty surprises.

- Investment properties also attract Capital Gains Tax (CGT). This is a 'theoretical tax' in the sense that it is only payable if and when a property is sold. CGT will be payable in line with your marginal tax rate and will be applied to your 'profit' (i.e. the difference between what you paid for the property and what you sold it for). If you hold the asset for more than a year, the rate at which you have to pay is halved but it can still turn out to be a massive hit. It is obviously wise to take the possibility of having to pay CGT into account when you plan your investment strategy. At the very least it may nudge you towards a strategy where you hold on to properties rather than engaging in buying and selling since the tax only becomes payable when you sell and make a profit.

**Renting to Invest and Finance**

When you rent to invest you will generally (all other factors being equal) be able to access a larger loan than would be the case if you were an owner occupier. This is because you now have an additional (new) income, the rent on your investment property. This might place you in a significantly better position in terms of accessing areas of the market that might otherwise have been inaccessible to you. It may also increase the extent to which you are able to benefit from the effect of gearing.

**'Saving you from yourself' by Helping You Think like an Investor**

The benefits discussed in this section are more intangible in the sense that they cannot easily be described in dollars and cents but that does not make them any less significant. Allow us to explain.

One of the most significant hidden costs associated with home ownership is the urge to spend large amounts on your home. On some deep psychological level, it makes sense: You are the king/queen of the castle so it is therefore only reasonable to make the castle as comfortable as possible! There will, therefore, for many home owners be the constant urge to spend capital to fix and improve the property. Copious amounts of money are spent on bathrooms, kitchens, fences, driveways, landscaping etc. All the while the owners might be telling themselves that they are 'adding value' to the property. In most cases they are deluding themselves in the sense that the value that they are adding is nowhere near the amounts that they are spending.

Living in rented accommodation can act as a natural barrier to the temptation to splurge on your home since you will be seriously disinclined to spend large amounts of money on someone else's property (it is in any way highly unlikely that you would be allowed to do so!). This can add up to a significant saving over time.

With a 'rent to invest' strategy you will, of course, own a property (or properties). It is, however, likely that you will be much less ready to make emotional decisions when it comes to renovations or improvements since the decisions will not affect your own living space but rather living space that you rent out to someone else. This means that you will be inclined to make decisions from a purely business perspective. This is true, not only in terms of what you do with the property but also in terms of the property that you invest in in the first place. You will be placing investments in areas that you have researched that are likely to perform, regardless of whether you would want to live there or not. In this way renting to invest can not only save you from costly mistakes but may also turn you into a much better investor, one who is able to make decisions with his/her brain rather than with their heart.

## Case study – rentvesting in action

To illustrate the value of rentvesting, let's consider a middle-income couple.

Kim and Murray wish to stay in the area that they currently rent as this suits their lifestyle, it's close to the city where they both work and they are close to their family and friends.

**Scenario 1 –Purchase own home**

Market research has led them to believe they would need to spend about $900,000 to purchase the style of house they would like to purchase to remain in the area.

Assumptions

- Desired purchase price -$900,000
- Additional purchase costs -5% of purchase price.
- Current savings: $50,000
- Current rent -$600
- Current expenses –$4,000 per month, plus $600 weekly rent monthly and $200 monthly credit card payment
- Combined gross annual income -$150,000, net income after tax $115,156

Based on the cash flow analysis below, Kim and Murray have a cash flow surplus of $33,556

| | Amount |
|---|---|
| Gross income (combined) | $150,000 |
| Net income (combined) | $115,156 |
| Current expenses: | |
| Rent where Murray and Kim live | $600 week |
| Living expenses | $4,000 month |
| Credit card | $200 month |
| Total expenses per annum | $81,600 |
| Current surplus cash flow | $33,556 |

Based on the above details, are Kim and Murray in a position to purchase their $900,000 home?

Based upon various loan amounts, Kim and Murray will need between $90,000 and $225,000 in conjunction with a borrowing capacity between $720,000 and $855,000 to purchase a property valued at $900,000. Based on their current savings of $50,000, this leaves them with a current shortfall of at least $40,000 to meet the minimum deposit/ expenses based on the maximum loan possible.

| | Purchase value - $900,000 | | | |
|---|---|---|---|---|
| Loan ratio against property | 80% | 85% | 90% | 95% |
| Required loan amount | $720,000 | $765,000 | $810,000 | $855,000 |
| Required deposit | $180,000 | $135,000 | $90,000 | $45,000 |
| Estimated purchase costs | $45,000 | $45,000 | $45,000 | $45,000 |

**Scenario 2 - Rentvest**

Murray and Kim decide to keep renting in the current area that is most desirable to them and purchase an investment property instead in an alternative suburb, where they have no desire to live. After researching the property market, they have selected a property valued at $450,000 based on income and capital growth prospects.

They are able to borrow $425,000. With their current cash savings of $50,000, this enables a 5% deposit ($25,000) and for 5% estimated purchase costs ($25,000).

Assumptions

Purchase price of investment property

$450,000 –Expected rent $400 per week

Additional purchase costs -5% of purchase price

Interest only loan of $425,000 –5% interest

Monthly repayments are $1,771 month on the interest only loan ($21,252 per year). After taking into account expected rental income of $400 per week ($20,800 per year), Kim and Murray would be required to fund the shortfall of $452 per year, or $9 per week, which is well within the constraints of their current cash flow surplus of $33,556 per year.

This is a simplified example and ignores the impact of the interest expense being tax deductible, depreciation and the costs of owning an investment property.

Being an interest-only loan, there is no principal repayments on this loan and so no debt reduction. The benefit, though, is that Kim and Murray will be living a lifestyle very similar to one they are enjoying now, because of a lower debt servicing requirement. They may choose to take out a principal and interest loan; however, the extra cost of the repayments will need to be accounted for in their cash flow. Also, some interest only loans permit a set amount of loan repayment each year.

By buying a property in an alternative suburb and renting it out, as rentvestors Kim and Murray can get into the housing market now, and possibly fast-track their capacity to move into their own dream home later.

## How can parents help?

Regardless of buying an investment property or home to live in, Baby Boomers need to help their kids get into the property market. Below are some options of how parents can assist.

**Just give them the money**

Let's not beat around the bush. If you want to help them and you have the means to do so, just give them the money. Call it what you want, a gift or early inheritance, but the bottom line is that it was your money and you made it theirs.

Saving enough money for a deposit nowadays borders on the impossible. After tax, living expenses, rent and the university debt there is not much left to save for a deposit that can easily reach $100,000. By the time they have been able to save the deposit, many years later, property prices have risen again and they never get to latch on.

If we put family relationships and politics aside, it really is a question of maths. Can you give them enough money to help them into the market without impacting your lifestyle? Even better, are you happy to have your lifestyle affected a little bit to help them in?

**The 5% Question**

Would giving them 5% of your net worth impact your lifestyle today? If your net worth was $3m, would giving then $150,000 affect you and if so how much? If your net worth was $2m, would $100,000 affect you and so on.

Or, you might say, that a large part of your net worth is in your home and illiquid, so then you could ask the question a different way. Would giving 5% of your retirement fund affect you? So, let's say that between your super and an investment property you have $1.5m, would giving them $75,000 (or possibly less than one year's returns) affect you?

You get the gist of the question. Whatever the amount or percentage is, what you are really asking yourself is whether you can do without that money in order to help a child into the market. One client comes to mind, who retired last year, with a net worth of about $4m. He gave his 28-year-old son $200,000 to help him and his wife buy an apartment near the city for about $800,000. It hasn't affected his retirement income in any material way and he is deeply satisfied with the fact he was able to get his son into the market. Now had he had five kids, his ability to help to that degree would have changed, but you have to work with the hand you are dealt.

We often hear concerns from parents around the loss of family wealth in the event of an adult child divorcing. It's a legitimate concern but one that has solutions if you get the right advice.

**Lend them the money**

Alternatively, you can lend them the money. This can take a variety of shapes and forms:

- These can be interest free loans, as they often are
- They can be an informal handshake agreement or they can be formalised with a written agreement
- They can have an indefinite repayment term, which makes them a gift by another name of an agreed repayment timeline
- They can be directly between you and your child or you can include a third party between you to formalise the arrangement

In you lend them the money on an interest free basis, you are in effect "gifting" them the interest on the money.

**Parent to child loan products**

A handful of loan providers have a formalised process that can be used to lend money to your kids. In effect, you are inserting a middle structure to help with the formalities. It is like letting your kids live in your investment property and pay rent, but getting them to deal with a local agent instead of you directly. More formal and potentially less family hassles.

Whilst these loans come at a price, they can certainly have their benefits. It can be a good tool to help the kids save on Lenders Mortgage Insurance (LMI) by lending them enough (via a second mortgage) to get them to an 80% loan, which means no LMI.

**HECS-HELP**

You could choose to pay for their university education so that they leave university unencumbered.

Or if they have a HECS-Help loan, you could choose to pay it off for them, which at the very least will help with any loan applications that they make. It will increase their borrowing capacity and increase their ability to cashflow any loans.

If they are paying say 6% of the gross income towards their student loan that could easily reduce their borrowing capacity by 20%.

**Parental Equity and Cross Collateralisation**

Cross Collateralisation is a mouthful, but in English it means using the equity in your home to support a loan that your kids could use to buy a property.

It is not a gift or a loan, but really a guarantee or a promise that if your child doesn't pay back the loan, you will take ultimate responsibility. You are "giving" them your financial firepower or credit.

Let's imagine that you have a $1m unencumbered home and your son, who has no deposit but a good income wants to buy his first home for $600,000. If the two assets are "Crossed" your son would be able to get the loan.

**Family Pledge and limited guarantees**

Another way of using the equity in your home to help the kids is by providing a limited guarantee or what is being called a family pledge. So, your child may need say $60,000 to get them over the line and especially if that number was required to avoid the cost of mortgage insurance. Well, a family pledge, secured via mortgage (including a second mortgage) against the home which has ample equity in it, might just do the job.

It may only need to be temporary because if the value of the properties rises, then you can have them revalued and if the new loan to value ratios are adequate, have the pledge released.

**Joint Borrower**

You could choose to jointly buy a property with them. It could be 50/50 or 60/40 or whatever percentage that works for your situation. You are on title and you are jointly responsible for the loan.

Your kids owning 50% of something is better than owning 100% of nothing.

You obviously are taking on the risk of the loan if your child fails to keep their end of the bargain, but there are varying degrees of risk within all these ideas and there is an assumed level of trust and reliability between parents and children for any of these strategies to work.

**Early Inheritance**

We have talked about this already, but it's important to think a bit deeper about inheritance while we are on the subject.

If you are 60 and your daughter is 35, helping her now with only some of your wealth could make a profound difference to her and a minor difference to you. But, if you go down the more traditional road of inheritance and give it all to her at your death, she could be waiting another 30 years and by the time she inherits the funds at 65, it doesn't have the same impact on her life because she has lived most of it already.

So, the whole idea of early inheritance is giving them the funds when it really matters.

**High LVR (95%) Loans**

Once upon a time these loans didn't exist, but today because of people's inability to save up large deposits and high property prices, they are a necessity for many first home buyers. The point here is that helping them get into the market may cost you less than you think.

Let's say we are talking about a $700,000 property (especially in Sydney or Melbourne), 10% or $70,000 might do the trick. 5% for the deposit and another 5% for costs, mainly stamp duty. If that is all you can do, that might be just enough for them. They will still need to contend with mortgage insurance and servicing a large loan, but if they (and you) want to get into the market, it's another way of doing just that.

**Cashflow Contribution**

Instead of a capital contribution, you could choose to help with cashflow and assist with the mortgage repayments (or part thereof) until their income reaches a point where they can comfortably pay the mortgage. I can hear you think; how did the bank lend them the money if they are struggling to pay it back? Well, it happens more than you think, people over extend themselves all the time and are able to find a bank that lends them more than they really should be borrowing.

**Offset Accounts**

If you have the funds and your son has a mortgage, you could get them to set up an offset account so that you could simply "park" your money in their offset account and save them the interest on that part of the loan. The only cost to you would be the "opportunity cost" of earning a return on that money in your own bank account.

If you had the money in your bank account you might earn 2% that you would pay tax on but in your daughters offset account she would save 5% on her debt, after tax.

**Helping them to compromise**

Too many people are struggling to make concessions to get into the market. If you have grown up in your parents' home, near the city, near amenity, near the beaches etc. you might be finding it hard to make the necessary concessions to moving out and being an hour away from work. But that is the journey many will need to take if they want to get into the market.

If a $1m property is simply not within your reach (with or without parent's support) then you should be looking at suburbs or property types that fit you (and your parents) budgets.

Parents may need to make their support conditional on some compromise.

The journey may begin in an area that is "less than ideal" but you can then work your way up the ladder over time and get closer to the city or work and lifestyle.

## When is the right time to rentvest?

Property investment is a long-term investment. Historically, the best capital growth from property investment comes when properties are held for periods of 7 to 10 years or more.

Property prices tend to move in cycles. The property market isn't as volatile as some other investment markets (e.g. shares which tend to have more frequent price movements). However, property prices may remain flat for long periods, before rising sharply in 'boom' periods.

Ideally you want to purchase at the bottom of the market (i.e. when property prices are at their lowest). However, as with any investment market, it is almost impossible to accurately predict the best time to enter the market.

The right time to enter the market is when it suits your financial circumstances to do so, with the additional advice that you need to be prepared to hold onto your property for the long term.

Buying and selling property can potentially involve significant additional costs such as CGT, stamp duty and real estate agent fees. It should therefore not be done frequently, especially due to the need to hold the property asset for the long term to maximise its capital growth potential.

## Where should you rentvest?

There is an old saying that there are three important considerations when buying property –location, location and location. However, many owner-occupiers don't take the time to evaluate the growth potential of a property location. This is because they are generally more emotionally invested in their property purchase decision.

They might know that they love a suburb, but they often don't take a step back and ask themselves whether it is a wise decision to invest in that suburb.

Canny property investors take the time to research the market and invest in suburbs with financial growth potential. For example, suburbs where new school, shopping, transport or entertainment facilities are proposed to be built. Or in inner city suburbs that are usually in high demand. While these factors may not be important for your own lifestyle, they are likely to be the drivers of an increase in the future value of your investment property.

Ideally, you are looking for suburbs that will outperform the market average in terms of future growth. These opportunities always exist; it's just a matter of doing your research to find them. You may be able to find yourself a bargain.

In addition, as mentioned earlier, when buying an investment property, you may be able to access a higher loan that will enable you to purchase in more affluent suburbs than you would if you were an owner-occupier. Such suburbs generally maximise both your potential rental income and your long-term growth.

## How to rentvest

Typically, when you invest in your own home as an owner-occupier or rent a property as a tenant, your mortgage or rent payments come out of your own pocket.

However, when you Rentvest, you can use the rent you collect from your own tenants to pay your investment property mortgage repayments.

Whether you are an owner-occupier or an investment property owner, you have invested in a property. In each scenario, you are paying down a mortgage. The difference lies in where the money is coming from to pay the mortgage.

While it's true that with Rentvesting you are also paying money to a landlord as a tenant, you now have additional income available to you –rent from your own tenant. The key to maximising your wealth is your effective use of this additional disposable income. Directing it to your investment property mortgage repayments is an effective use as it will reduce your investment property debt, increasing your equity at the same time.

**Your Deposit**

The larger the deposit you can save and have when considering a property purchase, the more options you will have to buy the property you want; reducing the compromises property purchasers are often required to make.

Having a reasonable deposit will allow for:

- greater power to negotiate with lenders,
- increased ability to comfortably afford the repayment of your loan
- the elimination of the extra cost of requiring a lender's mortgage insurance (LMI).

**Saving for a deposit**

It can be tough saving a deposit for a home, especially when you have to pay rent on top of the normal living expenses. If you have the opportunity to live with parents or relatives, then you should take advantage of this for as long as possible.

Alternative, rent cheaply during the years when you are saving a deposit. A few years of less than ideal accommodation when you are single or a childless couple could make a huge difference to your financial status and comfort when you have a family to support or are in retirement.

Whatever your income and accommodation costs, budgeting to save a healthy deposit for your first home is the first step towards financial prosperity.

**Some Tips of Effective Budgeters and Savers!**

The key to budgeting is discipline. You need to set your goals and stick to them.

The best way to budget is to list your expenses and mark those that cannot be reduced. Then, think about ways to cut those costs that are not fixed.

An approach to better understanding your expenses is to record all of your spending for a few weeks. Then examine these records to determine where some costs can be eliminated altogether or reduced (either significantly or even slightly) without sacrificing your lifestyle.

The accumulation of these reductions in your expenses and spending can make a real difference to your savings over time.

Another habit of successful savers it to immediately put aside savings when you receive your income, either as a fixed percentage of the income you receive or a specified amount you consider you can save above the amount you require to live. The aim of this exercise is to only spend what you have available, after your savings.

It would be preferable if you could place these savings into an account separate from the account that you use for your living expenses.

It would be even more preferable if these savings were in a fixed deposit account where your funds are not only not easily accessible but also working for you by generating income in the form of interest.

To build your savings, look for accounts that pay higher interest rates and have low or no-account fees. Online accounts can be attractive and can be a great way to track your progress. There are term deposits available that offer competitive returns if you have $5,000 or more in them.

The amounts you put aside from income not spent on unnecessary expenses, which are increasing from regular interest received, will help you with the deposit for your new home or in being able to comfortably meet your loan repayments.

**How much can you borrow?**

Your budget will assist you to work out how much you can afford to repay off your home loan.

A mortgage broker can help you work out how much you can borrow and what the repayments will be. They will go through your budget with you to check that repayments will be

manageable.

When calculating how much you can borrow, be sure to include all your loan costs, conveyancing fees, and stamp duty or transaction taxes.

State and Territory governments impose taxes on a range of paper and electronic transactions. These taxes are variable across States and Territories, and may be called stamp duty, transfer duty or general duty. They can add significantly to the cost of buying real estate. For example, if you buy an $800,000 home in NSW, you will pay up to $31,778 stamp duty on the purchase1 (see also the ‘Government help for first home buyers’ section of this eBook). Additional stamp duty will be charged on loan agreements.

Your lender will probably require you to obtain a professional valuation of the property. Some lenders arrange that for you at no cost. Others charge, or require you to pay a private valuer approved by them.

Other items you need to budget for:

- rates, taxes and body corporate fees, if applicable –these costs are ‘adjusted’ on settlement, and added to the total you must hand over when you complete your purchase.
- property insurance is essential for your own peace of mind. In addition, most lenders require proof that the property is adequately insured and may insist that they are listed on the insurance policy as the mortgagor.
- costs of moving and those unavoidable incidentals -you will invariably find a lot of little things that need fixing or improvement to make your home comfortable.

**Budgeting to Repay Your Loan**

Make sure your monthly budget includes provision for council rates, body corporate fees (if applicable), water and sewerage charges, plus home maintenance and repairs.

Ask your broker or homeowner friends how much to allow for these expenses. These are costs that your landlord paid when you rented and can cause stress if you don't allow for them in your budget!

It is also vitally important to budget for interest rate fluctuations if you have a variable rate loan.

It is also important to consider the likelihood that your income may reduce. For example, your partner might take time off work to have a baby, or you might decide to take time off to spend time with young children, or you may find that you are made redundant and need to look for a new job (which could take some time).

Consider insuring against accident or serious illnesses with income protection and other personal insurances. Be sure you have adequate life insurance so your family still has a home in the event of your accidental death.

A financial adviser can help you put a financial plan in place, part of which will help make sure you are prepared for any eventuality.

**Financing your Purchase**

You will likely need to borrow a large amount of money to purchase the property, which will need to be paid back over a long period of time.

It is therefore important to take great care to choose the right lender and negotiate the right loan terms. You will be with them for a long time and if you are paying too much (in terms of interest and fees) it can be very expensive if you are committed to these over many years.

Don't make the mistake of thinking you are powerless in your negotiations with a lender! There is fierce competition in the lending market and lenders are keen to win your business. If you are not a confident negotiator, engage a broker or agent to act for you to ensure you get the right deal for your needs.

It is important to do your homework before you begin the process of finding the best lender for you. Research and learn about the types of loans that are available on the market, remembering that new lending products are often being introduced. Understand the advantages and disadvantages of each, then familiarise yourself with some of the terms lenders will use when negotiating and on loan documents.

Finance brokers can help you with the process of financing the purchase of your home. They are experienced in these areas and knowledgeable on loans available to suit your needs. If you are not sure what to do, you can take advantage of their expertise.

**Lenders and Brokers**

Today, banks compete aggressively for your business and will lend to non-customers, even if you don't move your other accounts. There are also many non-bank lenders in the market.

Engaging a reputable, professional mortgage broker is a wise move for borrowers. Most brokers receive commission from lenders, so there is little or no direct cost to you for their services. Brokers have a wealth of experience dealing with lenders. They know exactly what each lender offers, so they can make accurate comparisons and bargain effectively to get you the best deal.

Brokers work for you, not the lender. Their reputation and future business relies on protecting your interests and getting you the best available deal. They can save you a lot of time, and probably a considerable amount of money.

They can also provide professional advice on how much you can afford to repay and which loan features will be advantageous to you.

Brokers can be a great help with the tedious loan application process. They can help you understand the loan contract correctly, so you are aware of all the risks.

A broker knows lender requirements well enough to tell you immediately if there is a risk of a lender declining your application, so he can eliminate frustration, delays, and disappointments.

**Which loan type?**

Most loans require regular periodic payments of principal and interest over a fixed term, although you can choose an 'interest only' loan, and pay the principal in a lump sum at the end of the loan term.

Common loan types include:

- variable interest (rates rise and fall with market changes)
- fixed interest (interest rates are agreed when the loan is accepted, and cannot change)
- capped interest (rates can fall, but cannot rise above an agreed cap)
- split (fixed interest on part of the loan, variable on the balance)
- fixed for a period (referred to as a 'honeymoon' period) then variable.
- Line of credit: like a cheque account with an overdraft. You can deposit as much as you like to the account whenever you please, and draw from it to pay all your expenses. The balance rises and falls, and interest is calculated on the daily balance. Limits and minimum deposit rules may apply.

'Basic' loans are inflexible, but inexpensive. 'Standard' loans and special loan packages have features such as redraw and offset facilities (see next section of this eBook), and allow you to make extra payments or pay out the loan early without penalty.

Redraw options and line of credit loans offer advantages for good money managers, but avoid them if you might be tempted to overspend!

**Important loan features to understand:**

- Redraw - After making payments for a time, you can take back (redraw) some of the money you have paid off your loan. The balance of the loan increases again, and either your term extends or your repayments increase, but you have access to cash. This is helpful if you encounter unexpected major expenses, or want to extend or improve your home.
- Offset - Some lenders will 'offset' the interest on your savings account against your loan interest. For example, you have a $250,000 loan at 4%, and $50,000 in a savings account. Instead of earning less than 2% interest on your savings (taxed at your marginal rate), you pay loan interest on only $200,000.

**The Application Process**

To apply for your loan, you will need to prove your income and expenses and the deposit you have saved. Pay slips, a letter from your employer, tax returns, or business profit and loss statements supplied by your accountant are all acceptable proof. A mortgage broker or lender will provide you with a checklist of the exact documentation you require.

Your lender will want to know about your living expenses. Be truthful! Document what you spend on everything. This includes memberships in professional associations, tools for work, electricity, telephone, motor vehicle expenses, insurances, food and clothing, entertainment, school fees, child care costs etc.

The lender will want to know who you owe money to, how much you repay each month, the interest rate that applies, and how much you currently owe. List all your financial obligations, including loans, leases, hire purchase agreements, time payment agreements with creditors, and any court ordered payments to a former spouse or children or to a creditor.

It is a good idea to document all this before you apply for a loan or start looking for a property. When you have added all income you (and your partner if you are buying together) receive and deducted all expenses (except rent if you are moving to your own home), the balance, less a 'contingency' allowance, is the amount you can afford to pay off your home loan. Don't commit to more! Lenders will often limit your borrowing so that your repayments, including interest, are no more than one third of your income. While that is a good rule, you should examine your income and expenses carefully to determine how much you are comfortable repaying.

A mortgage broker can help you assemble all this information with minimal imposition on your time, and will prepare your application so the lender can process it quickly and approval is assured.

The approval process may take several days, sometimes weeks. Once the loan is approved, a contract is drawn up and presented to you.

The lender should instruct you to take your loan contract to a professional adviser who will make sure you understand it correctly before you sign it. This is a legal requirement, for your protection. Make sure you understand the terms and conditions fully. Don't be afraid to ask questions!

**Mortgage insurance: what is it, and do you need it?**

Your lender may require mortgage insurance if you are borrowing 80% or more of the value of the property. You pay a one-off insurance fee, but the amount is added to your loan amount, so it costs nothing up-front.

You should understand that mortgage insurance protects the lender, not you! It protects the lender if you default on the loan and the property is sold for less than the outstanding loan balance. The bad news is that even though the insurer pays the lender the difference between the loan balance and the amount recovered by selling the property, you are still liable to the lender for that amount.

The only benefit of this insurance for you is that you can purchase a property with a smaller deposit.

If you are looking for insurance that protects you in the event of loss of income, consult your adviser about income protection insurance.

You should also review your life, sickness, and accident insurance. Your repayment obligations don't go away just because you experience misfortune!

**Making an Offer**

At this stage of the process we assume you have found the right property.

At this point, you may choose to take a copy of the contract to your solicitor. You can now make an offer on the property, either directly to the vendor or through an agent. If your solicitor has taken the contract you may choose to submit a conditional offer, subject to contract –which simply means you are waiting for your solicitor to read through the contract to make sure there is nothing in it that is of concern.

We are assuming in this case that the vendor is not choosing to sell the property at auction, which is a separate process and beyond the scope of this eBook.

Before making an offer, do your homework carefully and make sure the price is fair. Be clear about what is included in the price – generally anything fixed is included and movable items such as refrigerators or washing machines are not.

If you really want this property and there are other potential buyers interested, offering less than the asking price might result in disappointment, as the seller will likely accept the best offer. However, negotiation can result in considerable savings. Discuss your intended offer with the agent, but always keep in mind that agents act for the seller, not for you. The agent's job is to get the best price for the vendor.

You might be asked for a small initial deposit as an indication of your genuine intent. This does not necessarily secure the property for you. The property might remain on the market and the seller may consider other offers. The word 'gazumping' is used to describe the practice of buyers offering a higher price or more favourable terms after the seller has accepted an offer. It is disappointing for buyers, particularly if you have paid for building and pest inspections, but in NSW., there is nothing to stop the seller accepting the higher offer, although there is an unwritten 'code of conduct' that dictates that an agent 'should' keep you in the loop if your offer was first off the rank.

**Exchanging Contracts**

The Contract of Sale is produced in duplicate, one copy each for you and the seller. It details the terms and conditions of the sale and any special conditions, such as making the sale subject to finance, pest and building inspections, or your sale of another property. It should list inclusions, and may specify exclusions. It also specifies a 'settlement date' — the date on which you will pay the balance of the price and legally own the home.

Usually, the property is vacated ready for you to move in immediately on settlement, but sometimes the parties agree to allow buyers to move in early, or vendors to stay a while after settlement. Make sure these arrangements are specified in the contract, so that you don't find that you are unable to move into your own property when you think that you can.

Your solicitor will examine the contract carefully and explain it to you before you sign. Contracts are then 'exchanged', and your solicitor receives the seller's signed copy. You pay the full deposit (usually 10%) to the seller, the agent, or into an interest-bearing account until settlement.

After a five business day 'cooling off' period, both parties will be bound by the contract. You can use the five days to obtain building reports and confirm your finance. Your solicitor will perform title searches to check that the seller legally owns the property; that there are no caveats or liens (claims) on the title or any restrictions on property use; and that the property isn't about to be resumed to build railways, roads, or dams etc.

**Settlement**

After the cooling off period, your solicitor or conveyancer will arrange contract stamping. You have three months from the contract date to pay, but you must pay before settlement.

The settlement amount is calculated and agreed by conveyancers for the buyer and seller. This amount will include adjustments for unpaid rates and taxes or any advance payments. The conveyancer will then inform your lender of the total needed at settlement.

It is a good idea to arrange an inspection of the property immediately before settlement, to make sure no damage has occurred since you agreed to buy, and that the seller has not removed anything that was included in the sale.

Your lender will ask you to deposit the difference between the loan amount and the settlement sum in an accessible account ready for settlement.

Usually, your lender will send a representative to attend at settlement and pay for the property for you. Your conveyancer will check that documents are in order to finalise legal transfer, and either the conveyancer or the agent will collect keys on your behalf and hand them to you.

Following settlement, your conveyancer will attend to any final legal requirements to ensure you are registered on the title as the new owner.

## First home owners – government assistance

When purchasing your own home, the following government incentives could be available to assist with the purchase.

You can find out more on this in our eBook: 38 Tips & Insights for First Home Buyers – First Home Super Saver Scheme

On Tuesday 9 May 2017, the then Treasurer, Scott Morrison, released the Government's 2017/18 Budget.

One of the initiatives, the First Home Super Saver Scheme would allow first home buyers to withdraw voluntary contributions they make to superannuation, along with associated earnings, to be used towards a deposit for a first home.

This initiative took effect for contributions from 1 July 2017, with withdrawals allowed from 1 July 2018. The maximum amount that could be contributed, and later withdrawn, is $15,000 p.a., with a maximum limit of $30,000. Contributions may be concessional (pre-tax salary sacrifice) or non-concessional (post tax) contributions and count towards standard contribution caps. Concessional contributions will incur the standard 15% contributions tax deducted.

Upon withdrawal, concessional contributions and associated deemed earnings (equivalent to the 90-day bank bill rate plus 3%) would be taxed at the contributor's marginal tax rate (minus a 30% tax offset). Non-concessional contributions are tax-free however.

**Government Help for First Home Buyers**

The First Home Owner Grant (FHOG) was introduced by the Commonwealth Government in July 2000, to offset the impact of the GST for first home buyers. The Grant is offered and paid for by each State Government. As the time of publication, the name, level and eligibility requirements of the Grant vary greatly between States and we have summarised the current Grants available below:2

- New South Wales - The First Home Owner Grant (New Homes) scheme (the Scheme) was established to assist eligible first home owners to purchase a new home or build their home by offering a grant. The grant amount is determined by the date of the eligible transac- tion. This is the date of the contract to purchase a new home or contract to build a home. For an owner builder, the eligible date is when the building work commences.

  From 1 July 2019, the First Home Owner Grant Cap for new home purchases is $600,000; for a property where you enter into a contract to build, or are an owner builder the total value cannot exceed $750,000.

  For eligible transactions, the grant amount is $10,000.

- Queensland - The Queensland First Home Own- ers' Grant offered by the Queensland Govern- ment provides $15,000 toward the purchase of a new house, unit or townhouse valued up to $750,000. You can choose to buy off the plan or build.3

- Victoria - The Victorian First Home Owners' Grant offered by the Victorian is available for eligible applicants buying or building a new home valued up to $750,000 in metropolitan Melbourne. The grant is increased up to $20,000 for applicants buying or building a new home in regional Victoria valued up to $250,000.

**Stamp duty exemptions and concessions**

State Governments may also help first home buyers, with stamp duty concessions.

**New South Wales**

The First Home — New Home scheme was replaced by the First Home Buyers Assistance scheme on 1 July 2017

The First Home Buyers Assistance scheme provides eligible purchasers with exemptions on transfer duty on new homes valued up to $650,000 and concessions on duty for new homes valued between $650,000 and $800,000.

Eligible purchasers buying a vacant block of residential land to build their home on will pay no duty on vacant land valued up to $350,000, and will receive concessions on duty for vacant land valued between $350,000 and $450,000 To qualify for First Home Buyers Assistance, you must meet the criteria listed below:

- The contract and the transfer must be for the purchase of the whole of the property.
- All purchasers must be 'eligible purchasers'.
- An 'eligible purchaser' is a natural person (i.e. not a company or trust) at least 18 years of age who has not, and whose spouse/de facto has not:
- At any time owned (either solely or

with someone else) residential property in Australia other than property owned solely as trustee or executor

- previously received an exemption or concession under First Home — New Home.
- At least 1 eligible purchaser must occupy the home as their principal place of residence for a continuous period of 6 months, com- mencing within 12 months of completion of the agreement. (Where an eligible purchaser was a member of the permanent forces of the Australian Defence Force and all purchasers were enrolled on the NSW electoral roll, as at the transaction date, then all purchasers are exempt from the residence requirement).

Note: If all purchasers are not ‘eligible purchasers’, you may still qualify for a concession under the shared equity arrangements in First Home Buyers Assistance scheme.

**Queensland**

In Queensland, first home buyers receive stamp duty concession for properties purchased up to a value of $550,000, or vacant land less than $400,000. For example, duty on a $530,000 home will be reduced to $6,300 from $16,975.4

**Victoria**

The First-home buyer duty exemption or concession applies to land transfer duty (commonly known as stamp duty) for first-home buyers who buy a home with a dutiable value of $600,000 or less.

First-home buyers buying a home with a dutiable value from $601,000 to $750,000 will be entitled to a concessional rate of duty, calculated on a sliding scale.

In most cases, the dutiable value of a property is the price you pay for it minus any deductions (such as the off-the-plan concession). If the price you pay for the property is less than market value, the dutiable value will be the market value minus any deductions.

For more information about the First Home Owners Grant and Stamp Duty Exemptions you should contact the Office of State Revenue (OSR) in the State in which you plan to purchase your First Home.

## Take the next step

We trust you enjoyed this publication and found it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

We now invite you to take the next step and meet with an adviser to discuss what it was you were hoping to achieve when you downloaded this handbook and to establish if we can help you achieve your goals and objectives.

Next you will find details on how to book an appointment with an adviser.

We look forward to meeting you soon.

# Appointment booking request form

**About the Adviser**

**Our services**

**Contact details**

Please complete the Appointment Booking Request below and scan and email to:

________________________________________

Appointments are available Monday-to-Friday.

Please nominate your preferred day, date and time to meet with us. One of our client services representatives will call you to confirm your appointment.

**Preferred appointment day and time**

Day ____________________________________

Date ____________________________________

Time ____________________ am/pm __________

If you would like us to contact you via email to confirm your appointment or to answer any questions you have, please provide a valid email address for our records.

Email ____________________________________

**Your Details**

Title ____________________________________

First name ________________________________

Last name ________________________________

Mobile __________________________________

## Reader Notes

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## Reader Notes

**Wealth Adviser**

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