WealthAdviser

RENTING VS BUYING

WHICH IS BETTER IN THE LONG RUN?

Contents

Before you get started

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- Wealth Today (AFSL 340289)
- Sentry Advice (AFSL 227748)
- Synchron Advice (AFSL 243313)
- Millennium3 (AFSL 244252)

Before acting on any information contained herein you should consider if it is suitable for you. You should also consider consulting a suitably qualified financial, tax and/or legal adviser.

Information in this handbook is no substitute for professional financial advice.

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.

If ultimately you decide not to meet with us we still encourage you to consult with another suitably licensed and qualified financial adviser.

In any circumstance, before investing in any financial product you should obtain and read a Product Disclosure Statement and consider whether it is appropriate for your objectives, situation and needs.

Letter from the Wealth Adviser Library

Dear Reader

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.

Take the next step

Wealth Adviser (a division of WT Financial Group Limited) supports more than 400 privately owned and operated advice practices around the country. We invite you to engage with one of our advisers to discuss what it was you were hoping to achieve when you obtained this handbook, and to establish if they can help you achieve your goals and objectives.

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

Wealth Adviser Library

Introduction

Should I buy or rent a home? The answer is not so clear cut: Especially when you look at the matter purely from an investment perspective. The problem is that few people are able to take a 'pure investment perspective' when it comes to an issue as emotive as home ownership. Owning your own home has long been seen as an essential part of the 'Australian Dream'. Add to this the psychological security from having a place that you can call your own and you can see why many people would struggle to make this decision on a purely 'dollars and cents' basis.

We want to acknowledge the emotional aspect of the issue that we are discussing with this ebook right at the outset. There are, indeed, some things that are difficult to quantify and your reasons for wanting to own your own home may range beyond investment considerations. Having said that, we will do our best to discuss the question of 'owning vs. renting' in terms of long term wealth creation. You are then free to 'cross reference' this information with your emotional and psychological attitudes towards this issue. Who knows, it may even be that the case we make is so compelling that it changes aspects of your emotional response!

The basics: advantages and disadvantages of buying and renting

Before we begin to analyse the investment outcomes associated with buying and renting it might be good to have a few brief words on the relative advantages of the two approaches on practical as well as emotional levels. It should be noted that we are not, at this stage, digging into investment considerations. We are simply stating, in general terms, the kind of arguments that people would often cite in explaining their decisions to buy or rent.

Possible Advantages of Buying

- Being an owner occupier can be very emotionally satisfying and comforting
- Buying can bring stability: As long as you keep up your payments you cannot be kicked out of your home on a few weeks' notice
- You are able to really make a home 'your own' through the ability to make changes to suit your needs and preferences
- Well situated residential property can gain in value over time
- When the mortgage is paid up there are no more payments, it may also be possible to pay a mortgage off early thus saving a significant amount of money in interest payments
- First time buyers may be eligible for government assistance in the form of the First Home Owners Grant (FHOG), read our ebook on the subject on wealthadviser.com.au.

Possible Disadvantages of Buying

- Being an owner occupier may mean a lack of flexibility as it is not so easy to 'pack up and leave' (e.g. to move closer to a better school) if you are heavily invested in a particular property
- The very fact that you can make changes to your property may be a blessing as well as a curse since many homeowners cannot resist the temptation to overspend on getting their properties exactly as they want them. This may be great in terms of personal comfort but rarely adds value to the property in line with expectations

Possible Advantages of Renting

- Renters can generally move at relatively short notice, meaning that they are better able to choose their accommodation in line with their life circumstances
- It is generally cheaper to rent than to buy. Renting can therefore enable people to live in areas (e.g. desirable inner-city suburbs) where they

would not be able to buy

- The fact that renting is cheaper could also lead to more disposable income being available
- Renters pay only rent and utilities and are not responsible for maintenance.

Possible Disadvantages of Renting

- Renting often lacks predictability. You might be faced with a rent increase or a request to vacate the property at times when such changes are particularly unwelcome
- While a renter you may always be aware of the fact that you are not living 'in your own space'. This feeling can be reinforced by regular inspections and access requests by the landlord and/or estate agents
- You have to get permission to change your living environment (e.g. to hang pictures). Any unmoveable upgrading that you do will also be lost when you leave
- If you are not careful the extra disposable income gained through renting may simply be funnelled into increased lifestyle spending instead of being used to build long term wealth

We want to emphasise that the considerations listed above are general in nature and not specifically focussed on the investment implications of the two strategies.

We will now proceed to look at a possible way forward whilst taking the investment implications of both buying and renting into account.

A no brainer: buying vs. renting and doing nothing

There is one scenario where the decision to buy rather than rent is clear cut. It can be presented as follows:

- Buying a home (for at least 7-10 years) and gradually paying off the mortgage, vs
- Renting a home and not engaging in any other form of investment

When looked at in this way, the answer as to what you should do is pretty straightforward.

You will, of course, be significantly worse off if you've been a renter all your life without engaging in any kind of alternative investment.

This is because you will have been sinking hundreds of thousands of dollars into boosting the net-worth of landlords while not building wealth for yourself. After thirty odd years the owner occupier will be left with a significant asset while you will have nothing (besides perhaps good memories of all the wonderful places where you lived!).

The bottom line is this: If you are inclined towards renting you have to ensure that alternative investment strategies are firmly in place.

An intriguing alternative: renting AND buying (renting to invest)

More and more investors are coming up with an interesting answer to the classic 'buy vs. rent' question. 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. 'Renting to invest' 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 from the lists of advantages/ disadvantages associated with renting and buying that were presented above that there are some pretty compelling reasons to choose for either strategy. By opting for 'renting and buying' (also known as 'renting to invest') 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 will have to be taken into account:

- Land Tax is not payable on owner occupied properties but is levied on investment proper- ties 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. Gearing simply means that you use an initial investment to take control, with the help of a financial institution, of an asset with a much greater value than the funds that you have at your disposal. The extent of the borrowed funds available to you and the possible income that could be derived from the asset can both contribute significantly to the success of a gearing strategy. Borrowing to gain an income producing rental property may therefore be a very smart thing to do.

'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 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.

Conclusion

So should you rent or buy? It should be clear from what was said earlier in this guide that the answer to this question would strongly depend on individual circumstances and it would, therefore, be in your own interest to discuss your own investment profile with a financial advisor who will be able to help you make decisions that will be right for where you are at. In addition to noting that this is a decision that will have highly individual answers this guide also underlined the following principles:

1. If your choice is between buying to be an owner occupier and renting (without engaging in any other form of investment) you should buy. In this way you will be left with a significant asset after all the years of paying to have a roof over your head.
2. There are several advantages and possible disadvantages to both buying and renting. In terms of being an owner occupier the main benefits are probably not in the investment arena but on the psychological and emotional level. There is something to be said for the stability and fulfilment that comes from being 'king of the castle'. On the renting side the benefits are probably more concentrated in the area of long term wealth creation (but only if your decision to rent is part of a well worked out investment strategy like 'rent to invest').

You can also choose to rent the roof over your own head and buy investment properties to rent out to others. The benefits of this approach were discussed at length in this guide and it should be clear that this can be an excellent way to build long term wealth and to grow as a competent investor.

It is our hope that the information presented above set you thinking about some of the issues that you will have to pay attention to in planning your financial future. It would be impossible, however, to present a complete guide to all your financial planning needs in a document as brief as this. We urge you to continue your explorations by making use of some of the other resources and eBooks we have.

We also stand ready to serve you with professional advice, so please do not hesitate to contact us if we can be of further assistance.

Take the next step

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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

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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.

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