AN INTRODUCTION

IS HOME OWNERSHIP RIGHT FOR YOU?

Owning your own home – it's called the great Australian dream for good reason. Australia has one of the highest owner-occupier rates in the world. In fact, according to the Australian Bureau of Statistics, seven out of every 10 Australians own their homes – a huge proportion. Of these, about half own them outright while the other half are paying off a mortgage. The rest of us – three in every 10 Australians – are renting (but perhaps hoping to buy one day).

So, why is home ownership so popular? For one reason, it's long been a part of the Australian way of life. And we get lots of support and encouragement to buy, from our parents, our grandparents and even the federal and state governments (through First Home Owner Grants [FHOG], concessions and other incentive schemes).

Home ownership, it's said, is good for everyone – good for the individual, good for society, good for the economy. For the most part, that's true. Home ownership does have significant benefits, which we'll soon explore. But, as we're all too aware, the task is getting tougher, especially for first-home buyers. Therefore, it's important to realise that, these days, home ownership might not be for everyone. It's becoming much more of a personal choice based on financial and lifestyle needs. So if you do want to take up the challenge, it's vital to understand your motivation and assess whether home ownership is the right step for you.

THE PROS AND CONS OF HOME OWNERSHIP

In buying a home, you're about to take on what will probably be the biggest financial commitment of your life, and it's important to know that you're doing it for the right reasons.

There are many reasons for wanting to own your own home. For some people, it's seen as a pay-off for hard work – a key life goal that offers a real sense of achievement. For others, there's the emotional pull of having a place to call your own. There's also the view that renting is 'throwing money away', whereas paying off a mortgage is like an investment or savings plan, where in the end you get your money back plus interest (assuming your home increases in value). Some people – especially when prices are rising – are motivated by the idea of getting into the market while they can, fearful that if they don't buy soon, they'll be forever priced out of the market.

These are all good reasons to buy a home, and there are probably many more. The point is it doesn't matter too much what your reason is. If you have one to motivate you through what can be a difficult journey, then go for it! But, as with any major decision, it's always wise to weigh up the pros and cons first.

The upside to home ownership

Let's look in detail at some of the benefits of home ownership.

VALUE

It's a general rule that, over the long term, residential property goes up in value. Historically, prices *double* every seven to 10 years. This means that if you buy a property worth $500,000 today, it will probably be worth around $1,000,000 in 10 years' time. It's important to remember, however, that these are long-term trends. In the short term, property prices can and do fluctuate (*down* as well as up), usually in cyclical movements affected by factors including the health of the Australian and international economies (remember the global financial crisis in 2008); interest rates and the cost and availability of finance (which affects banks' willingness to lend); government grants and concessions (such as the FHOG and stamp-duty reductions); the availability of housing stock (the number of houses, units or apartments on the market to buy); and, finally, the level of demand (which, though it fluctuates somewhat, is generally very strong in Australia).

What this boils down to is simply making sure that you understand where in the property price cycle you're sitting before you buy, so you can decide whether the price you're paying is reasonable and – indeed – whether you're entering the market at the right time.

EQUITY

Many people consider a mortgage similar to a compulsory savings plan. It's compulsory because – assuming you've borrowed money to buy – you have to

make your repayments (weekly, fortnightly or monthly) on time, *every* time. As the balance of your home loan comes down and the value of your property rises, you can quickly build up what's called equity. This is the debt-free portion of your property – meaning you 'own' it. As it increases, so does your personal wealth.

For example, let's assume that you're able to buy a property worth $400,000. You've saved a 10% deposit ($40,000) and you're going to borrow the remaining balance of $360,000 over 25 years at a variable interest rate of 6.5%. Let's further assume that your property's value is expected to rise 7.5% per year for the foreseeable future. Over the next 10 years, how do your repayments and the expected price rise combine to affect your equity?

How equity in your home can grow*

Time	Now	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
House value	$400,000	$430,000	$462,250	$496,919	$534,188	$574,252	$617,321	$663,620	$713,391	$766,895	$824,413
Loan balance	$360,000	$354,056	$347,714	$340,947	$333,727	$326,023	$317,804	$309,034	$299,677	$289,693	$279,041
Equity	$40,000	$75,944	$114,536	$155,972	$200,461	$248,229	$299,517	$354,586	$413,714	$477,202	$545,372
Equity	10.0%	17.7%	24.8%	31.4%	37.5%	43.2%	48.5%	53.4%	58.0%	62.2%	66.2%
Reduction in home loan	–	$5944	$12,286	$19,053	$26,273	$33,977	$42,196	$50,966	$60,323	$70,307	$80,959
House price increase	–	$30,000	$62,250	$96,919	$134,188	$174,252	$217,321	$263,620	$313,391	$366,895	$424,413
Total equity increase	–	$35,944	$74,536	$115,972	$160,461	$208,229	$259,517	$314,586	$373,714	$437,202	$505,372

*Assuming a 7.5% yearly growth in value and 6.5% interest on the loan.

The table shows that you build more and more equity each year as your property's value increases and your home loan balance reduces. After the first year, your equity has already jumped from $40,000 (your initial deposit) to $75,944. After 10 years – during which your property's value has more than doubled to $824,413 – your equity reaches an impressive $505,372. This increase in value is due to two factors: (i) a $424,413 rise in your property's value; and (ii) an $80,959 capital reduction in your home loan balance achieved through your repayments (the 'compulsory savings' element).

The lesson here is that a rising property market and the reduction of your home loan debt combines to provide you with a substantial increase in the value and percentage of the equity you have in your home.

FUNDS TO INVEST

You can use the growth in equity as security to fund investment activities. For example, you could increase your home loan in line with the increase in property value to fund an investment, such as buying an investment property (see page 225) or shares or any other income or capital growth assets (subject to your lender's approval), or even borrow to make renovations or improvements to your property, thereby increasing its value to you, and hopefully its overall value in the long run. You don't have to wait until you sell the property to make the most of its increase in value or the increase in your equity.

TAX BENEFITS

One of the key financial benefits of home ownership is that under current taxation legislation, provided you live continuously in your home for more than a year any gain you make on the sale of the property is yours to keep tax-free. So in the example shown in the previous table, if the property was sold for $824,413 at the end of 10 years, the $424,413 gain (less selling costs like legal and selling agent fees) would be yours in full. This could provide a valuable tax-free nest egg on retirement, provide for some extra cash in the case of downsizing or contribute to the cost of a bigger or better house in the case of upsizing.

RENT-FREE LIVING

When your home loan is paid off, you'll have somewhere to live that is debt- and rent-free. This is a major personal and financial benefit. Not having to worry about finding the mortgage or rent money each month is a dream come true for most people. And the extra cash you save can be used to invest or spend as you wish.

STABILITY

Owning your own home provides a sense of permanency and belonging to a community. You'll have a stable environment knowing that you don't have to move unless you want to. Plus, you have the added benefit of being able to decorate and renovate your home to your own tastes and lifestyle needs.

The downside to home ownership

Buying your own home isn't all benefits, of course, and there are a number of downsides to consider before taking the plunge.

HUGE COMMITMENT

Home ownership is a massive financial undertaking – one that will stay with you for the next 25 to 30 years – the majority of your working life. Following the example shown earlier, borrowing $360,000 over 25 years at 6.5% will require you to pay – rain, hail or shine – $2431 per month for the next *300 months* (assuming interest rates don't change). If your loan reaches its full term, you'll have paid $729,000 in total, which is twice what you borrowed.

In short, before you can buy a home you need to be prepared – both financially and emotionally – to repay a very large debt over a very long time.

EXPENSE

It's not just the deposit you need to find, but many other costs as well. These include stamp duty, legal fees and bank fees. These can add up to many thousands of dollars of additional costs, so you need to take these into account when working out your sums. Of course, if you're eligible, there are a number of government grants and concessions that will help cover some of these costs – but they don't always cover everything so you will need to save more than a deposit when buying a home.

INTEREST RATES

If, like many borrowers, you choose a variable rate loan, then your monthly repayments will rise and fall as interest rates change. Lenders are free to move their variable rates as they see fit. For the most part, they follow the movements of the Reserve Bank of Australia's Cash Rate Target (an interest rate determined by the Reserve Bank which acts as a reference rate for banks and other lenders), but they don't have to. The rates that apply to you can go up by more or less than the cash rate, or not at all.

The example discussed previously begins with a rate of 6.5% and repayments of $2431 per month. The following table shows how significantly repayments can vary when interest rates change.

The effect of interest rate changes on home loan repayments

Interest rate	5%	5.5%	6%	6.5%	7%	7.5%	8%
Repayment	$2105	$2211	$2319	$2431	$2544	$2660	$2779
Saving from starting rate	$326	$220	$111	$0	–$114	–$230	–$348
Percentage saving from starting rate	13.4%	9.1%	4.6%	0%	–4.7%	–9.4%	–14.3%

An interest rate increase of just 1% more than the initial 6.5% means you have to pay $229 more per month on your repayments (while a decrease of 1% saves you $220). There can be big movements and while they can save you money as rates go down, they can also be quite painful as rates go up if your finances are tight.

REPAIRS

When you own your home, you're responsible for all repairs and maintenance – not the landlord and (hopefully) not Mum and Dad. Repairing roofs or rewiring entire houses can be expensive, especially for older properties. But if you want to be a home owner you'll have no choice but to foot the bill.

DIFFICULTY MOVING

When you own your home, it's a lot tougher to move house. The cost of buying and selling a home is substantial. If you need to move regularly, or will have to sell shortly after you buy, home ownership might not be right for you.

Selling a home takes time and effort and isn't something that happens overnight. This is especially important to remember if you want to sell in a hurry due to, for example, financial problems or changes in family circumstances. Demand is driven by market conditions and you may not be able to sell as quickly as you would like or get the price you want. If the market turns against you, you could be in serious trouble and if things get really bad you might even get repossessed – every home owner's nightmare.

DECREASED RESALE VALUE

While residential property can go up in value, sometimes it can and does go down. Adverse economic and housing conditions or negative changes in your neighbourhood or the surrounding suburbs can significantly affect your home's resale value. If your property goes down in value, you could find yourself with negative equity; that is, when your property is worth less than your mortgage, meaning you may not be able to sell because you can't pay out your home loan.

UNATTAINABLE LOCATION

It's an unfortunate fact that the average first-time buyer can't always buy the type of property they want in the location they want because they simply can't afford the asking price.

THE PROS AND CONS OF RENTING

While this book is about *buying* your first home, the possibility of renting must also be discussed. Renting is a good way to put the pros and cons of home ownership into perspective, especially if you are not quite ready to buy just yet.

When it comes to renting, there are various benefits to consider:

No home loan debt. Apart from signing a lease and paying a bond, you don't have to make any long-term commitments.

Cheaper than buying. In almost all cases, paying rent is cheaper than the overall cost of buying a home.

Flexibility. When renting, it's much easier to move. Often, it's also easier to find a place in the location you'd most like to live.

Little risk. As a home owner, you're financially exposed to interest rate rises, negative equity, repossession, capital loss, default and adverse credit reporting. As a renter, the most you are ever likely to lose is your bond – although be aware that when you are ready to buy, your lender will be looking for a history of timely rent payments.

No repair costs. When you're renting, maintenance is your landlord's responsibility. They also pay the council rates and taxes, leaving you to only pay the rent and household bills such as gas, electricity, water and telephone.

'More' money. With less income devoted to housing costs, there's more cash at your disposal. You might choose to invest in assets other than property – perhaps shares or cash investments – or even spend it!

Renting also has a few drawbacks:

Not an investment. When you rent, you're paying for a *service* – that is, a place to live. If the value of the property you live in goes up, only your landlord benefits from the capital gain. Plus, your landlord benefits from having you, the tenant, help pay off their mortgage. This is why rent money is called 'dead money'.

Bad landlords. Not all landlords are good people. You may find that yours is difficult to deal with, and doesn't respond to requests or make reasonable repairs when you need them.

Uncertainty. When your lease ends, you might not be able to renew it, or keep the same terms and conditions. Your landlord might want to move back in, or they might want to increase the rent to a level you don't want to pay.

Moving costs. Each time you relocate (either because you want to or have to) there will be a cost – moving, security deposit, mail redirection, telephone, power, utilities, etc.

Inflexibility. When renting, you probably won't be able to make changes to the property to suit your needs. There might also be restrictions on things such as pets.

Availability. In a rental market where demand exceeds supply, it can be difficult to find a property to rent, let alone one you can afford.

WHY IS HOME OWNERSHIP SO TOUGH?

Let's say you've weighed up the pros and cons and have decided that home buying is the way to go.

You don't need to be told that, right now, being a first-time buyer is difficult. From strong demand for housing to increased lending restrictions, it's a tough market for various reasons, and the fact that federal, state and territory governments have stepped in with grants, incentives and concessions for first-home buyers indicates that you, as first-home buyers, need all the help you can get.

At the moment, there are a few big obstacles for first-home buyers to consider, including housing affordability, obtaining finance and navigating the whole process.

Affordability

Property is expensive – now so expensive that many young Australians are realising they can't afford to get into the market and their dreams of home ownership may be unrealistic. Affordability has deteriorated and housing prices have skyrocketed thanks to Australia's growing housing shortage, in which demand for housing greatly exceeds supply.

Estimates place this shortage at around 200,000 homes, with annual shortfalls running at 60,000 a year. It's a situation that doesn't look like improving in the near future, as rapid population growth and inadequate government housing policies continue to widen the gap between residential property supply and demand. In fact, 10 years from now, some pundits say we'll have a shortage of 800,000 homes – meaning that getting onto the property ladder will be even harder.

Getting finance

Almost all first-home buyers need a home loan to purchase their home. But lenders are apt to change their lending criteria at short notice in the wake of changes to things such as: (i) their funding environment; (ii) changes to their risk appetite (which is reflected in changes to who they're prepared to lend to); (iii) social and political pressure to provide affordable home loan finance; and (iv) competitive pressures.

The upshot is that, as a first-home buyer, your ability to get a home loan can change dramatically and without warning.

The process itself

Buying your first home is a daunting task. There's a lot to think about and a lot to do. To keep things as painless and stress-free as possible, it's important to plan your steps – something this book will help you do. This is critical because the wrong moves can result in costly mistakes, adversely affecting your chances of getting finance, buying the right property at a good price and, eventually, owning your own home.

HARD? YES. INSURMOUNTABLE? NO!

While the outlook for new home buyers is a challenging one, the important thing to note is that it's not an impossible task. With hard work and a little patience, you can achieve your goal and buy your first home, and you'll find plenty of hints and tips in this book to get you over the line. Good luck for the journey, and now let's get started with some practical advice!