

# WRONG FINANCIAL DECISIONS FOR THE RIGHT REASONS

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HYDE PARK: Any regular reader of my articles will know that I am not a fan of residential property. I think residential property is a poor investment and should be treated as a lifestyle asset (like you would treat a Ferrari). In that light, I have a confession – my wife and I are in the process of buying a home. This decision is a source of great amusement for my friends and colleagues as I have never been restrained with my opinions on residential property.

## *WHY I DON'T LIKE RESIDENTIAL PROPERTY*

History shows us that growth in residential property value is largely a function of inflation – over 400 years, house prices have only beaten inflation by 0.5% per year in Europe. In SA, house prices have done slightly better 2.2% per year above inflation since 1960. By comparison, shares have beaten inflation by 7.4% per year in South Africa since 1900. In terms of capital growth, there is no better asset class than shares. This is especially true when you consider the transaction costs, maintenance costs and taxes on property vs. the low cost of owning shares. I realise that you can get gearing more easily on property but it is also possible to use shares to get gearing.

So, for the last 5 years, I have been a happy tenant with a great landlord. I have been paying half the cost in rent that I would have paid in a mortgage for the same property. Unfortunately, my wife is a real gardening fanatic and really wants to create her own piece of paradise and this means we need our own home.

## *SOMETIMES LIFESTYLE IS MORE IMPORTANT*

Given my wife's (very reasonable) desire for a garden of her own, we are making a lifestyle decision with the full knowledge that we are not making the most efficient financial decision. From a financial planning perspective, we will treat this home in the same way as we would treat a motor vehicle – it is not an investment asset that we can use to generate income. In fact, it is going to be a permanent additional cost in our budget, even after the mortgage is paid. I don't begrudge my wife her garden because I will get great benefit too and I know that we will both be happier in our new home. As one hack said, you can't live in your share portfolio.

## *HOW TO DETERMINE WHAT IS AFFORDABLE*

I have the great fortune of having a rational wife who understands budgeting and forecasting very well. This means that we were very careful when looking for a home to purchase. Our first consideration was the price of the house in comparison with the rental cost for the same home. After extensive research, we found a great home that would only cost us 23% more in monthly ownership costs. That means the mortgage + rates was 23% more than rent. In addition, we made sure that our total monthly property costs (including maintenance) would not exceed 30% of our joint monthly income *after* all deductions. This meant that the property was easily affordable to us and was not overpriced relative to its rental cost. This was as close as we could get to a housing equivalent of a low PE share.

## *MAKING LEMONADE FROM THIS SITUATION*

As shown in my article “Your home: buy or rent” it only makes sense to buy your home if you are going to live in it for a minimum of 9 or 10 years. So, my wife and I have agreed that we will live in this house for at least that period and preferably longer. In addition, we are going to pay the mortgage as quickly as possible until the repayments are at the same level as our current rental payments. Thereafter we will start investing the extra money into the stock market again. Given the high valuations of the JSE at the moment, I am happy to keep my existing shares but I am also happy to place new money into our mortgage. I know that the “return” on my mortgage is not fantastic but it is guaranteed and it is tax free. It is guaranteed because every extra rand paid in, saves me interest that I have to pay which is why it is tax free. At some point in the future, the market will be at lower valuations again and I will then switch new money back into the market.

### *PROPERTY TRANSACTION COSTS ARE REDICULOUS*

As an aside, I think the banks and property lawyers make far too much money from mortgages. It costs approximately 1% of your property price just to register the mortgage and pay the bank’s attorneys. There is no way that this is a true reflection of the effort involved in the process, it is no secret that the attorneys get their clerks to do all the work on these transactions. Clerks are paid a minimum wage so some lawyers are making huge money for very little work. In addition to these costs, you also pay transfer duties that could easily amount to another 6% or 7% of your property price. When you sell the property one day, you are going to pay another 5% - 7% in agents fees. So your total property transaction cost are going to be in the region of 10% - 15%! As an equity investor, I find these costs are almost criminal. You will have to own the property for at least five years before you start recouping the costs – remember that you have monthly running costs too. As I mentioned earlier, we are certainly not going to sell this house for many years – I don’t think I could stomach these costs again in the near future.

### *CONCLUSION*

I believe our decision to buy a home is the right one for our family, we are going to derive great satisfaction from this home. Having said that, I know that we are setting ourselves back from a financial perspective and this does cause me some concern. Ultimately life is all about balance and that is why this is the right decision.