RESIDENTIAL PROPERTY – A GOOD INVESTMENT?

South Africans have a fixation on residential property because we are told from a young age that we have to own a home. So, when we start work we duly buy a home and embark on our lifelong property adventure. As we grow older and have children, we buy a bigger house with a larger mortgage. This carries on until we retire and decide to look for a smaller home – hopefully this time without the need for a mortgage. Many of us never stop to question whether there is a better way to use our money.

The table below shows the long-term growth of all the main asset classes in South Africa and how they have beaten inflation. The growth is calculated annually over very long periods of time. We look at long-term growth because it eliminates the distorting effect of short term events and therefore gives us a proper perspective on these investments.

South African asset classes - performance over the long-term

Asset Class	**Indicator**	**Long-term annual growth above after inflation***
Shares	All Share Index	7,6%
Residential Property	ABSA House Price Index	1,5%
Listed Property	SA Listed Property	6,5%
Bonds	All Bond Index	2,0%
Cash	STefI Call	1,0%

Compiled by Galileo Capital. Source I-Net, Nedgroup Investments and Absa
*Updated annually since 1900 to 2012 or longest available period.

From the table we see that the best performing investment (asset class) is the share market. Over the long term it has beaten inflation by 7.6% per year whilst listed property is the second best performing investment as it beats inflation by 6.5% per year. Residential property in contrast has only beaten inflation by 1.5% per year since 1966 when the index was started.

The growth of residential property as indicated in the table does not take into account the purchase and maintenance costs of property. These include transfer duties, bond registration and legal fees. In addition, you will need to pay an estate agent 3% to 7% when you decide to sell. There are also the costs of owning your home - this could average as much as 1% of the value of your home per year. This may seem high but you need to maintain your home and garden and pay rates or levies.

Whilst most people would view a residential property as a low risk investment, there are some risks to consider. For example, suburbs can go through cycles where the area declines e.g. Hillbrow or Sea Point a few years ago. If this happens, you may struggle to get a reasonable selling price for a property and rental income will also decline substantially.

You also need to consider the value of the capital that you have tied up in your home that effectively does not “work” for you. An example of this would be a cash-strapped, retired person who lives in a R1 million home that is paid off. The retiree could sell the home and use the R1m to generate additional income which would partly be used to pay rent. The rent on a property valued at R1m should be less than the income generated by a properly diversified investment portfolio worth R1m. In addition there would be no maintenance costs as these would be for the landlord’s account, this would free up even more money for the retiree.

Financially, it often makes more financial sense to invest your money in growth assets and only rent a home. However, financial considerations are only one of the factors that influence your money decisions, if you are in a sound financial position, you may derive emotional security from owning your home and this cannot be underestimated.