

Rent or buy?

Contributed by Travis Morien

The decision to rent or buy is largely a matter of your time frame. Some people choose to rent for reasons other than financial, for example the flexibility to move house often and the opportunity to live in a much nicer house than would be possible on present earnings. Others have problems in saving a deposit.

If you wish to remain mobile for personal or job reasons naturally renting is a better idea. Transaction costs are enormous in real estate and I personally would not recommend you consider buying a house unless you are definitely going to stay at least a few years.

For a person on a low income, the availability of rent assistance from Centrelink may be a deciding factor, since all things being equal Centrelink has a policy of throwing more money at renters and punishing people with tangible assets and savings.

Yahoo Finance has a link to a calculator that looks at renting vs buying, which you might find worth looking at. http://au.biz.yahoo.com/pfinance/calc/rent_vs_buy

The calculator actually comes from Your Mortgage Magazine originally, so have a look, <http://www.yourmortgage.com.au> has this calculator and a number of other good resources for mortgagees.

There is a more fundamental question asked by people that merely wish to know if renting is a good idea compared to buying if you are going to spend all your "mortgage money" on buying a shares and property trusts portfolio instead. Are you better off putting your money into your own home, or an investment portfolio?

This is a complex question and experts disagree. Most of the advisers I have talked to generally find in favour of renting, but only by a narrow margin, and only with the assumption that investors really do put all of their money into investment and don't just waste it instead.

I won't dispute that opinion, at best if there is a case for renting or buying it is a weak one, neither are really all that much better than the other.

I personally lean toward buying your own home and paying the mortgage off quickly. If you pay off your house you get an implied tax free income stream for the rest of your life by not having to pay rent any more. What is even more important is that over time inflation will increase rents but make a mortgage easier to pay down, this favours a long term buyer over a rental strategist. Once a house is clear and paid for other expenses are fairly low and you can put a lot more money into the markets later.

I have another argument in favour of buying that most of the experts I have chatted with hadn't really considered. Quite apart from mathematical expectations of portfolio returns vs mortgage rates and all that other stuff (which may be a flawed approach if the assumed returns of the portfolio are too high, as they will be if you think they will be anything like those achieved in the 1990s), there is also a great advantage for aggressive wealth builders that own their own home.

This advantage is that banks offer relatively cheap finance with their mortgages. Interest rates are a good percentage point or more below the rate charged for margin lending products and unlike margin loans there are no margin calls.

Aggressive investors can borrow against their own home equity to buy shares, use the dividends to help pay down their principle mortgage and then draw out more equity as it comes along, thus transforming their debt over time from a non tax deductible residential mortgage into a tax deductible investment loan with a low interest rate and no margin calls.

Having no margin calls is great, you don't have to worry about volatility and the bank won't pull the blanket out from under you if the market falls. Aggressive investors that choose to invest their money directly in a portfolio instead of a house will have to use more expensive forms of finance that do not allow as much money to be borrowed.

So if you ask me, I'd say that you're probably better off buying a house instead of renting all your life. If you are an aggressive investor you can start looking at home equity loans or mortgage redraws a couple of years down the track but initially at least rapid mortgage reduction is a good strategy.