

## First Home Purchases .... and why keeping up with the Jones' is not a good strategy.

With the Reserve Bank of Australia announcement of a 0.25% interest rate reduction as of the 2nd September 2008 (ending a run of 12 successive increases and making the first interest rate cut in almost seven years or since December 2001), there is no better time than now to be reviewing your finances.

The drop in interest rates will spur on many first home buyers to contemplate on their prospects of entering the housing market – a daunting task even for the most experienced. Young couples will be especially vulnerable given their inexperience in such matters. Many will not even have the recommended 20% deposit.

I recently came across a young couple with about \$100,000 gross combined income, no deposit, no savings, but still suggesting that based on their research, the banks would lend them just over \$400,000 (4 to 5 time gross annual income).

Let's take a quick look at some case studies (benefits of the First Home Owners Grant excluded from calculations).

### CASE STUDY 1

Purchase Price of Property	\$400,000
Loan Amount	\$400,000
Interest Rate	8.66% pa (assumed constant for the duration of the loan)*
Loan Period (Years)	25
P&I Weekly Payment	\$753.26
Total Interest paid	\$579,245 over the life of the loan

A quick look at their budget soon revealed that to do the above (at P&I payments of 753/Wk), would stretch them to the very limit if not beyond. I struggle to understand how people can borrow all that they can to spend on their own home leaving them nothing for any unforeseen expenses. They max their loans, making minimum repayments each month and then wonder why the banks foreclose on them when things go wrong and they are unable to make the minimum repayments. Put simply, in the case of a young couple, should either partner lose their job or in the event of an interest rate rise (“unlikely” I hear some of you say) or even an increase in groceries and fuel cost, they have no safety net to cushion them. With no equity in the home, you leave yourself fully exposed!

What if they look for something more in tune with their surplus budget whilst incorporating a safety net?

### CASE STUDY 2

Purchase Price of Property	\$350,000
Loan Amount	\$350,000
Interest Rate	8.66% pa*
Loan Period (Years)	25
P&I Weekly Payment	\$659.10 (i.e. \$94.16 per week less than Case Study 1)
Total Interest paid	\$506,839 over the life of the loan (i.e. \$72,406 less than Case Study 1)

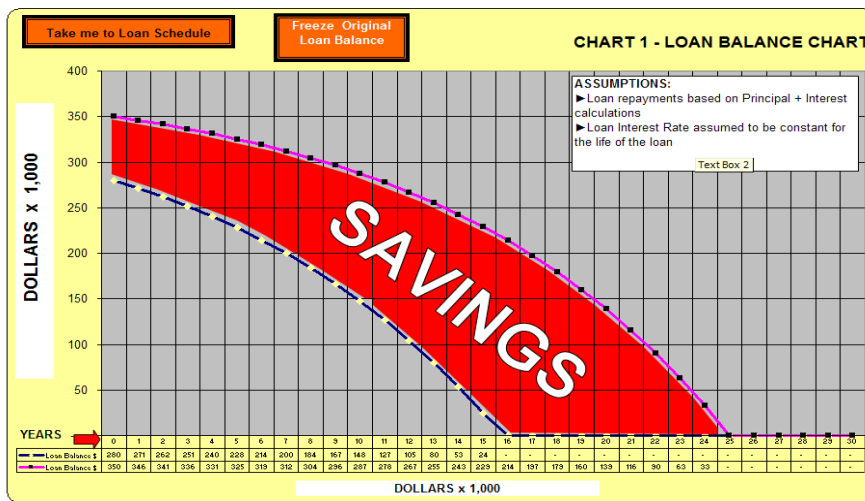
Click here for the latest on the Government's proposed First Home Saver Account.  
[www.homesaver.treasury.gov.au](http://www.homesaver.treasury.gov.au)

Let us now fast track: round up the \$94.16 savings to \$100 per week and investigate the option of using the \$100 as **extra** weekly payments in addition to a 20% deposit (\$70,000 = 2 Years of savings @ \$753/Wk).

**CASE STUDY 3**

Purchase Price of Property \$350,000  
 Loan Amount \$280,000  
 Interest Rate 8.66% pa\*  
 Loan Period (Years) 25  
 P&I Weekly Payment \$527 + \$100 = \$627 (i.e. \$126 per week less than Case Study 1)  
 Reduced Loan Period (Years) 15.83  
 Total Interest paid \$234,228 over the life of the loan (i.e. \$345,017 less than Case Study 1)

Would you like to know more about Loan Value Ratio (LVR) and why equity is important to investors?  
  
See contact details below.



As can be seen, in addition to having **equity** in the home, there are considerable savings to be made if a young couple look at purchasing a more modest home in addition to raising the 20% deposit and paying off an extra \$100 per week.

Some may say, why wait for 2 years to raise a 20% deposit and run the risk of increasing house prices? Our view – for young couples just starting out – is that they control what they

can rather than pitch their luck on market forces that are not within their control e.g. that housing prices **will** rise over the next 12 months. Even 1 year of savings at \$753 per week = \$39,156 = 10% deposit in the above case, will produce a very desirable result in addition to having some equity.

As many will find out – the hard way – keeping up with the Jones’, could come at a cost – the cost of loosing your home! The so called “Mortgage Belts” that surround our capital and regional cities, are not only evidence of this, but also confirms that we are a nation of risk takers for which we pay a high price. Seeking professional advice can help take the emotions out of this very important decision.

**Article and Spreadsheets by; Oscar Aguiar**

*Would you like to know more on how to use the equity in your home to purchase an investment property and why such a strategy is an essential component of YOUR wealth creation plans? Now is the time to diversify and make that shift into property.*



*For more information on Property Investment, contact Garry Lunn on 02 4962 5800. Your Trusted Financial Fittne\$\$ Coach*

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**Comments and contributions always welcomed.**

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