CASE STUDY

Family feels the heat

A bigger home can seem out of reach in a competitive market, writes Susan Hely

PHILLIP CASTLETON

NAME: Georgina Hannekum
STATUS: Married with one child
QUESTION: What is the best strategy to buy a bigger home and move to Sydney?
SOLUTION: You have plenty of options. One is to hang on to both current properties and rent where you are looking to buy. Or keep the Newcastle house and sell the Sydney unit so you can buy a home in Sydney.

When the property market is at boiling point, the likelihood of finding a well-priced home close to transport, work and schools can be daunting. Competition can be intense and it is easy to worry about being left behind. Georgina is trying to remain rational as the price of houses in her targeted areas are skyrocketing. But she knows not to jump in and buy a home that doesn't meet all her needs because it could end up costing her dearly.

Georgina has a foothold in the Sydney property market. She had lived frugally and rented and took the plunge six years ago, buying an apartment in the inner city. However, after the birth of her daughter, the open-plan apartment was no longer suitable so Georgina and her husband bought a terrace in Newcastle, a long commute. She realises they need to buy a home in Sydney.

They are happy to sell the apartment in Sydney. But should they sell the terrace in Newcastle? Is it a good investment that will supplement their income later in life? "Or should we consider selling Newcastle to reduce the mortgage and look at buying an investment property later?" asks Georgina.

They want a home in Sydney's mid-to-upper northern suburbs (ideally Roseville but perhaps Allambie Heights), not too far from Georgina's in-laws.

"We don't want to buy something not quite right," she says. "We want to be set for the next 20 years. We need more space and my husband needs a shed."

Or should they hold off for a couple of years and instead look at investment strategies that will boost their deposit? Also should they lock in part of their mortgage at current low rates?

An aggressive strategy

MARGARET LOMAS

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I always become concerned at the notion of selling a property in an area that may experience some good growth in the future. Because of the recent boom in Sydney's market, which is now showing signs of cooling, I expect to see some ripple growth occurring in nearby areas that have yet to experience that same boom. Already we see this on the Central Coast and I feel that within the year the same interest will spread to Newcastle.

I've done some calculations on your incomes and debts and I feel that, with the right kind of budget and the income from the apartment, you could pay off your present personal mortgage within five years. The expectation is for interest rates to remain low and, given this short period for you, locking in a rate may not be the best strategy.

This short time frame presents two options. The first is to move from your home in Newcastle, rent it out and rent where you wish to live in Allambie Heights. As you will not have another principle place of residence (PPR), you can claim the PPR exemption, resulting in no capital gains tax (CGT) accruing, along with all the expenses and depreciation benefits, on the Newcastle home.

At the same time you will live in a property which has a relatively low cost to rent – around 3.8% – in Allambie Heights. During that time you could pay down the mortgage on Newcastle and at some time in the future, when you see the right property at the right price, you could sell Newcastle, free of CGT, and buy again. As I don't see prices in Sydney moving too much more, I don't think delaying this purchase will impact you greatly in terms of the price you pay to buy in. And this way you have the time available to take a good look around, work out if you do really like living in that area and decide exactly where you would like to buy.

I am not inclined to suggest selling the apartment just yet – you will pay CGT on this sale and this will eat into the return. Unrealised gain is more valuable to you than realised gain and this is the property that you will be able to use to provide leverage into further investing, which I suggest you undertake immediately.

My calculations show that you have the equity and cash flow to employ a fairly aggressive property investment strategy – buying up to 10 properties in the coming two years alone! Doing so would provide a potential net worth of around $6 million after 15 years with a passive income of around $20,000 a month. I am not suggesting that you should race out and add 10 properties to your portfolio – your personal risk profile must be a consideration as to how fast you acquire these properties. You also need to learn how to become a skilled property investor first. But you do have more options than you probably realise and it is important that you explore them thoroughly.

Your second option is to remain in the Newcastle home and commute until such times as your mortgage is reduced. But due to the high yield you could get in relation to the outstanding mortgage, the CGT-free status of the property and the relatively low cost of renting in Sydney, your capacity to invest will not be enhanced by this option, and your lifestyle may suffer with those long commutes.

It's important that you get some good-quality advice from a qualified property investment adviser, as each of your choices needs to be fully explored and understood before you make a decision.

You have the equity and cash flow to buy up to 10 properties in two years

Boost the deposit

JOANNA McCREERY

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There is never one right way to go about things but if you understand your options you can make a plan that works best for you. Both of your properties appear to be eligible for the principal place of residence tax exemption; however, you can only claim this exemption on one property at a time. Even though you have been renting out your Sydney property, because you lived in it first and have rented it out for under six years, you should be able to claim the full exemption if you sell it within the next year or so (but check with your accountant).

By selling your Sydney property now, you should be able to make a substantial tax-free capital gain and raise a good amount of cash for a deposit on a new home. You will also be selling into a heated market, making it easier to consider buying into the same market. In addition, you will be able to lock in historically low interest rates by fixing part of your loan.

You need to be aware that the result of claiming the principal-residence exemption on your Sydney property for the period until it is sold means that any gain until that time on your current home will be taxable when you sell it.

By selling your current home too, you would increase your deposit, and reduce the size of the loan you will need to buy a house in your desired location. But while you are both working, you shouldn't have a problem servicing the necessary loan, based on the sale of just the Sydney property. Better still, you'd also be able to save for other needs such as your children's education.

You can always consider selling your current home at a future date if you wanted to reduce your home loan. In the meantime, it may continue to grow in value and the rental income you could earn on it will most likely cover the interest on the loan for this property at current rates.

If you want to hold off buying and save more funds to boost your deposit within a two-year time frame, then the best place for those funds is in your home loan offset account. It's really too short a period to invest in anything else.

One final piece of advice is not to overextend when you do buy your new home. If one of your goals is to work part-time at some point, make sure there is a way you can do that with the loan you take out. It's not worth sacrificing time with your family just for a bigger house.