CASE STUDY

A property is the top priority

It will take some serious saving to build up a good deposit, writes Susan Hely

NAME: Bianca
AGE: 26
QUESTION: Can I afford to buy a property in Sydney and not sacrifice too much of my lifestyle? Which is a better investment: off-the-plan or established apartment? One bedroom or two?
SOLUTION: Pay off your debt and save hard through an automatic savings plan to reach $72,000 to be able to afford a $550,000 property. Use a realistic 6% interest rate for your repayment calculations. Suburbs further from the CBD are cheaper and often include parking. One-bedroom apartments do just as well as two-bedroom ones.

Getting a toehold on the Sydney property ladder is a big challenge. With the median apartment price now $586,000, a 20% deposit of around $120,000 is needed to avoid paying costly lenders mortgage insurance (LMI). So it is no surprise that more generation Ys (born between 1981 and 1994) are renting. But Bianca, who has just turned 26, has buying a property as a top priority. Whether it is an investment or place to live in, she wants to get into the Sydney market.

Bianca has worked since she was 18 and is on a good income. "I'm in a lucky position," she says. She has been a good saver but spends her money on travelling, running a car and enjoying life. Often when she returns from her overseas trips she has to pay off a credit card debt and rebuild her savings from scratch.

She would like to keep travelling if possible and doesn't want to sacrifice too much of her lifestyle.

She currently lives at home. She would like to live close to the CBD in a suburb such as Neutral Bay, on the north shore, and is happy to buy a one-bedroom apartment but wants to know if two bedrooms would be a better investment. Can she realistically afford a place in the suburb where she wants to live or should she look further afield?

What suburbs are best for investment properties? An off-the-plan property appeals to Bianca as the deposit is often only 10% and it gives her more time to save while it is being built. Are they a good investment?

Get off to an early start

JOANNA MCCREERY

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For someone in their mid-20s with good cash flow, the idea of buying a property is a great option to consider. As well as the upside potential of the investment, it helps you focus on what you are doing with your money. I typically find that clients who have decided to invest earlier rather than later (whether it is a home to live in or an investment property) are in a better financial position in their 30s. They have some assets behind them by this stage and that gives them more options in life.

Bianca is in the enviable position of not only earning a good salary but also not having to pay the basic living costs of housing and groceries. This situation probably saves her $2000 to $3000 a month – bank these savings!

Save hard

Once your credit card has been fully repaid (you estimate in a couple of months), you can really start saving. Use the low-cost position you have to save $3000 a month from January 1, 2015. Aim to have $72,000 saved by January 1, 2017. Set up a direct debit to your savings account and don't touch these savings.

With $72,000 in total, you can consider properties costing up to $550,000. You will have to pay some lenders mortgage insurance (LMI) if your deposit is less than 20% but this may be worth the expense if property prices keep rising.

If you decide to buy a new house to live in, you may also qualify for the government's first-home owner grant as well as stamp duty concessions.

Will you have to cut back?

Yes. If you want to be able to save this amount, you will have to keep discretionary spending under $500 a week. Decide upfront how you want to budget for this expenditure. For example, you might decide to spend no more than $100 a night on going out two nights a week. Work out how much you can afford to spend on clothes. Always pay off your credit card each month.

If this sounds as if life will be no fun, then give yourself longer to save. Saving $2400 a month for 2½ years will also give you $72,000 to invest.

Check the repayments

If you plan to buy a home to live in, then you have to be able to afford the interest and principal repayments on your mortgage. On a $500,000 loan, they would be $3000pm at 6%pa. Current rates are lower but they can be expected to rise over time. This would mean sacrificing your current lifestyle in the longer term, so this is potentially not ideal for you.

Your other options are to buy cheaper or to buy an investment property. If you buy an investment property, then the rental income will help you fund the repayments. Repayments are typically interest-only on investment properties, so the gap between the rental income and the cost may be affordable. They will also be tax deductible. In this scenario, you need to be careful that you buy a property that people will always want to rent. Good rental demand will help support price growth.

Many things can change over the next two years: property prices may rise or fall or your ideas about where you want to live may change. But the one thing you can start doing now is to use your current low-lost living arrangements to really start accumulating assets. That will give you more lifestyle and investment choices in the future.

> Use your living-at-home arrangement to really accumulate assets

SCOTT HAWKINS

Forced to save

LOUIS CHRISTOPHER

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One thing property is good for is that it is forced saving and that makes it particularly useful for those of us who struggle to put away money each month. I would consider a property in Sydney simply on those grounds.

Our outlook for Sydney dwelling prices is that the market will keep going up. So despite the fear going around, I would still be buying into it now.

In terms of capital growth, the evidence suggests one- and two-bedroom apartments will perform in equal fashion, if everything else is equal. However, the "everything else equal" part is often not the reality. It is actually about what the local demographic is. For example, if you are an investor who wants exposure to the student accommodation market, you are likely to be better off going for a one-bedroom unit over, say, a three-bedroom unit more suited to families. Generally, a two-bedroom unit will appeal to a wider audience. But it should also be noted that one-bedroom units appear to offer higher rental yields. There are pros and cons for each option.

In Neutral Bay, one-bedroom units appear to start from $500,000. Covering a mortgage of, say, $450,000 plus the LMI might be a stretch. However, you are the best judge of what you can afford. Two-bedroom units start at about $660,000 and quickly rise to beyond $700,000. In Homebush and surrounds, one-bedroom units appear to start around $440,000. However, they are few and far between and the price quickly rises to $500,000 and beyond. There appear to be more two-bedroom units in this area, with the prices starting at about $490,000 and once again quickly rising to $600,000 and beyond.

You will probably find as well that many apartments in Neutral Bay demand premiums for parking. This is less the case in Homebush. So it does appear that Homebush is selling at somewhat lower price expectations, plus you are likely to be buying a modern apartment. Offsetting this is that Homebush is further away from the CBD.

As for off-the-plan developments, that is a column all to itself! There have been many who have lost money on off-the-plan purchases. But also there are many for whom it has worked well. Be sure you go with a well-known developer that has a good track record and reputation in the market place. And be sure to get an independent valuation no matter which option you choose.