

Buying or building, it's an investment decision

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Every dream costs money. The desire to be well housed is tempered by our capacity to pay, and by the marketplace's assessment of the 'real' value of our dreams. When it comes to buying or building our dream house we cannot do it without our cheque book, and none of us has unlimited funds.

IF YOU'RE A BUYER, YOU'RE ALSO A SELLER

Buying or building a house, or buying a townhouse, home unit or retirement unit, is an emotional decision. It is also an investment decision.

Many Australians move home on average every six to seven years. Younger people tend to move more frequently than the middle-aged. Statistics show that 18 per cent of Australians move every year. You are buying something that you will probably sell at some time in the future.

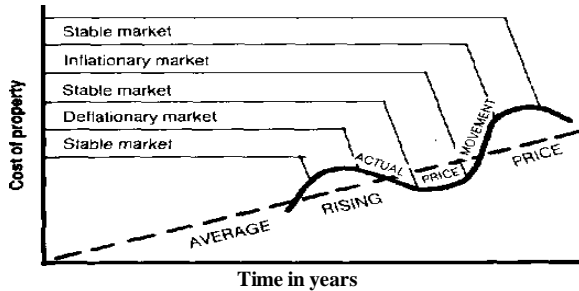
This is certainly the way banks and building societies look at it. They are not investing in your home, but in saleable real estate. The real estate market is essentially conservative. It looks for properties that are likely to be attractive to as many potential customers as possible, to maximise the chances of making a quick and easy sale. There is no advantage to real estate agents, or banks and building societies, if they have to hold onto a residential property for a long time before a buyer turns up. It simply costs them time and money.

INVESTMENT, PROFIT AND THE MARKET CYCLE

The message is quite simple, whether you're buying or building, this is an investment decision. When you come to capitalise on it by selling, you should expect to at least cover your costs, and hopefully make a profit. Whether you do, of course, is dependent upon many factors. The first of these is the market cycle and at which stage you buy and sell.

Is it an inflationary, stable, or deflationary market? The normal market cycle is a traditional S curve around a usually rising average price.

The stable period can occur either when prices are high, that is after an inflationary period when supply has outstripped demand, or at the end of a deflationary period, when lack of demand has caused prices to decline.



If you buy at the top of the curve and sell at the bottom, you may lose tens of thousands of dollars.

The extremes in swing between oversupply and lack of demand are caused by complex forces. Federal Government economic policies, State Government intervention, movements in population, town planning policies, the attractiveness of other forms of investment, the availability and price of land and properties suitable for development, the current financial policies of banks, building societies and credit unions, the state of the international economy, are a few of the forces which can affect housing prices.

The highs and lows, and the length of time between cycles also vary from state to state, and region to region. It is a complex business, and worth discussing with your bank manager and real estate agent when considering buying or selling.

To a certain degree the cycles are predictable. But such predictions are both intricate, and influenced by political decisions, buyer confidence and other factors difficult to immediately measure in dollars. However, one thing is clear, the timing of buying or selling is often decisive to present or future profits.

OTHER FACTORS WHICH AFFECT THE RETURN ON YOUR PROPERTY INVESTMENT

LOCATION

The location of the property can have a marked impact on the purchase price, and how attractive it is to other buyers. If it is located in a desirable area such as close to beaches or on top of a hill with good views, this will push the price up. If it is in an area that has been rezoned for higher density development, and is suitable for redevelopment, the price may also be higher.

The cost per square metre of the same type of house varies from place to place. A house of the same area will cost more or less according to the demand to live in the locality, the cost of building on the land, rezoning pressures if any, the typical costs of other properties nearby, and the state of the property market. The real estate investment market takes all these into account when determining the dollar value of any particular property.

SITE CONDITIONS

Site conditions such as steepness, rocks, the possibility of flooding, difficulty bringing in sewers, drains, electricity or drives, will have an impact on the cost of building—usually increasing it.

COUNCIL DEVELOPMENT STANDARDS

Differences between Council development standards affect land and property costs. Councils impose all sorts of development charges. These can often cause significant increases in the price the consumer pays.

QUALITY, ACCOMMODATION AND STYLE

The quality of the building you end up purchasing, how well built it is, its accommodation, style and presentation will be reflected in the price, and the return on your investment, when you come to sell.

HIDDEN COSTS

There are hidden costs. Cheap building blocks may require costly access drives, foundations, septic and stormwater drainage, not to mention arduous hours of landscaping. Corporately-owned town-houses, home units or high-rise apartments may contain expensive building maintenance problems that arise from poor workmanship five, ten, or fifteen years ago. The same can apply to separately titled houses, terraces and semi-detached houses, though the workmanship in these cases may be up to 100 years old. You may never recover the investment in these hidden costs.

COST OF FINANCE

The cost of borrowing housing money varies with shifts in the value of the Australian dollar, the current state of the nation's balance of payments for imports and exports, Federal Government interest rate policies, the competition from other interests for investment finance, the policies of lending institutions and the housing market cycle itself. The cost of borrowing money to finance a housing purchase or construction can be a major factor in determining the extent of return on your investment if, and when, you decide to sell.

CHANGES IN BUYER PREFERENCES

Shifts in market expectations and buyer preferences can cause previously unattractive properties to be highly sought after, and vice versa. In recent decades we have witnessed a shift in property values in previously low-income inner city suburbs, because many middle-income people decided that living closer to the city centre was preferable. Buying at the beginning of such a trend, and selling at the peak, netted many property investors handsome profits.

PLANNING CHANGES

Changes in property zoning, rerouting of highways, declaration of bushland as permanent parks, etc., can increase or decrease the attractiveness of a property, and its price.

All of these factors, many of which are totally beyond your control, influence or determine how successful your investment decision will be.

TRADING LOCATION AGAINST SPACE IS A COST EQUATION

Chapter 2, 'First, Choose Where to Live', helps you make the best decisions about location. Those decisions involve a question of costs, and invariably a trade-off between land costs, building costs, maintenance charges, the cost of travel, and the opportunities gained or lost through living in a particular location.

It becomes a question of how much 'home' do we sacrifice for 'access' to the opportunities and services we desire. It can, of course, be the other way round, and was during the 1950s, 1960s and 1970s. In these postwar decades, most Australians voted for 'space, house and garden', rather than 'closeness to city'. In the big cities, this is beginning to change, with more people wanting to live closer to services and urban centres. It is not, however, a universal pattern. Lots of people still prefer to live near bush or beach, or to be 'away from it all', and are prepared to accept longer journeys to work.

Whatever your preferences you need to strike a balance between such things as the location of the property and its closeness to things that matter, how much interior and exterior space will satisfy your needs and desires, the cost of rates, etc., and how much you can, or are willing to pay.

The cost equation is:								
COST OF LAND	+	COST Of BUILDING	+	COST OF FINANCE	+	COST OF MAINTENANCE	=	TOTAL COST OF HOUSING
TOTAL COST OF HOUSING		<i>balanced against</i>		OPPORTUNITIES GAINED OR LOST AS A RESULT OF LOCATION		<i>and</i>		TIME AND COST OF TRAVEL

FINAL COSTS ARE NOT ALL IN DOLLARS

All these influence the final cost of the housing you choose. Some of the costs are in dollars, some in travel time, some in time spent away from the family, and some in limiting the number of times you go to the beach, the movies, or the club. The impact of location on the dollar costs of land and housing, and the effect of age and condition of the building on periodic maintenance costs, is something to keep in mind when choosing where to live.

QUALITY HOUSING HOLDS ITS VALUE

Of course, if you don't sell for 15 or 20 years it's virtually impossible to predict market swings, except that 'quality' housing appears to hold its value. The best designed, best constructed housing has a lasting value—well beyond the initial investment cost. If you intend to build, or buy and alter, it is one of the reasons for choosing a good architect. Such an architect can add considerable long-term value to the property, far exceeding the cost of the architectural fees involved.

It's your home, but it's also the biggest personal investment most of us make. Better to seek the right 'investment advice' from your banker, your architect and your real estate agent.

HOW MUCH IS IT REALLY WORTH?

The value of a residential property is a mixture of hard market facts, intangible emotional factors, and functional design preferences.

How much the property is really worth will often vary from buyer to buyer. For one person, the intangible emotional factors will be so decisive that they are prepared to pay more than the majority of buyers. For another, these may not matter much. Its potential resale value in a few years matters more than aesthetic satisfaction.

Real value is in both the eye of the buyer, and the long-term evaluation of the market place. We must determine the balance for ourselves. Chapter 12, 'Buying Housing', takes you through the many questions that will help you decide the personal side of this equation. Familiarity with the marketplace is necessary to balance the equation. The more time you spend reading the real estate magazines and papers, and simply looking around, the easier it is to understand the way the marketplace will respond to your personal values. It may or may not agree with the type of housing you want to live in. Better to be informed and aware of the differences between your personal preferences and the general market choices, than surprised and disappointed.

CAPITAL COSTS AND FORGOTTEN COSTS

Housing involves two sets of costs; the cost of buying, and the cost of maintaining.

The cost of the property is the first price you will run into. The costs of Council rates, State land tax, water, gas, electricity and oil rates, fencing, landscaping, property maintenance, insurances, solicitors fees, stamp duty, white ant inspections, surveyors fees, corporate body fees, to mention a few, and in the case of retirement housing, the cost of delivered services (see Chapter 18 'Buying for Retirement'), are amongst the many second costs which can trip up your budgeting. The length of the list, and the cost of the items, surprises many first-time buyers.

Add to this the cost of carpet, curtains, selling furniture which doesn't suit at a loss, buying new furniture and furnishings, the cost of packing, moving and unpacking—and buying housing starts to look like a very complex business requiring the budgeting skill of an accountant.

FORGOTTEN COSTS CHECKLIST

The extent of 'second forgotten costs' varies according to the type of housing you are buying, the area, the Council, the legal title, whether it's private housing or shared with many other residents, and your furniture and furnishing tastes. At the time you decide to buy, it is wise to sit down and check through the following list and estimate the costs you can expect. You might have to check with your bank manager, solicitor, architect, and friends who have been through it before, to get the estimates right.

Purchasing costs

Real estate agents' fees Solicitor's fees and costs Surveyor's fees
Property inspection fees
Pest inspection and eradication costs
Insurance premiums
Stamp duty
Transfer of mortgage fee
Improvement costs required by lending institution

Moving and settling in costs

Services connection costs
Carpets
Curtains
Other floor coverings
New furniture and furnishings
Loss on selling old furniture
Moving costs

Fencing costs
Landscaping costs including:
paths, drives, steps,
drainage, etc.

Annual costs

Council rates
Water rates
Electricity rates
Gas rates
Fuel oil rates
Phone rental
Land tax
Corporate body fees and costs
Building maintenance costs
Retirement living service charges
Insurance premiums
Mortgage repayments

You will need to budget for these costs in three ways. Those associated with purchasing, with moving and settling in, and those which are annual costs. It is important to realise that all of them, except real estate agent fees, are on top of the purchase price.

These second costs and charges come out of your pocket, not the money you borrow from a financial institution. They sometimes change the attractiveness of a property purchase.

IF YOU'RE PLANNING TO BUILD

Human nature being what it is, and general unfamiliarity with the contingencies and costs of building, it is not uncommon for many people to start out with an unrealistic idea of the final cost they will have to pay for their 'dream home'.

The first estimates are just that, even for architects and builders. These estimates will change, and require fine-tuning, before they become a contract price. Even the contract price may not be the final price because of provisional sums and variations.

ALLOWING A CONTINGENCY

For such reasons, it is important to build in an allowance for error right at the beginning. Whether you are planning to build or to alter, allow at least 10-15

per cent contingency on top of your first estimate. In some cases, if the land is steep and rocky, you're not quite sure of how big a house you want to build, or don't really know how much it will cost to alter your house, it may be wise to allow a contingency of 25-50 per cent. In unusual cases budgets have been increased by up to 100 per cent to achieve desired ends.

COST OVERRUNS

The stories concerning cost overruns are nearly as numerous as the number of houses built every year. The reasons why, are far fewer. Basically they are:

- 1 Buying land, or a house, onto which it is expensive and difficult to build, or to alter.
- 2 Expecting to be able to buy more floor space than current building construction costs allow.
- 3 Not realising that your stylistic preferences are expensive.
- 4 Not accepting that your tastes in materials and fittings, such as cupboards, tiles and stoves, can add noticeably to the cost of building.
- 5 Not being firm about budgetary limitations right at the beginning, which, of course, requires you to have done your homework and decided how much you can afford to spend.
- 6 Agreeing to contracts where the provisional sums are not realistic (see Chapter 5).
- 7 Agreeing to contracts which don't clearly specify and document all the requirements.
- 8 Making variations to the contract without requiring costing of those variations before the work commences (see Chapter 5).

This eight-fold path can, and often does, lead many people down a rocky road to significant cost overruns on their housing project. It is a path down which it is easy to start and from which it is often difficult to retreat. Such retreat is often barred by emotional commitment to the amount of space, the design and the quality of finish, or by the type of contract you have already agreed to or signed. Undoing the emotional commitment is often painful. Altering the building contract so that you can build more cheaply is fraught with the risk of protracted delays and loss of motivation by the builder and his subcontractors.

In the first case the choice is between keeping the design that seemed so suitable, and burdening yourself, assuming you have the capacity, with the extra finance charges.

In the second case, the choice is between proceeding with a contract, and trying to negotiate reductions, or stopping the work and renegotiating prices on the basis of a modified design with the risk of losing the builder. It's an unenviable experience. Better to approach the process of building with a sound cost plan.

SIX STEPS TO BEING COST CONTROL WISE WHEN BUILDING

- 1 Check out the cost of building on the land, or altering the house before buying.
- 2 Be realistic about your space needs, and your aesthetic preferences.
- 3 Be realistic and firm about your budget.
- 4 Check the contract carefully, and ensure the plans and specifications document everything clearly.
- 5 Insist on realistic provisional sums.
- 6 Try not to vary the contract, or if you must, have the variation costed and agreed to in writing, before work on it starts.

These six steps can turn designing, or selecting the design, and building, into an agreeable experience.

CAN YOU AFFORD IT?

The cost of housing is part of the total household budget, and, in the past, a rule of thumb used in assessing borrowing capacity has been to set the cost at no more than 25 per cent of total income. Inflation has, however, made this figure more difficult to achieve.

Before deciding to buy, it is wise to analyse the effect of the anticipated purchase on the household budget. The following method (see p. 10) can be used as a starting point, though there will be personal differences from family to family, and from individual to individual.

This balance will determine, amongst other things, your capacity to borrow the necessary capital to purchase the housing, unless the value of the property and other assets you can currently sell, covers the purchase price or portion of it.

It also influences the number of years you will have to spend paying off the purchase, and the material quality of your lifestyle.

BORROWING IS A SPECIALITY

Controlling your finances when buying or building housing is very much bound up with available finance, interest rates, repayment terms, borrowing limits related

The impact of cost on your annual impact budget			
Total Annual Household Income		Food costs Clothing costs Health costs Transport costs Educational expenses Holiday and entertainment expenses Insurances Other debts	Annual balance available for financing purchase of housing and second forgotten costs
	Less		Equals

to income, job, age, marital status, household size, current assets and debts, sources of mortgages, not to mention Federal and State Government regulation or deregulation of home finance. Housing finance is a specialised field in which there are a number of operators ranging from the Federal Government with its first home loan grants schemes and general control of banking, to banks, building societies, credit unions, finance companies, and solicitors trust funds. It is a marketplace in which you need to shop around if you are to find the best deal. It's important to talk to the experts. A difference of 1 per cent in interest rates, or the length of time to repay, can mean hundreds of dollars a year, in, or out, of your pocket.

BE REALISTIC

Whether you're buying or building, the costs involved, to the vast majority of housing buyers, are huge. The fact that housing loans are 15-25 years long indicates the size of the investment involved. *Many people's investment in housing constitutes the equivalent of 6-8 years of gross income, or one-sixth to one-eighth of their income over their working life.* Being realistic and checking it out thoroughly before you sign that binding contract is essential to your peace of mind. Remember, you'll be paying for the mistakes as well as the pleasures, for a long time to come.