talk money with Ecstra Foundation

Finance facts: Buying property

Thinking about buying a property?

A home is likely the most expensive asset you'll ever buy. Starting the planning process and doing your research early will help get you into the best financial position.

Making a plan

An essential step in your plan is to decide on the type of property you need. For example, a young person might need a small place while a family of four will need a larger place. Keep in mind that your circumstances may change.

A plan should start with:

1. Deciding what type of property you require—a house, unit or investment property
2. Doing your homework and find out how much you will need to spend
3. Working out the amount of the deposit required
4. Calculating how long will it take to save the deposit
5. Setting a budget, which may include finding ways to cut spending back or earn more to save.

Understanding how much of a deposit you might need

The typical house deposit is generally either 10% or 20% of the property price. Some lenders will accept a deposit of 5%. If the banks accept a low deposit of 5% you may have to pay a higher interest rate than if you had a 20% deposit.

Additionally, you'll be required to pay Lenders Mortgage Insurance (LMI). LMI insures the lender against the borrower failing to repay the loan. LMI is charged for borrowers with Loan-to-Value Ratios (LVR) over 80%,

and can cost tens of thousands of dollars.

An LVR is the ratio of the loan amount to the value of

the property. If you are purchasing a home for $450,000, and will be using a $70,000 deposit, the LVR is 84% [(450,000 – 70,000)/450,000].

Remember if you have a smaller deposit, this means borrowing more money and therefore paying more interest over time.

Getting into the property market sooner rather than later could mean you own your home faster, so that could be a price worth paying.

Case study: Calculating a deposit

Rebecca has been working as a nurse for almost five years. At 28 years old she is ready to buy her first home.

Rebecca has lived at home with her parents and during this time she has saved $40,000. Rebecca has seen a small apartment not far from the city.

The unit is selling for $480,000. After visiting with her bank, they have agreed to lend her $432,000. From her savings record, the bank can see that she has been a good saver. With the extra help from her parents, Rebecca will be able to put down 10% deposit.

With a 10% deposit:

- Property price: $480,000
- Deposit: $48,000 (a 10% deposit)
- Loan amount: $432,000
- LVR: 90% [(480,000 – 48,000)/480,000]
- LMI around $8,500.

Note if Rebecca had saved 20% deposit then she doesn't have to pay this insurance. LMI calculators are available online by lenders.

Interest payments

You will have to pay interest on the money you have borrowed. It is expressed as a percentage and will be set by the lender, but it is worth asking for a lower rate and shopping around. The interest is to compensate the lender for the funds and risk they have taken by lending you the amount to purchase your property.

Be aware that if an interest rate rises even by 0.5% this could add quite a lot to your regular mortgage repayments.

Case study: Interest rate increase

Ben owns a property which he bought for $600,000. He is paying off the loan over a 30 year period, currently he is paying 4.5% interest. Interest rates are set to rise and Ben's bank has told him the current rate will rise by half a percent. This means Ben will have to pay an extra $180 a month when his interest rate rises.

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Buying versus renting

People are renters for various reasons. Renting is great if you need to be mobile for work or happen to move a lot. Some people rent as saving for a deposit is challenging. Renting can be a cheaper option than owning a home, particularly if rent is shared among other tenants.

Renting normally means there are fewer ongoing costs to worry about—the council rates, home insurance, general maintenance and repair costs are generally covered by your landlord, unless you have caused the damage. As a renter you need to maintain the property and bring repair issues to the landlord or their representative (a property manager) but are not financially responsible for normal wear and tear repairs.

A home is often more than a place to sleep. When you own your home you have the freedom to paint, renovate and landscape at any time without needing to ask permission from a landlord. Most people save for the deposit for many years, and forego spending on eating out or going on holidays. To reach their goal, they have to organise their finances with a budget and stick to their plan as much as they can.

If the property is in a good area, then most likely it will increase in value and become a good investment. However, like any investment purchase, the value may also decrease. It is essential that you research the area you are buying in, including town planning information on past activity and future plans, and property price trends. If the area relies on few employers, it is a risk to the value of your property that those employers might leave the area sometime in the future.

Did you know?

Many Australians own an investment property, that is, a property that they don't live in themselves, and that they rent out. In 2021, the Australian Tax Office estimated that there are over 2 million property investors in Australia. However, only around 400,000 Australians own two or more investment properties.

Tips for buying a property

Buying a home is complicated, so find people in your network to talk it through, and search trusted online sites such as ASIC's MoneySmart website to develop your checklist.

Due to how expensive properties can be, it is essential to start doing your research early to give yourself plenty of time to save up a deposit and understand the different home loan products available.

It's good to understand your financial situation and the budget limitations you have before you start looking. This will keep you focused on properties in your price range.

Glossary

Interest rates	Expressed as a percentage, the interest rate is multiplied by the principal (amount loaned) to work out the amount of interest to be paid to the lender.
Lenders Mortgage Insurance (LMI)	An insurance to protect your lender. The best way to avoid paying LMI is to keep your Loan-to-Value ratio (LVR) below 80%. If you have a 20% deposit (which is an LVR of 80%), you don't have to pay LMI. If you can buy in a more affordable area where your deposit stretches further, or find cheaper coliving arrangements for 12 months to save money, you may be able to build a bigger deposit and avoid paying LMI.

Links

Home loans: https://moneysmart.gov.au/home-loans

To calculate how much interest you will need to pay go to: https://moneysmart.gov.au/home-loans/mortgage-calculator

About Talk Money with Ecstra Foundation

Talk Money with Ecstra Foundation is designed to help Australian students learn money lessons for life, to be confident talking about money and to make informed financial decisions. We offer facilitator led workshops for Years 5–10 students and additional resources to reinforce learnings. The program is provided at no cost to schools, enabling more students across Australia to access financial education at key life stages.

About Ecstra

Ecstra Foundation is an independent charitable foundation committed to building the financial wellbeing of Australians within a fair financial system. Ecstra launched Talk Money in February 2022.

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