RICHARD WHITFIELD

CASE STUDY

It's time to get serious

A young couple feel they may have wasted their potential and now want to take control of their finances

NAMES: Martin Kaareng & Heidi Benjaminson
STATUS: Getting married this year
QUESTIONS: Where do we invest our money to work for our future? What are the advantages and disadvantages of buying property on the Sunshine Coast for our retirement? Or should we buy in Brisbane where we currently live? Or is an exchange traded fund (ETF) portfolio better in case we move back overseas? Or should we use half the money to buy a share portfolio and the other half for a cheaper property on the Sunshine Coast?
ANSWERS: Buying property can be time consuming and expensive and there is the uncertainty of its value until you have sold. Stick to liquid investments such as low-cost ETFs. You can use gearing too, just as you do with property. Pay off your tertiary loans, particularly while the Australian dollar is strong. If you do want to invest in property, rentvest but not in Brisbane or the Sunshine Coast; there are other areas with better prospects.

When you have lots of options, it is hard to know where to settle down. Heidi is from the US and her fiance Martin is from Norway. They have lived and worked in Australia for five and a half years and later this year they will be married in the US.

They love living and working in Australia but because of the pull of family commitments they haven't made up their mind entirely where they will settle down. But putting this important decision on hold means that they haven't taken out a mortgage and bought a home. "Since we immigrated here in our late 20s, I feel like we are at least five years behind where we should be financially," explains Heidi.

Every year they travel back home to visit their respective families and friends, which costs them around $10,000 each time.

They are great savers but their money is sitting in a term deposit and cash, earning little interest. Heidi says one of the reasons they haven't made any investments is that they want to keep their options open. "We do want to come back here after the wedding and set ourselves up for the future."

Their assets include superannuation, to which they each contribute up to the maximum concessional cap of $25,000pa, as well as the savings in the term deposit and cash. They each have student loans overseas.

One option they are weighing is buying a home on the Sunshine Coast. Heidi believes they can get more for their money there than they can in Brisbane, where they live. They love the beach lifestyle and can see themselves retiring to the Sunshine Coast in 40 years. It is too far to commute to Brisbane so it would be an investment property.

Even if they had a mortgage to pay off, Heidi thinks they could still save at a high rate. "We can save a lot if we put our mind to it. We would put the brakes on leisure and travel. We could buckle down and save Herculean sums."

Another idea is buying a home in Brisbane, for up to around $750,000, in a 12- to 15-kilometre radius of the CBD. Which suburbs are good value with growth potential?

Alternatively, asks Heidi, is it better to buy an ETF portfolio in case they move back overseas, as it would be easier to manage. "Maybe instead of buying a house in Brisbane we could use half our money for a share portfolio and half for a cheaper property on the Sunshine Coast?"

"I feel like we're the definition of wasted potential and an interesting case study of inaction at work," she says. SUSAN HELY

Low-cost ETFs will provide flexibility

JASON PETERSEN

Jason is a Sydney-based financial planner and head of wealth management at independently owned boutique planning business 5 Financial.

With so many options available and uncertainty around their future, it's been understandably easy for Heidi and Martin to settle into a state of inertia and do nothing. It's great to see they're now ready to take control of their financial future.

The key to making any investment decision, whether property or shares, is having a clear understanding of the investment's purpose and how it fits in with their future plans.

Heidi and Martin don't need to lock themselves into something with high entry and exit costs that can't be easily exited. This applies very much to property, with its high entry costs such as stamp duty, legal costs and inspections – not to mention the time cost involved in searching and completing the transaction. On exit, there are agent's fees and, of course, there is a lack of price transparency in that you don't know what the property is truly worth until you have a signed contract in your hand.

Additionally, if changes are likely in Heidi and Martin's family situation and work arrangements, being locked into a mortgage isn't a great idea.

The foremost risk-free strategy is for Heidi and Martin to pay off expensive personal loans – in particular Heidi's student loans in the US, especially with the Australian dollar being stronger. This gives an instant return of 6.8%pa tax free.

In our experience, global workers need to maintain flexibility when investing. ETFs, through the likes of State Street and Vanguard, provide ultimate flexibility. Offering excellent liquidity and diversification benefits (the No. 1 rule of investing), the underlying investments are highly transparent, with the value absolutely known between 10am and 4pm Monday to Friday. Furthermore, transaction costs are minimal relative to property.

Investing is more than just which asset performs better. Transaction costs and strategic management are significant considerations. With ETFs, managing future capital gains (should Heidi and Martin need to sell in the future) is easier as they can sell down parcels over multiple years rather than all at once. In this way, they avoid paying tax on a fair chunk of the gains at the top marginal rate of 49%. They can also easily shift ownership around with minimal cost. This would be important if one of them takes time off work to care for children, and therefore has a low tax rate.

One of the powers of property investing is being able to gear – that is, to borrow to invest, giving you a much larger asset base. The same can be said for ETFs, particularly using self-funding instalment warrants (SFIs), which have the added benefit of protection against price drops below a certain level.

Heidi and Martin could use their existing savings, less the funds for their wedding and travel home, to establish a geared ETF portfolio using SFIs.

Given their strong savings capacity, Heidi and Martin can add to the investment on a regular basis. This gets their money working for them straight away.

Overall, SFIs over ETFs offer Heidi and Martin greater flexibility, diversification, transparency, liquidity and cost advantages compared with being locked into a property investment.

Build a portfolio by rentvesting

BRYAN LOUGHNAN

Bryan is a buyer's agent and head of Australia-wide property acquisitions at Propertyology.

Heidi and Martin need to be congratulated on their impending wedding – and their dedication to investing at such a young age. They're in a great position to secure their financial future and ensure that, unlike 82% of Australians currently aged 65 or more, they avoid falling victim to the aged pension trap.

With an upcoming wedding and uncertainty about where (and when) they would like to settle down, it wouldn't be unusual if their needs and wishes change over the next few years.

Given the exposure their super already provides to the sharemarket, I suggest they retain flexibility for career and lifestyle by rentvesting: renting where they are happy while investing in property markets that appear to have solid fundamentals and growth potential. Depending on how determined they are and on their long-term objectives, it's possible Heidi and Martin could be in a position to purchase two investment properties in the short term using this strategy.

Heidi and Martin can build a diversified portfolio, taking advantage of locations with better potential than the Sunshine Coast. Purchasing an "investment" property to potentially one day retire into may sound nice but trying to decide now where and what they may want to live in 40 years down the track is a waste of time.

I recommend they buy one property now and a second within six months. To maximise opportunities and minimise risk, they would be in different cities (possibly different states). The combined asset value would be around $600,000 and I'd estimate combined annual holding costs could be as little as $5000.

Investing across multiple locations and in various states is something very few people do; it's also a common reason for people not realising their full potential. Individual suburbs (which are effectively just dotted lines on a map) do not go up and down in value. Furthermore, not every street in a specific suburb or region may be acceptable for investing purposes. History shows that regions with strong fundamentals such as affordability, economic development, controlled supply and positive sentiment perform better from an investment perspective over a longer period. It requires an investor mindset, treating property as a financial instrument, not a home.

Following this process is how Propertyology uncovered the now strongly performing Hobart market for our clients three years ago.

With all of this in mind, while very select pockets of Brisbane and the Sunshine Coast might not be bad investment decisions today, there are other markets throughout Australia that are more affordable and have stronger fundamentals that I would consider for Heidi and Martin.

Based on the price range of properties I've purchased for clients, in the most affordable of these locations we would look to spend between $230,000 and $280,000. Rental yields in these locations for a three- or four-bedroom house are currently around 6%.