CASE STUDY

$250k could be a big relief

Rebecca with Daisy and Jaycee.

PHILLIP CASTLETON

A busy mother hopes an inheritance will take some of the stress out of her life

NAME: Rebecca Arthurs
STATUS: Single mum, 26, with two daughters, Jaycee, 2, and Daisy, 4.
QUESTIONS: What should I do with my $250,000 inheritance? Can I afford to buy a home on Sydney's northern beaches? Or should I look somewhere cheaper such as the Central Coast? Is it a good time to buy with house prices falling? Or should I invest the money and use it to boost my income?
ANSWERS: Losing your mother is a highly stressful event, so don't rush into making any big financial decisions. Take your time and consider renting and investing in a portfolio of exchange traded funds (ETFs). This lets you "try before you buy" so you can experience living in a new location before committing. It also means you are not locked into a big mortgage. Instead you are building an asset that's diversified, liquid, low cost and tax effective and provides an income to pay your rent. When you do want to take out a loan for a property, the bank will take into account the property you own with your former husband so it may be the right time to sell your share to boost your borrowing capacity.

An inheritance often represents more money than you've ever received at one time. If it is a significant amount then it can be life-changing. But after the windfall has been shared among relatives, it is more likely to be a smaller sum.

Rebecca Arthurs realises her inheritance is a one-off opportunity and hopes it can help make her life easier. She has two jobs, one full time and one part time, to cover her rent, childcare, running a car and living costs. As well, she helped to look after her ailing mother before she died.

Rebecca estimates she will inherit $250,000 when her mother's house is sold. "Although this is a lot of money, I know it's not life-changing."

Her dilemma is what to do with it. She is hoping it will give her some financial freedom. "What I want is to have a stable home, and to be able to work less hours, so I can spend more time with my kids and study. How do I achieve this?"

Ideally Rebecca would like to buy a home. When she moves out of her mother's house, she expects to pay $570 a week to rent an apartment on Sydney's northern beaches. In Frenchs Forest, where she works, property prices are high and there are few apartments.

Can she afford a two-bedroom apartment in nearby Dee Why? She likes to be near the beach and has lived on the Central Coast, where she jointly owns a house with her ex-husband. He is currently paying off the $400,000 mortgage and she pays half the expenses such as rates and insurance. Should she move back to the Central Coast where property prices are lower but job opportunities aren't as good as in Sydney. Or should she invest the money?

There isn't much spare time in Rebecca's busy life but she would really like to study.

COMPILED BY SUSAN HELY

Try before you buy

JASON PETERSEN

Jason is a financial planner and head of 5 Financial's wealth management division in Sydney. 5financial.com.au

Among the most stressful events in life are relationship breakdowns, loss of a loved one and purchasing a home. At just 26, Rebecca has experienced all three and is now considering going through the home ownership process again. Rebecca's dedication in having cared for her late mum while working long hours to provide for her daughters is also quite remarkable.

In deciding her next steps, we recommend Rebecca be guided by what's most important to her: a stable home life, having more time for her daughters and studying.

There is a common belief that buying is better than renting. However, this is regularly and rightfully challenged. A study by Ernst & Young highlighted how renters can be significantly better off as long as they invest what they had for a deposit plus any surplus.

Based on Rebecca's income, her borrowing capacity sits at around $300,000. So with costs, a potential purchase would be about $550,000. Options in this price range are limited on the northern beaches. However, there's likely to be more choice on the Central Coast (although this affects job options and commuting time).

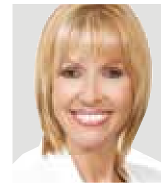
With interest rates at record lows, principal and interest repayments are about $330 a week on a 30-year term. A key issue for Rebecca is her repayment capacity and the financial stress when rates increase. Costs such as rates, strata fees and maintenance must also be considered.

Alternatively, renting while simultaneously investing in a diversified portfolio of ETFs with a moderate level of borrowing could be an attractive option. Income from the portfolio would assist with rent and interest payments, resulting in a similar net cost to a mortgage but giving Rebecca far greater flexibility, as shown in the table. She would also be building an asset for the longer term that she could tax-effectively cash in to purchase a home, or use the income to support home loan repayments:

Rebecca is doing a remarkable job providing for her young daughters and the best thing she can do now is to consider what will give her greater flexibility.

With this in mind, Rebecca should consider renting and investing. This lets her "try before she buys" so she can experience living in a new location before committing, and it also means she is not locked into a mortgage. At the same time she will build an asset that's diversified, liquid, low cost and tax effective.

	Buy home	Invest and rent	Notes
Purchase price	$550,000	$550,000	
Loan	$320,000	$300,000	Home loan includes stamp duty and costs
Investment income (4.5%)	–	$476pw	
TOTAL INCOME	–	$476pw	
Loan repayments (P&I)	$356pw	$375pw	Home 4%, investment 5%
Rent	–	$570pw	Northern Beaches
Home costs (strata fees, rates, etc)	$154pw	–	$8000pa
TOTAL COSTS	$510pw	$945pw	
Net cost	**$510pw**	**$469pw**	**Save $41pw by renting and investing**



Vital points to consider

MARGARET LOMAS

Margaret is the founder of Destiny Financial Solutions as well as author of nine property investment books, including titles such as 20 Must Ask Questions for Every Property Investor *and host of the web TV show* Property Investing Matters.

To answer all of your questions, we must list your priorities, and then look at what you can do. The most important aspect for you right now is your job. Can you get the same job elsewhere or would you have to keep that particular one? If you need to keep that job, how do you feel about commuting to it if you were to buy a house on the Central Coast? How would your children cope? The answer determines what you can do – as in whether you can move to the Central Coast or not.

That then leads to the next priority – your budget. If you are not happy to (or can't) commute, then what are your local options? A two-bedroom apartment in Dee Why will cost around $580,000 plus extras. So you will need around $620,000. You will have $250,000, so you will need to borrow $370,000. By my quick calculations, you are unlikely to be able to borrow this amount, and I have estimated a maximum borrowing power of around $200,000. This may be complicated by the house you own with your ex, as even though you do not pay the mortgage your name is on it and the bank will consider it a joint debt. Even if you could find a lender to give you the $370,000 you would need to buy the apartment in Dee Why, the monthly payment would be $1750, and this would place severe stress on you.

The next priority is lifestyle. A two-bedroom apartment in Dee Why would be small and as your children grow you may like to have more space. Depending on where this sits on your priority list, this will have an impact on your final choice.

So when you consider all of this, you have to make choices based on your job, your lifestyle and your budget.

If being near your job is critical, then your only option may be to rent that apartment in Dee Why and put your inheritance into an investment property with a good yield in a growing suburb, so that the property pays its own costs and your funds are working for you. The cost of this option is tenure and lifestyle.

If lifestyle for the kids is the most important thing, and you are happy to commute or you can get a job on the Central Coast, then buying a house there and using the equity in that house (which you will have because you used the $250,000 cash as a deposit) to immediately also invest in property might be the better choice. This will have the added advantage of giving your kids stability, as you will have security of tenure in the house. If you chose this option, your mortgage payments would probably be lower than the Dee Why options, and so your budget won't be as strained. The cost is that you may have to commute longer distances, at least until you can get a job closer to where you live.

Whichever of the two you choose, and this depends on what you are prepared to compromise, I think you should also sell the home you own with your ex-husband. This property will hold you back from being able to borrow, and may even prevent you from buying something on the Central Coast, even at a lower price. Lenders consider joint debts to be yours alone when thinking about your servicing ability, just in case one party stops paying, and this debt you have with him will definitely get in the way of further borrowing. Selling that will not only boost your potential to borrow in your own right, it will give you a little extra money to lower that new mortgage.