Renting versus Renting

November 2015

It has long intrigued us that the banks and media have a fixation about long term loans especially loans over fifty years and "shock horror" interest only. Yet renting a property for a life time is accepted as reasonable behavior!

What we would like to suggest and explain is that in the long term it would be better, more economical even to rent money than rent a property. We first wrote this article February 2007 and it still makes sense now.

Just how do you make such a comparison? If you rent a property then all you have as an out going is rent.

Let's look at this over a 10 year time period.

At present rents provide a yield of approx.. 6% pa (excluding Auckland) so for arguments sake lets say the 3 bedroom home is worth $350,000. So a yield of 6% on this amount would be approx. $21,000 pa or $404 pw.

Mr & Mrs Renter

Mr and Mrs Renter looked at their options and decided that renting was the way to go as it was the cheapest option, after all they argued, who wants to pay rates, insurance, interest and maintenance. This would just cost us too much. So they decided to rent.

Mr & Mrs Renter			
Year	**Rent pw**	**Rent pa**	**Cumulative total**
One	$404	$21,000	$21,000
Two	$412	$21,420	$42,420
Three	$420	$21,848	$64,268
Four	$429	$22,285	$86,554
Five	$437	$22,731	$109,285
Six	$446	$23,186	$132,471
Seven	$455	$23,649	$156,120
Eight	$464	$24,122	$180,242
Nine	$473	$24,605	$204,847
Ten	$483	$25,097	$229,944

In this table we have worked on inflation of 2 percent per annum and we can calculate that over the 10 years our renters have paid out $229,944 in the 10 years they have rented.

Mr & Mrs Owner

Mr & Mrs Owner how ever had a different mind set and believed that in the long run owning their own property was a better way to go.

Year	**Debt**	**Property value**	**Operating Expenses**	**Interest**	**Cumulative costs**
One	$350,000	$367,500	$7,000	$17,500	$24,500
Two	$350,000	$385,875	$7,210	$17,500	$49,210
Three	$350,000	$405,169	$7,426	$17,500	$74,136
Four	$350,000	$425,427	$7,649	$17,500	$99,285
Five	$350,000	$446,699	$7,879	$17,500	$124,664
Six	$350,000	$469,033	$8,115	$17,500	$150,279
Seven	$350,000	$492,485	$8,358	$17,500	$176,137
Eight	$350,000	$517,109	$8,609	$17,500	$202,246
Nine	$350,000	$542,965	$8,867	$17,500	$228,614
Ten	$350,000	$570,113	$9,133	$17,500	$255,247

Using an interest rate of 5.0 % pa fixed for 5 years and rolled over at this rate for another 5 years. We have also factored in rates, maintenance and insurance as operating expenses at approx 2% of purchase price and increasing by 3% p.a. inflation.

We have used a higher more conservative rate than that advised by an experienced property investor as follows *"I've always found that 15% of the Gross income is a reasonable amount to take off for operating expenses. (Or 23-25% if managed as well.) This has always stood me in good stead over a great variety of residential property types as a rule of thumb.*
Tony Brazier, Brazier Property Investments Ltd. MREINZ

So on the face of the number we have it is costing Mr & Mrs Owner approx $471 per week from the outset and $67 pw in extra payments over what Mr & Mrs Renter are paying. This amounts to approximately $25,303 in additional outgoings over 10 years.

A no brainer you would think!

But is it a fair comparison if we ignore the fact that properties increase in value and double every seven to 10 years. If you look at the table above, we have shown the property value increasing at only 5 % per annum, which is well below historical capital appreciation in NZ which has averaged over 10 % pa over the last 45 years.

So Mr & Mrs Owner have spent approx. $25,000 more than Mr & Mrs Renter but now have capital in their property of approx $255,000. Over the 10 years their wealth has gone up by $490 pw.

What about the opportunity cost to Mr and Mrs Renter, what if they invested their savings each year and compounded the interest, say at 5 % pa.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total
Rent	$21,000	$21,420	$21,848	$22,285	$22,731	$23,186	$23,649	$24,122	$24,605	$25,097	$229,944
Own	$24,500	$24,710	$24,926	$25,149	$25,379	$25,615	$25,858	$26,109	$26,367	$26,633	$255,247
Diff	$3,500	$3,290	$3,078	$2,864	$2,647	$2,429	$2,209	$1,987	$1,763	$1,536	$25,303
5%	0	175	348	520	689	856	1020	1181	1340	1495	$ 7,622
Total	$3,500	$6,965	$10,391	$13,774	$17,111	$20,395	$23,624	$26,792	$29,894	$32,925	

So Mr and Mrs Renter could turn their savings into approximately $32,925 (ignoring the tax, if only!) but they would have to save this and my experience tells me, very few are likely to do this.

How does this compare to the capital growth of approx $255,000? We know a lot of commentators are always saying that the property boom is over, and it may be for a short time, GFC 2007-2009 did hit property prices for a while. But we know we will continue to back historical growth trends, both in NZ and internationally.

We need to point out the risks involved in each scenario. i.e. – with renting you run the risk of being forced to move frequently and the extra costs involved with that, also recently in Christchurch we have seen market forces push the rent up much higher than usual so as a renter you are vulnerable to that. As a buyer you can suddenly find your costs are substantially higher if major maintenance is needed or there are large hikes in insurance premiums as a result of a natural disasters. You could find that the market value of your house increases far more than expected as the area you live in becomes more desirable or that your property value plateaus or even drops due to changing circumstances as in East Christchurch after the earthquakes or in towns where a major employer has shut down.

When deciding whether you are going to rent or buy, all these risk factors must be considered, and then a decision can be made, but, of course, one cannot plan for every eventuality in life!

Renting the House or Renting the Money, you do what works for you. Just make sure you make an informed decision.

David Weusten is a finance Broker who brings with him over 36 years' experience in the finance industry, both in NZ and overseas. He has personally been involved in arranging for his clients finance in excess of $200 million. He has been published in the Sunday Star Times, the New Zealand Franchise Magazine, and regularly on various websites. He has also published a business guide "What do banks want? So you can get what you want", "Owning your own business, an overview of what to consider" and also "Money, Your Master? Your Slave? Your Choice!". He would be happy to answer any questions you may have related to Business, Finance, Franchising and Banking. Email him at dweusten@fspnz.com. If you would like to know more about his company, Financial Service Providers NZ Ltd visit their website www.fspnz.com.