HOLM TRUTHS

Down to earth advice for New Zealand savers and investors from independent journalist Mary Holm

SUMMER 2001

Pay yourself first!

What does saving mean to you? Does it mean:

(A) What you do with any money left over after you've bought what you need or want? Or

(B) A regular contribution you make each pay day?

There are four reasons – and they're not all obvious – why the latter is a better approach.

Even if you're already saving regularly, what follows might encourage you to save more.

AN EARLY START

If you start saving early, you don't need to save nearly as much to reach your savings goal. Let's look at what a difference a decade can make.

If you save $100 a month for 10 years, with an average return of 5%, you'll accumulate around $15,500. If you save just $40 a month – less than half – but do it for 20 years, you'll accumulate around $16,300.

Another example: If you save $100 a month for 30 years, at 5%, your savings will total about $82,000. With savings of just $60 a month, but for 40 years, you'll have around $89,000.

• It's pretty painless

If you save the same amount each pay day, or each month, after a while you won't even miss the money. You'll be used to operating with $100, $1000 or whatever less a month.

To make it easier at the beginning, you could start by saving $25 or $250, and then raise it gradually.

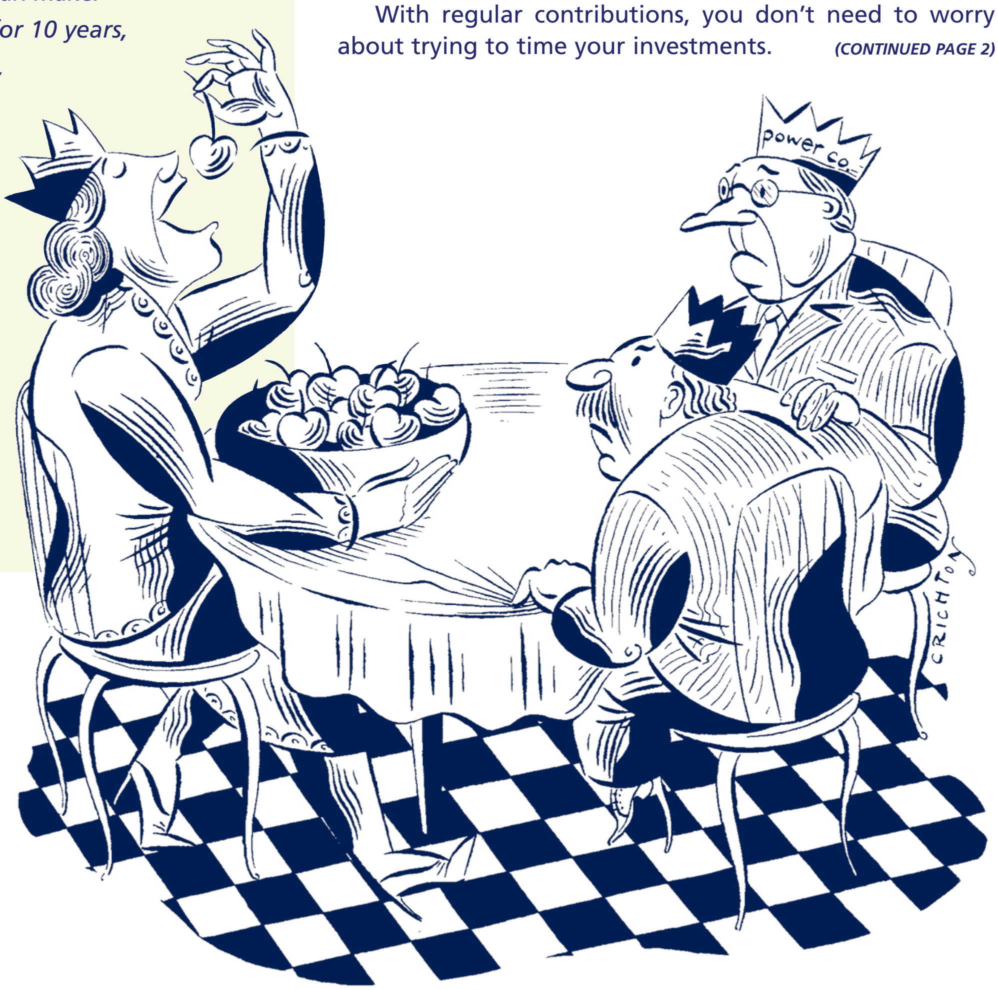
• It's simple and worry-free

Many savers put a lot of effort into working out when they should invest, perhaps based on the outlook for interest rates, share prices or foreign exchange.

The fact is that nobody – not even the experts – is much good at such forecasting.

As one sage put it, the best time to invest is when you have the money to do it.

With regular contributions, you don't need to worry about trying to time your investments. *(CONTINUED PAGE 2)*



(PAY YOURSELF FIRST, CONTINUED)

• Dramatic growth

We all know how compounding interest can make an investment grow. But investment growth is even more dramatic when you're adding money regularly.

As our graph shows, if you contribute just $100 a month – not much more than $3 a day – and get a return of just 2% a year, you'll have more than $13,000 after 10 years.

After 30 years, the total will be close to $50,000. And, if you start young enough to save for 50 years, it will be more than $100,000.

On a higher annual return, of 5%, after 10 years you'll have $15,500; after 30 years, more than $80,000; and after 50 years, more than $250,000. That's quarter of a million dollars – a pretty serious retirement nest egg from a few dollars a day.

Growth will be higher still, of course, if you can earn higher returns. But don't count on it!

I chose 2% because it's what a fairly conservative saver – who invests in a mix of shares, fixed interest, and perhaps property – might get on average, after taxes, fees and adjustment for expected inflation.

And 5% is what a less risk-averse long-term saver – who invests in shares or share funds only – might get on average, again after taxes, fees and inflation adjustment.

Note that, because we've allowed for inflation, the savings totals are in today's dollars. For example, on a 5% return, in 30 years you'll be able to buy whatever $80,000 buys now.

Note, too, that the lines on the graph could be misleading.

Anyone who invests partly or fully in shares will receive quite widely fluctuating returns. In some years, they'll be negative; in others, they'll be way above average.

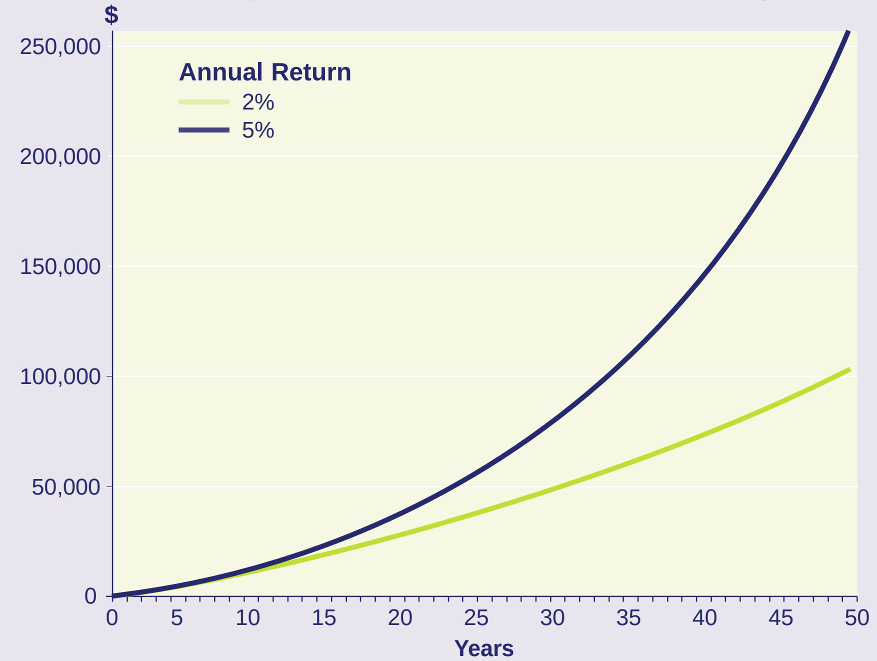
The 5% line, in particular, would in fact wobble quite a lot around the trend line. But over the long term it should grow pretty much as it does in the graph.

• Buying bargains

Most people who save by making regular contributions automatically buy lots of bargains.

This is because of "dollar cost averaging". It applies whenever you invest regularly in assets whose value fluctuates, such as shares and property.

How savings of $100 a month will grow



Can you save more?

If you can contribute $200 a month to your savings, multiply all the numbers in the graph by 2. For example, after 50 years at 5% you would have more than $500,000. If you save $500 a month, multiply by 5; if you save $1000 a month, multiply by 10.

The best way to show how it works is through our example, below, which could apply to shares or units in a unit trust.

In the example, the price is very volatile, ranging from $4 to $16. With less extreme price fluctuations, you would get smaller savings. But you would still end up paying less than the average price for the units you buy. Why? Because you buy more units when the price is low.

Top priority

When you're paying your bills, make the first payment to your savings.

I'm not suggesting you do this at the expense of your power bill. But, as long as you set your savings at a manageable level, you should be able to pay everyone else and yourself.

Better still, save by automatic payment, or have your employer withhold the money from your pay cheque.

The Magic of Dollar Cost Averaging

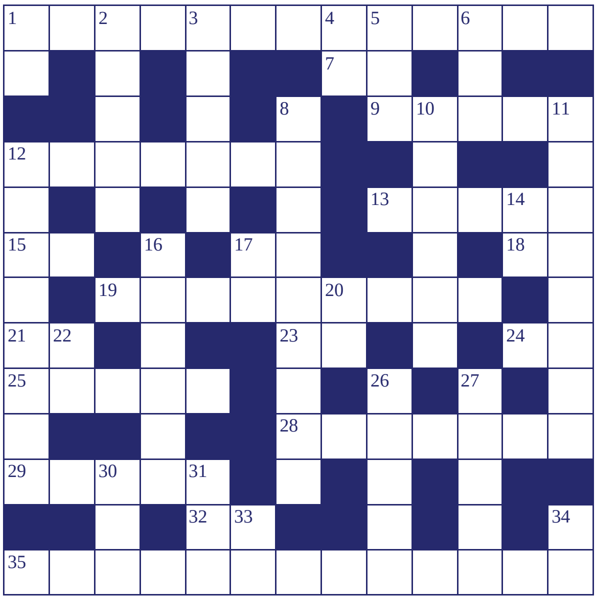
*Let's say you're **saving $120 a month** for a year.*
Price of units: $4 for 4 months, $10 for 4 months, $16 for 4 months.

Average price: $10

When units cost $4, you buy 30. Over 4 months, you get 120 units.
When units cost $10, you buy 12. Over 4 months, you get 48 units.
When units cost $16, you buy 7.5. Over 4 months, you get 30 units.

Total units bought: 198
***Total payments: $1440** (12 x $120)*
With an average price of $10, you'd expect to pay $1980 for 198 units.
You've saved $540, or 27%!

It takes 20 years to make an overnight success
Eddie Cantor



HOLM TRUTHS CROSSWORD Summer 2001

ACROSS

1. Housing (13)
7. Either (2)
9. Share plunge (5)
12. A good buy (7)
13. Sharp pain (5)
15. Property (abbrev). (2)
17. Letter in alphabet (2)
18. Exclamation (2)
19. Dollar cost _ _ _ _ _ _ _ _ _ (9)
21. Not off (2)
23. _ _ be, or not _ _ be (2)
24. Not 33 Down (abbrev.) (2)
25. Concern (5)
28. Forecast (7)
29. Sires (anagram) (5)
32. Exists (2)
35. Payments to fund (13)

Solution: Back page

DOWN

1. Morning (abbrev.) (2)
2. Graph (5)
3. Gold, steel etc. (5)
4. Carry out (2)
5. Curved line (3)
6. Irish rebels (abbrev.) (3)
8. Rising prices (9)
10. Credit assessment (6)
11. Volatile (4,4)
12. Opposite to lender (8)
14. Not yes (2)
16. Disinclined (6)
17. Our Queen (abbrev.) (2)
20. Move (2)
22. Same as 14 down (2)
26. Begin (5)
27. Case or folder (5)
30. Celestial body (3)
31. Knight (3)
33. NZ mainland (abbrev.) (2)
34. Big country (abbrev.) (2)

GREAT DEBATE • GREAT DEBATE • GREAT DEBATE

RENTING vs HOME OWNERSHIP

It's taken for granted by most New Zealanders: If you don't live in your own home, you're hoping to do so in the future.

But is home ownership always the right way to go? Should renters stay renters? Should – perish the thought! – home owners sell their homes and become tenants?

There are no indisputable answers to these questions.

Let's start by looking at Hannah Homeowner, who has bought a house with a substantial mortgage.

Her accommodation costs are mortgage interest, rates, house insurance and maintenance.

Note that we don't include repayments of mortgage principal in accommodation costs. These payments aren't really a cost. Hannah is increasing the equity in her house.

Nor do we include home improvements, as opposed to maintenance. Done properly they, too, should boost equity.

That means the money Hannah puts into principal repayments and improvements – along with her original house deposit – is an investment.

Meanwhile, Ronnie Renter, who is on much the same income as Hannah, is also investing.

A disciplined chap, he regularly saves what he would otherwise have put into a house deposit, principal repayments and improvements if he had bought a home. *(CONTINUED PAGE 4)*

RENTING PROS

- ✓ May get higher return on invested money
- ✓ Greater flexibility with savings
- ✓ Better savings diversification
- ✓ Less responsibility
- ✓ Can move easily and cheaply
- ✓ May be easier to live close to downtown
- ✓ No worries about maintenance

RENTING CONS

- ✗ Can be kicked out
- ✗ Not your choice of decoration etc.
- ✗ Need savings discipline
- ✗ Exposed to rent increases

HOME OWNERSHIP PROS

- ✓ Accumulate equity in house
- ✓ Retirement accommodation taken care of
- ✓ Easier to borrow for business etc.
- ✓ You decide when you'll leave
- ✓ Decorate and garden as you please
- ✓ Pride of ownership
- ✓ Security

HOME OWNERSHIP CONS

- ✗ Need good credit rating to get mortgage
- ✗ Home maintenance
- ✗ More difficult and expensive to move
- ✗ Inflexible savings

> ***I have laid aside business, and gone a-fishing***
> (The Compleat Angler), Izaak Walton, 1593-1683

(RENTING vs HOME OWNERSHIP, CONTINUED)

If his rent is lower than Hannah's accommodation costs – which is sometimes the case, depending on market conditions – he also saves the difference between his and her costs.

If his rent is higher than her costs, his savings are reduced by that difference.

These are long-term savings, and Ronnie can cope with market fluctuations, so he puts the money into shares or a share fund.

Who builds up the bigger retirement nest egg?

At first glance, it would seem to be Ronnie, for two reasons:

- The costs of getting into a share fund are lower than buying a house.
- Over the years his investment is likely to grow faster than house values.

Figures back this up. From 1970 to 2000, an investment in New Zealand shares grew almost twice as fast as in New Zealand housing. An investment in overseas shares grew more than three times as fast.

So far, though, we've ignored the fact that Hannah has a mortgage. This means her investment is geared, which ups the ante.

If house prices should fall, she could lose her deposit or worse. But if prices rise, her deposit may double, triple or even more over the years.

Given that the long-term house price trend is upwards, as long as Hannah stays in her house for quite a few years she is likely to do pretty well out of her investment.

(Note that Ronnie could also gear his investment, by borrowing to add to his savings.

(It's more difficult, though, to borrow to invest in shares. And most people find it more nerve-wracking. If Ronnie is a typical New Zealander, he won't gear.)

How, then, does Hannah's slower-growth but geared investment compare with Ronnie's higher-growth but non-geared investment?

That depends on many factors: the difference in accommodation costs, the size of Hannah's mortgage, the growth rate in house values, the growth rate in shares and so on.

If we plug in one set of reasonable numbers, Hannah wins. Change a few assumptions, and Ronnie wins.

There are other financial considerations, too. If Hannah wanted to raise a loan to develop a business, she could borrow against the equity in her house. Ronnie might not raise money as easily.

On the other hand, Ronnie could cash in his savings and invest directly in the business.

Also, Ronnie can more easily diversify his savings.

But often of greater importance are non-financial considerations, as listed in our pros and cons.

In some ways, tenants are freer – to move easily, and not worry about maintenance. In other ways, home owners are freer – to decorate, garden and make improvements as they please and to move only when it suits them.

For the younger, more transient person, the advantages of renting might dominate. For the family with children in school, that's less likely.

And as people get older, most find the security of mortgage-free home ownership outweighs other considerations.

For all that, though, New Zealand's high rate of home ownership has been falling for some years now. And it's not just the young who are spurning home ownership. Some retired people are moving to rental accommodation, freeing up the money that was tied up in a house.

It's not necessarily a bad move.

Holm Truths Crossword Solution

A	C	C	O	M	M	O	D	A	T	I	O	N
M		H		E			O	R		R		
		A		T		I		C	R	A	S	H
B	A	R	G	A	I	N			A			I
O		T		L		F		S	T	I	N	G
R	E		A		E	L			I		O	H
R		A	V	E	R	A	G	I	N	G		R
O	N		E			T	O		G		N	I
W	O	R	R	Y		I		S		F		S
E			S			O	U	T	L	O	O	K
R	I	S	E	S		N		A		L		
		U		I	S			R		I		U
C	O	N	T	R	I	B	U	T	I	O	N	S

Tips for Tenants

- *The landlord and tenant must both sign a written tenancy agreement before the start of the tenancy. Both should keep a copy.*
- *Landlords and tenants should together record the condition of the property on a property inspection report (attached to the tenancy agreement). This will prevent the landlord from later blaming you for damage caused by others.*
- *The landlord cannot ask for more than two weeks' rent in advance, or more than four weeks' rent as a bond.*
- *If all members of a flat sign a tenancy agreement, they will all have the legal rights and obligations of a tenant. That means any tenant is liable for rental arrears or repairs, even if another tenant causes them.*
- *The tenant must tell the landlord a soon as possible of any damage or if repairs are needed.*
- *The landlord cannot enter the premises without the tenant's consent or without giving notice. The landlord must give 48 hours notice of inspection, or 24 hours notice for repairs.*
- *If you have any problems regarding your tenancy, contact Tenancy Services, a division of the Ministry of Housing. They will provide information and advice and, if necessary, mediation.*

  For more information, see the Ministry of Housing website, www.minhousing.govt.nz. Click on "Enter Tenancy Services".

WRITER AND PUBLISHER

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