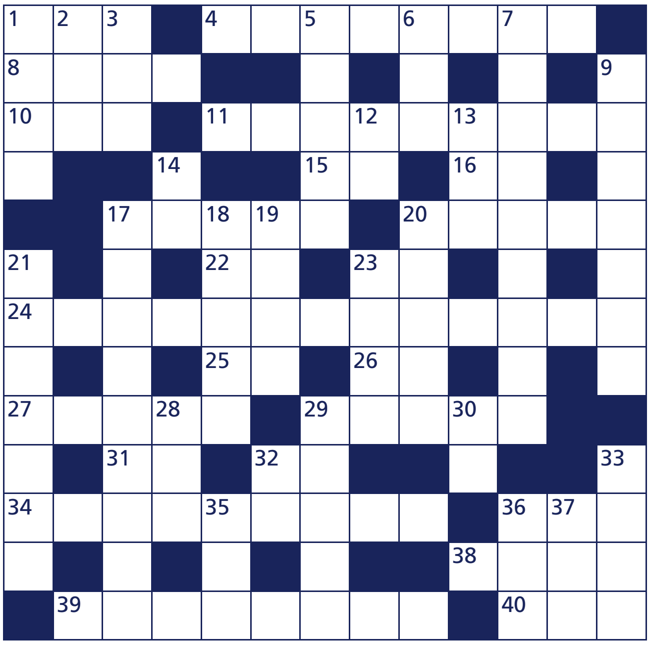
HOLM TRUTHS CROSSWORD

AUTUMN 2007



Solution: Back page

ACROSS

1. Ocean (3)
4. Coins and paper money (8)
8. Period of loan (4)
10. Deer (3)
11. I race nuns (anagram) (9)
15. _ . _ . Eliot (initials) (2)
16. Computer science (initials) (2)
17. Fund in card games (5)
20. Liquid food (5)
22. Not she (2)
23. Hello (2)
24. All of us (3, 10)
25. Not he or she (2)
26. Exercise at school (initials) (2)
27. One who does poorly (5)
29. Overcooked (5)
31. Yes (2)
32. Male title (abbreviation) (2)
34. To give variety (9)
36. Light brown (3)
38. To lease (4)
39. Real estate (8)
40. What 20 down did (3)

DOWN

1. Stalk (4)
2. Snakelike fish (3)
3. Noah's boat (3)
5. Corroded (5)
6. To make a mistake (3)
7. Huge land mass (9)
9. Least strong (7)
12. Country with biggest stock market (initials) (2)
13. What we breathe (3)
14. Yes in Spain (2)
17. NZ's new savings scheme (9)
18. Of them (5)
19. Nipple (4)
20. Restaurant customer (5)
21. Uncle Di (anagram) (7)
23. Maori subtribe (4)
28. What we see with (3)
29. Prickly bush (5)
30. Not yes (2)
32. Female title (2)
33. Up the _ _ _ _ (4)
35. Tear (3)
36. A hot 20 across (3)
37. Insect (3)

From the Mailbox

Dear Mary:

My wife and I are both 35 and we own our $440,000 home mortgage-free.

We will have only my income from July onwards as my wife is expecting our first child. When my wife stops working we will likely have about $50,000 cash in the bank and surplus cash flow of around $700 a month. We have no other superannuation or investments.

We have both been wondering whether we should be utilising the equity we have in the house to better effect. We have half considered rental property through a managed investment (we have no interest at this point in being "hands on" landlords), although have not fully investigated that.

Aside from borrowing against the house and investing in managed funds/shares (which doesn't really fit our combined risk profile) are there any other options?

Obviously we could forget about the equity in the house and make regular contributions into a managed fund for the meantime and re-assess things when my wife returns to work. However, that doesn't feel very productive given the equity we have.

Are we missing something?

- **A mortgage-free home gives security.**
- **If investing borrowed money, go with property or shares.**
- **Commit for at least 10 years.**
- **The extra gain might not be worth the extra hassle.**

Dear Reader:

Many people love the security of a mortgage-free home. About half of all New Zealand homes are owned mortgage-free. Whatever else happens in your life, you still have a base that nobody can take away, and "free" accommodation. That's particularly attractive if, for example, you want to go into business.

Note, though, that I put the word "free" in quotes. While you don't have to pay for housing, you do pay what's called an opportunity cost – the gain you could have made if you did something else with the money.

That's what seems to be bugging you two.

It's certainly true that at your ages, and with a $50,000 emergency fund in the bank, you could do something riskier with your home equity.

This is especially true if you are confident that the $700-a-month excess will continue. Is your job secure? Or, if not, are you sure you could get another job on similar pay?

Assuming the answer is yes – and taking on board that you don't like big risk – you might take out a $100,000 mortgage to invest. If you got a 30-year loan, fixed for five years at 8%, monthly payments would be $734 – almost all covered by your spare income.

Of course, the rate might rise after five years. But by then your income is likely to have risen. And, in any case, your investment may generate some net income.

What should you invest in?

It's probably got to be property, shares or a property or share fund. Those are the only investments likely to bring you a higher total return than the interest you would be paying. And if you don't get that, your investment will leave you worse off than if you had never made it.

Rule Number One about shares or

(CONTINUED PAGE 4)

"Money can't buy friends, but you can get a better class of enemy." Spike Milligan

> **“Sometimes your best investments are the ones you don’t make.”** Donald Trump

(FROM THE MAILBOX, CONTINUED)

property is that you should commit to investing for ten years or more, regardless of how badly the market performs in the meantime.

Over shorter periods there’s too big a chance your investment will be worth less when you sell. But over a decade or more it’s highly unlikely you will lose money and highly likely you will do well or very well.

I’m not clear what you mean by a managed rental investment. If you mean hiring somebody to manage a property for you, your returns will of course be reduced by management costs.

Note, too, that property carries more risks than are sometimes considered. See “Possible property pitfalls”.

Even if you can find a property where the rent covers all expenses, if any of the pitfalls happens that might no longer be the case.

If you mean a property fund that owns several commercial buildings, you’ll be less aware of the risks, but in fact they are similar – although you’ll reduce risk through diversification. Nevertheless, changing market conditions can affect many buildings at the same time.

All in all, property isn’t necessarily lower risk than a diversified low-fee share fund investment – it’s just different.

The share market tends to be more visibly volatile than the property market. But if you stick with it for ten years or more – and are never forced to sell at a particular time – that volatility shouldn’t matter much.

Having said that, one advantage of a share fund investment is liquidity. If something goes wrong and you can’t make ends meet, you can easily sell perhaps a small portion of your units.

Another advantage of a share fund is that you will be earning dividends. And they, unlike rent, won’t be swallowed up by expenses. It would be best to automatically reinvest the dividends. But if times got tough you could always take the money to spend.

It’s also far easier to diversify in a share fund, and that considerably reduces your risk. You can own shares in different-sized companies, different industries, even different countries.

Promoters of property investments often push what is called negative gearing. This means that you make a

loss on a property year by year – because the rent doesn’t cover the expenses – and you can deduct that loss from other income on your tax return.

But that’s hardly a good thing. Say you deduct $1,000. Depending on your tax bracket, that will cut your total tax by $390, $330 or $210, but you still suffer a loss of $610, $670 or $790.

If you deduct depreciation, that’s not a cash expense, so it can seem like “free money” at the time. But as long as you eventually sell the property at a gain, that depreciation will be clawed back on your tax return. There may still be some gain from this, but it’s not nearly as good as promoters make out.

In weighing up your options, keep in mind that while borrowing to invest can considerably boost your wealth, you benefit only to the extent that your total returns – including gains when you sell – exceed the mortgage interest you pay.

It wouldn’t be at all silly to decide, instead, to invest your spare monthly $700 in a managed fund – perhaps going with a fund that holds largely shares and property, to get higher average returns.

As you say, you could reassess your situation when your wife returns to work. At that point, you will probably be in a really strong position to take on more risk if you wish.

POSSIBLE PROPERTY PITFALLS

- *Falling property values*
- *Falling rents*
- *Periods without tenants*
- *Tenants who don’t pay*
- *Tenants who do damage*
- *Rising property rates*
- *Rising insurance costs*
- *Rising maintenance costs*
- *Unexpected maintenance eg: discovery of leaks.*

Holm Truths Crossword Solution

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

You’re welcome to send questions to From the Mailbox. Email them to mary@maryholm.com, or mail them to P.O. Box 8520, Symonds Street, Auckland 1150. Please include your phone number. Unfortunately, Mary can’t answer all questions in Holm Truths, and cannot correspond directly with readers.

HELPFUL WEBSITE

Mary Holm’s website www.maryholm.com has all sorts of useful information for Holm Truths readers.

- Read her latest NZ Herald column and her latest syndicated column (which runs in the Waikato Times, Dominion Post, Christchurch Press and other major newspapers).
- Try and buy! You can read the first and last chapters of her best-selling book “Get Rich Slow: How to grow your wealth the safe and savvy way”, and then use the simple click-through to buy it online.
- Subscribe to the website – for just $50 a year – and you can search through Mary’s many articles and newsletters for information on any financial topic.
- Learn about how Mary can run a seminar for you.

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