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Debt—the grease that oils the property wheel

Okay Mouseketeers, this book is talking about money and property, so I want you to start by having a quick look in that place where you stash your cash. So take a second to grab your wallet or purse.

How much is in there? Probably somewhere between \$0 and \$300. A quick survey of some Facebook friends suggests the average is probably \$50. (But a startling number of my mates had less than ten bucks!)

What will chump change of \$50 get you? It will fill roughly half of your car's petrol tank, which might get you 300 kilometres out of Dodge. It might get you a new tie, if it's on sale. It might also get you drunk (once). But it won't do much more than that. And it definitely won't do all three. Unless you drive a Vespa, buy your ties at an op shop and are a really cheap drunk.

Clearly, it won't buy you a house.

If you bought this book because you intend to buy property, and you are staring down \$50 in your wallet, then your best bet might be to play Monopoly—and fantasise about global domination and making millions.

Or you could track down 13000 of your closest mates, con them into giving you the \$50 in their wallets, and then you could purchase the

average Australian house. Got that many mates? You'd have to hold a house-warming with more beer than the fraternity in *National Lampoon's Animal House* to pay them all back.

True, our wallets aren't where we keep most of our cash these days. We're not yet the cashless society predicted a few decades ago, but most of our money sits in bank accounts, where it enters and departs largely electronically. Depressingly, many people have more money in their wallets than they do in their bank accounts.

Since you're reading this book, one thing is certain: you don't intend to let a little problem like a current lack of savings stop you from achieving the 'Great Australian Dream'. No chance.

So you want to buy a property. Is it a home or an investment property you've got your eye on?

Well, I hope this news isn't going to be too disappointing for you, but you can't buy property with cash. Not with your cash, anyway. Not what's in your wallet. Not what's in your bank account. Not even if you were to max out a cash withdrawal from your credit card.

Short of winning the lotto, or having a childless aunty die and leave you her millions, you will never have enough cash in your wallet, or the bank, to be able to buy a home or an investment property.

You can't save your way to a home

I've seen friends try to save their way to buying a home. Well, that's what they seemed to be doing. They saved and saved, for year after year. The more money they saved, the higher house prices went and the bigger the place they wanted as their first home.

They ended up with the biggest deposit I've ever personally known — about a quarter of a million dollars — which had taken them about ten years to save. But over that decade, what they wanted as a home had grown from around \$300 000 to about a million bucks.

Yep, had they bought the same home when they had a deposit of \$50 000 or \$100 000, they probably would have had a mortgage of \$270 000 (with a \$50 000 deposit), instead of about \$800 000 (with a \$250 000 deposit).

Simply, you can't save yourself all the way to owning a home. You want to buy property? You are going to need help. You're going to need other people's money. That, dear readers, is going to involve borrowing money.

And assistance on that front would be the point of this book.

Property and borrowing go hand in hand, even more so than love and marriage in Frank Sinatra's classic song of the same name (synonymous for a certain generation with Al and Peg Bundy in *Married... With Children*).

Property comes with debt. Lots of it. It's generally going to be multiples of the combined annual income of you and your partner. For property virgins, it's a total freak-out mountain of debt. Signing up for your first home loan is usually more gut-churning than walking down the aisle, anticipating your HSC results and watching an all-night marathon of Freddy Krueger movies.

Well, it tends to be that scary and come with that level of debt in the beginning at least.

Not helping those fears is the bad-arse reputation that debt comes with, at least part of which is not deserved. (A bit like Ozzy Osbourne. Yes, he bit the head off a bat at a concert in 1982. But no, he didn't realise it was a *real* bat—he thought it was made from rubber.)

If you think debt is a dirty four-letter word, then you need to stop, take a minute and make a decision. Debt is a tool. And unless you're going to save here in Australia and then go and buy in a third-world country, you and debt are going to have to get acquainted.

So, you either need to (a) get over it and accept that property and debt go together like Vegemite and toast, or (b) put down this book and continue renting forever.

The point of *Mortgages Made Easy* is not to try to convince you to take on debt—the reality is you have no choice if you want to own property. The point of this book is to show you how to best make mortgages work for you in your goal of wealth creation via property.

There is no such thing as 'the perfect mortgage'. Some mortgages will suit you. Others won't. The point about mortgage debt is to find a package

or solution that works well for you. To do that, you need to understand what mortgages are and how they can and can't be used to make your dream of property ownership and wealth creation a reality.

But before we go on, there is something critical that I need you to understand, which is so often misunderstood by people looking at property for the first time.

Homes versus investment properties

At its most basic, property ownership has two forms. There's owning a property for you to live in (a home). And then there's owning a property for someone else to live in (an investment property). They are both real estate. They can look exactly the same—even be next door to each other.

But they are very, very different. And never the twain *should* meet.

I go into more detail about this in chapter 2. But for now, understand that they are worlds apart. One you will live in; the other you won't. The base reason for buying them should be very different. They are total opposites when it comes to tax. The way you should view them as purchases is different. The way you should spend money on them is different.

We will make the distinction between *home* and *investment property* throughout *Mortgages Made Easy*, while *property* and *real estate* could mean either homes or investment properties.

So why did you pick up this book?

I'm assuming you want one of the two—either a home or an investment property. You might even be thinking ahead and wanting to buy both! Fantastic! I'm a card-carrying nut for property both as homes and investments—this is my sixth book that covers property in one dimension or another—so there will also be plenty of tips on purchasing property in this book.

But the main aim of this book is to explain how to make mortgages and banks work best for you in improving your future wealth through property.

I want you, through reading this book, to gain the confidence to take on debt on your terms and in a way that will help you own your home sooner, or build your wealth via your property portfolio faster. (Or, if you still need help, I will show you how professional mortgage brokers could assist.)

It is crucial to get the debt part of property right. If you do get it right, you can potentially own your home *years* sooner, or make your investment property work thousands of dollars a year better for you.

If you came looking to buy a home, great. Buying your own home is the cornerstone of wealth creation (and we go into more detail on this in chapter 5). People who buy their own home generally end up wealthier than those who rent their whole lives. Getting started might seem hard and the mortgage mountain might seem like a painful hill to climb. I get that. But, like everything in life, including your finances, it's a case of 'no pain, no gain'. There has to be some sacrifice.

If it's investment property you're after, then avoiding the mortgage pitfalls is critical to maximising your investment returns. Getting an investment property wrong can be financially disastrous. And with 15 years of being involved in, and writing about, the property market, I can help save you from some of the property disasters awaiting the unsuspecting.

What's your goal?

As a financial adviser, I see a lot of people who want to improve their finances, but don't necessarily know how to do it. As an author, I know that anyone who buys finance books wants to educate themselves to do the right thing for their finances.

But just thinking and reading won't get you anywhere. Nothing happens without action. If you're reading this book, you're 'in the market'. You just want to make sure you do it right.

You've got two choices. You either arm yourself with enough information to do it yourself. Or you hire good help.

But prior to any of that, you need a purpose. You need to set some goals.

Fear + greed = powerful motivators

The two best motivators in life are fear and greed.

Fear is the emotion that says: 'I don't want to live out my old and cranky years eating baked beans on the age pension.' Anything that drives you to strive for more is a healthy fear, isn't it?

But greed has a reputational issue. The Catholics insist it's one of the seven deadly sins; but Michael Douglas (playing Gordon Gekko in *Wall Street*) told us 'Greed... is good'. When it comes to my own finances, I'm on the side of making sure I can look after myself (and my clients should too). If you want something more out of life, then you'll need at least a hint of greed. Is greed really evil if you're simply trying to create a better life for your family?

Part of that 'better life' can come with property ownership—either via homes or investment properties. And if that's why you picked up this book, then you need to make yourself some promises.

Setting your targets

So, let's cut through the crud. I want you to be certain about why you're doing this.

Plans are worth nothing unless they're written down. So take a minute or two to put them down on paper, then pin them up somewhere you will regularly see them (such as above or beside your computer). Seeing them regularly makes for a powerful reminder every time you sit down to work.

Here are some suggestions:

- getting out of the rental rat race and into home ownership
- paying off my home in 15 years
- buying an investment property
- building a property portfolio that will allow me to retire sooner
- creating a rental income stream to eventually replace my own income

- buying a holiday home for my family
- planning for a wealthier retirement.

Only you can decide what goes on your list. It could be one of these goals, or a number of the ones on that list. Or a whole bunch that you've come up with yourself.

Then be more specific. By what date is your home going to be paid off? How many properties are going to be in your portfolio? At what age do you want to retire? How much passive income do you want from property?

Property has been a great wealth creator over hundreds of years, for millions of people. Those who make property fortunes have inevitably done so by getting the important things right, and avoiding the easy-to-make errors that stand in your way.

What does *getting it right* mean?

Some people will claim that *getting it right* when it comes to property and debt is simply about making sure you get the lowest interest rate.

Nope. Wrong. On so many levels.

Interest rates are one part of the equation. And overpaying a bank anything is wasteful. But to a degree, interest rates are negotiable. And, often, many lenders will match a rate for you.

Just as important is making sure that you have the right 'optional extras' on your property loan to suit your lifestyle and what you're trying to do. These are often the tools that may help you pay down your mortgage faster. Your choice of tools depends on you making some important decisions, such as whether you need offset or redraw accounts, whether interest-only is best for you, and whether you'd benefit from taking on professional packages, free credit cards and fixed versus variable loans. This is covered in great detail in chapters 4 and 8.

Just as importantly, you need to get the ownership structure right at the start. Getting this wrong could be devastatingly expensive. At its worst, poor ownership structure could lead to you losing not just your investment property, but also your family home. (Come home and explain that one to your partner!) We cover this in chapter 8.

Debt is a tool ... use it properly

Anyone who is about to pile into debt for property also needs to understand that debt has a dark side. It can be very Jekyll and Hyde.

Borrowing is also known as leverage. And financial ‘leverage’, as with machines, means that a small effort can have a much larger impact. A bicycle is a machine. It’s a lot faster to get around on a bike than it is to walk, for about the same effort.

Leverage is great when markets are going up; not so much when they are going down. And debt can quickly get very dangerous when things get downright ugly in the economy.

Property is a long-term investment. You need to be able to ride out the bumps. You can’t control the economy, which moves in cycles, but you need to be able to go the distance with a property investment.

And the biggest tools of all ...

Debt can be used in really stupid ways. And so many people get stuck in a rut with debt. Getting out of a bad-debt rut can be difficult, but until people learn to overcome the behaviours that are keeping them in their financial situation, getting ahead will be even harder.

An understanding of the different types of debt is critical to using debt correctly to build wealth. There are three types of debt—*dumb*, *okay* and *great*. And I go into detail on the types of debt in chapter 3.

But we do need to get one thing crystal clear. Right now.

If you have multiple credit cards that are never (or rarely) paid down to \$0, if you often buy furniture or electricals using interest-free periods (and don’t pay them off in time), if you paid half a year or more in salary for your current car, or avoid family and friends because of how much money you owe them, then you’re not using debt the right way. And wealth through property is going to be difficult until you can change those behaviours.

These are all examples of *dumb debt*, and they are consumer traps. The interest rates with these types of debt can be stratospheric. They indicate that you don’t understand the difference between *need* and *want*. They

suggest that you're living a lifestyle beyond your current income. You're not used to having to deny yourself anything.

If I've just described your current finances, then you might have some work to do on your budget and understanding of savings. (You will find some budgeting tools at www.brucebrammallfinancial.com.au.)

Delayed gratification—money's golden rule

Money has rules. And the truly wealthy understand those rules intimately. The most important money rule of all to understand is the concept of *delayed gratification*.

Delayed gratification is a concept that was tested by American scientist Walter Mischel in the 1960s and 1970s. The professor ran a test on a bunch of four-year-olds. He put them in a room with a marshmallow on the table. These kids were told that if, when an adult came back into the room, the marshmallow was still there, they could have two marshmallows. However, if they ate the one on the table, they wouldn't get a second.

Oh, the humanity! The cruelty to children! What an evil professor! They were just ... Generation X ... babies!

But it showed something really important. Most kids succumbed within minutes. Some just wolfed it down the second the door was closed. Others tried hard to stop themselves—they tried to fall asleep or turned their back on it. Others picked it up, licked it, then put it down again. But 90 per cent ate it.

About 10 per cent of the kids were able to delay their gratification and got two marshmallows. Smart kids. What's a five-minute wait to double the pleasure? Later, the researchers followed up with them. They found that those same kids were more financially successful. They were more likely to have completed university degrees, be wealthier and have more friends, and less likely to have tried drugs.

Delaying gratification is tremendously powerful. Those who can will achieve far greater financial success. It is, in fact, the key to success. If you don't spend that \$1 now, you can invest it for your financial future.

Why's that important here? Buying property—whether for a home or for investment—represents delayed gratification, financial strain now in the

hope of greater financial rewards later. It is almost certainly cheaper, up to the medium term, to rent a house rather than to have a mortgage on the same house. And much investment property is negatively geared for the first seven to ten or so years of ownership; that is, the owner has to subsidise the person renting the house.

You could spend that money instead. But by understanding the importance of delayed gratification, you can make real, positive changes to your financial future.

But let's move on to chapter 2 and look at why property can be a great asset for your financial future.

Property purchasing principles

All the people I have helped to buy homes or investment properties have either already had some clarity as to what they were looking to achieve, or they were very close. Some people just need to sit down with a financial professional to make sure their property goals are realistic and achievable in the medium to long term.

Property purchases are inevitably big financial decisions that require the right starting mindset. That mindset requires you to have a degree of hunger to improve your financial situation.

And just to ram it home ... here are the key points to take away from this chapter.

- Debt is necessary to buy or invest in property.
- Homes and investment properties are completely different beasts.
- You need to understand your goals before purchasing property.
- Fear and greed are essential factors in gaining a better life.
- The lowest interest rate is not the only factor in deciding which mortgage works for you.
- Dumb debt is disastrous for your future and needs to be addressed before investing in property.
- Delayed gratification is key to financial success.