Te Tohu Whakahaere Pūtea
Certificate in Money Management

Wāhanga Tuatoru:
Ngā Whakatupuranga Hanganga
Module 3: Property Investment

Whakamātautau Tuarua:
Te Whakapūmautanga Whare
Assessment 2:
Home Ownership

Ngā Whakautu Hei Tauira
Model Answers

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Part One

Ngā Pātai (Questions)

Question 1

Based only on the information in the case study, would you recommend that Ana and Tipene:

a) Buy a home, or

b) Rent a house?

Give at **least three reasons** which support your answer. Each of these reasons must correctly reflect advantages of the option you selected.

In addition, reasons must be logical and relevant to Ana and Tipene's situation. That is, **they must correctly refer to information in the case study**.

Note that, it is possible to achieve this learning outcome regardless of which option you choose (i.e. you can select either option (a) or (b)). It is the reasons you give for your decision that are most important.

Tauira can identify either option (a) or (b). Rationale given may vary. Some example answers for each option are as follows:

Option (a): Buy / Build a Home

- ***They could get a flexible mortgage option that allows them to fulfil both aspirations of having children and owning a house.***
- ***Given that the market is currently experiencing a downturn, they may be able to get a house at a cheaper price.***
- ***If they wait until after they have finished having children, house prices may have substantially increased. If they buy a house now it may substantially increase in value when the market improves.***
- ***If necessary, they could rent their house out at times that Tipene is working in Australia (i.e. all live in Australia where Tipene can earn good money, and put tenants in their house in New Zealand).***

Option (b): Rent a House

- ***Tipene's earnings are not stable – it may be difficult to meet mortgage obligations when Ana is on maternity leave.***
- ***Neither of the couple is good at repairs and maintenance.***
- ***If they were to buy, the cheapest house that would meet all of their criteria would likely cost at least $330,000. This is quite high given they only have a $65,000 deposit. If they are required to have a deposit of 20%, the maximum they could pay for a house would be $325,000. It may therefore be more suitable to rent a house until they have a larger deposit and are therefore more likely to find the perfect house (and less likely to have to settle for buying a house that is not perfect).***
- ***Ana has knowledge of the financial markets and is working at a firm where she can glean investment advice from colleagues also. These experts consider that house prices may be low for several years, therefore maybe the couple should wait to see if house prices actually come down a little and, in the meantime, try saving a larger deposit.***

Question 2

Assume that Ana and Tipene find a house that they are interested in buying. However, they are told that a cross-lease applies to the land.

a) What is a 'cross-lease'?

A situation in which there are several dwellings on a piece of land and all of the owners own the land together. Each owner leases the land from the other owners for a small cost.

b) Give an example of a problem that Ana and Tipene could possibly face if they purchase this property.

Tauira responses may vary. The most common response would relate to a situation in which Ana and Tipene want to extend / alter their house or put a new building on the property, change fences, etc. They would need to get consent from the other party for this, and this party may not provide it.

Another problem may be that it is more difficult to sell. That is, people are less willing to buy a property for which a cross-lease applies.

Question 3

In the house-hunting process, Ana and Tipene unexpectedly come across a property which they think is a real bargain. It meets all of their criteria of what they want in a house and is less than $300,000. The vendor is keen to make a fast sale, but Ana and Tipene are not organised and not ready to make an unconditional offer.

If Ana and Tipene were to make an offer on the property, what are three relevant conditions that they could make their offer subject to? What does each of these conditions mean?

For example, Ana and Tipene could make their offer 'subject to a satisfactory engineer's report'. This provides them with the opportunity to check if there are structural or land issues. If there are, Ana and Tipene would not have to go ahead with the purchase.

Tauira responses may vary. Some examples include:

- ***Subject to finance that is satisfactory to you: This means that if you cannot arrange a loan for which you are happy with the terms, you do not have to buy it.***
- ***Subject to a valuation report: This provides for you to check the market value of the house.***
- ***Subject to a LIM report: This allows you to check what information the council has about the property to make sure there are no problems with matters such as consents or flooding. If there are, you don not have to buy.***
- ***Subject to the sale of another house: If, in order to buy the house, you need to first sell your existing house but cannot, then you do not have to buy the house.***
- ***Subject to a title search: This provides for your lawyer to check if there are any problems with the title (e.g. restrictions or covenants that you need to know about). If there are and you are not happy with these, you do not have to buy the house.***

Note: Although it is better to include the word 'satisfactory' in some of these conditions (e.g. Subject to a satisfactory LIM report) tauira do not have to do this to achieve this part of the assessment.

It would not be appropriate to include a clause which allows the buyer access to the property prior to settlement date for the purpose of showing potential tenants through the property (given that they would be living in the house themselves).

Question 4

Ana and Tipene also want to consider the option of building a house, instead of buying a house.

What are two advantages and two disadvantages, relevant to Ana and Tipene's situation, of building a house instead of buying a house? *Make sure that your responses refer to details in the case study*.

Tauira responses may vary. Some examples include:

Advantages:

- ***They are quite particular about the type of house they want. If they build, they can get exactly what they want.***
- ***Neither of them is good at home maintenance. If they build, it is more likely they won't need to make repairs for a number of years.***

Disadvantages:

- ***Given the housing market is not good, there could be problems securing some stages of finance. That is, they could commence building work and then, when it is time for the bank to release the next part of the loan, they would need to get a valuation. If, due to market conditions, the valuation turns out to be lower than expected, they may not be able to get the finance they need for the next stage of the building process.***
- ***If they need to move to Australia at times in order to get enough money to pay the mortgage, they may be less willing to rent out their own house that they have built, than they would be to rent out a house that had previously been lived in by others.***
- ***Building is often more expensive than buying.***
- ***They have been told that they are likely to need to spend $330,000 to get what they want, but if they are required to have a 20% deposit, it is likely that they will only be able to spend $325,000. This means they would likely have to settle for a house that does not quite meet their criteria.***

Part Two

Question 5

If Ana and Tipene decide to buy or build a house, they would like to consider getting a mortgage of up to $285,000. Given they have a $65,000 deposit, this means they would look at houses worth up to $350,000. If they did this:

a) What would Ana and Tipene's loan to value ratio (LVR) be?

LVR = $285,000 / $350,000 x 100
= 81.43%

b) What is one possible consequence of trying to get a mortgage with this LVR?

Example responses include:

- ***You may be required to get mortgage insurance (an additional cost)***
- ***Your lender may charge you a 'low equity premium'***
- ***Your application may be declined, particularly if you do not have a really good credit history and secure income***

c) Ana and Tipene have been told that it may be better to aim to have an LVR of 80%. If they were to do this, what is the maximum amount they could pay for a house (i.e. their deposit plus the mortgage)?

Hint: their deposit of $65,000 = 20% of the maximum house price.

If they only have a deposit of $65,000, then this amount would need to represent 20% of the final price. They could only borrow four times this amount (i.e. 80%), which is $260,000. The maximum amount they could therefore pay is $325,000 (= $65,000 + $260,000). Another way to calculate this is as follows:

- ***Final house price x 20% = $65,000***
- ***Final house price = $65,000 / 20%***
  = $325,000

Question 6

If Ana and Tipene buy a house, they would prefer to aim for a $260,000 mortgage. They seek advice on mortgage options. The first option they are given is a table mortgage.

When they use the mortgage calculator on the Sorted website, and assume an interest rate of 7.0% per annum over a 20 year period, they see that they would need to pay $2,015 per month to pay off a $260,000 mortgage.

a) How much would they need to pay towards the mortgage in total (in nominal terms) over the period of the mortgage?

   Note: since you are writing your answer in 'nominal terms', you do not need to do any extra calculations to account for inflation.

   Total amount to pay = $2,015 x 12 months x 20 years
   = $483,600

b) How much interest would they pay (in nominal terms) over the period of the mortgage?

   Remember: since you are writing your answer in 'nominal terms', you do not need to do any extra calculations to account for inflation.

   Interest = Total paid – mortgage
   = $483,600 - $260,000
   = $223,600

Question 7

Ana and Tipene are considering the option of having their first child as soon as possible. Their mortgage adviser suggests that, in this situation, they could consider getting an interest-only mortgage for a two year period. At the end of this time, they would change to having a table mortgage.

a) If the mortgage is $260,000 at an interest rate of 7.0% per annum, what would be Ana and Tipene's *weekly* payment for the first two years of the mortgage, assuming the interest *does not* compound?

Weekly Payment = 7% of $260,000 / 52 weeks
= 0.07 x $260,000 / 52
= $350.00

b) Identify one advantage to Ana and Tipene of having an interest-only mortgage for the first two years.

Tauira responses may vary. The most common answer is likely to be that the payments will be lower, so it is more likely that they could afford the mortgage on Tipene's wages alone while Ana is on maternity leave.

Question 8

Some friends of Tipene have a reducing mortgage and say that it is working out very well for them. Ana and Tipene therefore want to consider this type of mortgage.

a) What is one advantage to Ana and Tipene of choosing a reducing mortgage instead of choosing a table mortgage?

Tauira responses may vary. The most common answer is likely to be that, by the time they have their second and subsequent children, mortgage payments will be much lower and they may therefore be able to afford it better while Ana is on maternity leave.

b) What is one reason as to why a reducing mortgage may not be suitable for Ana and Tipene?

Tauira responses may vary. Two example responses are as follows:

- ***Provided all goes well with her employment, Ana's income is likely to rise over the upcoming few years. Therefore, she will be able to afford to pay more in several years' time than she can now. They may not be able to cover the higher payments now, but would be more likely to be able to in a few years time.***

- ***Another reason is that the couple want to have a child very soon. It may therefore be quite difficult for them to pay the higher mortgage payments associated with the early years of a reducing mortgage.***

Question 9

At their next appointment, the mortgage adviser tells Ana that many young couples, like her and Tipene, are choosing to have a revolving credit mortgage.

a) Identify two reasons as to why a revolving credit mortgage may be suitable for Ana and Tipene.

Tauira responses may vary. Two example responses are as follows:

- ***The couple has excellent budgeting skills.***
- ***They will be able to match their mortgage payments to their income. In years in which Ana is working, they can make larger payments than in years in which she is on leave.***

b) What is one possible disadvantage to Ana and Tipene of having a revolving credit mortgage?

Tauira responses may vary. An example response is that a variable interest rate will apply, which is likely to be higher (but not necessarily) than some fixed rates. They may also say that the variable interest rate is riskier than the fixed rate as it may suddenly increase by a substantial amount.

Question 10

Ana and Tipene meet with their mortgage adviser one more time before making a final decision as to what type of mortgage they would like to select. They have a list of questions for their adviser about mortgage options and the process involved in arranging a mortgage.

Answer their questions in the spaces provided.

a) "We are concerned about the amount of interest that we will end up paying on the mortgage. We are thinking about trying to reduce it by either:

- making weekly payments instead of monthly payments, or
- reducing the term from 20 years to 15 years.

Which of these two options would have the biggest impact on the amount of interest we pay?"

Reducing the term of the mortgage will have the biggest impact.

b) "We are not sure about which lender we would like to choose. We are thinking that we will use our current bank to start with. But if we later see there is a better deal offered elsewhere, we would switch lenders. What is a disadvantage of doing this?"

There may be high costs associated with changing lenders. Lenders frequently charge costs for paying off a mortgage early (i.e. if they are to get finance from another lender, they would need to get enough to pay the mortgage plus any early repayment fees).

c) "What are three documents / pieces of information that the lender will require from us?"

Tauira should identify three of the following:

- ***Proof of income***
- ***Up to date details of outstanding debts***
- ***A current budget***
- ***A copy of the Sale and Purchase Agreement***
- ***A registered valuer's report***
- ***Identification***
- ***A copy of the ratings valuation (RV)***

It is also acceptable to identify a Land Information Memorandum (LIM) although this is less likely to be required.

d) "We have been told that we need to allow for 'conveyancing fees'. Who are these paid to and what are they for?"

Conveyancing fees are paid to a lawyer. These are to cover the costs associated with transferring the ownership of the property.