Motor or home investment and the three little pigs **November 2014**

We all grew up with the story of the three little pigs teaching us that age old lesson of investing in quality brick and mortar. Not many versions of the story explore how life could've worked out for the pigs had the wolf not vandalised their property; or if there were other asset classes that could've grabbed the attention (and resources) of the pigs.

A modern day South African adaption of the tale will probably involve three bright young students writing a smartphone app in their final year that earns them R3 million profit after tax. Let's say these three students - Mr Khaya, Plain Jane and Sir Carr - graduated near the end of 2009, and each of them took their share of the profit to buy a house and a car.

Mr Khaya, being a firm believer in the wealth and profit potential of property investments, decides to set aside a large portion of his budget (R900k) to buy a house and the remaining R100k for a car. Plain Jane is tired of being so plain and decides to splurge a bit on a R400k car, but still keep a larger proportion of her budget (R600k) for a house. Sir Carr can't resist that exotic car and ends up spending R750k on it, leaving him with only R250k for his house.

Because there was, and still is, tiered tax and fees structures when buying a property, Mr Khaya and Plain Jane are worse off than Sir Carr immediately after buying these assets. They are OK with this as conventional wisdom tells them that property will generally appreciate over time, while vehicles will depreciate. They therefore expect to recover these costs in the appreciating asset over time.

In order to analyse the magnitude of this effect, Lightstone tracked what would've happened to our three friends over the past five years, and the results highlight some interesting anomalies.

As we have had relatively strong positive house price growth during the last five years in South Africa, we'd expect Mr Khaya to be significantly better off than Plain Jane, and Sir Carr to be significantly worse off than Plain Jane.

What we found was that although Plain Jane and Sir Carr will both lose wealth over the period, in reality, Sir Carr's decision would've not been that much more costly than Plain Jane's.

	Mr Khaya	**Plain Jane**	**Sir Carr**
Property budget	900 000	600 000	250 000
Transfer fees and estimated other costs*	*63 900*	*36 900*	*75 00*
Property value bought	**836 100**	**563 100**	**242 500**
Vehicle budget	100 000	400 000	750 000
Registration fees	2 000	2 000	2 000
Vehicle Value	**98 000**	**398 000**	**748 000**
Total asset value January 2010	**934 100**	**961 100**	**990 500**
Total asset value November 2014	**1 090 165**	**946 099**	**915 027**

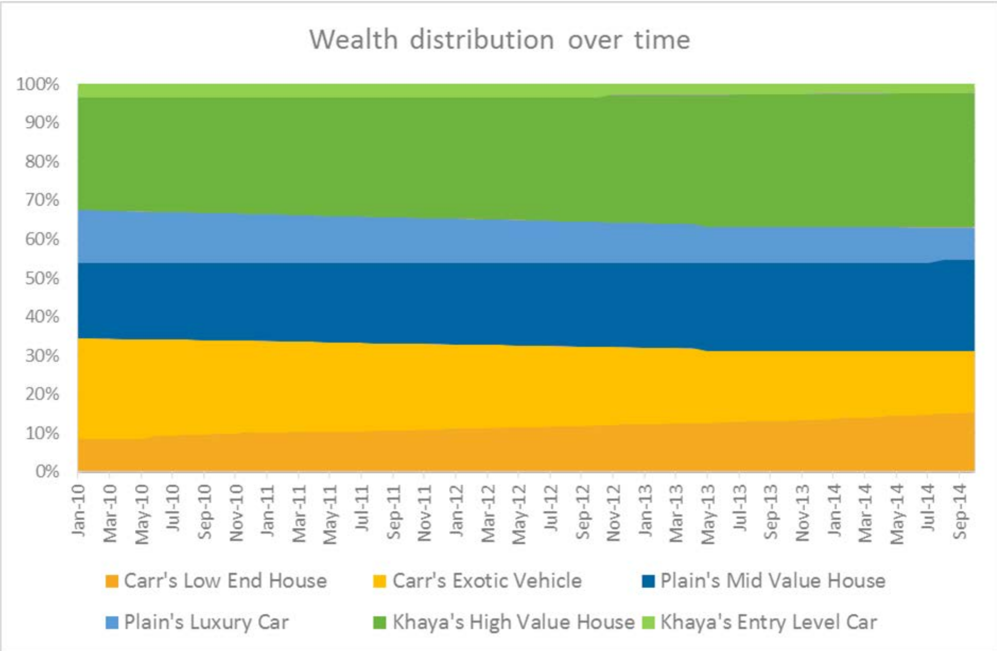
**Estimated using Jan 2005 tax structure + 1% fees*

How's this possible?
The two market anomalies mainly responsible for this effect were:

- Higher than average growth in the low end housing market.
- Exotic cars in the R750k range proportionally not depreciating significantly faster than other luxury vehicles in the 400k range.

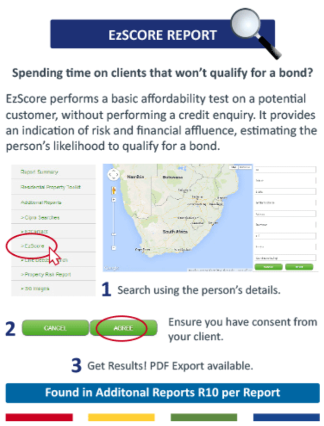
These factors, in combination with the additional fees and transfer duty that Plain Jane had to pay, resulted in the difference in wealth of Sir Carr and Plain Jane being much smaller five years later than what we expected. At the other end of the scale, sanity prevailed and Mr Khaya remained better off and saw more value in his decision than both of the other two owing to the very large proportion of his asset base being an appreciating property.

When looking at the movement in proportion of overall wealth of the three friends, it's easy to spot the eroding effect of depreciating vehicles, but we also see the strengthening effect of the appreciation in home values offsetting it.



While this study is quite theoretical and does not address things like insurance premiums, fuel costs, and living quality of these youngsters, it does show that a robust property market can offset some of the losses that are incurred with depreciating cars, particularly if there is a large portion of wealth in a high growing market segment. While the appreciation effect of the low value property was impressive for Sir Carr and left him close to Plain Jane in terms of investment value after five years, the fact that the property made up a very low portion of his initial investment portfolio, meant it could not fully beat the eroding effect of the exotic vehicle. Plain Jane and Mr Khaya's properties were in average growing market segments, but the fact that they had larger proportions invested here meant that the offsetting effect still managed to offset some or all of the eroding effect of depreciation on their cars.

When it comes down to it and you have the choice to invest a lump sum in a property or a motor vehicle, and you are looking for a solid investment that will show the best return over a few years, given the current market growth, your investment will most likely be better off in a property.



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