

Property Investment



Workbook 2



Taxation



Yield



Ownership



Strategy

The Taxation System

Negative Gearing

Gearing means borrowing to invest and **negative** means the investment is producing a negative result.

So you borrow money to invest to get a negative return – WHY?

You do this because...

- » You think that the investment will increase in value (capital growth)
- » Your borrowing costs are tax deductible

For property investors, by far the largest expense is interest on the loan that was drawn down to buy the property. Other expenses include body corporate fees, council rates, cleaning, property management fees, repairs and other maintenance costs, etc.

Conversely, your rental income is classified as taxable income.

Importantly the tax loss might be further amplified by depreciation and capital works deductions, which are not cash outgoings but were part of the purchase price and are also tax deductible.

What makes negative gearing particularly tax attractive is that the net loss can be offset against other income that would otherwise be included in your assessable income.

Resident Tax Rates 2019-2020

June 27, 2019

Taxable Income	Tax on this Income
\$18,201 – \$37,000	19c for each \$1 over \$18,200
\$37,001 – \$90,000	\$3,572 plus 32.5c for each \$1 over \$37,000
\$90,001 – \$180,000	\$20,797 plus 37c for each \$1 over \$90,000
\$180,001 and over	\$54,097 plus 45c for each \$1 over \$180,000

Therefore, if a dollar of income would otherwise be taxed at 45.0%, every dollar of negative gearing loss which offsets that income will save you 45% cents!

The Taxation System continued...

Meanwhile, if the investment property goes up in value (and you do not sell the property), no CGT will be payable. Even if you do sell the property after 12 months, the capital gain will be discounted by 50%.

The bulk of property investors that use negative gearing to buy properties are earning \$80k p.a. or less.



Negative Gearing by Tax Bracket

Tax Bracket	Number of Non-Negatively Geared Individuals	Number of Negatively Geared Individuals
<\$20,000	2,889,400	204,940
\$20,000-\$37,000	2,577,050	179,195
\$37,000-\$80,000	4,253,035	499,005
\$80,000-\$180,000	1,525,815	313,950
>\$180,000	223,900	69,615

My Notes

The Taxation System continued...

Gearing – let's look at some examples...

Assumptions

- » Taxable income of \$90,000 p.a.
- » No deposit, using existing home equity
- » Loan rate 4.9% – ownership with primary taxpayer
- » Building depreciation @ 2.5%
- » PAYG variation for cash flow



Brisbane – Townhouse
3 Bedrooms, 2.5 Bathrooms, 1 Garage

Price	\$345,000
Weekly Rent	\$340
After Tax Cost	\$62pw



Brisbane – Waterfront home
4 Bedrooms, 2 Bathrooms, 2 Garages

Price	\$650,000
Weekly Rent	\$675
After Tax Cost	\$52pw



Why is this so?

It does seem a little upside down doesn't it?

\$345k townhouse for \$62pw after tax

and

\$650k executive home for \$52pw after tax

\$300k more borrowings = \$10pw LESS

Financial Modelling


We have a unique software package that will produce cash flow modelling examples to assist you with your planning – example below...

Asian Pacific Forest Lake

19-Aug-2019

Prepared for: Cash Flow Example
 Consultant: Hugh Ochremienko
 Property: Middleton Park Estate - Logan Reserve
 Description: 4/2/2

SUMMARY

	Assumptions		Projected results over 10 yrs	
	Property value	\$489,000	Property value	\$723,839
	Investment	\$0	Equity	\$218,790
	Gross yield	4.95%	After-tax return /yr	46.20%
	Net yield	3.47%	Net present value	\$155,543
	Growth rate	4.00%	IF SOLD	
	Inflation rate	3.00%	Selling costs & CGT	\$78,791
	Interest rate	4.90%	Equity	\$139,999
	Taxable income	\$75,000	After-tax return /yr	38.57%

PROJECTIONS

Investment Analysis		Projections over 10 years					
End of year	2019	1yr	2yr	3yr	5yr	10yr	
Property value	\$489,000	508,560	528,902	550,058	594,943	723,839	
Purchase costs	\$10,046						
Investments	\$0						
Loan amount	\$505,049	505,049	505,049	505,049	505,049	505,049	
Equity	\$-16,049	3,511	23,853	45,009	89,894	218,790	
Capital growth rate	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	
Inflation rate (CPI)	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	
Gross rent /week	\$475	24,206	24,932	25,680	27,244	31,583	
Cash deductions							
Interest (I/O)	4.90%	24,747	24,747	24,747	24,747	24,747	
Rental expenses	29.24%	7,222	7,439	7,662	8,128	9,423	
Pre-tax cash flow	\$0	-7,763	-7,254	-6,729	-5,632	-2,587	
Non-cash deductions							
Deprec.of building	2.50%	6,113	6,113	6,113	6,113	6,113	
Deprec.of fittings	\$0	0	0	0	0	0	
Loan costs	\$6,003	1,201	1,201	1,201	1,201		
Total deductions		39,283	39,499	39,722	40,189	40,283	
Tax credit (single)	\$75,000	5,303	5,086	4,862	4,466	3,473	
After-tax cash flow	\$0	-2,460	-2,168	-1,867	-1,166	886	
Rate of return (IRR)	46.20%	Your income /(cost) per week					
Pre-tax equivalent	70.53%	(47)	(42)	(36)	(22)	17	

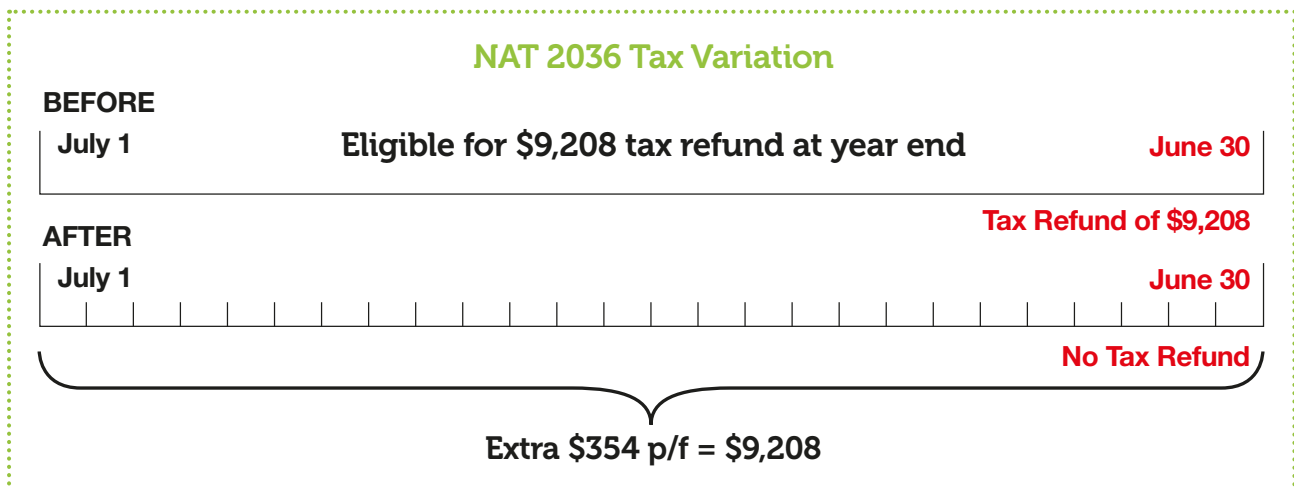
Disclaimer: Note that the projections listed above simply illustrate the outcome calculated from the input values and the assumptions contained in the model. Hence the figures can be varied as required and are in no way intended to be a guarantee of future performance. Although the information is provided in good faith, it is also given on the basis that no person using the information, in whole or in part, shall have any claim against Asian Pacific Forest Lake, its servants, employees or consultants.

Tax Variation

Ownership of an investment property (if correctly structured) can be a very effective way to minimize personal tax liabilities.

Most employees pay tax under the PAYG system (Pay as You Go). As you earn your income, you pay tax. This is deducted from your wage.

If you are “negatively geared” into an investment and entitled to a refund at the end of the tax year you can actually apply to the ATO to vary the amount of tax that you pay at each pay period so that you receive this “refund” during the course of the year.



This will have an immediate impact on your cash flow and provide extra funds to pay the outgoings for your investment property.

My Notes

Frequently Asked Questions

How is my loan structured?

The loan amount will need to be for the full house and land package price. The land needs to be settled before construction can commence so it is important that your finance is structured in a manner that allows this.

The construction funding is paid in six tranches as the build progresses. Due dates are itemized for the Lender in the building contract. When the house is for investment purposes the client should request that the *interest on the loan be capitalized and paid at settlement instead of being paid by instalments*.

Are there separate contracts for the house and land?

All house and land packages are structured in two contracts. One for the land and the other for the house build. As you would expect both need to be secured. This is usually done by signing an Expression of Interest and paying a small deposit which is held in trust until settlement. Most clients prefer us to manage the contract process for them and deal with the owner of the land on their behalf.

Our builders use a standard Master Builders Queensland Level 2 Residential Building Contract which most legal practitioners are familiar with.

What does Full Turn Key mean?

All of our House and Land Packages are Full Turn Key which means that everything is ready for you (or the tenant) to move straight in once the keys are handed over. This is perfect for new home owners and investors alike. The home is complete including all flooring, window coverings, security/fly screens, clothes line, driveway, turf and even the letter box. A full list of inclusions will be provided.

How long does it take to build the home?

Work starts once your finance has been approved and the deposit (5%) has been paid to the builder by your Lender. The building certification process then begins and takes around four weeks. During this time we arrange for soil tests, engineering reports and a host of other regulatory issues including compliance with current energy usage legislation. We would expect to be working on site within 4 weeks of receiving Building Approval.

The actual contracted build time is 20 weeks for a low set home and 28 weeks for a high set.

Can I put your home on my own block of land?

Yes you can... you can source your own block or choose one from the land that is available through our real estate agents / developer network. There are many to choose from throughout the greater Brisbane area. If you have a preference for a particular suburb or estate please let us assist you to source and negotiate a block that meets your needs.

House & Land Packages make great investments

When people are considering an investment property they look towards existing homes or apartments, but the benefits associated with a new house and land packages should not be overlooked.

Let's understand why house and land packages make great investments...

1 Stamp duty savings

The big saving for house and land packages is the stamp duty on the purchase. On a package of around \$450,000, you will save about \$8,000 in stamp duty. This is because when you are building a new house you are only paying stamp duty on the value of the land component not the house and land components, as the home hasn't been built yet.

2 Choose your block and design

You get to choose the most suitable block and customise the house design to make it highly attractive to tenants as well as suiting your investment budget and goals.

3 Brand new homes attract better tenants

As a landlord you want to attract high quality long-term tenants to your property. New homes have the advantage of being incredibly attractive to tenants with modern conveniences and offer a place that tenants will love and want to stay in for many years. New homes also have the benefit of being able to charge premium rent so you will gain higher returns for your investment.



House & Land Packages continued...

4 Depreciation and tax benefits

Having a brand new home means you can claim on depreciation more so than you would be able to in an established home. A plant and equipment allowance covers fixtures and fittings, appliances, carpets and blinds. The idea here is that as your house ages, the equipment inside will lose value as the condition gradually worsens. If you receive rental income from your property, then you can claim the depreciation as a tax deduction. In order to meet the requirements of the Australian Tax Office, you'll need a depreciation report from a quantity surveyor.

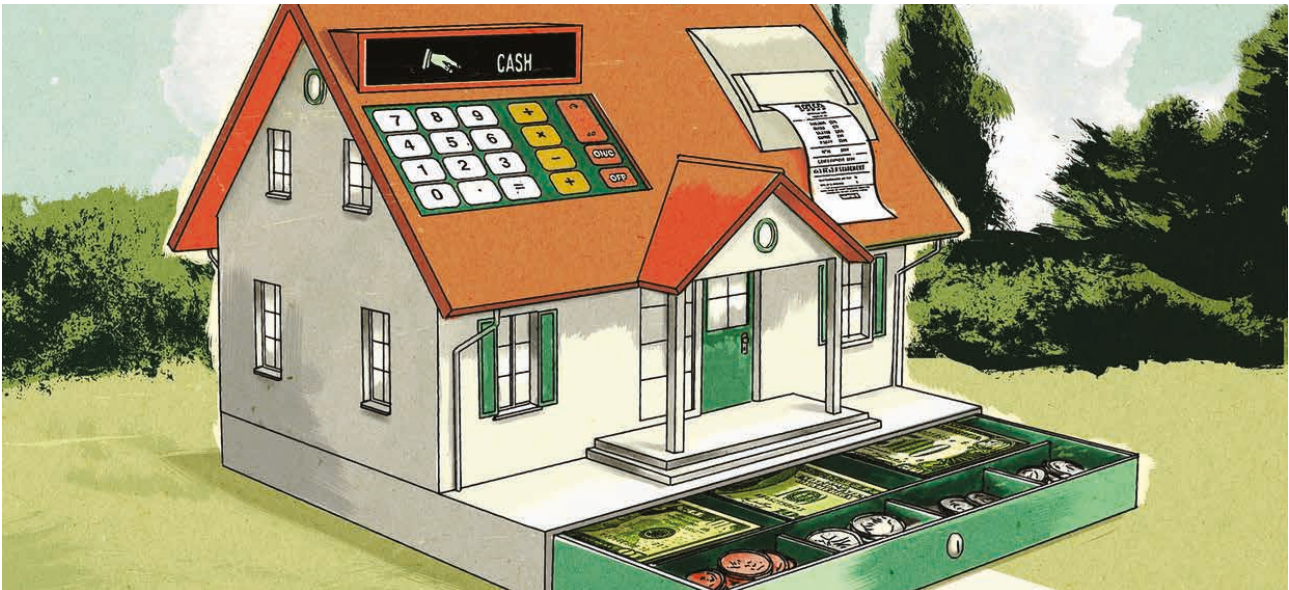
5 No maintenance

Finally, they have little or very low maintenance. Often the building, fixings and fittings will be covered by a builder's guarantee, which can often last 5 years here in Queensland. This is quite significant when you consider that one of the main costs of an investment property is the maintenance and upkeep. A new home will have lower costs and retain its value for longer.

In addition our reputable builders are using higher quality materials and better construction techniques than ever before meaning homes are well built and incredibly efficient to maintain.



Understanding Equity



- » An Equity Access Loan is a revolving line of credit secured against your property.
- » Use your equity to renovate or invest. Once approved, your line of credit is ready to use when you need it including for unexpected expenses.
- » You only pay interest on what you've used of your available credit.
- » You can draw on your credit up to your approved limit. Make payments and redraw again, whenever you need.
- » You can also choose to make as many repayments as you want. Or you can choose to pay interest-only repayments or take full advantage of the revolving loan and let the interest add to your balance – as long as your balance doesn't exceed your approved limit.

$$\begin{array}{ccccc} \text{HOUSE WITH UPWARD ARROW AND DOLLAR SIGN} & - & \text{MORTGAGE DOCUMENT WITH DOLLAR SIGN} & = & \text{HOUSE WITH DOWNWARD ARROW AND DOLLAR SIGN} \\ \text{VALUE OF YOUR HOME} & \text{minus} & \text{AMOUNT OWED ON YOUR MORTGAGE} & \text{equals} & \text{YOUR HOME EQUITY} \end{array}$$

Understanding equity continued...

Work out your home equity using this formula...

$$\text{Property's market value} - \text{Remaining loan balance} = \text{Home equity}$$

For example, if your home is worth \$700,000 and there is \$300,000 remaining on your home loan, you have home equity worth \$400,000.

However, bear in mind that not all of this will be accessible, with lenders only allowing you to borrow 80% of the property's value without being charged for Lender's Mortgage Insurance (LMI). In other words, to avoid paying LMI, keep your Loan to Valuation Ratio (LVR) below 80%. In this given example, that means:

$$\begin{aligned} 80\% \text{ of the property's market value} &= \$560,000 \text{ (this is the maximum you can borrow without incurring LMI)} \\ \text{Remaining balance on loan} &= \$300,000 \text{ (this is the amount you have already borrowed)} \end{aligned}$$

$$\$560,000 - \$300,000 = \$260,000$$

So in this example, the amount of equity you can access without incurring LMI would be \$260,000.

One of the great things about investing in property is that you can use the equity from existing properties to purchase new properties and grow your portfolio. If we want to use equity to purchase an investment property then we need to understand exactly what we mean by 'equity'.

My Notes

Increasing your returns from your property investment (Yield)

9 Factors Affecting Cashflow...

INCREASE these factors:

- ⬆ Rent
- ⬆ Tax Return
- ⬆ Depreciation

DECREASE these factors:

- ⬇ Loan Repayments
- ⬇ Body Corporate Fees
- ⬇ Rental Management Fees*
- ⬇ Council Rates
- ⬇ Insurances*
- ⬇ Maintenance

Rental yield is the measure of how much income your property produces each year as a percentage of that property's value.

How to work out rental yield %

 \div  $\times 100$

ANNUAL RENTAL INCOME divided by VALUE OF THE PROPERTY multiplied by 100

My Notes

\$25 week more income for Landlords

A typical roof could produce an extra \$25 per week of income with SunYield®.

SunYield® Solar Power System...

- » **ALWAYS ON:** You can have an income all year, even if the property isn't tenanted. Solar power system for new tenants and owners.
- » **FLEXIBLE AND TRANSFERABLE:** SunYield® can easily be adjusted to suit new owners and tenants. Discounted electricity for tenants.
- » **EASIER TO RENT:** Tenants get discounted power reducing their power costs by \$275/year. Homes offering cheap power could be easier to rent. Solar power battery.
- » **BATTERY READY:** Add a battery to store excess solar generated, allowing increased profit potential.

Investment Property Tenants...

- » **HAPPIER TENANTS:** Once a tenant becomes accustomed to discounted electricity they may be less likely to want to move.
- » Tenants moving into Queensland's newest rental homes can expect to save around \$275 a year on electricity.

SunYield® allows both the landlord and the tenant to benefit from solar on new build and existing rental properties. Investors can use the SunYield® solar power system to sell solar power produced on the roof back to the tenants that occupy the investment property.



Ownership Structures

» Individual / Joint / Tenants in Common

» Trusts

» Companies

Each of these structures has a differing effect on personal tax, CGT and asset protection.

Individual Ownership

- » Owned and controlled entirely by one person.
- » Any net income/loss assessed at the owner's marginal tax rate.
- » A CGT concession of 50% of the capital gain applies on disposal.
- » Assets are fair game for litigation.
- » Property forms part of the individual's estate on death.

Note:

1. A large taxable capital gain may push an investor into a higher tax bracket.
 2. The investor could plan to dispose of the property at a time when he/she can manage to reduce the marginal rate of tax say, just after retirement.
 3. The adjusted capital gain will now be taxed at a lower rate hence reducing the tax liability.
-

Joint Ownership

- » Two or more individuals own equal shares.
- » All income/losses distributed to the owners in accordance with their holding.
- » Each other's assets are still at risk.
- » On disposal, CGT is attributed proportionately.
- » If one owner dies, their share is distributed equally to the other owners.
- » For CGT purposes, surviving owners deemed to acquire their portion at the date of death.

Ownership structures continued...

Tenants in Common

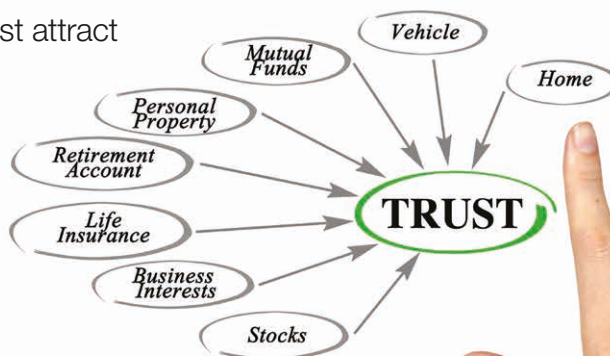
- » Two or more individuals own predetermined portions of the asset.
- » All income/losses distributed to the owners in accordance with their holding.
- » Personal assets are still at risk.
- » On disposal, CGT is attributed proportionately.

Note:

- 1) Individuals have the ability to sell their interest to others.
- 2) If one owner dies, their share passes to their estate.
- 3) For CGT purposes, the estate is deemed to acquire that portion at the date of death

Trusts... what are they?

- » A trust is a legal entity created to hold assets on behalf of beneficiaries.
- » It has its own set of rules called a Trust Deed and is controlled by a trustee/s.
- » Trustee/s may be two or more individuals or a corporation (company trustee) controlled by one or more directors.
- » There are different types of trusts...
- » Trusts cannot distribute losses to beneficiaries. The loss is carried forward and offset against future income.
- » The CGT concession applies to gains distributed to individuals.
- » Assets are quarantined and protected from any litigation against the trustee or beneficiaries.
- » Any funds remaining in the trust attract tax at the top marginal rate



Ownership structures continued...

Family Discretionary Trusts:

- Used mainly for Tax and Asset protection.
- Trustee holds assets and conducts business on behalf of the trust.
- May have any number and class of beneficiary.
- Beneficiaries have no claim over the assets in the trust.
- The trustee controls the regular distribution of income generated in the trust and eventual distribution of assets.
- The distribution may vary from year to year as the trustee decides.
- Trust distributions are taxable in the hands of the beneficiary.

Fixed Unit Trusts:

- Same principle as a discretionary trust however the beneficiaries hold a fixed number of units each.
- Distributions are in accordance with the number and class of units held and cannot be altered from year to year.
- Suitable structure for unrelated parties.
- On disposal, asset gains are also distributed according to shareholding.
- Units may be sold. This may activate a CGT event with possible stamp duty liability.

Hybrid Trusts:

- A combination of a Discretionary Trust and a Unit Trust.
- Gives the trustee/s the ultimate flexibility in distributions.
- Although beneficiaries hold units, the trustee can vary the income distribution year by year.
- Can overcome some of the capital gains distribution problems.

Companies

- » One or more Directors.
- » Can pay franked dividends.
- » No distribution flexibility.
- » Company owns property in its own right.
- » No CGT relief available.
- » Complex estate planning issues.
- » Not a desirable form of property ownership.

My Notes

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