Negative gearing's nip, tuck

Scalpel-like tweaks rather than chainsaw massacre

Nick Bruining

With nearly two million property investors in Australia, and more than half of those using negative gearing arrangements, there's no surprise that this month's Federal Budget nip and tuck on allowable deductions has a few investors worried. Under the changes announced on May 9, residential investors will lose the ability to claim travel expenses and to double dip on depreciation.

The travel expense change was pitched to taxpayers on the basis it would shut down arrangements where the annual inspection of the Gold Coast apartment magically morphed into an extended holiday.

While that crackdown will have most taxpayers' heads nodding in agreement, people with kosher travel expenses will pay the price.

People who travel across town to collect rent or load up the trailer with garden rubbish won't be able to claim those travel expenses.

The double dip change relates to depreciating capital items a second time, when a property changes hands. Let's say you put in a new dishwasher and claim depreciation on the unit. When it comes time to sell, the new owner can engage a quantity surveyor who'll value the same dishwasher and, in effect, that will allow the new owner to claim depreciation a second time round on the same asset.

RSM Australia's tax partner Con Paoliello says that while there's little that can be done about the ban on travel expenses, investors should keep accurate records of depreciation charges applied to plant and equipment. "If the property is sold and you have those records, the proposed law may state that the new owner may be able to use the written down value of the previous owner and continue depreciating the asset," he says.

Damian Collins, managing director of Momentum Wealth, thinks the added costs to investors, while not catastrophic, aren't inconsiderable. "We estimate the change will probably cost the average investor up to $2000 a year," he said, adding that rises in interest rates would probably have a greater effect on the long-term viability of some negative gearing arrangements.

Others are arguing that the effects of the changed taxation treatment could see the extra landlord expense passed on to tenants and rents increase. But valuer Gavin Hegney says that the current state of Perth's property market should protect tenants in the short to medium term.

"While rents are a function of specific tenant demand versus local supply from investors, overall rents are dropping in Perth because of the very high vacancy rates of about 6.5 percent," he says.

"Pressure on rental increases probably won't come into play unless those vacancy rates get down to around 3 per cent."

And while Treasurer Scott Morrison is keen to distinguish the changes as scalpel-like rather than "taking a chainsaw to negative gearing", it does highlight vulnerabilities of investment strategies which are dependent on legislation to survive. As superannuation law demonstrates time and time again, governments of both persuasion have no hesitation in tweaking things here and there when it suits.

And every now and again, the chainsaw is bound to appear.

DEBTMAN'S TAKE

Plenty will have their opinion on where the market is heading. But how you react depends on your personal situation:

- If you're a first-homebuyer who has felt trapped out of the market, understand this important principle: "Buy when you can afford to buy." And given that prices are considerably, relatively, cheaper than three to four years ago, stop moaning and buy.
- Capital gain should not be your primary motivation as a first-homebuyer. In the future, you will buy and sell in the same market as you trade up.
- If you're an investor, it's a different story. This is about making money. If you believe there is more pain to come, wait. If you're happy not to be paying the crazy prices of a few years ago, then perhaps now is your time.

For investors, I'm sitting on the fence. You make the call.
— Bruce Brammall

Go for selected buys in the right areas

FROM P1

Rents were pushed up by a vacancy rate of 2 per cent in the boom, the published data says it's now 6.5 per cent but industry insiders have suggested it may be closer to 10 per cent.

That makes it very tough for investors who rely on rent to service their mortgages.

So how does that affect house prices?

It's all about basic supply and demand economics. When there's a shortage of supply and plenty of demand, prices go up. When there's a shortage of buyers and ample supply, prices fall.

We've already explained the sinking demand side of the equation and, unless there's some reasonable drivers to fuel our economy and attract people back to WA, it may take a while for that side of the equation to pick up.

On the supply side?

Let's remember that there's a lag in getting new places built. From subdividing the land to getting the keys to your new home, it represents a timeline of at least a year. Delayed supply, fuelled by the optimism of the past few years is still feeding into the market as new homes are completed. This particularly applies in the apartment market.

And finally, there are a few external factors. Property buyers in the main need money to fund the acquisition. The tightening supply of money (caused by the regulator's intervention in trying to slow the Eastern States property bubble) means that demand side is further restricted.

Real estate agents will tell you that one of the biggest issues at the moment is property buyers who can't raise the finance.

So the question remains, where would this Amorphophallus titanium want to put down it's roots as an investor with an eye on the future?

Well, stay clear of any new development, apartment or off-the-plan project. One suspects the aches in those sectors are not over yet.

For an established home in an area with a community, shops, transport and services — be prepared to watch and wait.

Get yourself into the best possible position with finance. Get the deposit up and for first-homebuyers establish a clear savings history to demonstrate you can handle the responsibility of repaying a mortgage.

The good news is, you probably have plenty of time to buy. It's happened before. Perth houses stayed pretty much flat for most of the 90s and long enough to see the corpse flower bloom again.

Straight talk from one of the nation's top financial analysts and humbug detectors

DEBTMAN

with Bruce Brammall

On the property merry-go-round

"There's a fine line between pleasure and pain." I'm tipping there are a few people surveying Perth's property market feeling that at the moment.

Is it in the bargain basement? Or somewhere else?

There is nothing pretty, or promising, about property prices in Perth. But real estate is just so damn sexy an asset class that people will never switch off.

It's like a train crash.

Why? Because we have all seen dreams come true via property. We've seen many of average means make money from property.

Given the pull-back, is now the time to buy? That will depend on what sort of buyer you are.

There are only two sorts of residential property buyers — home owners and investors.

They are opposites. They buy for opposite reasons. Their motivations are opposite. Their tax positions are opposite. They usually don't even want to buy the same sort of property — though I would argue this is wrong and property developers are usually to blame.

Homebuyers should buy for emotional reasons. They want property close to family, friends, a lifestyle, their work, the kids' schools. They are buying somewhere to live to make them feel happy.

In reality, a homebuyer doesn't need property prices to rise. Though it would be nice if their home simply kept pace with the same relative value as similar properties.

However, you buy an investment property for one reason, and one reason only. To make money.

Not making money from an investment property is death. Property investors need property prices to rise over time. Because otherwise they would be better with their money in other asset classes.

So, is this now a market for first-homebuyers, or investors?

Let me tell you what usually happens in a property market cycle. And what has certainly happened on the east coast during recent decades.

When prices were falling, earlier this decade, first-homebuyers didn't want to know about property. When the property market started its upswing, FHBs held back. The statistics showed that the early property push in this cycle was driven by investors, while first-homebuyers were staying away.

I don't know why. I'm equally astounded every time it happens. But, during every property cycle, it's the same story.

Prices peak. Homebuyers scream about being locked out of the market. Prices start falling. No-one wants to buy. Prices eventually bottom. Investors step in. First-homebuyers stand back. Prices rise a bit. First-home buyers continue to sit on the sidelines. FHBs eventually step in, as investors start to pull back. Prices scream ever forward. FHBs moan about unaffordability (while continuing to buy), then property prices peak . . .

And the cycle starts again.

So let's keep it fairly simple.

If you are a first-homebuyer and you've been watching the property market for a while now, here are some facts. Property prices are now about 7.5 cheaper than the top of the market in late 2013 (according to REIWA's stats). If you add in the impact of inflation over 3.5 years, prices are more like 13-15 per cent lower than you would have been paying 3-4 years ago.

Yes. Really.

At a 15 per cent discount.

Have we hit a bottom?

Probably not. Vacancy rates for Perth are now above 6 per cent. That's very high and suggests considerable oversupply. Median rents are still falling like an eagle kicked too early out of its nest, which suggests the same thing. And my opinion? This ain't over yet, baby . . .

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There's major new superannuation rules to take note of as July 1 approaches rapidly

DIY SUPER

Monica Rule

With so many superannuation changes happening from July 1, 2017, you could be forgiven for not understanding all aspects of the new laws. I've heard many people say why couldn't the Government just keep things simple?

One new law affects the amount that you can contribute into your super fund. Up until July 1, 2007, the amount of post-tax contributions, known as non-concessional contributions, that you were able to make was unlimited.

Then a $150,000 annual cap applied from July 1, 2007 to June 30, 2014. The cap was then increased to $180,000 a year from July 1, 2014.

The annual cap will decrease to $100,000 a year from July 1.

The cap does not restrict you from putting more money into super if you want to. It just limits the amount that will be exempt from tax on the way into the fund. Anything in excess of the limit will attract tax at a rate of 49 per cent on the way in.

If it was just the $180,000 cap being changed to $100,000, all this would be relatively easy to understand.

I'VE HEARD MANY PEOPLE SAY, 'WHY COULDN'T THE GOVERNMENT JUST KEEP THINGS SIMPLE?'

However, the Government changed the law so that there are other criteria that need to be satisfied before you can make contributions into your superannuation fund.

Then on top of that, they also put eligibility thresholds as to how much you can contribute. So from July 1, 2017, you have to check two things.

First, you must check whether you can make non-concessional contributions into your super fund. Secondly, you must check how much you can contribute.

You need to make sure your total superannuation balance is below $1.6 million to be able to make non-concessional contributions into your super fund. Then the amount that you can contribute is based on the following thresholds:

- If your super balance is less than $1.4 million, then you can contribute up to $300,000 in non-concessional contributions.
- If your super balance is between $1.4 million and $1.5 million, then you can contribute up to $200,000 in non-concessional contributions.
- If your super balance is between $1.5 million and $1.6 million, then you can contribute up to $100,000 in non-concessional contributions.
- If your super balance is $1.6 million or more, you cannot make any non-concessional contributions.

You will only be eligible to make more than the $100,000 non-concessional contributions if you are under the age of 65 at any time in the year of the contributions and you have not fully used your bring-forward cap in the past two financial years.

If you are already aged 65 or over on July 1, then you are limited to making just the $100,000 annual limit provided your super balance is less than $1.6 million.

What many superannuation members may not realise is that if your super balance is $1,599,999, it does not mean you can only contribute $1. You can actually contribute up to $100,000 because you are still considered to be below the threshold.

The $1.6 million total super balance is tested each financial year. This means, even if you qualify for the two year bring forward limit, it does not guarantee that you will be able to contribute up to $300,000 over three consecutive years.

For example, let's assume at June 30, 2017, your super balance is $1,399,999. Then in the 2017/2018 financial year you contributed $150,000 in non-concessional contributions and triggered the two year bring forward cap of $300,000.

Then at June 30, 2018, due to good investment performance, your super balance increased to $1,600,000.

Although you have only used half of your $300,000 bring forward cap, you will not be able to make any further non-concessional contributions in the 2018/2019 financial year.

If the good investment performance continues, and your super balance stays above $1.6 million in the following year, it means you will lose the balance of your unused bring forward cap.

There's a lot to remember so having a good adviser is the key.

Monica Rule is an SMSF Specialist and author of The Self Managed Super Handbook - Superannuation Law for SMSFs in plain English
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