MORTGAGE NEWS

catalyst finance solutions

Winter 2005 Edition 2

Welcome to the Winter Edition of our Catalyst Newsletter. In this edition we have included two articles from Directors; Jason Cheetham and Matt Rigby regarding Selling or Accumulating properties and also Quantity Surveyors and how they can save you thousands.

PROFIT or ACCUMULATE?

I often get asked the question ***"Should I take the profits and sell my investment property, investing the money elsewhere?"***.

Well this is a very good question and the answer can differ depending on your particular circumstances, most importantly it relates to your cash flow.

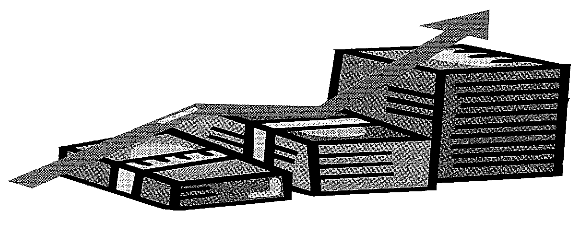
Over the last few years many of our clients have gained from the benefits of a strong real estate market and then asked me whether they should sell or retain these properties to "harness" the growth. I am no expert but I have several clients who I think are well qualified in this regard. The bottom line is if your cash flow allows you to retain the investment property or properties then there is no real reason to sell it.

Let me give you my personal circumstances as an example. Having lived in Mandurah for a couple of years during the 90's the real estate market there was very slow, partly due to high unemployment in the area and a lot of old properties weren't connected to the sewer line. As well there was more supply than demand with new subdivisions popping up everywhere with less buyers than sellers.

During this time I purchased 3 rental properties very cheaply with a rental return of around 7%, which is good by today's standards. One of them I kept for 8 years, selling it for $2,000 less than I paid for it (I wanted to sell because we were moving back to Perth and the tenants it was attracting were no good – an older fibro home on a big block). Now before I got the offer from someone to buy it, it was on the market for probably 2 years. Two offers were received within a week and one was from a real estate agent – I should have withdrawn it from the market at that point.

Anyhow that property has since trebled in value and someone else has reaped the rewards. Now I think to myself, if it was returning 7% per annum, then as long as it wasn't causing me personal distress I should have kept it because it was paying for itself (with an interest only variable loan) in terms of rent received and mortgage payments.

Over the next 12 to 18 months the market in Mandurah climbed steadily to a point that an agent called me to see if I was prepared to sell one of my other rentals because he could get me a good price for it. I ummed and ahhed before saying well if you can find me a bit more than the figure you mentioned then yes they can have it. Also a very silly thing to do – obviously demand was increasing so I should have kept it. Although it was sold for a good profit it has probably doubled in value since then (over the past 3 years).



INVESTORS NOTE: *How a Quantity Surveyors Report Could Save You Thousands in Tax!*

In this article we hope to show you a little known way of **saving thousands of dollars** off your tax bill by using a professional called a Quantity Surveyor.

The Quantity Surveyor, although capable of enhancing your ability to capitalize on the wealth created by your investment property, is a relative unknown compared to those more recognized professions such as your real estate agent, property manager, or most importantly, your mortgage broker!

The Quantity Surveyor estimates and monitors construction costs from a feasibility stage, through to the completion of construction. After construction, they may prepare depreciation schedules, which is where they become most prevalent to us…..the investor.

As the astute investor knows, there are legal tax deductions (depreciation) to be claimed from the wear and tear of not only the building itself, but the fixtures and fittings that are in a rental property. For example, carpets, window treatments, air conditioning unit and light fittings.

The Quantity Surveyor can be used to review and inspect your existing rental property and prepare a report that estimates the allowable depreciation that can be claimed for tax purposes. The fact is, that most investors have no idea that such reports exist, and are therefore missing out on thousands of dollars worth of **claimable deductions**.

The other tax deduction that may be claimed by property investors are the write-downs related to capital works associated with the construction or improvement of income producing buildings. For example, if you were to build a brand new rental property, the cost of construction could be written off at 2.5% per annum for 40 years.

Because depreciation and capital works are non-cash items, it means that a tax deduction can be claimed without any outlay of money. This is what makes negative gearing all the more attractive.

In simple terms, the Quantity Surveyor can inspect a property you have purchased or built and prepare a report outlining the amounts available to claim as depreciation and capital works income tax deductions.

As a general rule, the newer the property, the more deductions for depreciation and capital works that will be available. However, don't rule out the possibility of tax savings just because your property isn't brand new.

Please feel free to call us here at Catalyst for the number of our associate Quantity Surveyor, Trevor Phillips to find out if it is worthwhile having a report done on your investment property.

Matt Rigby

RIDDLE

Three people check into a hotel. They pay $30 to the manager and go to their room. The manager finds out that the room rate is $25 and gives $5 to the bellboy to return. On the way to the room the bellboy reasons that $5 would be difficult to share among three people so he pockets $2 and gives $1 to each person.

Now each person paid $10 and got back $1. So they paid $9 each, totalling $27. The bellboy has $2, totalling $29. Where is the remaining dollar?

Email the answer to cassie@catalystfinance.com.au for a chance to win a beautiful bottle of 2001 Penfolds Bin 407 Cabernet Sauvignon.

If any of your details have changed please call, email or even drop in, we are situated next door to the Ascot Quay Apartments and 150 East.

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Now I know that Mandurah has boomed probably more than most Perth suburbs but the same reasoning applies. If you purchased a property for say $100,000 and it was returning $125 per week then that is a 6.5% rental return – hard to find these days because rents have not increased in proportion with property prices. At 7% interest it is more or less paying for itself (after tax deductibility is taken into account).

If in today's market this property is worth $180,000 and is returning $140 per week then you may well think "let's sell" and move on to something else or reduce debt on your own home loan. But hey it was paying for itself when it was returning you $125 per week so now it is cash flow positive – so you have an appreciating asset that is paying for itself. If your cash flow allows it, then why sell?

Better to use the equity from the property value growth to invest in something else.

However some reasoning that is often used with share market investments sometimes holds true also for property. Stockbrokers recommend that if you have a bad stock that has not performed to expectations then dump it in favour of something else that shows a greater possibility for growth.

All Perth suburbs have reaped the benefits of a booming property market and in the future there are always going to be some suburbs that outperform others and there are obvious reasons for this: location and infrastructure spending are two of many. So if you did sell a standard suburban residential investment property and bought in a better location then perhaps there is an argument for selling but I think this would be the only case.

It is incredible how much banks are prepared to lend consumers these days and this is all due to deregulation and a competitive lending environment. Banks will factor in cash flow savings from negative gearing when taking into account how much you can borrow. In fact most people are speechless when I work out their borrowing capacity, especially if they have been out of the borrowing market for a few years.

The smartest investors I know buy and never sell and they always buy for capital growth rather than for rental return. Naturally rental values increase over time whilst the price you pay for a property remains a constant so one day it should nearly pay for itself on a rental return basis.

Just remember it is the land component of any property that appreciates and the building value depreciates; therefore strata titled properties should not have the same level of growth as green title or normal title properties.

SO do your numbers carefully or ask us to do the numbers for you – accumulate now and the future can be so much more rewarding.

Remember the aim is to have only good debt (ie tax deductible) and no bad debt (non tax deductible such as the loan for your place of residence). By minimising your repayments on tax deductible debt you (1) Free up more cash to effectively reduce non tax deductible debt and (2) Maximise your tax deductible debt by not reducing it.

Once you have freed yourself of bad debt then naturally you can then begin to reduce good debt or you may choose to use your increased equity to buy something else.

Invest happily!

Jason Cheetham

A WINTER RECIPE EVERYONE WILL ENJOY

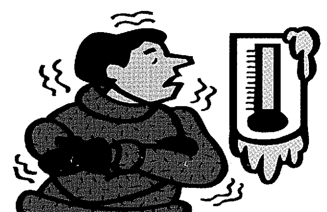
Matt's Mum's Osso Bucco

Ingredients:
1.5kg Osso Bucco (veal from the butcher)
1 cup plain flour
2 tbsp vegetable oil
2 medium onions, sliced
4 garlic gloves, crushed
2 cans (425g) crushed tomatoes
½ cup dry white wine
1 cup beef stock
1 bay leaf
1 tbsp chopped fresh thyme
1 tbsp chopped fresh oregano
2 tbsp chopped fresh parsley

Method:
1. *Toss the veal in flour. Shake away excess flour.*
2. *Heat oil in pan, add veal in batches, cook until browned all over. Drain on absorbent paper.*
3. *Add onions and garlic to pan, cook, stirring until onions are soft.*
4. *Return veal to pan, add undrained crushed tomatoes, wine, stock, bay leaf, thyme and oregano.*
5. *Simmer, covered for 1½ hours, stirring occasionally.*
6. *Remove cover, simmer about 1 hour or until veal is very tender.*
7. *Discard bay leaf.*
8. *Sprinkle Osso Bucco with parsley, serve with rice or mashed potatoes.*

WINTER TIPS

Winter has definitely arrived so I've created a list of helpful tips that you may want to go through for a safer warmer, winter.



- Service your gas or electric heaters.
- Cars should also be serviced, especially tyres.
- Seal external doors, unused chimneys and windows to prevent draughts.
- Cook with plenty of garlic to avoid those nasty colds and flu's.
- Keep pets up off the cold floor to avoid painful arthritis.
- It's also time to prune those roses.

NETWORKING GROUP

Quite frequently we are asked the question *"do you have the name of a quality Builder"* or *"could you refer me an expert Financial Planner"*. So we thought we would construct a Networking Group which can be made available to you.

Should you wish to get in touch with any of the below industries please do not hesitate to call Cassie and she will be only to happy to put you in contact.

Accountant, Book-keeper, Business Broker, Residential Builder, Financial Planners, Home Improvement Company, Insurance Brokers, Property Developers, Real Estate Agents, Settlement Agents and Solicitors.