28th Feb 2011

**Welcome to 2011 Opportunities**

Investors,

2010 year started with a massive property surge in most areas, certainly in most of Melbourne.

After successive interest rate rises the market cooled to more normal levels by mid year and probably stayed at that level for the remainder of the year.

Some states move in different cycles depending on demand and supply, macro economic factors and interest rates as well as supply of new properties as can be seen from various data provided by property reporting organisations.

2011 may be a very different year with some property experts saying we should get good investor opportunities in the areas where location matters, limited supply and increasing demand. However the **lending landscape** has changed where the strategies of the past decade may no longer be applicable to what we now need to do in the future. The introduction of the National Consumer Credit Protection Act (NCCP) and as typically the case, perhaps broadly written legislation designed for one thing to get a very different animal at the end. Some lenders are taking the view that responsible lending includes making sure that borrowers can now repay any home loans by retirement age.

For instance, St George now requires a separate review for any borrowers over 55 years or will be over 75 by the term expiry date (read 45 years for a 30 year term loan). See below for an extract of an e-mail sent to brokers:

Please provide comments with the loan application as to how the applicant will service the debt post retirement age (e.g. through Superannuation, or other investment income), and also to how the debt will be retired without selling the applicants owner occupied property.

It will be more difficult to use a **revalue and refinance strategy** that so many investors previously relied upon as we approach our mid life years. That means we need to review our finance strategy to make sure we can achieve our goals. It will also mean we need to reconsider the type of purchase and to make sure that we are on the path to achieving our goals, rather than get distracted from the main game.

For many, **the end goal** is about having a **disposable net income on retirement** (whenever that is). Once we have decided what our net income needs to be, we then work backwards to decide what net investment assets we need to have to produce that income. Obviously we can add in the strategy of reducing assets over time as well, making sure we have a healthy safety net in case we live to 120 years and still want to party hard!

Net investment asset means the market value of the investment assets you hold less the associated debt. As we move through our life/work cycle, it is appropriate to build the asset base first and take on debt to do so (unless we are lucky enough to win Tattslotto) and continue to do so while we can continue to service the debt levels of the often negative gearing associated with inner suburb residential properties through our working life. However at a point in time, we need to start reducing the debt levels as well. We start in the most tax effective way by reducing non deductible debt first (own home loan, credit cards, personal loans etc in order of the highest interest rate debt first) then look at reducing deductible debt when it is time to do so. After all wealth is assets less liabilities.

The old mantra of **never, never sell will only work** **if** the investment properties (IP) purchased are or are becoming positively geared, otherwise you need to fund the cash shortfall. The debt recycling strategy we use assists with cash flow management and is an effective method in reducing non deductible debt at the cost of increasing deductible debt but may not in itself be sufficient to obtain your end cash flow goals for retirement. Many investors need to give serious thought to the type of IP’s they are holding and consider whether there is a more effective mix of their IP’s they own. If you own an IP that is just too draining on cash flow and unlikely to reach reasonably rent yields in the foreseeable future, it may be better to sell this, take the opportunity to reduce debt and free up some equity to purchase a better performing IP.

If you are not achieving at least 4% rent yield on current market value, irrespective of capital growth, then it is an IP that you need to consider offloading. You may very well take a hit on capital gains tax (CGT) but an asset held > 12 months, the CGT is discounted by 50% before it is added onto your other taxable income.

*Using an example, a property purchase in 2002 for $240k, sold in 2010 for $450k. CGT is calculated on net sales price less the cost base, in this case roughly $440k - $260k = $180k \* 50% = $90k that is now added to the normal PAYG (or self employed) income for the year. At a marginal tax rate of 30%, the actual income tax payable becomes $27k (using a marginal tax rate of 37% = $33k). If you borrowed using an interest only loan back in 2002 even at 90% or more, from the net $440k sale, you pay back $220k to the bank, set aside perhaps $40k for additional tax and you now have $180k you can use to reduce non deductible debt or other debt or use to invest in more appropriate IP’s. The $30 to $40k in additional income tax you pay is only a small factor in the overall picture, effectively representing 2 years interest payments*.

If you have an $800k IP and getting a 2.5% rent yield, it may make sense to sell, reduce your debt and then purchase 1 or 2 median priced IP’s at far better rent yields. Capital growth is important but unless you can extract equity from the IP, the negative cash flow may limit your ability to achieve your goals.

If you would like to review your options or even discuss the possibility of selling and ways to minimise CGT or delay having to pay this by timing the sale, please give me a call.

**Purchasing Opportunities**

Within your goals, you may incorporate other strategies to reduce debt including buying an investment property which increases value in the short term and sell to make a profit and generate cash to reduce debt. This could include the type of opportunities that buying within a group could achieve.

1. I have previously sent around newsletters from Advantage Property Group who but a small block of units for investors, strata title them, do external renovations etc and for some investors, they take the opportunity to sell after 12 months and realise a healthy gain. I have attached their last e-mail opportunity.
2. Investors Direct (a company run by Bill Zheng) has refocused their own business where they now are arranging for clients to purchase land and then build and sell (or hold). They are focused on the 20km+ areas west and north of Melbourne, building 4 bed, 2 bath, double garage, single level houses. They say they have negotiated with developers and a few builders to achieve volume discounts in addition to stamp duty savings and due to the nature of staged land releases, they claim profits are made within 6 to 18 months in a relatively risk free environment. These are median priced homes where affordability is not so much an issue. Even if it is as low as $20k cash after tax, that could be a reasonable method to achieve additional cash flow in a short period.
3. Occasionally opportunities are shown to me that I will pass onto clients, one such is from a property manager that I use. I have attached it for anyone interested in a unit in Hawthorn. I have attached the e-mail I received from Hayley. You may be in a position to purchase this at a price below market but do your own research.
4. Another method of investing is being an investor at the ground floor of a development project. One came across my desk a week or so ago that I have included the details of as well. This is to provide part of the finance for a development in return for an appropriate risk interest rate. By all means do your own research to see if this would suit your own goals and cash flow position.

**Our Service to You**

We provide a specialised service for investors wanting to create long term wealth for themselves and their families. We are finance strategists, credit advisers and mortgage brokers, helping you achieve your goals. Give us a call when you think its time to consider your options.

As well as providing a service to investors, we will assist you in purchasing as an owner-occupier, or upgrading to a new property, or simply looking at better pricing or structuring options for your current loans and banking or assisting seniors looking at possible reverse mortgage options.

Our business is built on referrals provided by clients, so please don’t keep us a secret, feel free to forward this e-mail to family and friends interested in their own financial future. Give us a call and book an appointment to see if it makes sense for you.

If you have any questions about any of these topics, give me a call.

***Helping People through Finance***