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Helping People through Finance

The Strategy – Reasons Why **July 2010**

Client – Joe and Mabel Surname

Background

Joe and Mabel own their own home (PPOR) in New Zealand. Joe works as a Ships Master and is paid in Australian Dollars and is an Australian resident for tax purposes. Based on accounting advice, they want to start a property portfolio in Australia to create long term wealth so they can afford a comfortable retirement in the next 12 to 15 years. They are comfortable residing in New Zealand and will continue to do so for some years.

Joe is a Ships Master for Overseas Shipping Company and been with them nearly 2 years. Mabel is an ESOL Teacher and has been in the role for 14 years.

They are expected to have clean credit files. The PPOR is owned outright with no debt. They do have approximately $130k savings in a Cash Management account and a further $29k in a Term Deposit to use as the base funding for this investment property (IP) purchase.

The End Goal

The long term goal is to own 5 to 6 IP's in the next 10 years to put themselves into a position to afford a comfortable retirement lifestyle. As New Zealand does not have compulsory superannuation, they only have a small amount to date funded by Joes current employment in Australia. His company pays 14% and he salary sacrifices another 5%.

Servicing

Their serviceability or Maximum Borrowing Limits show a range of $796k to $1.05m based on their Joe's sole incomes for the first IP.

Issues

With the intention to build a portfolio as quickly and safely as possible, the issue will be to minimise the Funds to Complete the first IP using their own Cash savings while still allowing them a health safety net. It is also to allow them to purchase the next IP as soon as it is comfortable to do so, so we will look to use a LVR of around 87% to 89% for each purchase. Joe's income can easily show servicing for loans to be able to purchase an IP at the median price range.

With the work Joe does, his income is around $150k per annum including interest, even though he does salary sacrifice some money into superannuation. His PAYG amount for 2010 is $44k per his last payslip.

While Mabel is paid on a part time basis, she is effectively working full time. The intention is that she can retire from work in the next few years. Joe intends to work for another 12 to 15 years if needed.

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Strategy
The first step will be to obtain a pre-approval and then purchase an off the plan (OTP) property in Melbourne in the short term. A 10% deposit will be required but as it is an OTP purchase, stamp duty is significantly lower than for a similarly priced established property. This will enable them to take the first step into the property market with a low deposit and funding cost. It will also allow them time to arrange the second part of their funding.

The second step will be to arrange a line of credit facility (LOC) secured against their PPOR. This should be around $200k or just under an 80% loan to value ratio (LVR). This will just be used for investment purposes so not to contaminate the purposes when claiming the interest costs as a tax deduction.

The third step is that once this is in place, to ‘reimburse’ the Cash Management account for the funds used for the deposit on the OTP IP.

The fourth step will be to obtain a pre-approval for a loan for a second IP. This will more likely be an established property where some work needs to be done to add value and increase the rental yield.

After that, it will be a review of the strategy with the thought that the next IP after that may be purchased as a more cash neutral property in Mabel’s name.

Consideration and advice needs to be taken whether it would be more effective to transfer the Cash Management account and Term Deposit into Mabel’s name with the view for more asset protection and as a by-effect to reduce the income having to be declared by Joe.

Ownership
The first two properties will be purchased in Joe’s sole name. The OTP purchase has two purposes, one to minimise the stamp duty and defer the settlement date until after the NZ PPOR refinance is in place and the second is to give Joe the benefit of the higher tax depreciation and allowances so as to reduce his own PAYG tax currently being charged.

Property Type
The first purchase will be an OTP median priced property around $420k, perhaps a 2 bedroom unit/apartment, close to the CBD. The rent yield is expected to be in the 4.5% to 5.0% range making it slightly after tax cash flow negatively geared. Any shortfall will have to be funded from the new NZ LOC facility.

Loan to Value Ratio
A property around the $420k purchase price seems to be suitable due to wanting to purchase 2 IP’s in the next 12 and to minimise their cash outlay. Using a LVR of 87% plus capitalised LMI, will bring a final LVR to around 89%. The Funds to Complete will be approximately $56k,

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which they will use Cash initially then reimbursed from their LOC facility when set up. This will leave a balance of $144k.

Loan Structure
The loan structure will be one offering Interest Only variable rate Investment loan. The reason is to take advantage of only paying interest to reduce the cash outlay and claim maximum tax deductions for the cost.

Loan Selection
The 4 loans considered for IP #1 are based on the lenders offering competitive products but have the lower borrowing capacity (leaving the other lenders for the next IP), with Homeside (NAB) offering the lowest long term cost (as per the Comparator model). An additional benefit is that Joe is a current customer.