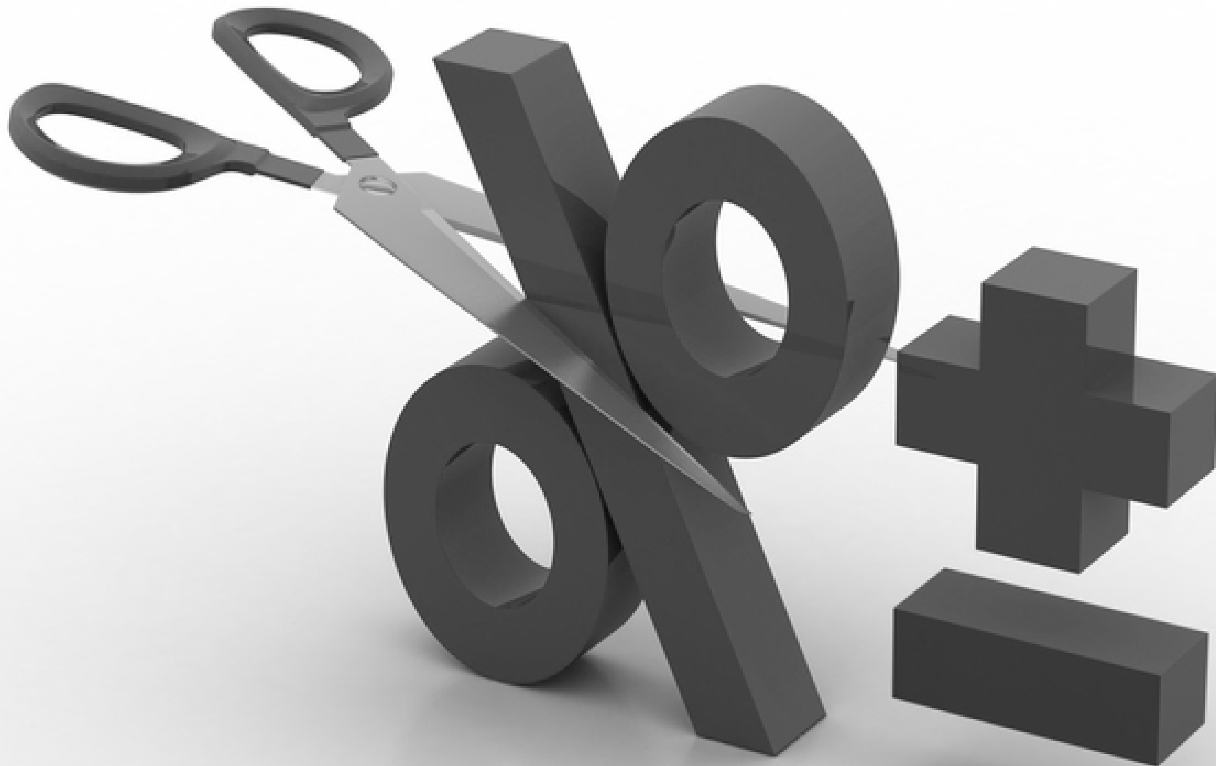

7 Fun Federal Budget Facts For Property Investors

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While this year's budget wasn't as overtly brutal on investors as last year's (think drastic SMSF changes), there's nonetheless been a number of proposed measures that will potentially impact our property markets and in turn, your portfolio.

Treasurer Scott Morrison was in fine form as he cast his net far and wide with arguably more concerning than constructive proposals, clearly aimed at raising revenue via key investment sectors…including the banks.

Whether all of the measures pass muster as they stand will be a matter for the Senate to ultimately decide, but experts suggest some compromises will have to be made over coming weeks to make some of the budget propositions more palatable.

To save some valuable time…hopefully you didn't waste too much of it watching the rather unremarkable event that was Budget 2017/18…here are 7 facts about this year's budget announcement to get your head around as an investor…

1. Negative gearing not touched

Okay, so this might be stating the obvious, given Turnbull had already assured punters he wasn't prepared to mess with the controversial legislation that allows property investors to claim expenses related to their portfolio.

But let's start on a positive note, given the amount of conjecture there's been around what might happen to negative gearing entitlements throughout this entire housing affordability debate.

Likewise, speculation surrounding capital gains tax was quashed, when the 50 per cent discount for investors who hold property for more than a year remained intact.

2. Not everyone will escape…

While negative gearing and CGT have been left alone however, highflying property investors are in for a shock, with travel-related expense claims used to turn holidays into property inspections set to be scrapped.

The loophole is reported to currently cost our government $120 million every year.

"This is an integrity measure to address concerns that such deductions are being incorrectly claimed and abused," said the Minister Assisting the Treasurer on Housing (yes, that's a real title!), Michael Sukkar.

"This will rein in a high-growth deduction item and improve taxpayer confidence in the negative-gearing system."

3. We thought you weren't going to touch it?

It's interesting how politicians do things. On the one hand, we're assured that negative gearing entitlements will remain intact.

On the other however, investor's wings have been clipped with regard to not only travel related expenses, but also depreciation deductions for plant and equipment associated with the holding of investment properties.

Based on current claims, it's estimated this will save the government $1.4 billion.

In a recent report from the Financial Review, one property investor declared his reticence to purchase residential real estate after hearing of the proposed amendment.

"The budget was a big surprise…those who negatively geared created a decent tax benefit by this plant and equipment depreciation," Ramon Tan told the Fin Review.

"Now I'm considering moving into commercial property investments."

For many in the industry, it's apparent that while the government has promised not to touch negative gearing legislation on the one hand, they've done the exact opposite with some of these measures.

This includes the bank levy, which is a sneaky way to impose a property investment tax without appearing to touch current entitlements for investors.

"It definitely impacts the investment strategies of future investors who want to be positively geared also," said Tan. "This is a curb on negative gearing by not actually saying so."

Under current laws, investors can deduct depreciation from rental income under Divisions 40 and 43, with the latter relating to the building's structure and the former covering 'plant and equipment', which includes items like air conditioners and dishwashers.

MCG Quantity Surveyors director Mike Mortlock told the Fin Review that the average depreciation rate is about 30 per cent, but in dollar terms can equate to almost 50 per cent of total deductions for investors.

Tax depreciation quantity surveyors BMT's chief executive Bradly Beer says for an $800,000, six month old, two bed apartment in Sydney's Waterloo, an investor with a 37 per cent marginal tax rate could lose $7181 in the first year with these deprecation amendments.

SQM Research's Louis Christopher said this change would be the "straw on the camel's back" in cooling investor activity in the markets, with bank lending and rental property deduction changes turning off future investors.

4. Foreign investors to feel the pinch

The introduction of a $5,000 flat levy to be paid on foreign-owned residential dwellings that are left vacant is set to earn the government an additional $500 million, which will help to fund the $30,000 salary sacrifice scheme for first homebuyers. Exactly how this will be policed and enacted remains unclear however.

Further targeting foreign investment, which has been demonized for contributing to housing affordability issues, is a developer and overseas buyer's cap, which will prohibit developers from selling more than 50 per cent of their residential buildings to overseas buyers.

In addition, the 10 per cent capital gains tax withholding system for foreign investors will be lifted to 12.5 per cent.

5. I got them bank levy blues

This is one of the measures that will potentially have the most far-reaching implications for every Australian. So much so that I've dedicated an entire article to its contemplation…

6. Some less than super ideas

Another area that will impact investor's property portfolios and virtually every retiree's pension fund…

7. An interesting development

Of further significance to the housing markets and investors is the government's proposed National Housing Finance and Investment Corporation.

The $1 billion infrastructure facility will be established to provide loans to recalcitrant councils holding up developments with planning red tape and refusal to fund local infrastructure projects that would encourage property development.

Through the scheme, investors in affordable housing will receive a 60 per cent capital gains tax discount, with the program's centerpiece being a rewriting of the social and affordable housing compact between the commonwealth, states and territories in a move to alleviate rental stress.

Defence land in Melbourne and Sydney will also be made available for new housing developments, starting with a 127-hectare site in Victoria's Maribyrnong.

The government has also offered a new $4.6 billion National Housing and Homelessness Agreement, including $375 million for homelessness.

"To support Australian households, the government has a comprehensive plan to impact across the housing spectrum – from the homeless and those who depend on social housing, to first-home buyers and older downsizers," Sukkar said.

Will it really fix affordability?

Although some of the proposed budget measures will likely impact future buying decisions for property investors, most experts suggest it falls short as the promised, "comprehensive plan to address housing affordability."

Indeed, some suggest the only real way to 'fix the problem' and curb any future bursting of a housing bubble is to encourage those who already hold property to pay down their record high levels of debt now, before the inevitable happens and interest rates start to rise once more.

Not Just Banks Singing The Budget Blues

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Well, another annual budget has been and gone. I don't know about you, but I found it riveting viewing from beginning to end. No really. Is it just me? Or did all of the proposals put forward allude to a great deal of forethought for the nation's future?

Okay, now that you know I'm obviously leading with a hint of sarcasm, let's consider how far short this budget falls, particularly when it comes to the intended principal focus… housing affordability and our property market calamity.

Opening a Pandora's Box in the banking sector

Not many of us like the banks much. Most people feel beholden to them and at their whim. Consider when some of the big boys started raising interest rates independent of official policymakers, before posting record profits for instance.

If there's one thing the banks like, it's a big bottom line. So what was the Treasurer thinking when he decided to stick his hand deep into their collective pockets and take a further $6.2 billion in tax from the sector?

Australian Banker's Association chief Anna Bligh said the policy was a last minute "smash-and-grab" for more revenue.

"It seems not only were the banks kept in the dark on this tax, but perhaps Treasury officials had been kept in the dark up until now," she observed.

"This is a government now playing fast and loose with Australia's financial system and this is a dangerous place for us all to be."

The reason this tax has such far reaching implications is that the burden of the banks' loss will be borne by pretty much every Aussie with a Super Fund of some description.

Not to mention anyone with a home loan, and the raft of retirees dependent on term deposit dividends to supplement their pension. So yeah…all of us really.

"If you are a working Australian and you have a superannuation account, then you own shares in one of the major banks, and the treasurer is saying this tax should be passed on to your investments," said Bligh.

When you get down to brass tacks, the proposed banking levy is almost like a 'seven degrees of separation' tax liability to be passed on to all of us, whether employed, retired or otherwise.

With many households already feeling the weight of a significant debt burden, including mortgage repayments, and our entire economic balance hanging on a housing market thread, it's difficult to see how this could go well.

Who has the hand?

NAB chief executive Andrew Thorburn, reminded the government during a talkback radio interview last week that messing with the financial services sector was perhaps not such a wise move right now.

"I'm surprised to see it from any government, to be honest, because the banking sector is so crucial to the strength and viability, and the growth of our economy," he said speaking on 3AW.

With the fate of this country's $6 trillion property sector (and in turn our entire economic well being) largely resting on the banks' shoulders, you do have to question the wisdom of raiding lender's coffers.

UBS warned investors that the levy could pose a risk to the alleged 'housing bubble', while ratings agency Moody's forecast a pre-tax profit cut for the banks of around 3.8 per cent.

And that's just for starters. UBS analyst Jonathon Mott has suggested that one banking levy could easily beget more tax hikes, with further cherry picking from the sector to raise government revenue.

"Pandora's box has been opened," Mott wrote to investors, pointing to the fact that the UK bank levy has been raised nine times since its inception.

"Future governments could also raise the bank levy as an easy source of revenue to fund spending, tax cuts or the deficit, especially as none of the political parties oppose this policy."

Mott suggests the government could attempt to use the levy and threats of future increases, as a so-called 'accountability' measure to influence interest rate movements and other internal policymaking by the banking sector.

He believes the government could raise the levy from its 1st July rate of 0.06 per cent of banks' liabilities, as punishment for hiking rates, as happened in the UK.

Of course this would see a push me-pull you conflict ensue, with the banks passing on any additional liability (as a result of an increasing tax burden) to stakeholders, staff and mortgage holders alike.

Yet another rabbit hole we find ourselves meandering down due to the zany antics of our politicians.

The banks question policy planning

Commonwealth Bank chief executive Ian Narev described the levy as policy conjured up "on the run."

"This will test well in the opinion polls," he said in an interview on ABC radio. "The question we should be asking as the public is, if a government is going to judge its success as an economic budget on the next day's opinion polls, is that the kind of economic policy we want?"

Further demonstrating the impact this levy could have on the banking sector in the long term was a massive dive in Australian bank shares, when the proposed budget measure was leaked to the media prior to its official announcement.

According to Westpac CEO Brian Hartzer, "$14 billion of value was wiped off Australian bank shares because of speculation around this new tax."

It's not difficult to put two and two together and recognise that every retiree who relies on bank dividends will effectively take a pay cut. And of course interest rates are an obvious target to start clawing back the losses banks are already, well, banking on.

Sage advice?

Having repriced their mortgage books to reflect tougher regulatory pressure around investor and interest only loans, analysts are concerned that more rate rises from the banks could have injurious impacts on the housing market.

Particularly given recent reports suggesting over half of all Australian mortgage holders would struggle with an increase to their mortgage repayments of just $100 per month.

"If the banks reprice their mortgage books this would put further pressure on household cash flows which are already suffering from near record low income growth, higher mortgage payments and higher power bills," said Mott.

"While the implication on the 'animal spirits' in the housing market is difficult to predict, we see substantial risk to the Australian housing bubble.

"We struggle to see the upside case in owning the banks in the current environment," Mott said.

But Malcolm Turnbull of course had all bases covered in this 'well thought out' agenda, suggesting if the banks are to raise their rates, punters could simply trot off to a competitor and seek out a better deal. Because it's that simple when you're an investor with a property portfolio of course.

"If people feel that Westpac of the Commonwealth Bank is charging them too much, they can take their business somewhere else," Turnbull told the Seven Network, suggesting smaller lenders might be more amenable with their charges.

When queried as to what might happen if everyone suddenly decided to ditch the Big Four in favour of smaller players like Bendigo Bank or Suncorp, Turnbull responded, "You shouldn't run up the white flag and surrender to the banks. They are the most profitable banks in the world."

And for good reason Malcolm! It's called the property market that's keeping your leaky economic boat adrift right now, and their massive economic interest in it.

While it's tricky to feel sorry for the banks when they cry poor on something like the proposed levy, we need to keep in mind the bigger picture.

There's no doubt this cost burden will not be willingly absorbed by the banks. And if the levy does indeed start to rise, where does that leave customers and stakeholders?

According to Narev, the banks have a responsibility to explain the levy's impact to the general public and the fact that "it really is a tax on all Australians."

But, he adds, they can only do that effectively once they're more aware as to what's really going on with this proposal.

Right now however, it seems we're all in the dark regarding the finer details of what's being described as a "hastily designed" and harmful move from the government.

Super Ideas For The Budget Boys…Or Perhaps Not So Much?

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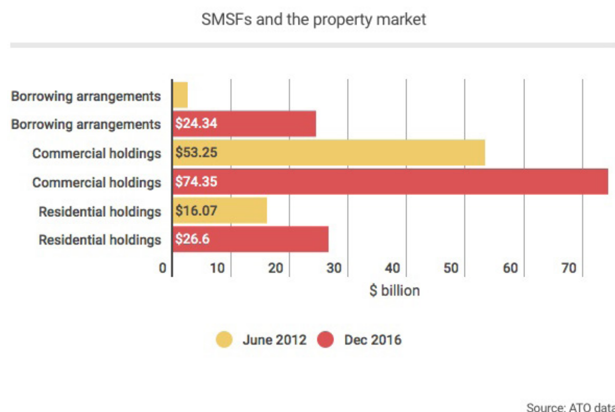
As if things weren't complicated enough for those of us heading into our golden years, with significant life transitions; downsizing from a life of full time work to full time...well, time! And we're faced with major decisions about our extended financial future as life expectancy rates give us even more time!

Traditionally, Australian retirees have relied largely on their superannuation fund to pay for the post-employment lifestyle they desire.

This has been particularly true since self-managed super funds were given the green light to borrow money to invest in property (albeit with a raft of Fine Print). Suddenly real estate portfolios started to expand within a very favourable tax environment. Hello golden years!

Property panic sabotages SMSF borrowing

As evident from the below table, SMSF borrowing has increased almost ten-fold over the last four and a half years, from $2.5 billion in June 2012 to $24.3 billion last December.



The changes and what they mean for SMSF holders

Perhaps the most contentious reform is around legislation governing Limited Recourse Borrowing Arrangements (LRBAs), which is of course the only way an SMSF can borrow money.

Essentially the new draft laws, which have been upheld in the recent federal budget, mean that any debts in the super fund are added to its asset base, in order to determine the new $1.6 million limit on super pensions.

What does that sentence actually mean? Well, in essence, further legislation changes will limit the tax-free amount an SMSF can hold as it moves from its accumulation to pension phase, to $1.6 million.

And to stop people trying to get around the cap by using borrowings to reduce asset value, any debt the fund owes will be included in that $1.6 million.

This is the government's way of restricting the tax-free amount you can have in your Super Fund throughout retirement. Once you exceed that cap, you start paying 15% into their pockets.

Further amendments that will see SMSFs suffer through additional tax losses, a slower accumulation of funds, restrictions on salary sacrifice arrangements and insurance premiums paid within super...all the small things that can add up to a significant impact on your retirement savings...include:

• A reduction in the tax-deductible contributions limit. The maximum amount you can contribute into super as at 1st July 2017 whilst obtaining a tax deduction, is down from $30,000 to $25,000 (irrespective of age).

• High-income earners subjected to higher tax liabilities. When the new financial year ticks over, the 30% tax rate (normally 15%) that's currently applied to SMSF contributions for those earning $300,000 or more per annum will be applied to anyone earning $250,000 or more.

• Less capacity to move existing assets into super. Existing rules allow you to contribute up to $180,000 worth of assets per year from your personal name into your fund (or $540,000 in one lump sum if you bring forward three years of contributions). However, as at 1st July this will be cut to $100,000 (or a $300,000 lump sum) for a super balance of less than $1.4 million.

Any good news?

It really depends on your perspective I imagine. The pollies were putting a positive spin on things at the recent budget announcement, celebrating pensioners' ability to sell the family home, and make a non-concessional contribution of up to $300,000 into their super from the proceeds.

These contributions that come from downsizing for anyone aged 65 or older won't be subject to a work test, or the $1.6 million balance test for making non-concessional contributions.

At the other end of the spectrum, the government is using superannuation changes as a means to champion (or at least appear to be) that all-important first homebuyer cause.

Those desperately seeking a foothold on the housing ladder will be able to make voluntary salary sacrifice contributions into super, later withdrawing these amounts and any associated earnings for a first home deposit.

Mind you, with a cap on these contributions of up to $15,000 per year and $30,000 in total, it's difficult to see how this will equate to a timely and sufficient deposit in most property markets, as things stand presently.

Normal salary sacrificing tax arrangements apply to these contributions, with the 15% rate applied once the contribution hits the super fund, and any tax on earnings inside the fund capped at 15%.

While this may allow first homebuyers to save a housing deposit that little bit faster, this proposal really demonstrates that lack of foresight we've come to expect from our one-term wonders.

For a start, it's only open to a very narrow band of young savers who'll be in a position to make voluntary superannuation contributions. And ultimately, this is a move that encourages people to draw on their retirement savings, removing money early from their super.

Overall, it's likely that the clarification on treatment of superannuation borrowings will limit the appeal of acquiring further assets with any associated debt for the more than one million SMSF operators in this country.

Will the moves assist in housing affordability over the long term? Hardly I imagine. But it might earn this and future governments, who could easily determine to reduce the $1.6 million cap further, a little bit of extra tax money to play with.

The Keys To Successful Cashflow Forecasting

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Cashflow is critical to the survival of a property portfolio. I've made that statement on many occasions…probably because it's the most undamental truth of investment.

Without capital coming in, how do you safely and sustainably acquire, and hang onto, a retirement fund that grows to provide sufficient wealth for you and your loved ones when you stop working? You don't. Period.

Although some people balk at the idea of number crunching, finding the process of calculating their personal net worth too daunting to contemplate, developing a cashflow forecast doesn't have to be a traumatic undertaking.

So let's go through the very simple steps, and explore the critical elements you'll want to attend to, when developing a cashflow forecast…

Doing the cashflow four step

Analysing figures is really about lateral thinking and common sense, and can be broken down into four basic actions…

First, add up all of your current and anticipated income for the year.
Second, add up all up all of your current and anticipated expenditure for the same period.
Third, deduct the answer you derive in the second step from the first step. i.e. Take away your expenses tally from your income tally.
Finally, what are you left with?
While it can be tricky calculating some of these items, given potential unexpected fluctuations in things like income tax rates, pay rises or decreases, or commissions and bonuses, it's important to be as accurate and forward thinking as possible.

If it's a positive outcome, yay you! That's the goal when it comes to financial planning; particularly for property investors who need some type of cashflow buffer in place to reduce the risk exposure of a highly geared investment.

How big is your buffer?

Once you do your calculations, it might be that you have very little left to contribute to a cashflow buffer; a critical component of your portfolio intended for emergency use only.

If this is the case, it's time to drill down further into other potential risks to your cashflow position, including reduced income or large, unforeseen expenses, such as emergency repairs to rental premises or extended vacancy periods.

Then it's about considering alternative strategies, such as fixing a portion of your investment debt to reduce the chances of a sudden increase in your monthly mortgage repayments.

How do I predict the unpredictable?

One of the most complicated tasks you'll have to attend to when producing a comprehensive cashflow forecast is attempting to work out any ebbs and flows in your future earnings.

The key is to be conservative, as it's always better to underestimate your financial capacity and be pleasantly surprised with any surplus, rather than the reverse scenario! Don't forget to account for all revenue sources, including rental income.

Consistency can also be difficult to achieve when it comes to forecasting future expenses.

Things like interest rates might currently be a little more predictable than we've seen in the past. But that's not to say things like banks making independent rate rises on their loan products won't have any impact on your cashflow.

A good rule of thumb when calculating your cashflow capacity is to work on an interest rate of around 7 per cent. Not only will you satisfy the bank's risk assessment criteria, you'll also have a very comfortable safeguard against future rate rises.

As for general living expenses, mortgage brokers generally base their projections on the going rate of inflation, which is ideally managed at around 2 to 3 per cent by monetary policy.

Ultimately, a cashflow forecast is really a bunch of simple mathematical equations…the kind of adding and subtracting you most likely learnt in primary school.

The critical aspect of this planning is that it gives you genuine clarity on your financial perspective and where it is you're heading, which in turn will provide a confidence boost as you venture further along the property investment journey.

If in doubt, seek advice from an appropriately qualified accountant or financial planner. Better yet…give the team here at Trilogy Funding a call, and we can guide your way with our extensive industry experience.