



Depreciation – Do houses actually drop in value?

Claiming depreciation on construction costs and principle items is a great way to maximise the returns from your property portfolio. The Australian Tax Office classifies the building and fittings as depreciating assets, meaning they reduce in value over time due to wear and tear. This allows us to use the dollar amount of depreciation as a “non-cash losses” to reduce the amount of tax we pay, effectively increasing the total cash return from our investment and giving our cash-flow a nice boost.

That all sounds great; our land is appreciating and our cash-flow is good, but doesn't that mean that we're actually losing on the house in the long run? Surely high depreciation tax benefits translate to high losses through wear and tear come sale time? Dinner party wisdom often says “yes”, but hard data indicates otherwise. Let me explain...

The Act Government Department of Treasury recently published a working paper which examined the pricing of houses over a seven year period. This was done by splitting capital gain into two components; the increase in land value and the change in house value. The study excluded houses that had been renovated in order to ensure that the resale price remained comparable to the original build price. The Treasury's analysis shows that where an individual purchased vacant land and built a house both the land and house increased in value. On average, house values increased by around 10 per cent per year while land values grew by 16 per cent per year. ¹(Note- this was a period of outstanding growth in the ACT; what matters is not so much how big the figures are but the fact that they're both positive)

The Treasury paper goes on to say:

“While wear and tear will reduce the value of a house, increases in the cost of replacing the house will increase the value. On balance, the long life of houses means that replacement costs tend to rise faster than the house depreciates.”²

This statement is supported by other respected industry bodies. The Master Builders Association of Queensland regularly publishes reports on the cost of housing construction in South East Queensland. The reports have identified that, since the year 2000 the cost of constructing a four bedroom, two bathroom, two garage home has increased by an average of 5.1% per year.³ This is significantly faster than the CPI (approximately 3.3%) and more than double the depreciation rate attributed by the Australian Taxation Office (2.5%).

So what does this mean for us?

- Be confident in the power of depreciation as a cash flow tool
- Be confident that whilst wear and tear is real, a well built house on a well selected block will appreciate in value over the long term.
- And always trust hard data over dinner party conversation.

**Written by
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¹ Do House Prices Fall Over Time (Treasury Working Paper), ACT Government, Dept. of Treasury Aug 2008.

² Ibid.

³ Interpreted value from Graph 2, Master Builders Queensland & Cordell Housing Cost Index for new home construction in South-East Queensland, September 2008 Report.



A Reminder about our Free Monthly Investor Seminars

Learn the Steps to Successful Property Investment

- Which properties to invest in
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- How to maximise capital growth
- Pay off your mortgage years earlier
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- Best finance options
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- Where NOT to invest
- How to maximise negative gearing
- How to receive tax benefits in your pay
- Whose name to put on the contract



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Brisbane: Tue 28 April 2009
Ipswich: Wed 29 April 2009
Toowoomba: Thur 30 April 2009
Mackay: Wed 22 April 2009

For any information on the seminar dates and times please call Sarah on 1300 429 040, or e-mail any questions you have to info@newprojectsaustralia.com.au

NPA Case Study

The following case study of an actual situation is provided to give an insight into two new properties that were purchased and constructed initially in cash flow positive times of 2001 and are now 8 years old.

We keep the clients names anonymous for privacy reasons.

Two properties were purchased in Townsville suburb of Idalia (Fairfield Waters). The area was identified as the closest new estate to the Townsville CBD and offered entry into this new estate with land prices of \$49K for a 700m² block. Two blocks were purchased and two build contracts were entered into at the cost of \$159K each. Total price for each property was \$208K. With purchase costs and building interest the total Interest Only loan for each property was \$219K.

Scenario at this stage:

2 House and Land packages @ \$208K each
= Total property acquired \$416K
Total Loans = \$438K

Rental return of \$280 per week each from day one.

Client Incomes at the time \$50K per year and \$40K per year. The location was chosen due to the level of development and infrastructure to be undertaken in the area. Due diligence and market analysis was also carried out based on

the value of the land in this area at a comparable price level to inferior sub divisions at the same price point.

Due to the high depreciation benefits of a brand new constructed property and the high rental yield at the time of purchase, these properties were roughly cash flow positive after all expenses to the tune of approximately \$80 per week each. Therefore being \$160.00 per week cash flow positive in total after the use of Taxation Variation Authority. (The ability to have tax benefits paid in advance on a pay basis rather than wait until the end of the financial year as is usual.)

Over the duration of the 8 years there properties have been held they have maintained an overall cash flow positive to cash flow neutral situation allowing for the rise and fall of interest rates, rent increases and higher tax bracket cut offs.

The current situation for these 2 properties is as follows:

2 Properties now valued at : \$450K each

Total Property value: \$900K
Total Loans Still: \$438K
Total Equity: \$462K

The following observations can be made:



New Projects Australia Investor Monthly April 2009



- The house and land packages constructed in Fairfield Waters have well exceeded doubling in value over the 8 year period.
- The approximate equity gained stands at \$462K
- These properties have been cash flow positive to cash flow neutral for the duration of this time.
- The rental income from these properties is now \$400 for one and \$395 per week for the other.
- The increased equity has been utilised for further purchases in other areas allowing further Capital Gains over this period.

As we all know when it comes to Property Investment no two cases are the same. In relation to these two purchases however the ability to create equity through Capital Growth whilst at the same time not having a negative effect on cash flow has well truly been achieved.

Some people believe it is good luck, others believe it is just being fortunate. I believe it is developing the right knowledge, having the right people assisting you, having good plan in place and then believing in the maths and logic of your decision then following it through.

To find out where you could apply a similar strategy in today's market, contact NPA or visit www.newprojectsaustralia.com.au.

(Note. This example has been published with the permission of our New Projects investor client. This example has been provided in good faith to outline the previous success of the New Projects analysis/investment techniques. Whilst New Projects conducts



thorough analysis and research into all its property recommendations, it cannot and does not guarantee future performance).



NPA Current Investment Opportunity

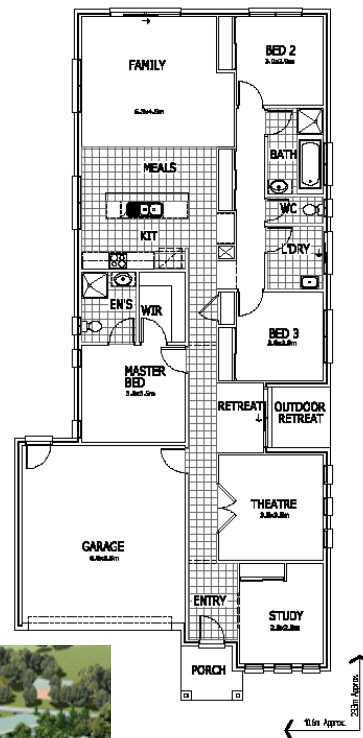
Melbourne is seen to be a definite Hotspot

Investing in Melbourne has the advantage of diversification. There are markets within the market. Melbourne has a population of 3.8 million people and is currently enjoying a population growth of around 70,000 people per year, with this comes capital gains. Infrastructure projects are the normal behaviour as it becomes a requirement to continually update and upgrade.

Melbourne is seen to be a steady player in a portfolio. Were some markets may see massive highs and lows, consistency is the name of the game with Melbourne. The main growth corridor is currently within a 20km radius, within this radius there are many possible investments to achieve average to above average capital growth in the first few years as this area develops.

Packages are available from the low \$330,000 however, there are a few major developments that will commence soon. Our market analysis and research has lead us to believe that investing at \$370,000 to \$380,000 in these strategic locations will secure good growth in your portfolio.

Address: Melbourne, Australia
House Size: 204 m2
Land Size: 428 m2
Land Price: \$175,000
House Price: \$195,000
Total Package Price: \$370,000
Indicative Rental: \$370-380 / Week



This newsletter was brought to you by Craig Whaley at **New Projects Australia**. We do our best to keep all investor clients up to date and well informed. If you have any questions, we will be happy to help, feel free to give us a call.

Next month Wayne Taylor