The Loan Flag

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Pre paying interest on your rental property

Paying your interest in advance can have more than one benefit for investment loans. The ability to pre-pay interest is appealing to property investors, rather than owner-occupiers, because only investors are able to claim a tax deduction for interest payments on their loan as well as other costs.

By paying 12 months interest in advance, investors can claim the deduction this financial year, rather than wait 12 months for the tax benefit.

The strategy is especially appealing whenever tax cuts are scheduled for an upcoming financial year. It makes sense to bring forward deductions to a year when you are liable to pay more tax. So, whenever tax cuts are scheduled to be introduced on 1 July, make sure that you consider prepaying interest in June for the upcoming financial year.

You should also consider prepaying interest in one financial year if you expect to receive less income in the following financial year.

But the ability to pre-pay interest is only suited to individuals with the cash flow to take advantage of the opportunity, not just this year, but each year for the term of the loan.

At today's rates, 12 months' interest* on a $250,000 loan would amount to $17,850. This is a significant amount of cash to have on hand and while the full amount is tax deductible, the amount you get back is determined by your marginal rate. Hence, someone on the top rate of 46.5 per cent who paid $17,850 interest in advance and claimed it as a tax deduction would get back $8300 through the tax system but still pay out $9550.

Investors need to ask themselves if the strategy will be ongoing and for how long. If you think rates are likely to go up in the next 12 months and you know you will have the ability to pre-pay interest on an annual basis for a number of years, it may pay to fix your rate for longer.

Your ALCo broker can make arrangements with the lender to have the loan drawn down in time to allow pre-payment of interest by 30 June.

* 7.14% p.a.
Source | La Trobe Financial

What expenses can you claim?

If you own an investment property, you may be able to claim a tax deduction for a raft of expenses in addition to the interest on your loan.

The Australian Taxation Office advises on its website that you can claim expenses relating to your rental property, but only for the period your property was rented, available for rent and advertised for rent. A handy guide to this process is available from the ATO website, http://www.ato.gov.au/content/00270214.htm.

When landlords claim body corporate fees, they should also make sure they don't include contributions to sinking funds, which can't be claimed as a deduction. Items such as fridges and washing machines can't be claimed as an upfront deduction but must be depreciated over a number of years. Depreciation can be claimed for items such as freestanding furniture, whitegoods and TV. You can claim the full amount of items costing $300 or less in year one.

You may also be able to claim a capital works deduction for construction costs such as improvements to driveways, fences and retaining walls.

Expenses could include:

- Advertising for tenants
- Bank charges
- Body corporate fees
- Borrowing expenses
- Council rates
- Decline in value of depreciating assets
- Gardening and lawn mowing
- Insurance
- Land tax
- Pest control
- Property agent fees or commissions
- Repairs and maintenance
- Stationery
- Telephone
- Water charges
- Travel undertaken to inspect the property or to collect the rent

Additionally, if part of your property is used to earn rent, you can claim expenses relating to that part only. You will need to work out a reasonable basis to apportion the claim. Your accountant will be able to do this for you.

Source: La Trobe Financial

Pros and cons of property investment

Before committing to an investment of any kind, you should consider the pros and cons, such as the ones listed below in relation to property investment:

The benefits:

- Property can be less volatile than shares or other investments
- You can earn rental income and benefit from capital growth (if your property increases in value over time)
- If you take out a loan to purchase an investment property the interest on the loan is tax deductible
- You are investing in something you can see and touch
- Large range of finance options available
- A way of diversifying income
- Conservative way of investing, you can sleep easy at night

The pitfalls:

- Rental income does not usually cover your mortgage payments or other expenses so you may have to use your regular income to cover these costs
- A jump in interest rates will affect your return and decrease your disposable income
- There may be periods of time where you don't have a tenant and will have to cover all costs yourself
- You can't sell off a bedroom if you need to access some cash in a hurry
- If your property investment is your major investment then you may have little or no diversification
- If the property market goes down so does your whole investment. There are many instances where people have ended up owing more than their investment property was worth; this is known as negative equity
- There are very high entry and exit costs

Source: MoneySmart.gov.au and Australian Loan Company

Buying off the plan

If you are considering buying an apartment off the plan, here are a few things to consider to avoid a dud investment:

- Research the developer, check if they have a history of being sued, bad reviews etc. to get an idea of their reputation
- First-time developers also require some caution, especially family businesses where the plan is to build a small block with many if not most of the apartments owned by relatives, funded by sales of the other units to unsuspecting individuals
- Be careful of buildings that are aggressively marketed overseas. You could end up with the building being controlled by a mixture of 'blind' proxy votes from overseas investors
- Noise is one of the major issues in apartments, no matter how it may be marketed, but many first-timers are happy to put up with a little bit of noise leak between units
- Beware of the low levies 'honey trap'. Lifts, swimming pools, security, gyms, cleaners – they all cost money and you, the owners, are who pays for them. Your levies may be attractively low in the first year, but they can go through the roof when reality bites and it's you who's paying the bill

Source | Flat-Chat.com.au

Business Mogul

Looking at buying a vehicle for business use?

Your ALCo representative can take the hassle and stress out of buying that car. All you need to know is what type of car you are looking for and your budget.

To find out more ask your ALCo member.

Source | Australian Loan Company

Contact your local office for further information:

Australian Loan Company Limited | ABN 40 100 947 804 | Australian Credit Licence 377711 | Head Office: Level 6, 2 Elizabeth Plaza, North Sydney NSW 2060