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Investor dilemma

When you buy property, should it be old or new? Pam Walkley consults the professionals

ONE OF THE MANY CHOICES facing real estate investors, including those buying property within a self-managed super fund, is whether they should buy new or old property. Both have their advantages, and expert views are divided.

If you want a set-and-forget investment, new is likely to be better. But if you want to add value to your property by renovating or redeveloping, old is probably the way to go. But renovating within an SMSF has its challenges, which we will look at later.

Veteran real estate researcher Michael Matusik is a fan of new property for passive investors. Indeed it is the first of his 10 rules for "lock and leave" investors, who he estimates form more than 90% of the market.

"There are significant tax benefits in buying a new property versus an old one," says Matusik, who has honed his rules helping over 500 new residential projects come to fruition (see www.matusikmissive.com.au).

He uses a simple example (see "Doing the sums", right). It shows the investor in new property is significantly ahead at tax time. The investor in the new property would have a positive cash flow of about $54 a week if they earned an annual income of $75,000 from their regular job. The old property would cost the investor, earning the same amount, about $54 a week to hold. This can be a very important consideration if cash is tight.

And Matusik points out that independent analysis finds the likely costs to renovate a similar older dwelling to the same specifications as a new dwelling in the same area would be at least 20% more than the profit from reselling the renovated older property.

Other pluses of new property are that it eats up less time and money in maintenance, lower vacancy rates because more people prefer living in new buildings, and the construction is warranted for a certain period.

Buyers agent Patrick Bright, principal of EPS Property Search, says he prefers buying properties with renovation potential as investments for his clients. But, of course, it does depend on the location and client preferences.

"We then do the works, taking the property to its highest and best use, manufacturing capital gains and increasing rental returns along the way," Bright says.

The trick is to neither spend too much (overcapitalise) or too little (undercapitalise). "It's a fine line and balance to get it right, but when you do it's very profitable," he says.

Several reasons have stopped Bright buying brand-new for his clients or himself, including the difficulty of securing a genuine discount on quality developments, more problems and expense in holding builders responsible for shoddy work, and dependence on capital growth for higher rentals.

"You need a genuine discount to buy new as brand-new property is a little like buying a brand-new car in that its value tends to drop in the first year or two of purchase. However, unlike a car, it then goes up."

And now that government grants focus on new houses and apartments, developers win enough interest without offering discounts, Bright says.

The argument that the tax benefits of depreciation are a great reason to buy new is narrow and flawed, he says, as they are only better in the first five years. Quantity surveyor and investor Tyron Hyde agrees the choice of an investment property should never be driven just by tax benefits.

That's in spite of the fact that his

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PROPERTY FOCUS

With Lisa Montgomery*

Thanks to several interest rate cuts during the year, many borrowers on standard variable loans have already seen substantial drops in mortgage repayments. For newer borrowers yet to experience rising rates, it's important not to be lulled into a false sense of financial security as things can change very quickly.

Prepare for the time when rates will eventually increase by:

- Always allowing for a rise of 2% in your financial capacity to manage your mortgage repayments;
- Cutting back on your use of, and reliance on, any high-interest credit;
- Developing a realistic budget for all areas of your spending.

One positive outcome from recent cuts is a wider range of loan options.

*CEO Resi Mortgage Corporation

DOING THE SUMS

Investor A: buys old house for $500,000
Rent: $23,000 a year
All deductible cash expenses: $27,000 a year
Tax break on: $4000
Investor B: buys a new apartment for $500,000
Rent: $23,000 a year
All deductible cash expenses: $27,000 a year
Depreciation building[1]: $11,500 a year
Depreciation fixtures and fittings[2]: $7142 a year
Tax break on: $22,642
Investor B would be $108 a week better off than investor A[3]

[1]Assumes construction cost of $450,000. [2]Assumes $50,000 worth of fixtures and fitting depreciated according to prime cost method. [3]Assumes annual income from regular job of $75,000
Source: Matusik Insights report

company, Washington Brown, prepares real estate depreciation schedules for investors so they can claim their tax breaks. Hyde says that while there is undoubtedly more depreciation on a brand-new property, he likes to buy properties three to four years old. "I still get a lot of depreciation, but I can see what the resale price of other properties in the development go for."

Other benefits of older properties can include lower price tags compared with new property in the same area, and higher gross rental yields.

If you are considering property partly funded by borrowings through your SMSF, there are some additional rules that might sway you towards newer property. Basically you cannot borrow to improve your SMSF property, though you can to maintain it, so this rules out "renovator specials" for SMSFs taking out limited recourse loans to buy their property. Even if you use other SMSF funds to improve a property, a breach of the rules occurs if the improvements you make change its character, such as demolishing a house and replacing it with three strata units.

Pam Walkley, former property editor with The Australian Financial Review, has hands-on experience of buying, building, renovating, subdividing and selling property.