

What will a change of government look like for future property investors?



As you are most likely aware, a federal election is expected in May.

What will this mean to you as a property investor if we have a change of government?

Firstly, what are the proposed changes?

In summary, Labor's negative gearing and capital gains tax (CGT) reform is intended to include:

1. **Limiting the current negative gearing incentives to new properties only.**
*This means that as long as you purchase a brand new property for the purpose of investment, you can still claim your losses against your wage income, **but not** with other residential investment property.*
2. **The capital gains tax discount will be reduced from 50% to 25%¹ for assets held longer than 12 months.**

So what does this actually mean in dollars left in our pocket (or not)?

1. **Negative gearing implications for property investors**

Negative gearing is where the investor's loan and other related expenses are greater than their rental income and therefore incur a 'loss' from that investment. These losses can be deducted from their salary and wage income.

For example:

Chris buys a unit for \$500,000 with a 90% LVR (ie a \$450,000 investment loan) with interest only repayments at an interest rate of 4.5%.

Rental income is \$350 per week and his annual salary is \$85,000.

Let's assume the annual income loss equates to say \$5,500 per annum. Depreciation has not been included for this example.

The current tax benefit (via negative gearing) would land Chris a \$1,897² per annum rebate from the ATO.

With the proposed changes, the investor (Chris) would lose this rebate if the investment property was not brand new. Ouch!

2. **Capital gains discount reduction**

Most investors who decide to use a negative gearing strategy for property do so because of the potential uplift in capital gain over the years of holding the investment. They will take the hit of the losses now, with the expectation that in the future when they sell the property they will make a significant enough capital gain to make the exercise worthwhile.

So in this example, if Chris decides to sell the property in 10 years' time and gets a sale price of say \$815,000 (approx. 5% compounding capital growth on average each year over a 10 year period) then Chris would have invested wisely and made \$315,000 in capital gain.

Currently the capital gains tax (CGT) payable (at 50% discount) would be approx. \$66,700, and Chris would be left with a tidy sum of approx. \$248,300³.

Under Labor's proposed reform the CGT payable would instead be approx. \$103,700 and Chris would only be left with a approx. \$211,300 balance (ie. approx. \$37,500 less in your pocket).

I hear you – that's still a good outcome, but not as attractive as it is now.

The total difference being \$56,470 less in your pocket under a Labor government (includes the 10 years reduction in tax of \$1,897 PLUS the \$37,500 in additional CGT).

What's the good news?

If you are an existing property investor, your current properties will not be affected but they will be fully grandfathered* for BOTH reforms.

The suggested changes will not affect investments made by super funds or change for small business assets. *Yay – good to know.*

What are the potential challenges IF these reforms are implemented?

Firstly, we are not economists or political spokespeople and we certainly do not have a crystal ball. Any changes are still to be 100% confirmed and implemented on a future yet-to-be-determined date AND ONLY if there is a change of government. So we may be unnecessarily concerned at this stage.

What will a change of government look like for future property investors?

However, as your finance specialist we feel it is our obligation to share the potential downsides to you as an investor.

Many of our clients, if they are not already property investors, have aspired to join the growing group of investors who are helping to house our Aussie renters while supporting the Australian government with public housing.

So although the intention of the Labor government is to ensure our tax system is fair, sustainable and targets jobs and growth, the downside of these decisions could very well include:

- Having less investors in the market as the popular Australian wealth building strategy becomes less attractive. This may in turn put upward pressure on the rental market through reduced supply of investment housing, rental supply and increased rents.
- It could actually impact and unintentionally increase the price of new properties and further push first home owners out of the new home market.
- If the government removes tax claims and discounts, will it force investors to increase rents to cover the additional holding costs?

These decisions, along with the tight lending criteria, speculation on interest rate movements, high cost of living and current debt levels, may further fuel Australians' financial stresses.

As your finance specialist we can keep you updated on the latest trends and policies and help you make the right buying, selling and investing decisions suitable to your situation.

Call us today for an in-depth discussion on your property requirements for the next 12 months.

* Grandfather Clause

A clause in a new law, regulation, or anything else that exempts certain persons or businesses from abiding by it. For the above proposed changes: if a new government passes a new law stating that there is no longer negative gearing incentives on property. A grandfather clause would allow persons who already own investment property to continue to receive these incentives, but would prevent people who do not already own investment property from receiving these incentives. Grandfather clauses can be controversial, but they are also relatively common.

References:

- 1: www.alp.org.au/negativegearing
2,3: www.yourmortgage.com.au/calculators

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