REEDFinancial

Your Wealth Bulletin

Video of the Month

[What Bernie Maddoff couldn't steal]

Matt Weinstein reflects on his experience and what he has learnt since.

Money Links

Education Rebates

Environment Rebates

NSW Hot Water & Toilet Rebates

Fridge Buyback

Free NRMA roadside(For 16-20 year olds)

Child Care Estimator

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Dear David,

Welcome to the August edition of Your Wealth Bulletin.

"It pays to plan ahead. It wasn't raining when Noah built the ark.".(Thomas Edison)

We continue to add new suggestions to our 'Money Links' section of the newsletter. If you'd like to see what's new in terms of rebates and money websites, make sure to have a browse in the box to the left.

Investment Properties - Buying New or Old?

A common question from property investors is whether to buy a property new or second-hand.

Combined with the opportunity of purchasing property within a Self Managed Super Fund, this query is worth discussing further.

Dr Tony Hayek from Blue Wealth Property outlines that from an investor's perspective, new property provides a number of key advantages which include::

* Easy due diligence on the property to inspect
* Potential close location to your home
* Statutory protections from the builder
* Reduced maintenance costs
* Potentially lower vacancy rates
* Generally higher tax deductions
* Usually a higher component of depreciable plant and equipment for higher tax deductions in the early phase.

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Older properties also have a number of advantages including:

* Due to age, they can be a comparatively lower price than a new property.
* Generally speaking, gross yields are slightly higher for older properties than new properties.
* Financing the property may be easier.

Many of us would agree on these points above. Dr Hayek then provides an interesting case study for a Self Managed Super Fund (which pays tax of earnings at 15%).

The two investors both earn $100,000 per annum, both contribute 9 per cent per annum, and have both borrowed 70 per cent to purchase the properties within their own SMSFs. The major difference is that John buys an older property and Jane buys a new property. Both are two bedroom units of comparable size and features.

Both properties are located in a southern Sydney suburb, are within close proximity to each other and both cost $400,000.

In order to keep the analysis consistent, they have used the following assumptions for both properties: the interest rate on the housing loan is 7 per cent, the vacancy rate on the properties is 0 per cent, the real estate management fees are 6.6 per cent and the loan-to-value ratio (LVR) is 70 per cent plus costs.

New Property - Jane pays a $400,000 price, rent is received of $20,800, there is a depreciation claim of $11,711, interest costs are $20,870, rental costs are $6,602.

This means that the shortfall in cashflow is $6,680. After tax, equals $3,829. This has a holding cost of $74 per week.

Old Property - John pays a $400,00 price, rent is received of $20,800, there is a depreciation claim of $1,550, interest costs of $20,879, rental costs of $7,202.

This means that the shortfall in cashflow is $7,280. After tax, equals $5,872. This has a holding cost of $113 per week.

As it stands, the two properties are of equal value and the only assumed difference is age. As shown, the holding costs are lower for the newer property mainly due to the difference in the depreciation claim.

In dollar terms the older property will cost $39 per week more to service. In other words, the older property costs 53 per cent more to service.

This lower cash servicing cost provides greater comfort for long-term holding of the property. It is likely to rely less on ongoing contributions to service the loan. Most lenders who specialise in SMSF property loan products apply a rigorous servicing model. As a result, serviceability is usually the constraint on the level of borrowing available, rather than deposit size.

An alternative approach

The lower after-tax holding cost means an SMSF can support a higher value property for the same level of after-tax cost. This provides access to greater amounts of gearing and, importantly, provides a greater asset base over which to amortise the additional fixed costs of borrowing in an SMSF.

For example, Dr Hayek has outlined in his article how a $570,000 new property (using the same assumptions as to the previous comparison) can have a similar holding cost to a $400,000 'old' property.

So while the new property is worth a lot more, and would cost a lot more to acquire, the cash flows for the two properties are almost identical.

The new property costs $3 per week less to hold, even though the property is worth $170,000 more.

Assuming that over the next 10 years both properties grow at 6 per cent, in that time the older property will be worth roughly $716,339 and that property's profit before tax will be $316,339.

The new property at the same growth rate will be worth roughly $1,020,783. Therefore, the new property's pre-tax profit will be $445,783.

This represents a pre-tax profit of an extra $129,444, even though both properties are almost identical in cash flows.

The new property owner has, of course, invested an additional $51,000 in deposit to maintain the same LVR.

Dr Hayek then summarises that "if the aim of the investment property acquisition for the SMSF is to meet the sole purpose test and build retirement wealth, then the debate about new versus old regularly falls in favour of the new property on all objective criteria."

* Courtesy of Morningstar. Dr Tony Hayek is chief executive of Blue Wealth Property. Free subscription access required to read original article: http://www.morningstar.com.au/article.mvc/smsf/old-or-new-property/1914

Quarterly Market Update

After a mostly positive start to 2010, some jitters entered the market in the 2nd quarter. This was due to concerns of public sector debt, particularly in Europe.

European authorities responded with a $US1 trillion support package for any countries needing emergency funding.   In late June, the group of 20 leading economies pledged to halve public sector deficits by 2013 and start to stabilise debt0to-GDP ratios by 2016.

In Australia, signs of a moderation in consumer spending emerged, a sign that six increases in cash rates were starting to bite. This was offset by a pic-up in business investment, bouyant house prices and strong jobs growth.

The Global equity markets (MSCI World Index) fell during the quarter however for unhedged Australian currency investors, the falls were cushioned by an 8% decline in the Australian dollar.

Overall, it would appear that uncertainty continues to be the constant theme in global markets. It is impossible to predict which way the markets are going to move, particularly in this environment. Our advice is to continue to hold growth assets in a weighting that are appropriate to your goals, and ignore the media noise for your future long term investment success.

Change of Address

Please note that as of this week, we have moved address.

We haven't gone far, just into the next suburb, Caringbah.   This provides us with more office meeting area for when you come in.

Our phone number stays the same, but our street address and fax number has changed.

We're now at Suite 5, Level 1, 28-30 President Avenue, Caringbah. Phone remains (02) 9525 0777, and Fax is (02) 9526 5477.

We'd welcome you to call in for a coffee next time you're nearby!

If you would like to discuss any of these issues further with us, please feel welcome to ring me on 9525 0777 or emailenquiries@reedfinancial.com.au

Warm Regards!

David Reed

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