7 THINGS you need to know about OWNING AN INVESTMENT PROPERTY

1. Why own an investment property?

Owning an investment property has become a popular long-term investment strategy in Australia, mainly due to the tax advantages, depreciation allowances and income benefits associated that can increase a person's wealth and secure their financial future.

Investing in property can be a long-term or short-term venture. Types of investment properties include residential, commercial and industrial.

Investment properties can also be held through a range of entities, such as, individual investor, trusts, companies and SMSFs. Advice should be obtained prior to making a purchase.

2. You need an investment strategy

Whether, you invest for steady rental income or capital growth, you need an investment strategy.

Generally, it is unlikely for a property to deliver both high rental yields and strong capital growth. Therefore, investors need to focus on a strategy that best suits their personal circumstances.

Capital growth focuses on the property's value rising over the long-term. Properties located in inner-city, high population areas generally have strong capital growth. However, the downfall is they are usually more expensive to purchase upfront, and incur more costs. However, investors can benefit from negative gearing to claim losses as a tax deduction.

Investors who are looking to break into the market may be more suited to properties that will provide constant cash flow via rental income. These types of properties are usually located in regional areas, have lower entry prices and can provide surplus cash flow. However, their capital growth is usually slow.

3. Property can be held in different entities

Investors can choose to hold their investment property through different entities, for example under the one name, as joint tenants or tenants in common (where the ownership of property is divided between two or more parties), through a company, trust (unit or discretionary) or SMSF.

Choosing an ownership structure is particularly important, as it can have a significant impact on the tax and depreciation implications for the investor.

There are a number of tax advantages associated with each ownership structure. To understand and fully maximise the benefits of each structure, professional financial advice should be sought.

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4. You can claim immediate deductions

Investors may be able to claim an immediate deduction (against their current year's income) for expenses related to the management and maintenance of the property.

Some expenses investors may be entitled to claim as an immediate deduction include:

- Advertising for tenants, council rates and water charges
- Cleaning, gardening and pest control
- Insurance and interest expenses
- Property agent's fees and commission
- Repairs and maintenance

5. Other expenses can be deducted over several years

An investment property's borrowing expenses, depreciation and capital works expenditure can be deducted over a number of income years.

Individuals can claim a deduction for borrowing expenses associated with purchasing an investment property and depreciating assets acquired as part of the purchase of the property.

Deductions for construction expenditure (capital works deductions) on residential rental properties are generally spread over a period of 40 years. You can claim a deduction if construction began after:

- 17 July 1985 and the property is used for residential accommodation or to produce income
- 19 July 1982 and the property is not used for residential accommodation
- 21 August 1979, the property is used to provide short-term accommodation for travellers and it meets certain other criteria.

A deduction may also be available for structural improvements made to parts of the property if work began after 26 February 1992.

6. There are ongoing costs associated with property investment

Once you have paid the upfront costs of the property, you will need to consider the ongoing costs. These can vary between year to year or even month to month, so be sure to anticipate and factor them into your investment strategy.

Some of the most common ongoing costs include:

Insurance: Building and landlord insurance will help cover any unforeseen repair costs and tenant related issues, such as damage etc.

Mortgage repayments (and fees): On top of monthly mortgage repayments, your loan may include a loan servicing fee.

Land tax: Generally, property owners are subject to land tax as the property is not their principal place of residence. States and territories impose their own land tax.

Property management fees: Using a property agent is a popular option, especially for those investors who do not live near the property, are busy or do not understand the tenancy laws very well. Most agents charge a letting fee and a management fee based on a percentage of the gross weekly rental plus other fees, i.e. advertising costs and preparing the tenancy agreement.

Repairs and maintenance: It is often hard to predict or control the costs associated with ongoing repairs and maintenance.

Water rates: Property owners are generally liable for water rates where there is no separate metering device.

7. Negative gearing

Negative gearing gives investment property owners the ability to offset the cost of owning a property against their assessable income.

Negative gearing involves generating short to medium term tax losses, which arise from tax-deductible costs that are higher than investment income, and leveraging this to increase exposure to potential gains and losses.

It is a popular strategy due to its ability to reduce an investor's taxable income through their tax losses, resulting in a lower annual income tax bill.

For example, if the rent of a property was $350 per week, and the property was fully tenanted for a full financial year, the rental income would be $18,200. If the deductible expenses for that year were $30,000, the net rental loss would be $11,800. The $11,800 loss can then be applied to reduce the property owner's taxable income.

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