



Rental Property Focus

Taxation reforms not as bad as feared

This year's Budget delivered the most significant taxation reform in years, but property investors weren't affected as much as had been feared.

While the Tax Working Group had recommended a raft of reforms aimed at discouraging investment in housing and removing alleged taxation advantages for property investors, in its recent Budget announcement the Government did not target property investors with ring fencing or a land tax or capital gains tax.

They did however outline a range of reforms including the following, some of which are directly related to property:

- Income tax rates are to be reduced across all income bands from 1 October 2010;
- GST will increase to 15% from the same day;
- The company tax rate is to be cut from 30% to 28% from 1 April 2011;
- Assets purchased after the Budget no longer qualify for the +20% loading of depreciation;
- The depreciation rate on all rental buildings has been reduced from 3% to nil;
- Qualifying and loss attributing companies are to be treated as "flow-through" entities as from 1 April 2011;
- Investment losses (such as losses from rental properties) will be excluded from the definition of income for the purposes of calculating Working for Families entitlements from 1 April 2011.

The Budget estimates the changes to property tax will raise \$685 million in 2011/12, rising to \$690 million in 2013/14.

Finance Minister Bill English said he expected the Budget changes would have a "mild" impact on rents, but opinion is divided as to how much that increase is likely to be.

Treasury has forecast rents will increase 1.4% over the next one to three years, the New Zealand Property Investors Federation (NZPIF) says it expects increases of 4.5% to 6.5%, while Infometrics Managing Director is reported to be expecting rental inflation of 5% by March next year and 8% by 2012.

The NZPIF has said it calculates the changes to depreciation would cost around about \$1,250 a year for the average rental property, with landlords also facing increased costs on rates, insurance and repairs as a result of the increase in GST.

New Zealand real estate sales figures

The latest figures released by the Real Estate Institute of New Zealand show the residential property market remained quiet ahead of the Budget announcement, as property investors amongst others took a wait and see approach.

Total residential sales fell to 5,207 in April and the time taken to sell a house rose to a median of 40 days while the median house price was \$356,000, which was 1.2% lower than the previous month but 4.7% higher than April 2009.

Month	Median price	No. of sales	Median days to sell
April 10	\$356,000	5207	40
March 10	\$360,500	6161	35
February 10	\$350,000	5029	46
January 10	\$350,000	3666	43
December 09	\$360,000	4957	33
November 09	\$355,000	6056	33
October 09	\$355,000	6091	31
September 09	\$350,000	6464	33
August 09	\$342,250	5878	34
July 09	\$340,000	6014	37
June 09	\$340,000	6040	41
May 09	\$337,500	6291	42
April 09	\$340,000	6210	42

Source: Real Estate Institute of New Zealand

Rental prices (New Zealand totals)

The latest statistics available show the median rental for one, two and four bedroom rental properties increased in April 2010 when compared with the same month the previous year but declined slightly for three bedroom properties.

APRIL No. of rooms	Median Rental		Range		Number let	
	2010	2009	2010	2009	2010	2009
One	\$225	\$210	\$160 – 290	\$150 – 280	1881	1744
Two	\$290	\$280	\$240 – 350	\$230 – 340	3390	3325
Three	\$340	\$330	\$290 – 400	\$285 – 390	3880	3946
Four	\$430	\$400	\$350 – 550	\$335 – 495	1123	1173

Source: Department of Housing and Building

Property Talk by Frank Newman

The changes announced in the Budget will cost property investors, but they are unlikely to see an exodus from the market.

Let's take the example of an average home worth \$356,000, with a land value of \$180,000 and building improvements of \$176,000.

Historically investors could depreciate the building at 3% (diminishing value) each year. In the first year they could claim \$5,280 as a depreciation expense, which would result in a tax benefit of \$1,478 (or \$28 a week) in the first year, assuming the new 28% company tax rate. That amount would reduce in subsequent years as the building's book value diminishes.

This opportunity has been eliminated, but the amount involved is hardly a deal breaker for property investors, especially given most never got to keep the tax savings because the depreciation expense had to be clawed back in part or full when the property was sold (assuming it was sold for more than its book value).

A surprise is that the depreciation policy includes commercial buildings.

The other surprise is with respect to Loss Attributing Qualifying Companies (LAQCs), which from 1 April 2011 will become "flow through" entities, thus profits or losses will flow through to the shareholders' personal tax return. Investors will still be able to claim losses but when they make profits it will be taxed at their personal rate, which may or may not be higher than the 28% company rate.

This change will not have the dire consequences of ring fencing of losses though!

In summary, the taxation regime changes announced in the Budget will make property investment a little less attractive, but are unlikely to turn people off it.

Of more significance I think are changes to interest rates, which at the time of writing many were predicting a rise in soon.

Frank Newman has authored numerous books on investment matters and created the NZ Investment Game. Contact him on frank@newman.co.nz.

Focus on fit-out costs

Depreciation claims for chattels and fit out were not affected by the Budget, but still could be.

In his Budget speech the Minister of Finance said the treatment of commercial building fit-outs would be reviewed post-Budget and if necessary amended prior to 1 April 2011.

It is unclear whether this review will include residential buildings but in a discussion document released in December it was proposed to only allow assets that are an "entirety by itself" to be shown separately from the building.

As a general rule plumbing and piping, electrical wiring, internal walls, doors, fitted furniture, kitchen cupboards, bathroom fittings, lino, tiles and water heaters and hot-water cylinders are not separate assets.

Wardrobes and cupboards not built into the wall, carpets, fences, air conditioning units, curtains and blinds are usually regarded as separate from the building.

Did you know?

- The IRD has received additional funding to increase enforcement measures, including around property traders who don't pay tax on gains.
- In April property values across New Zealand were 6.1% up on the same time last year according to QV, which also said nationally values in April remained

3.9% below the market peak of late 2007.

- Treasury is forecasting inflation will jump to 5.9% in the first quarter of 2011, including through the rise in GST and the introduction of the Emissions Trading Scheme. It is also forecasting 90-day bank bill rates will increase from 2.7% to 5.4% by June 2013, which gives some insight into likely movement in mortgage interest rates.
- The ANZ is predicting downward pressure on New

Zealand housing prices over the next year, according to the 10 property gauges they use. On the plus side immigration is still positive and demand for housing exceeds the number of new homes being built.

- Most break-ins occur around the back of a house, so while it's important to have a good lock on your front door it's vital you ensure you don't forget about the security measures on doors and windows at the back of your home.