ATTACKS ON NEGATIVE GEARING THREATEN NEW INVESTORS

The Sydney Morning Herald, Business Day ran an article on 29/9/2014, 'Kill negative gearing to calm housing market, says Saul Eslake'.

Saul Eslake is the chief economist from Bank of America Merrill Lynch and he believes that negative gearing contributes more to a potential housing bubble than Chinese property investment.

"Eslake called on the Abbott government to end negative gearing for new investors, a week after the Reserve Bank said macroprudential policies such as raising the capital requirements on mortgage banks may be necessary to prevent the housing market from overheating. Negative gearing allows investors to reduce their tax liabilities by deducting losses from rental properties on their other income. Data has been notoriously unreliable on the amount of foreign investment in Australia's housing market, but The Grattan Institute pegs the cost in lost tax revenue to the federal government at $2.4 billion a year.

He accepts that it is not politically feasible to abolish negative gearing entirely because around 15 per cent of voters are currently taking advantage of negative gearing - a tax regime that allows them to buy assets and deduct the interest costs against other income.

But he says that it would be easy for Canberra to decide that any new investment past a certain date would not be eligible for negative gearing.

He then goes on to argue that there are three choices on how to restore the balance

"They can let the market run, which history has shown is not a good option. Or they can lift interest rates which will cruel the rest of the economy to stop an alleged risk in the housing market.

"The third option is to introduce new macro prudential rules to limit how much the banks lend to certain types of borrower.

But the risk here is that the new rules either don't work or that they hurt the wrong people, such as first home buyers."

In contrast, if Canberra decided to curtail negative gearing, it would reduce borrowing by investors, which would mean that investors either paid less for properties or did not buy as many.

It is the opinion of this office that this is potentially disastrous for investors. When rent does not cover the average mortgage on an investment property then there has to be other means to recoup the losses otherwise investors will sell off their portfolios and new investors will not enter the market which will leave the rental market in chaos.

Saul Eslake mentioned briefly that after the former Treasurer Paul Keating decided to abolish negative gearing in 1985 there was a steep jump in rents. This was the law of supply and demand in action; as investors sold off their properties there were fewer properties to rent and so rents went up.

When finally sense prevailed and this policy was reversed the government of the day had to throw in the additional carrot of allowing owners to claim the depreciation of their investment properties against taxable income in order to entice them back.

How quickly we forget!

Do we really have to go down the same old route and repeat the mistakes of the past?

Supporters for axing negative gearing say that rents only went up sharply in Sydney & Melbourne but that other factors were involve in those cases. They also point out that it was only pressure from the real estate lobby that reversed the decision not problems in the rental market itself.

What they don't consider is that it is not guaranteed for rents to increase immediately because renters will not automatically choose to pay more; they can simply pass over expensive properties and search for the cheaper ones. This delay in the market adjusting will be prolonged when vacancy rates are already higher than normal. A lack of rental properties will tend to push rents up but when this trend starts in a market where vacancies are already high the net result will be offset and so delayed.

For rents to go up the push needs to be more or less universally embraced by investors and this can take time especially where the pressure from loss of rebates can take up to 12 months to be felt since many investors might still only be claiming their reimbursements at the end of the tax year.

The only concession to axing negative gearing is that this will only apply to new investments, which means that current investors will still be able to claim all the benefits of negative gearing.

This means two things. Firstly you will be less inclined to want to sell those investment properties you now own because of all the benefits you will lose and ...

Secondly we should all start buying new investment properties immediately before negative gearing is axed.

This is by no means a foregone conclusion but we might end up seeing a bigger rush on investment properties by Aussies than we have ever seen so far and it may well over shadow any Chinese spending spree.

"THE QUICKEST WAY TO GET INTO THE PROPERTY MARKET"

A SECOND LOOK

Last month we ran this article about getting into the property market and we stressed that there is a lot to be said for buying a quality new or as new home as an investment property that will give an immediate low cost, neutral or slightly positive rent return.

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And if bought in a growing suburb it will have potential for capital growth that will further boost future returns.

This becomes all the more telling now in view of moves to axe negative gearing because it is negative gearing that will often change an investment from making a loss into a profitable exercise; maybe not immediately but certainly within a short time frame.

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SPRING AND SUMMER ARE LOOKING TO BE GOOD SELLING MONTHS

So many commentators are saying that this selling season, from roughly September 2014 to April 2015 is looking to be a bumper season indeed.

For this office we must agree. We have sold two properties in the last 4 weeks that could be considered to be high for their respective suburbs but they have gone quicker than we could have hoped.

10 Rapid Court Huntfield Heights sold in 8 days for $360,000. And it was not one of the homes in the new development areas.

36 Ripon Road Clarence Park sold in 10 days before Auction for $625,000.

Speak to us if you are thinking of selling or if you only want to find out what your home is worth.