Driving up losses

It could all end in tears for many of the 1.3 million Australians who have negatively geared property, writes **Karina Barrymore**

CRUNCHING THE GEARS?

NEGATIVE GEARING CASE STUDY ($50,000 deposit)	
PURCHASE COSTS	
Property price:	$400,000
Buying costs:	$20,000
TOTAL:	$420,000
HOLDING COSTS	
Annual loss after rental income:	- $10,000
Tax break @ 37%:	+$3700
Ongoing annual loss after tax:	- $6300
BREAK-EVEN SALE PRICE	
(Four years later)	
Starting cost:	$420,000
Ongoing losses:	+$25,200
Selling costs:	+$15,000
Opportunity cost @ 4%:* ($50,000 dep, $25,200 losses)	$12,000
BREAK-EVEN SALE PRICE:	$472,200

* Average returns forgone on bank investment

Source: Smartline, Propertyinvesting.com

AT best, negative gearing is an expensive tax break. At worst it's a highway to financial loss. Either way, it's a risky strategy that often does not pay off, according to several experts.

Australia's unjustified love affair with property is the sole driver of this flawed strategy, PropertyInvesting.com chief Steve McKnight says.

"The biggest pitfall is that it's a strategy designed to lose money. As an investor, losing money is something you should avoid at all costs," Mr McKnight says.

"There are only two types of people who give you advice about negative gearing, accountants giving information about tax deductions and people selling overpriced property."

The claim that buyers can make a loss in the short term but benefit in the long term is also unlikely, he says.

"They're all told the same thing. You take a loss now and make money when the property goes up in value.

"In the meantime, you get a tax deduction and you don't pay tax on the increased value until you sell," Mr McKnight says. "That sounds like a very powerful carrot to a lot of people and it makes them do something that just doesn't make sense."

Smartline Mortgage Adviser spokesman Sam Ghoreyshi agrees.

"Understanding the real impact of negative gearing reinforces the argument that it is generally best used as a short to medium-term investment strategy," Mr Ghoreyshi says.

"While no one would run a business for 10 years at a loss, it's not unusual to see people negatively gear a property for that long.

"Assuming a 37 per cent marginal tax rate, an investor is spending $1 to get 37c back — in the hope that the 63c they're losing out of their pocket will be made up by future capital growth."

However, what people consider their break-even sale price still often leaves them in the red. As well as the property's purchase cost, investors need to add in stamp duty, other buying costs, holding costs, ongoing losses plus the eventual selling costs, to get a break-even price.

In addition, he says, investors also need to factor in the "lost opportunity". That is, what they could have earned on the deposit money and top-up amounts they have ploughed into the property if they had put that money in a profitable investment or even if it had just sat earning interest in a bank account.

"That means that the break-even point on your investment is not your cost of purchasing the property, it's actually much greater than that because you have to factor in all the losses you're making as you go," he says.

"It may well be that you could have done something more positive with that money, that would add greater long-term benefit to your financial position."

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SAM GHOREYSHI

Despite the so-called tax advantage of negative gearing, even the experts are torn.

According to Taxpayers Australia head of tax services Mark Chapman, negative gearing is a "very expensive" tax break for investors and the wider economy.

Almost three-quarters of property investors have incomes of less than $80,000, he says. That means even the tax breaks aren't that good.

"At these incomes, they should be looking for a new tax adviser and property adviser because it almost certainly isn't worth their while," he says.

"They're getting a tax break on about a third of the loss and, given the substantial additional costs of keeping the property, plus the burden of carrying the loss through the year until they can claim a refund, it's unlikely the tax saving is really worth the trouble.

"From a wider policy perspective, negative gearing makes little sense.

"The losses are being supported by the rest of the taxpaying population becaus the overall cost to the government is more than $13 billion a year in tax break

"Of course, the governme does claw some money back from tax on positively geare property. But these propertie are the minority and only generate profits of about $5 billion — so there's a big gap that the rest of us are paying for," Mr Chapman sa

karina.barrymore@news.com.au

SECURE INCOME IS A MUST

BUYERS' advocate Catherine Cashmore warns that anyone who is considering negative gearing a property must have a secure income or job.

"The loss of a job such as unexpected redundancy can cause you to quickly pull up short," she says. "Property is not easily liquidated, as it's a long-term investment.

"And in the coming years it's expected part-time jobs and short-term contracts will increase compared with full-time positions."

PropertyInvesting.com chief Steve McKnight says a primary income is vital for investors who plan to negative gear a property.

"Investing this way means you need your job more than ever as you have to have extra income to soak up the losses and to get the tax benefit," Mr McKnight says.

"Anything that makes you 'need' your job that much is a dangerous strategy."

Funding model targets long-term players

INVESTMENTS

A NEW funding model that aims to reward investors committed to long-term greenfield projects while slashing tendering costs is being billed as the ideal way to lure investors into backing Australia's next phase of infrastructure projects.

Global fund manager IFM Investors, which has offices in Melbourne and Sydney, has told a Singapore forum of leading finance delegates its "inverted bid" model could cut bid costs in half by erasing fee leakages.

In its presentation to the G20 and Organisation for Economic Co-operation and Development, IFM said its model could also push forward the delivery of greenfield projects by 30 per cent.

IFM Investors chief Brett Himbury said the model had the potential to be adopted worldwide. "This thought leadership has been developed via 20 years of deep involvement in infrastructure investing both in Australia and globally. We believe we have a model with global applications," Mr Himbury said.

The model involves a two-stage bidding process where equity finance is secured initially before separate tenders are issued for the project's construction, operation and management and debt. IMF said this meant a long-term equity owner would be appointed prior to competitive tenders for other project partners — removing barriers faced by long-term equity investors such as pension funds from getting in on the ground floor.

Brett Himbury

Treasurer Joe Hockey's budgetary announcement last month of $11.6 billion in new infrastructure projects was built around job creation and fostering growth — but wooing private investors on board during a period of economic consolidation could prove problematic.

IMF said its model also gave greater certainty to governments because the investors asked to take the greatest risk would also be responsible for pricing that risk over the life of the investment.

BAUXITE ON REVIEW

RESOURCES

ALUMINIUM producer Alcoa says it is reviewing options for its Suriname bauxite subsidiary just days after the country's leader said the multinational was preparing to slash local operations.

Alcoa spokeswoman Monica Orbe said the company was working with the South American nation "to ensure the long-term viability of the operations" in Suriname, where it has had mining operations for nearly a century.

On Tuesday, Suriname president Desi Bouterse told parliament that Alcoa was planning to cut local production by a third and l off about 200 employees a 800 contractors.

Ms Orbe made no menti of job cuts or other specific stressing that discussions with the Suriname Government were "focuse on resolving issues on the long-term supply of bauxit and finding a "competitive energy solution".

The mining industry is t backbone of Suriname's economy. Globally, high levels of aluminium suppli have led to lower prices, a Alcoa has repeatedly cut it smelting capacity in respo