

# ‘Off the Plan’ Property Investing



## Positives vs Negatives

Buying property ‘Off the Plan’ is very common in Melbourne. There are many positives and some negatives but property developers often need to sell 60% of the units before the bank will commence lending on the project. Accordingly, most developers need to market and sell a number of units before construction can commence.

### Positives

- Let’s focus on the example when an investor buys a one bedroom unit for \$400,000 and is required to pay a 10% deposit. A bank guarantee for the \$40,000 deposit will cost the buyer \$800 pa for the two years to settlement. This is virtually the only cost the investor will have up until settlement.
- The property is brand new which maximises the annual depreciation benefits. The depreciation deduction is anticipated to be say \$5,000 pa compared to next to nothing for a 20 year old established apartment.
- There is a big stamp duty saving when buying before construction has commenced. The investor will pay approximately \$2,000 at settlement on a \$400k property compared to \$19,660 if they bought an established property in Victoria. This is a saving of around \$18,000 and the investor also borrows \$18,000 less.
- The investor’s after tax cost of servicing this property (once settled) will be approximately \$125 per week or \$6,487 pa. This compares to \$241 per week (\$12,583 per annum) for an established property (see cashflow projections over page). As settlement is not for another 2 years, we encourage first time investors to put aside the \$150 per week so a cash reserve is established prior to settlement.
- Entering into a forward contract for a fixed price of \$400,000 means the investor is getting into the property market at

today’s prices and will benefit from any increases in value over the two years. Accordingly, it is possible that the investors’ property is valued at more than the purchase price at settlement.

- Buying a unit ‘Off the Plan’ usually only requires an initial 10% deposit. By contrast, a ‘house and land package requires funding the land purchase plus draw down borrowings for builders’ progress claims. The investor is effectively funding the house construction, whereas ‘off the plan’ unit investors only require funding for the balance of 90% at settlement which represents a significant interest saving.
- Please note the investors 10% deposit or bank guarantee should never be at risk. The deposit is legally the investors’, so if settlement does not occur as a result of the developer or vendor not performing, then the deposit is returned.

### Negatives

- If property prices decrease between purchase and settlement date, this may create difficulties in obtaining an adequate valuation to secure finance to settle the property. You should ensure that you have sufficient equity in your home or other property so finance is not an issue in the event of a market dip.
- There is an element of concern because you do not see the ‘end product’ before you buy. It is important to deal with reputable developers who have a history of delivering exactly what has been marketed. Display suites, marketing material and detailed specifications provide investors with confidence and the developer has contractual obligations and warranties that also provide investors with confidence. Unemotional investors are normally less concerned than homebuyers.

## Summary

Buying brand new Melbourne property ‘Off the Plan’ is a very common process that provides many benefits to investors. Over the years we have found by dealing with reputable developers, our clients have secured quality investment properties, obtained the benefits summarised above and found the whole process to be a rewarding experience!



# Investing In ‘Off the Plan’ vs Established Property

ESTABLISHED PROPERTY VS OFF THE PLAN	Notes	Established Apartment – 20 Years Old	Off The Plan - New Apartment
Purchase Price	1	\$400,000	\$400,000
Vic Government Stamp Duty	2	20,272	2,000
Legal & Conveyancing Costs		1,200	1,200
Other Costs		2,500	2,500
<b>Total Purchase Costs</b>		<b>\$423,972</b>	<b>\$405,700</b>
<b>CASHFLOW (Pre-Tax)</b>			
Rental Income	3	\$17,680	\$ 20,020
<b>Expenses</b>			
Council Rates		\$ 900	900
Water Rates (excl. consumption)		550	350
Body Corporate Fees		2,500	2,000
Landlord Insurance		300	300
Agents Management Fee (7% of Rent)		1,361	1,542
Letting Fees (1.5 weeks rent + \$250)	3	760	828
Mortgage Interest @ 7%	4	29,678	28,399
<b>Total Expenses</b>		<b>\$36,049</b>	<b>\$34,319</b>
Pre-Tax Cash Flow (Deficiency)		(\$18,369)	(\$14,299)
<b>NON-CASH DEDUCTIONS</b>			
Depreciation on Fixtures & Fittings	5	0	5,000
Building Allowance 2.5% x \$	6	0	5,500
<b>Total Tax Deductions</b>		<b>(\$36,049)</b>	<b>(\$44,819)</b>
<b>Tax Loss</b>		<b>(\$18,369)</b>	<b>(\$24,799)</b>
Tax Benefit at 31.5% Tax Rate	7	5,786	7,812
Pre Tax Cashflow Surplus (Deficiency)		\$(18,369)	\$(14,299)
Annual After Tax Cost – Year 1		\$ 12,583	\$ 6,487
<b>Cost Per Week</b>		<b>\$ 241</b>	<b>\$ 125</b>

## Notes & Assumptions

1. The cost of both properties in Victoria is \$400,000
2. Stamp Duty savings apply when you purchase ‘off the plan’
3. Rental income from the off the plan property will be slightly higher (\$385 vs \$340)
4. You borrow the full purchase price (including stamp duty, conveyancing and legal costs) on an ‘interest only’ loan at the rate of 7% per annum
5. Depreciation on furniture and fittings in year one for the off the plan property will be \$5,000 and depreciation on the established property would be negligible
6. Building construction costs for the off the plan property were \$220,000 providing an annual building allowance claim of \$5,500 for the next 40 years
7. The taxpayer’s marginal tax rate is 31.5% (taxable income between \$35,001 and \$80,000 at 2009/10 rates)

**Disclaimer :** We believe the information and opinions contained in this comparison table are accurate, however, we do not warrant the accuracy of the information, opinion or calculations. It is purely for illustrative purposes and we further disclaim all responsibility for any loss or damage which may be suffered by any person relying on such information.

