Martin Josselyn - t/a Rule Three

PROPERTY INVESTMENT ANALYSIS (DESCRIPTIVE)

16-Jul-2014

Prepared for: Mr & Mrs Investor
Consultant: Martin Josselyn (Rule Three)
Property: WYNNUM WOODS Cnr Ropley & Kianawah Roads Wynnum Qld 4178
Description: Three Bedroom Townhouse

SUMMARY

Assumptions		**Projected results over**	**10 yrs**
Property value	$397,500	Property value	$711,862
Initial investment	$55,908	Equity	$354,112
Gross rental yield	5.26%	After-tax return /yr	21.23%
Net rental yield	3.45%	Net present value	$200,406
Cap. growth rate	6.00%	**IF SOLD**	
Inflation rate	4.00%	Selling costs	$23,631
Interest rate	5.05%	Equity	$330,481
Taxable income	$100,000	After-tax return /yr	20.45%

COMPUTER PROJECTIONS

Investment Analysis		Projections over 10 years				
End of year	2014	1yr	2yr	3yr	5yr	10yr
Property value	$397,500	421,350	446,631	473,429	531,945	711,862
Purchase costs	$14,338					
Investments	$55,908					
Loan amount	$357,750	357,750	357,750	357,750	357,750	357,750
Equity	$39,750	63,600	88,881	115,679	174,195	354,112
Capital growth rate	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
Inflation rate (CPI)	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Gross rent /week	$410	20,894	21,729	22,599	24,443	29,738
Cash deductions						
Interest (I/O)	5.05%	18,066	18,066	18,066	18,066	18,066
Rental expenses	33.69%	7,184	7,471	7,770	8,404	10,225
Pre-tax cash flow	$-55,907	-4,356	-3,808	-3,238	-2,028	1,447
Non-cash deductions						
Deprec.of building	2.50%	5,306	5,306	5,306	5,306	5,306
Deprec.of fittings	$24,605	3,435	3,382	2,721	1,848	820
Loan costs	$1,820	364	364	364	364	
Total deductions		34,355	34,589	34,227	33,989	34,418
Tax credit (joint)	$100,000	4,759	4,532	4,073	3,248	1,800
After-tax cash flow	$-55,907	403	724	835	1,220	3,247
Rate of return (IRR)	21.23%	Your income /(cost) per week				
Pre-tax equivalent	32.17%	8	14	16	23	62

Disclaimer: Note that the computer projections listed above simply illustrate the outcome calculated from the input values and the assumptions contained in the model. Hence the figures can be varied as required and are in no way intended to be a guarantee of future performance. Although the information is provided in good faith, it is also given on the basis that no person using the information, in whole or in part, shall have any claim against Martin Josselyn - t/a Rule Three, its servants, employees or consultants..

Detailed Notes on Spreadsheet Items

PROPERTY VALUE

The property (or market) value refers to how much the property is worth (i.e. how much you could sell it for). Its book value, on the other hand, refers to how much you have paid for it plus the cost of any immediate renovations.

Property price:	397,500
Renovation costs:	0
Total book value:	397,500
Property market value:	**$397,500**

PURCHASE COSTS

These include your solicitor's conveyancing fees and, where applicable, State Government stamp duty charges. In Australia, stamp duty varies from State to State and is a function of purchase price whereas, in New Zealand, it has been abolished on all property transfers since May 1999. Conveyancing costs may also be dependent on purchase price and may be negotiable. In some States of Australia (e.g. A.C.T.), purchase costs are tax deductible in the first year of the investment, though normally they will only be taken into account in Capital Gains Tax calculations in the year of sale.

Conveyancing costs:	2,000
Stamp duty:	12,338
Total Purchase costs:	**$14,338**

INVESTMENT & LOAN

Your initial investment is usually just the total of all monies outlayed at the time of purchase. These may include contributions toward any, or all, of the costs listed below. The remainder will largely determine the size of the loan. If you have sufficient equity in other property, it is possible to outlay nothing, and actually borrow the lot (i.e. the purchase price, purchase costs, loan costs, any renovation costs, and even additional monies to cover such things as fittings). If you are modelling an investment from some point in time after purchase (e.g. to assess the return on major renovations), your investment might also include the equity you already have built up in the property.

	Investments	**Loan**	**Total Cost**
Property costs:	39,750	357,750	397,500
Renovation costs:	0	0	0
Purchase costs:	14,338	0	14,338
Furniture costs:	0	0	0
Loan costs:	1,820	0	1,820
Totals:	**$55,908**	**$357,750**	**$413,658**

CAPITAL GROWTH & INFLATION RATES

Rate of capital growth is your anticipated annual compound rate of increase of the property value. It will undoubtedly vary substantially over the short term, but over the longer term (10 years or more), it has generally been about 2 to 3% above the rate of inflation.

Average rate of inflation (%):	4.00
Average rate of capital growth (%):	6.00

EQUITY

The equity is the difference between the property value and the loan. The equity increases in line with the increasing property value in the case of an interest-only loan. For a principal & interest loan, it also increases with the decrease in the debt.

Projected values over	**5 yrs**	**10 yrs**	**15 yrs**	**20 yrs**
Property value	531,945	711,862	952,632	1.275m
Loan	357,750	357,750	357,750	357,750
EQUITY	**$174,195**	**$354,112**	**$594,882**	**$917,086**
Approximate costs if sold......				
Solicitor's fees	2,660	3,559	4,763	6,374
Sales commission	15,123	20,071	26,692	35,553
EQUITY (after sale)	**$156,411**	**$330,481**	**$563,426**	**$875,159**

INTEREST COSTS & TYPE OF LOAN

The type of loan can be either interest-only and/or principal & interest. Repayments for interest-only loans, as the title suggests, consist of interest only. Repayments for principal & interest loans include a component of the principal. Interest-only loans are usually of a shorter term (e.g. 3 to 5 years) at which time they are usually rolled-over.

Loan type:	I/O Yrs 1-40
Interest rate (yr 1) (%)	5.05
Loan:	$357,750
Loan costs (written off over 5 yrs):	$1,820
Monthly payment:	$1,506
Annual payment:	**$18,066**

RENT

The potential annual rent is simply the rent per week times 52. The actual annual rent must account for any period that the property is vacant. Annual rents are assumed to increase in line with inflation.

Rent per week:	410
Potential annual rent:	21,320
Vacancy rate (%):	2.00
Actual annual rent:	**$20,894**

ANNUAL RENTAL EXPENSES

These are all the real operating costs associated with the investment property with the exception of loan interest payments. The first cell of the spreadsheet represents the expenses expressed as a percentage of the potential annual rent. As a guide, expenses could vary anywhere from 13% to 30%, depending on the maintenance and whether a professional property management agent is used. For holiday letting, with higher vacancies, the percentage can be more than 50%.

Normal Expenses:	
Agent's commission (8.25%):	1,724
Letting fees:	410
Rates:	1,400
Water:	600
Landlord Protection Ins:	750
Body corporate:	2,300
Special expenses:	0
Total expenses:	**$7,184**
Normal expenses as % of annual rent (%):	33.69
Net yield or Capitalisation rate (%):	3.45

PRE-TAX CASH FLOW

These are all of the monies that flow out of your pocket before tax is taken into account. Normally, it would represent the gross annual rent less interest and rental expenses. This will vary if interest or expenses are capitalised or rents used directly to reduce the loan.

Year		1yr	2yr	3yr	5yr	10yr
Rent		20,894	21,729	22,599	24,443	29,738
Cash invested	55,908	0	0	0	0	0
Principal payments		0	0	0	0	0
Interest		18,066	18,066	18,066	18,066	18,066
Expenses		7,184	7,471	7,770	8,404	10,225
Pre-tax cash flow	**$-55,907**	**$-4,356**	**$-3,808**	**$-3,238**	**$-2,028**	**$1,447**

DEPRECIATION ON THE BUILDING

This represents the capital allowance on the construction costs.

Property value:	$397,500
Construction costs:	$212,240
Depreciation allowance rate (%):	2.50
Depreciation allowance:	**$5,306**

DEPRECIATION OF FITTINGS (diminishing value method)

Item	Value	Effective Life (yrs)	Depreciation
General fittings	21,759	15.00	2,901
Low-value pool	2,846	4.00	534
Total	**$24,605**		**$3,435**

LOAN COSTS

In Australia, the loan costs are written off over the term of the loan (or five years, whichever is the lesser).

Establishment fees (0.28% of loan):	1,000
Valuation fees:	300
Registration of mortgage:	230
Registration of title:	115
Search fees:	175
Total loan costs:	**$1,820**

TOTAL TAX DEDUCTIONS (Cash & Non-Cash Deductions)

These include both "cash" (e.g. interest, rental expenses) and "non-cash" (e.g. depreciation) deductions.

Year	1yr	2yr	3yr	5yr	10yr
Interest	18,066	18,066	18,066	18,066	18,066
Expenses	7,184	7,471	7,770	8,404	10,225
Deprec.-building	5,306	5,306	5,306	5,306	5,306
Deprec.-fittings	3,435	3,382	2,721	1,848	820
Loan costs	364	364	364	364	0
Total deductions	**$34,355**	**$34,589**	**$34,227**	**$33,989**	**$34,418**

TAX CREDITS & AFTER-TAX CASH FLOW

The after-tax cash flows are all of the monies that flow in or out of your pocket AFTER tax is taken into account. They represent the PRE-tax cash flow LESS any tax credits (or tax refunds). In this analysis, it is assumed that the investor has obtained a tax variation from the Taxation Office and thus the tax refunds are credited for the same year in which they are based.

Year	2014	1yr	2yr	3yr	5yr	10yr
Pre-tax cash flow	-55,907	-4,356	-3,808	-3,238	-2,028	1,447
Tax credits		4,759	4,532	4,073	3,248	1,800
After-tax cash	-55,907	403	724	835	1,220	3,247
Income /(cost) per week		**8**	**14**	**16**	**23**	**62**

INTERNAL RATE OF RETURN

The internal rate of return (IRR) is the method of calculating the return on a series of cash flows where the time factor is taken into account. To understand it, think of the money you are outlaying on your investment property as being deposited in a bank account, with interest added each year. In this case the "deposits" are represented by the after-tax cash flows

Year	2014	1yr	2yr	3yr	5yr	10yr
After-tax cash flow	$-55,907	$403	$724	$835	$1,220	$3,247
Equity						$354,112

The total amount in your "account" (including interest) at the end of the period is the equity ($354,112) in the investment property. The IRR (21.23%) represents the effective "interest rate" that you have received, but with one important difference - because the interest remains in the property, it is not taxed. To receive an equivalent return from bank interest, you need to get 32.17% before tax.

If the property were to be sold at the end of the period, the after-sale equity would be reduced to $330,481 after taking account of selling costs and the IRR after the sale would be 20.45%.

TAX BENEFITS

These are shown below for the given taxable incomes and are based on the specified tax scale.

Number of properties: 1

	Investor	**Partner**	**Total**
Ownership: joint names	99.00%	1.00%	100%
Current taxable income:	65,000	35,000	100,000
Rental income:	20,685	209	20,894
Total income:	85,685	35,209	120,894
Rental deductions:	34,011	344	34,355
New taxable income:	51,673	34,865	86,539
Current tax:	13,622	3,272	16,894
New tax:	8,891	3,244	12,135
Tax savings:	**$4,731**	**$28**	**$4,759**

INVESTMENT CAPACITY

Buying 1 such properties (registered in joint names), and taking into account current net incomes and expenses as shown, the difference between total income and total committed expenses in the first year would be $83,508. Total initial outlay would be $55,908.

Number of Properties: 1		Registered: joint names
Ownership:	Investor (99.00%)	Partner (1.00%)

Income

Current net income	
Current assessable income (Investor):	65,000
Current assessable income (Partner):	35,000
Total net income:	100,000
New rental income:	20,894
Total income:	**$120,894**

Expenses

New tax (Investor):	8,891
New tax (Partner):	3,244
Rental expenses:	7,184
Investment loan expenses:	18,066
Total expenses:	**$37,386**
Net surplus (first year of investment):	**$83,508**
Total initial outlay required:	$55,908