

Positive vs negative

What investment strategy is right for you?

When can a negative be beneficial? *When it makes you money of course.*

When considering any good investment, be it property, shares or cash, the main aim is to generate a return in the form of income (sometimes called yield), a capital gain or a combination of the two. Some investment properties may have a high income return while others may have low income with the potential to generate a high capital return.

It is always important to consider the total return from your investment (being the addition of the income and capital return) when making an investment decision.

Given the capital outlay required to invest in property, most investors will also need to consider their borrowing strategy and its impact on their return on investment. The amount borrowed will generally determine if the property will be negatively or positively geared. This is often the cause of much confusion to new property investors. As with most things in life **there is no one right solution for everyone or every situation.**

Negative gearing

PROS

- The ATO will help pay for your investment property
- Enables you to start investing in the property market sooner with a lower deposit

CONS

- A longer term investment of 7-10 years should be considered
- If your income decreases, rent is unavailable or interest rates rise you may not be able to cover repayments

Positive gearing

PROS

- Produces an immediate return
- Less dependent on capital growth
- Makes it easier to further develop the property portfolio

CONS

- Your income will be higher so you will pay more tax
- Typically requires a larger deposit

Negative gearing

A negatively geared property occurs when the total of the mortgage interest expense and operating costs (eg council rates, water rates, strata fees, management fees etc) is greater than the rental received. As a result a monthly contribution will be required to offset the difference in the expenses.

Negative gearing usually occurs when the majority of the capital cost of the investment property is funded by an investment loan.

The main benefit of a negatively geared property is that this negative return is able to be claimed as a tax deduction resulting in the Australian Taxation Office (ATO) refunding a proportion (equivalent to your marginal tax rate) of the negative return. In effect this means **the ATO is assisting in the purchase of your investment.**

However it is always important to keep in mind that even though the ATO is assisting with your investment property, unless you are likely to earn a capital gain greater than the negative income return over the long term, the investment property may not be a good investment.

Positive gearing

A positively geared property occurs when the rent received is adequate to cover the mortgage interest expense and operating expenses with a little profit left over for you.

The benefit of a positively geared property is that it generates an income stream from day one and there is no need to wait for property prices to increase to realise a profit.

The downside is that in order to achieve a positively geared property from day one you will likely have to contribute significantly more equity to reduce the loan (and resulting interest expense) required to purchase the property.

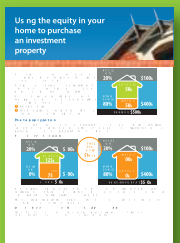
Ultimately most investors will over time move closer towards a positively geared property as the interest expense reduces due to the mortgage being paid off and rental returns increasing with inflation. Market factors such as tenancy demand, infrastructure or employment developments will affect the time it takes for a property to become positively geared.



Each approach to property investment has its advantages. If you are thinking of purchasing an investment property and would like to find out more or discuss options for your situation, please call the office.



Ask us for our article on Using your existing equity to finance an investment property.



If you would like more information on Buy Australian Properties and how they can help you, please phone Finance Detective on:

Phone: (08) 6500 3546

Email: info@financedetective.com.au

Website: www.financedetective.com.au

Address: 1/799 Beaufort Street, Mount Lawley WA 6050



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