# Off-the-plan buys going off the boil

Property Be aware of the rule changes before being tempted by lucrative incentives, writes **Duncan Hughes**.

Investors considering off-the-plan apartments are facing the loss of generous tax incentives and depreciation allowances, tougher borrowing conditions, falling rents and rising supply.

Developers continue offering lucrative incentives to buy – such as free furniture and fixtures – despite their usefulness as long-term tax deductions being under threat from changes in the recent federal budget.

Signing a contract to purchase an apartment that has yet to be built can lock in gains from a rising market and avoid stamp duty.

There are still good opportunities for investors buying quality apartments in areas close to the CBD and schools, shops, transport and other popular amenities.

But rising costs, falling tax deductions and tougher markets mean investors must be aware of changing conditions, such as falling demand from foreign buyers.

"Keep your eye focused on a balance of sustained capital growth and reliable rental income," says Christopher Foster-Ramsay, principal of mortgage broker Foster Ramsay Finance. "Don't be distracted by special deals or offers that do not contribute to the long-term value of the purchase."

Lou Farinotti, a senior partner with Holding Redlich Lawyers, adds many investors have little idea what they are purchasing when they look at the building's plans.

"They need to visit more sites and get an idea of what 40 square metres, or 50 square metres, looks and feels like," Farinotti says.

Stamp duty exemptions for investors are being cut, amended or switched to regional areas in Victoria, Queensland and Tasmania from July 1. It means an investor in a $2 million off-the-plan apartment in Melbourne could face an extra $110,000.

Further, property transfers between spouses and de facto partners in Victoria will no longer be exempt from stamp duty and a tax will apply for some vacant residential properties.

In Queensland, first-home-buyers' grants will revert back to $15,000 for new properties, including buildings being constructed, and in Tasmania the grant will decrease to $10,000 for the purchase of a new home, construction or off-the-plan apartment.

Some developers are offering buyers who sign before July 1 generous furniture and fixture packages worth tens of thousands of dollars, usually in postcodes where there are many other apartments being completed.

Popular negative gearing tax breaks remain but rules are being tightened around what can be claimed, such as travel expenses to view an investment property and depreciation allowances. Tax specialists believe property buyers renting out the apartments will no longer be able to depreciate new furnishings, plant and equipment, even if it is near-new with a resale value.

Under the existing rules, plant and equipment items such as furniture, washing machines and ceiling fans have an effective life set by the Australian Taxation Office that can be claimed as a deduction over future years by the investor.

But new rules coming into effect from July 1 mean the deductions will be allowed only if the investor bought them.

The changes apply to items purchased after the federal budget. Existing arrangements will be grandfathered.

Tax specialists are seeking clarification on the depreciation status of furnishing and fixtures that are relatively new and have a resale value. There are potentially 167 plant and equipment depreciation items.

Focus on potential capital growth and reliable rental income when buying off the plan. PHOTO: GRAHAM DENHOLM

Bradley Beer, chief executive of BMT Tax Depreciation says nearly 80 per cent of the 63,000 depreciation schedules it compiled last year will be affected.

Major lenders, such as National Australia and Bank and Westpac, are tightening apartment valuations to prevent developers supporting prices by repurchasing any apartments coming on to the market in a block before all have been sold to prevent price falls.

NAB says apartment valuations used to assess loan applications will have to include comparable sales outside a development and resales within the development.

Recent analysis by Herron Todd and White revealed 30 per cent falls in the sale of apartments acquired off the plan and then resold in the market to a genuine buyer (rather than back to the developer) within 12 to 18 months. Investors also need to check whether their apartment can be used as security for future residential purchases.

Some lenders are excluding student accommodation, company share titles and residential properties less than 50 square metres (including balconies and car parking) – that are being used as a serviced apartment.

Potential investors should heed repeated warnings about apartment oversupply over coming years everywhere except Sydney and identify postcodes where demand remains strongest.

In Perth, apartment rents have fallen by more than 9 per cent during the past 12 months. The national average growth is 2 per cent, which is equivalent to the headline rate of inflation.

Rental growth in Melbourne is more than 6 per cent.

## Checklist

- Given where the market is going in your area, clarify how much you'll be saving on price.
- Are you eligible for stamp duty concessions?
- Location is all-important, for example within 15km of the CBD.
- Check the specs. What guarantees do you have the fixtures will be equal quality to the display apartment?
- Get a lawyer to check any terms allowing the developer to change the original plan.
- Check the builder's record of completed projects and quality finishings.
- Many lenders refuse apartments less than 50 square metres. They are also reluctant to take them as security over property loans.
- Research the likelihood of finding tenants in terms of competition from nearby planned constructions.
- Make sure the developer has not registered by-laws giving exclusive use of the common property to some owners.
- Inspect the management contracts to confirm your potential financial liabilities.

SOURCE: ME BANK AND SHINEWING

# Top 10 ethical investment choices

Where to invest **Tony Featherstone** offers a snapshot of ETFs, listed investment companies, stocks and unit trusts that suit ethical investors.

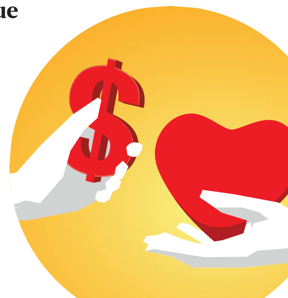
**1 BetaShares Global Sustainability Leaders ETF** This newcomer provides exposure to 100 large global stocks that lead on climate and rate well on responsible investment considerations. It's weighted towards US equities and about a third of stocks in its index are IT companies. A management fee of 49 basis points annually is well below fees in ethical LICs and unit trusts. The ETF returned 10.1 per cent in three months to the end of April 2017.

**2 UBS IQ MSCI World (ex Australia) Ethical ETF** One of five UBS ETFs that provide ethical screening for global equities; others cover Asia, Europe, Japan and the United States. The ETF excludes tobacco and controversial weapons stocks, thus suiting investors who want to invest responsibly in overseas equities, without the comprehensive sector screening of "deep green" ethical funds. An annual management cost of 35 basis points appeals. The ETF's limited screening may not appeal to investors seeking "deep green" exposure and a wider range of sector avoidance.

**3 Russell Investments Australian Responsible Investment ETF** The ETF provides exposure to a responsible investment portfolio that is enhanced for environmental, social and governance (ESG) considerations. The ETF excludes companies involved in tobacco, alcohol, gambling, pornography and armaments, as well as producers of carbon-intensive fossil fuels. The ETF's dividend yield and franking credit focus suits income-seeking investors who want to invest in ethical Australian companies. An annual fee of 45 basis point is competitive given the ETF's screening and yield focus.

**4 Morphic Ethical Equities LIC** The recently listed LIC avoids companies involved in fossil fuels, tobacco, alcohol, gaming, intensive farming and aquaculture, and deforestation. The portfolio focuses on companies involved in sustainability, clean water and air, recycling and future technology. As the LIC market's first long/short ethical equity fund, Morphic can profit from taking a negative view on companies with poor ESG criteria. An annual management fee of 1.25 per cent and performance fee (15 per cent of any outperformance relative to the LIC's underlying benchmark index over 12 months) might deter some investors. But Morphic's strong record, established through the Morphic Global Opportunities Fund, should justify the fee. Morphic has traded in line with its $1.10 issue price since listing; most LIC floats trade at a discount after listing.

**5 Hunter Hall Global Value LIC** One of the market's best-known ethical investors was the subject of a long-running, controversial ownership saga resulting in the merger of Hunter Hall International's funds management business with the privately owned Pengana Funds Management. Conservative investors might wait until there is greater clarity on Hunter Hall's direction and market sentiment improves. Others will look closer, given the influence of some well-performing investors on its share register and the LIC's potential to boost its dividend. Hunter Hall traded at a 10 per cent discount to its pre-tax net tangible assets in April 2017.



**6 Australian Ethical Investment** Australian Ethical's performance shows why it pays to buy shares in the company that manages the funds, rather than the funds themselves. Magellan Financial Group is an example of that rule. Capped at $93 million, Australian Ethical, a minnow among listed fund management companies, is a well-established leader in ethical investing. Its funds under management grew at 35 per cent in the first half of the 2017 financial year. But the share price has fallen since March after weaker earning guidance, principally because of one-off technology issues around unit-pricing errors affecting its superannuation fund.

**7 Perpetual Wholesale Ethical SRI** A leading option for investors seeking ethical exposure to Australian shares. Launched in 2002, the fund has consistently outperformed its underlying benchmark index and is the largest fund of its kind in social responsibly investments by assets managed ($1.3 billion at March 2017). The minimum investment is $25,000 and the annual maximum fee is 1.175 per cent. A drawback is the fund's lower sustainability rating: Morningstar rates it two out of five stars on this metric, which analyses the sustainability of companies in a fund's portfolio.

**8 Generation Wholesale Global Share** Arguably the pick of sustainable funds for Australian investors who seek global equities exposure. A five-year annualised return of 20.6 per cent is best in class and the fund has performed strongly over short and long periods, with average volatility. The fund has a five-star Morningstar rating for performance and four-star Morningstar sustainability rating. The minimum investment is $5,000. Higher fees are the main drawback.

**9 AMP Capital Responsible Investment Leaders International Share** The fund ticks several boxes for investors seeking exposure to ethical global stocks. An annualised five-year return of 14 per cent to March 2017 puts the fund among the top 10 in socially responsible unit trusts and it has a four-star Morningstar sustainability rating. The fund avoids exposure to a range of harmful sectors and limits exposure to the fossil fuels sector. An annual management fee of 97 basis point is competitive.

**10 BT Sustainable Balanced Fund** BT Investment Management, an early mover in responsible investment strategies, has four main socially responsible/sustainable funds. The BT Sustainable Balanced Fund, BT's largest of this type by assets managed, has returned about 10 per cent (after fees) annually over five years, in line with the benchmark return. Almost 60 per cent of the portfolio is in shares; the rest spread across fixed interest, property, alternative investments and cash. The main negative is index-like returns.