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PropertyInvesting.com 'Insider'

Discover proven tips, strategies and techniques to dramatically increase your property investing profits

Issue 2, Volume 3 - March 2003

By Steve McKnight

Hi and welcome to your March 2003 edition of 'Insider' - the PropertyInvesting.com e-bulletin for positive cashflow investors seeking a lifetime of passive income through real estate.

Are you receiving this newsletter for the first time? If so then I'd like to extend you a warm welcome on behalf of the entire Property Investing.com community.

This month's topics are:

1. [No More Room at The Masters Inn](#)
2. [Capital Gains... Trick, Trap Or Treasure \(Part II\)?](#)
3. [The Ultimate Tenant From Hell Story](#)

As usual there's a lot to get through this month. Let's jump straight in.

No More Room At The Masters Inn

As expected, the upcoming Australian Property Master's Seminar has been completely sold out, well over two months in advance. If you're lucky enough to have a ticket then you should have received a confirmation e-mail from me by now. If you haven't then please contact the office asap on 1800 660 630.

Already a number of requests have started come in to be placed on the no-obligation waiting list, just in case there's a last minute cancellation. If you'd like to be placed on the list then [please send us an e-mail](#).

The upcoming Masters seminar promises to be the best one yet, and I'm excited that it's only a mere eight or so weeks away.

Capital Gains... Trick, Trap Or Treasure? (Part Two)

[Last month](#) we began a discussion about which is better - capital gains or income returns?

We examined the nature of capital gains and concluded that most property values are likely to increase in a real estate boom.

The real challenge is securing capital appreciation in a flat or negative market, which can be done by focusing on the person and/or buying a property that has more demand than supply (see [last month](#) for more info).

Now let's turn our attention to how you can cash in your capital gains, which can be done three ways:

Option One: Selling The Property

You may decide that the best way to cash in your capital gains is to sell or dispose of your property. In this case you'll probably use the services of a real estate agent

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who'll charge you a commission for finding and signing up a buyer.

Selling your property permits you to access 100% of your gain and allows you to exit the market temporarily or permanently.

For example, I've known a few large investors to essentially cash in their chips near retirement age and transfer lump sum capital gains into an allocated pension. This reduces investment risk close to retirement age since no one ever went broke taking a profit, and there are often some attractive tax planning opportunities too.

However a few complications exist when you decide to sell a property.

Complication #1 - Capital Gains Tax

First, when you sell you dispose of the property which triggers a capital gains tax (CGT) event.

CGT will generally apply to property acquired on or after 20 September 1985, however there is a full exemption available for your principal place of residence.

Until recently the method of calculating your capital gain or loss involved indexing the value of the asset (for inflation) over the time you owned it. However this all changed on 21st September 1999.

Since 11:45am on the 21st September 1999, a new calculation was adopted that replaced indexation with a discount, currently 50% of the capital gain for individuals and trusts, and 33.33% of the capital gain for superannuation funds. The major requirement to access the discount is that you must have owned the asset for at least 12 months.

As far as indexation is concerned, you were allowed to index the value of your asset up to September 1999, but not after this date.

The workings of the capital gains system in Australia raises one of the golden rules of accounting, which is not to buy an appreciating asset in a company structure as companies are not eligible for any capital gains discount at all.

Complication #2 - Sale Costs

If you decide to sell then you must also pay sale costs, which depending on the value of the property can amount to thousands of dollars.

Your major cost will be agent's commission, which might be as high as 3% (or more) of the sales price on top of other costs such as advertising. Then there are loan payout fees, solicitor costs and government charges which all whittle away your profits.

It's important to weigh up the costs vs. the benefits when deciding to sell. The great news is that these days there's enough flexibility in most loan products, which means you can still access a portion of your equity and/or capital gains without needing to sell.

Did you note that I used the words 'equity' and 'capital gains'? **Equity** is the difference between the value of your asset and what you owe. **Capital gains** are the difference between what you receive when you sell the asset, less what you paid.

Option Two: Mortgage Redraw

Most loans allow the borrower to redraw principal repayments, back to a preset limit, sometimes as much as s/he borrowed to begin with.

The process of redrawing your repaid principal is usually easy enough - perhaps a matter of filling in a few forms. Be careful of fees since some basic loan products offer this flexibility, but for a charge that might make redrawing a costly exercise.

Let's look at an example at how a mortgage redraw facility works.

I have a friend, Allan, who owns a recording studio, which is a huge black hole into which nearly all of his available cash is funnelled to maintain and upgrade his

equipment.

Allan likes the idea of investing in property, but believes his lack of cash prevents him from buying anything.

Allan, together with his financier, co-own his home which he bought for \$320,000. His initial mortgage was \$256,000, but after repayments and the passage of time, he now only owes \$230,000.

As shown below, despite his lack of cash, Allan could access up to \$26,000 in the form of a mortgage redraw facility and use it to pay for deposits and closing costs on a potential property investment.

Allan's Property Value	\$320,000
Bank's Maximum Lend (1)	80%
Bank's Maximum Loan	\$256,000
Less Allan's Current Loan	\$230,000
Equity Available	\$26,000

Option Three: Refinancing

The third way to access your equity / capital gains is to refinance your loan, which means paying your original loan and replacing it with another.

This can be an explicit process, where you swap lenders entirely, or alternatively it can be a subtle process where you use the same lender to revalue your property and then write a new loan (or update the existing loan) based on the capital appreciated value of your asset.

You can then use this money to reinvest in property, or as has been advertised by the Commonwealth Bank under their 'Equity Mate' TV ads lately, to buy a big screen TV, a boat or other consumer items.

Let's use Allan as an example here too and imagine that the value of his property increased with the current property boom to \$400,000. If he refinanced his loan then his available equity is now:

Allan's Property Value	\$400,000
Bank's Maximum Lend (1)	80%
Bank's Maximum Loan	\$320,000
Allan's Current Loan	\$230,000
Equity Available	\$90,000

Unlike redrawing equity, there's a lot more red tape when you try to refinance your loan which makes the process potentially expensive and time consuming too.

However redrawing or refinancing won't trigger any capital gains tax because you're not selling. Just a higher interest bill because you have borrowed more money.

Which option is right for you?

Only you can answer this question after carefully analysing the pros and cons of each option.

Sometimes it's better to sell, repay debt and move on. Other times it would be silly to sell one good quality asset and then have to replace it with another one when you can keep it and still obtain a cash injection by redrawing / refinancing.

The Ultimate Tenant From Hell Story

Thank you to all the people who have helped me by contributing 'tenant from hell' stories. There were some absolute shockers, but this one, from Charlie, was so bad that I [posted it on the forum](#).

I've had tenants from hell, only because I didn't know what I was doing as a landlord. If I'd had the experience, they wouldn't have got past the phone interview. As it's sometimes said, good judgement comes from experience and experience comes from bad judgement!

The first was a young couple, planning to get married. When the rent came late, or not at all, I took the 'we're-friends, we-can-work-this-out' approach.

Things improved for a little while, but not for long.

I sat down with them and was told point blank that HE put in his half of the rent, what SHE did with it had nothing to do with him.

I blindly ignored the red flashing lights and alarm bells, and extracted a written agreement for the rent to be paid on time and the arrears at \$20 per week.

After another couple of missed payments, I called around to find the house empty - sort of. There was furniture scattered about, but not enough to be livable. The missing bed was a clue that they'd moved out. The holes punched through the walls were a clue that it hadn't been an amicable departure.

I eventually tracked him down at his parent's house. I walked up after dark, knocked on the front door, and waited. I heard a rustling sound behind me and I turned around to see the biggest, blackest, most evil looking Rottweiler in the world, front legs braced on the step behind me, and lips curled back in a silent snarl.

It gave a low growl and visibly bunched up its muscles, ready to attack.

I was going to die. Horribly. Painfully. I did the first thing that came into my head. I stuck my hand in front of its nose.

"Giddy, pup! You being a good guard dog? That's a great set of teeth you've got there. What a good dog!"

The Rottie stopped in mid growl, tipped his head to one side, and looked at me as if I'd just escaped from the loony bin.

The door opened and my tenant looked out, obviously surprised to see me. "Where's the dog?"

"Right here," I said, reaching behind and giving the Rottie a pat.

"Jesus! Are you nuts? Didn't you see the sign and the bell push by the gate?"

"Nope. Anyway, I'm here about the rent and the damage to the property."

Turns out they'd split up, he'd taken his furniture and left her to it. He paid me his half of the back rent and the wall damage took care of their bond.

It took four weeks to find her and get her stuff shifted out. I had to promise her parents not to chase her for the rent otherwise they would leave her furniture there for another few weeks.

It was only then that I could clean and fix the property and get more tenants.

This time I was more careful. We let the estate agency vet them. We rented the house to a woman who had recently split up from her husband and who had a small baby. The rent wasn't a problem because it was being paid by Social Welfare.

I paid a courtesy call a week later to see if she was happy and the door was answered by another woman. She was a friend who had also moved in, with a couple of small kids, to share expenses. Thanks for asking me!

All three children had colds and were coughing. The house was cold and damp, they hadn't had the heaters going even though it was pouring rain in the middle of winter.

I'd bought a dehumidifier for my own house a few weeks before, on a 12-month interest free deal. I couldn't see kids suffering like that so I whipped it around and got it going. At least I had the sense to add it to the chattel list on the rental agreement.

Sure enough, rent day came and went. I rang Social Welfare and they said it took a few weeks to go through, and it would be paid as a lump sum. OK.

Two more rent days came and went. Social Welfare said its been paid. I said I hadn't got it. "Oh, we pay it to the beneficiary, they pay it to you!"

I called around, since they hadn't had the phone connected. No sign of my tenant, but the second woman and her kids were there. "Oh, she moved back in with her husband a couple of weeks ago." We agreed to transfer the lease into her name and she would start payments as of that date.

Two weeks later, no rent, popped around to find the house deserted. Cleaned out. No furniture, no dehumidifier, no curtains. Even the light bulbs and 98c plastic light shades had gone. The back door had been kicked in, wrecking the frame and breaking the glass panels.

The police came and spread black fingerprint dust over everything, and said that was about all they could do. They phoned a day later to say that they couldn't prove anything, but the word on the street was that the squatter had gone back to her husband, they'd taken everything out of the house and booted the door in to make it look like a burglary. Forget it.

It was kind of hard to forget it, when for the next nine months the electricity bill arrived with an amount added for the dehumidifier.

Once the door was fixed and the place cleaned, we found Tenant Number Three. Bad things come in threes, or was it third time lucky?

He was around thirty, and didn't have any references because he still lived with his parents. I knew to make my own checks now, so I spoke to his mother and his boss at work. He was a good clean boy and a valuable sales assistant in the home appliances department. But he had a dog. A smallish, light brown medium dog, short haired - but clean.

I didn't mind the dog, because we had two of our own, and he promised to keep it outside. And it was clean.

What he didn't tell me was that it was a vicious psycho death beast.

Because the rent was being paid on time, every time, and the outside of the place was tidy and the lawns mowed, I didn't bother going around until the six-month inspection was due. "Phone before you come round, I'll put the dog in the garage." "Sure!"

I wandered around and walked up to the gate. His dog was lying on the path sunning itself, maybe ten feet away. It lay there and looked at me and thumped its tail a couple of times. I leaned over the gate and had my hand on the latch when it struck like a cobra.

It just exploded and came up at me like a ginger cannonball. I'd flung myself back but it still sunk its fangs into my hand. If I hadn't moved it would have been my face.

I stood there, white as a sheet, blood dripping onto the concrete. The dog casually walked back to its spot on the path, turned around twice and lay down.

It looked at me and thumped its tail a couple of times.

Just then the tenant walked around the corner of the house. "Oh, you're here. I'll just shut the dog away."

"Ah, thanks, we've already met."

With my hand wrapped up, I checked the grounds.

Lawn like a bowling green, zero weeds in the garden, not a single dog poo anywhere. We went inside.

You know there's untidy-but-clean, normal clean, then there's neat-freak clean? Well the inside of the house was scary clean, with just a faint whiff of disinfectant.

Not a speck of dust anywhere. None.

Not in the bedrooms. Not in the kitchen. Not in the bathroom. Not in the spare room with the leather gear hanging up on the wall, not in the lounge with the huge rear-projection TV and surround sound and bookshelf full of accurately lined up selection of adult videos.

I signed off the inspection and said I wouldn't be doing anything about the dog, though he'd better put a warning on the gate. I couldn't get out of there fast enough.

The rent continued to be paid on time, every time, for the next three years until we sold the property to investors. As far as I know he's still there, quiet, clean, and a good payer... the ideal tenant!

Wow - what an amazing story. In fact there have been a lot of good quality posts lately. If you haven't been to the forum in the past week or so then grab a coffee [and spend ten or so minutes surfing around](#). You're sure to pick up several great tips to improve your property profits and read a few good yarns to keep you entertained.

Summary

This month we've continued our review of capital gains returns and found that your options when it comes to cashing in your equity or capital appreciation include (1) selling, (2) redrawing your mortgage and (3) refinancing your mortgage.

It was also great to hear from Charlie and his tenant from hell story.

Well, that's probably enough for this month. Best of luck with your property investing and remember that success comes from doing things differently.

Regards,

Steve McKnight

P.S. If you've got a spare few minutes then don't forget to [check out the forum](#).

P.P.S. Since we've covered some technical accounting ground in this edition, it would be remiss of me not to mention that I'm not providing tailored advice. Before making a decision about how to maximise your wealth be sure to consult your accountant or financial adviser.