negative versus positive gearing - what makes more cents ?

Even with an uncertain economy and the possibility of interest rate rises, rental yields are still expected to continue to increase in most capital cities.

As the population in these cities continues to grow, demand for housing will also increase. However with the recent economic conditions this increase in demand has not been satisfied with an increased supply of housing, resulting in a shortage of housing stock. Falling vacancy rates and higher rents have made it more difficult and expensive to find rental accommodation.

As many astute investors are aware, we are in the midst of a severe housing shortage which encourages increasing rents. As rental yields on most properties rise, this has created the possibility of a positively geared investment property.

In addition, many economists are predicting that the property market in most capital cities is likely to start increasing in the next few years. So now is a great time to be considering your personal financial circumstances and the opportunity for an investment property as part of your wealth creation program.

Like all good investments you first need to consider the property to be purchased. As with all property investments, location is the key consideration. Generally properties located within 20kms of the CBD with good train, bus and freeway access will offer stronger returns.

Once you have researched your future property, you will then need to decide on the gearing strategy that best suits you. This will be determined by your financial circumstances, retirement strategy, the level of your deposit, equity available, surplus monthly cashflow (income less expenses) and your acceptable level of risk. These considerations will clarify whether negative gearing or positive gearing strategies are most appropriate to your situation.

Current high rental yields and low interest rates herald the return of the positively geared investment property.

So, should you have positively or negatively geared property investments?

Here's a brief description of both gearing strategies to help you identify with the possibilities of each.
Positively geared properties are when the rental return is higher than your loan repayments and outgoings. Positive cash flow properties are self funding and are considered to be a conservative investment strategy that provides an income with exposure to the prospect of capital growth.

Bear in mind that with positive gearing there is the potential that tax will be payable on the net income (after the consideration of depreciation and other tax deductions). Positive gearing is beneficial when an individual does not have surplus cashflow to fund income losses during the ownership period or other income to offset losses.

Negatively geared properties are when the rental return is less than your loan repayments and outgoings (placing you in an income loss position). There is however the underlying expectation that the accumulated losses will be more than offset by the capital growth on the property. In this circumstance the rental return is not considered as important in the decision process.

The key benefit associated with negative gearing is that the loss associated with the property ownership can be offset against other income earned, reducing your assessable tax income, thereby reducing your tax payable. The result is that the cost of owning the property is being funded by your tenant (in the form of rent), the tax office (in the form of tax savings) and your surplus cash flow.

Generally high tax payers choose the negatively geared investment option to maximise their tax returns and benefit from the long term capital growth potential. Investors closer to retirement or in a lower income bracket may choose positively geared investments to maximise their income potential.

Feel free to call the office and ask us to calculate the various loan to income ratios that may help you decide which gearing option is best suited to your individual circumstances. As always it is best to seek professional advice before proceeding with any investment strategy.

*Disclaimer: This article is generic in nature. All investment decisions should be considered wisely and based on your personal and financial circumstances. Seek proper advice before committing to any course of investment action. This is not deemed as advice.