THE AUSTRALIAN

Rentvesting may be a better option than paying high purchase price

With huge demand and high prices in central locations in Melbourne and Sydney, many are looking at 'rentvesting' — buying an investment property and renting where they want to live. Picture: Jay Town.

THE AUSTRALIAN 12:00AM March 26, 2017

Around 20 years ago when Miriam Sandkuhler was getting ready to buy a house, she knew she wanted to live in Albert Park.

It was a desirable location, not far south of Melbourne's CBD, and near a lake and beaches. The only catch was she couldn't afford to buy a house there.

As a compromise, she bought an apartment in South Yarra as an investment and rented a two-bedroom house in Albert Park, which she shared with a flatmate.

The strategy, sometimes called "rentvesting", allows first home buyers to get into the property market by buying a place within their budget and leasing it to tenants while renting in their preferred location, often closer to the city.

The strategy has pros and cons. A range of considerations includes the tax treatment of the properties and the costs involved in a buyer's individual situation.

The flexibility of rentvesting is a key advantage, says Ms Sandkuhler, now the chief executive of Property Mavens and a licensed buyer's advocate.

Buyer's advocate Miriam Sandkuhler. Picture: Tony Gough

Not only can a buyer stay in the suburb they prefer to live in – perhaps closer to where they grew up, or near friends, workplace or entertainment – rather than moving to a cheaper outer suburb, they can also adjust their living situation as their personal circumstances change.

"You might start renting with a flatmate. You then might have a spouse, and then might have a family on the way," she says. "Renting gives you options over your lifestyle changes."

She also notes that it's cheaper to move as a renter than an owner, given all the transaction costs involved in selling one property and buying somewhere else.

It may also be possible to get a tax benefit on the investment property if it is negatively geared. That is, if the rental income you receive is less than the interest and other expenses you pay, you are making an investment loss, which can be used to reduce your taxable income.

It's important to make a wise choice when selecting an investment property, Ms Sandkuhler says. She recommends looking for a place that's clean and has good light, off-street parking, a balcony or courtyard, and air conditioning or heating.

Picking the right location is key, but don't forget the impact of capital gains. Picture: Jay Town.

Don't choose somewhere noisy, such as right next to a train line, and avoid apartment blocks with a swimming pool and gym as these can push up the body corporate fees.

Although rentvesting looks attractive for someone whose lifestyle is important to them, capital gains tax can have a significant effect on the bottom line, says buyer's agent Chris Curtis, managing director and licensee in charge of Curtis Associates.

When a buyer sells an investment property for more than they paid for it, they will pay tax at their marginal rate on the gain. If a buyer holds the asset for more than 12 months, they are taxed on only half the gain.

But the family home is exempt from capital gains tax when it is sold, he points out.

For someone looking to build wealth over the long term, Mr Curtis has some frank advice on the rentvesting strategy.

"It's a euphemism for buying a flashy lifestyle in the meantime; it's not a pathway to wealth creation," he says. His recommendation? "Live in a good owner-occupied home that may not be as flashy but offers good capital growth potential and pay off your mortgage quickly."

And think about where your payments go. "Paying rent is paying someone else's mortgage and that's dead money," Mr Curtis says. "Interest on your home is not necessarily dead because when you sell that home you're going to make more than the interest."

As property prices rise, there have been frequent calls for federal changes to both negative gearing and capital gains tax to reduce investor demand.

Although the Coalition government has been hesitant to alienate its base with extensive reforms to these taxes, Mr Curtis encourages clients to consider the "Plan B" scenario that Labor wins the next election and implements its policy of limiting negative gearing to new housing and halving the capital gains tax discount.

"Run that scenario and just make sure you can cover all your borrowings," he suggests. "If you think the Libs are never going to get turfed out don't give it a moment's thought."

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