



# YIELD OR GROWTH – WHAT WORKS FOR YOU?

Investing in property is ‘the dream’ of many with the opportunity for wealth creation. Realistically, not all investments are equal, and deciding on how to invest depends on many factors including your long-term goals.

## ‘Gearing’ simply refers to the notion of borrowing to purchase an investment property

In Australia, the split of positively geared to negatively geared investment properties is 40/60 respectively<sup>1</sup>.

### Meet Paul

Paul has been working as a chef for several years. He started out by washing dishes before scoring an apprenticeship where he learned the art of pastry. After graduating, he gained experience with others before setting up his own bakery. Paul worked hard to save \$80,000 towards his investment property.

He found a three-bedroom home in a regional location for \$300,000 with a weekly rental of \$350 – a rental yield of just over 6%.

After taking into consideration the principal and interest repayments, property management fees, council and water rates and insurance, Paul had a small weekly surplus that he saves as a buffer for unforeseen events.

*This is an example of **positive** gearing.*

### Meet Veronica and John

Veronica is an office manager working for a large organisation and John has his own plumbing business. They

are currently paying off their own home and bought an investment property.

They purchased a two-bedroom unit close to the city with great access to public transport and amenities. This property cost \$640,000 and rents for \$500 per week. Since they have been paying down their own home loan they borrowed 100% of the purchase price and used the equity in their home as security.

Veronica and John have taken out an interest only loan so any additional money they have can continue to be utilised for paying down the loan on their principal residence.

The investment property is costing them approximately \$60 a week to hold after taking into consideration the interest on the loan and the associated holding costs. As they will obtain a tax deduction for this amount, they are comfortable in anticipating that the capital gain from the property over time will more than offset this amount.

*This is an example of **negative** gearing.*

**No one investment strategy is better than another**, but rather your investment strategy needs to be developed having regard to your personal income, age, asset position and financial goals.

## What factors influence strategy choice?

### Location of purchase

Aside from the recent disruption to the market caused by the pandemic, the price growth in capital cities generally outperforms those in regional areas. Research undertaken by RiskWise in 2018 indicated that houses in capital cities delivered on average 52.2% in capital growth in the previous 5 years compared to 23.5% capital growth in regional areas<sup>2</sup>.



In contrast, rental yields in regional areas are generally between 1% and 2% higher<sup>3</sup> than those in capital cities.

As a result, it is more likely that you will be able to positively gear a property in a regional area than in the city, however you are more likely to obtain a larger capital gain in the city.

As the pandemic has demonstrated, past performance is no indication of future performance, with many regional areas outperforming capital cities in the 12 months to May 2021<sup>3</sup>.

### Your age

Generally, as you near retirement age you become more focussed on creating passive income streams to replace your working salary. As a result the closer you approach retirement, the more likely you are to invest in property that is positively geared, while when you are younger you may have a preference to seek higher capital returns.

### Available funds

Your mortgage repayments are the largest cost of property investment. While the size of these mortgage repayments is driven by many factors, two of the largest issues are the size of the loan and whether you choose an 'interest only' or 'principal and interest' loan.

It therefore makes sense that the larger the deposit you have available the more likely you are to be able to create a positive cashflow. Similarly, as repayments on an interest only loan are lower, you are also more likely to be in a cash surplus position.

### Financial goals

There are many different financial objectives for buying property and these can vary from:

- creating a passive income stream
- purchasing property for later development
- offsetting a large annual tax liability, and
- many more.

Your goal in purchasing property will help to determine the gearing strategy to be adopted.

Most importantly, regardless of the gearing strategy you wish to pursue, your property selection needs to be based upon sound market research to ensure that it will deliver your financial goals. Remember, your gearing strategy will only assist in the achievement of your financial goals and will not compensate for a poor investment decision.

Remember to contact the office before deciding on your strategy. We are here to assist you in making well informed financial decisions.

#### Sources

1 [duotax.com.au/positive-gearing/](https://duotax.com.au/positive-gearing/)

2 [riskwiseproperty.com.au/News/capital-cities-vs-regional-areas](https://riskwiseproperty.com.au/News/capital-cities-vs-regional-areas)

3 [smartpropertyinvestment.com.au/research/22744-chasing-rental-yield-or-capital-growth-here-are-the-best-regions-for-investors](https://smartpropertyinvestment.com.au/research/22744-chasing-rental-yield-or-capital-growth-here-are-the-best-regions-for-investors)

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**'Looking Closer At Positive  
Versus Negative Gearing'**

