

Coping with negative cash flow



Margaret Lomas reveals practical tips on how to deal with cash flow squeeze

The world is in the grips of an economic crisis, the end of which not a single analyst is really able to predict. We have landed at a place we have never really been before where, like the butterfly effect, our global markets respond instantly to murmurs being heard half a world away.

Technology is the culprit and also the reason why the outcome is so hard to determine. History is simply not repeating itself, and so we as reluctant players in the drama must strap ourselves in, hang on for the ride and hope that it comes to an end before we suffer any real damage.

Australia has not been immune, and previous to this latest raft of share-market crashes and rebounds, property investors in some markets were already feeling the pinch. For some, this pinch manifested itself as a negative cash flow – in some cases in the extreme – which not only caused financial hardship but which kept many new investors away from a market

they felt they simply could not afford.

For those investors who today find themselves in the position of having a negative cash flow (that is, a shortfall between income and expenses), it's time to sit down and examine the property, your goals for the future and your finances, so that you can make some decisions about what your next step will be.

Here are some options for you.

Claim your deductions now

This is obvious to a lot of investors, but many still like to wait until the end of the year to make their deductible claims, so they can get a lump sum of money back.

This makes no sense. The ATO will not pay interest to you for the privilege of holding your money for the year. You, on the other hand, can save interest by using the tax you can get back from your deductions to make additional repayments into your loan, offsetting interest and adding a small amount to your cash flow.

To do this, you have to obtain an Income Tax Withholding Variation (ITWV) form from the ATO. You can even download one of these from www.ato.gov.au. Using this form, you must estimate the income you are to receive from the rent, the expenses you will have throughout the year, and also the amount of depreciation you will be able to claim on the building, fixtures, fitting and furniture. For those who have held their property for some time, this information is easy to obtain, especially if you have been diligent with tracking your expenses and income. Those who have only just purchased will need to obtain past figures from the agent, or make as close an estimation as you can. Depreciation is easy – simply have a depreciation schedule prepared by a reputable quantity surveyor and you will have the exact figures for each year, for the entire life of

the allowable depreciation.

Once you have completed the form and lodged it, it will be assessed and your employer advised of how much to reduce your tax withheld by. The amount will be based on how much you have already paid for the financial year, and so it's important that you complete a new form at the start of each financial year.

If you're worried that you will over- or underestimate, and so incur a penalty from the ATO for doing so, don't. As long as you keep track of your income and expenses, you should be able to tell within around two months of the end of the financial year how close you have been. If you're more than 10% out either way, there will still be time to lodge another form rectifying this, prior to the year coming to an end.

Receiving your tax breaks weekly in your pay could provide an extra \$40 or \$50 a week to you, and this could mean the difference between being able to manage the costs, or having to sell up.

Adding value

This is a method that I'm not quick to recommend, as in many cases the cost to add value has no marked effect on the ability to increase rent. However, if you decide to explore this option, there are some things you must do.

Firstly, work out exactly how you intend to add value, and establish whether it's an action that is likely to impact on your yield. For example, a property in a tropical climate may be more in demand and obtain a higher rent return if you install an air conditioner, whereas such an improvement may mean little to someone who rents property in Melbourne or Adelaide. The addition of a bedroom could be the solution if your property is in an area where people demand property with more bedrooms than you currently have, but where your property is typical of the average

home and already satisfies demand nicely, it may not be worth it. Aesthetic enhancements such as gardens, new paint and carpets or an upgraded kitchen may add an appeal that brings more tenants, but may not impact greatly on how much they will pay.

Be guided by your property manager in this regard, and then do a cost benefit analysis. For example, a new kitchen may cost \$10,000, which at 8.5% interest will cost you an extra \$850 a year on your loan. You would need to achieve an extra \$17 a week in rent to pay for this. An air conditioner may only cost you \$2,000, or \$170 a year, but could add \$10 to a rental return in far North Queensland.

Remember, if you're a long-term property investor, you aren't looking to add value to achieve a higher sales price – you're after more rent. While adding value may give you a higher valuation which allows you to leverage into more property, if cash flow is your problem today you're probably not in a position to buy more property anyway, and so the ability to increase value becomes a moot point for the short term.

Increase rents and have shorter-term leases

This may sound like I'm stating the obvious, but I often meet investors who are either too busy to keep their eye on market values, are relying on their property manager to suggest rental increases, or don't want to upset what they perceive as a good tenant by increasing the rent.

Most parts of Australia are in the midst of great pressure on rent returns. For many years, values increased in unprecedented amounts in many areas, and rental yields were left behind. After a period of sustained values growth, rental yields will also follow and experience a wave of pressure. If you add to that our

current housing affordability crisis, and our alarming undersupply of housing – a fact which is being exacerbated by the inability of developers to access funding to build – then it's clear that pretty soon, people will be almost fighting in the streets to rent a property. It's likely that the current rent you're asking for on your property is already out of date, and an increase is easily achievable.

In addition, be sure to keep all of your leases short term, usually around six months only. During these times when there are more tenants available than properties to house them, it's crucial that you keep up with the market. Locking a tenant, no matter how good you perceive them to be, into longer-term leases will mean that you will miss out on the frequent opportunity to increase rents and so ease your own cash flow issues.

For those of you who feel a responsibility towards a good tenant who you've had for years, now isn't the time to be overly benevolent. By all means allow them some privileges, but don't charge under market rent. Times are tough, and keeping rents so low that you experience cash flow problems could mean that it becomes a case of you or the tenant – and it will most likely be you. There are a lot of good tenants around at the moment, and your job isn't to be worrying about cash flow management for your tenant.

Finally

Start in your own backyard. Examine your budgets, and see where you can make cuts. It's during tough economic times that those who stick with it become the most successful. In the olden days where positive cash flow property was abundant, investing in property was easy. You could buy anywhere and do well, and many properties were positive cash flow, meaning that you had now commitment from your own pocket. Now that the yields are down, property

investing has once again become difficult, and only those with a desire to get ahead will see the opportunities which presently abound.

If, on the other hand, your cash flow is so tight that you aren't able to meet your current commitments, then it could be time to sell. Be aware that to do so you will need to have a reasonable expectation of what you can achieve as a sales price, and you will be entering a market which many others are entering at the same time. Selling will be difficult unless you're prepared to take a lower price than anyone else.

If you do manage to sell, and you exit the investment with cash left over, use it to immediately reduce your other commitments, so the time at which you can reinvest comes sooner. Resist the temptation to reward yourself with a holiday or new car and make your commitment to achieve a better financial situation by minimising debt wherever possible.

For those determined to stay in, remember that we're now facing a temporary period of low cash flow on property, and it's time for you to make some sacrifices if you wish to be successful over the long term. Tighten your belt and increase your commitment to your future financial security. Do anything you can to avoid selling, because the situation is already easing every day, and you don't want to look back and wish you'd tried harder to hang on to an asset which may have one day provided a comfortable future for you. ■

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