

Feasibility Analysis: A Quantity Surveying Service in perspective

In a building context, feasibility analyses are used to help decision makers determine the viability of an investment. A Feasibility analysis varies in quality from very good to downright dangerous. At best Feasibility analyses are a means of informing decision makers, at worst they can actually mislead decision makers. It is worth emphasising the word 'inform' decision makers since ultimately decision makers have to weigh up many conflicting demands before making a commercial decision.

Ideally a thorough Feasibility analysis should include all major project variables, which are likely to influence an investment outcome. This is an easy statement to make, but in reality quite difficult to achieve.

An accurate Feasibility analysis at minimum considers the following:

1. Market Research;
2. Financial analysis;
3. SWOT Analysis;
4. Projected Depreciation;
5. Sensitivity analysis of the Internal Rate of Return (IRR).

One of the essential features of any Feasibility analysis is to determine what size the model should actually be or 'determine

the system boundaries'. The first step in building a Feasibility model is to attempt to identify all the factors which might have an influence on the outcome of the investment proposal. The economic definition of variables which are within the model is "endogenous", and for those factors which are outside the model, "exogenous". Several endogenous and exogenous variables which can be considered include:

ENDOGENOUS	EXOGENOUS
1. Land cost	1. Weather
2. Building cost	2. Political
3. Financial charges	3. Industrial action
4. Selling price	4. Marketing
5. Profit	Success/Failure

In conclusion, Feasibility analyses are a model and a simplification of reality. It is important to note that models are tools to help decision makers and are not to supplant the decision makers thought processes. A good investor and decision maker will have an inbuilt feeling for market trends, consumer references and many other factors which will supplement the core feasibility model.

BMT WILL CONTINUE, IN FUTURE EDITIONS OF "MAVERICK", TO EXPAND UPON EACH OF THE QUANTITY SURVEYOR'S SERVICES.

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IN THIS ISSUE:

- GST: Planning for 1 July 2000
- Ralph Review Impacts – Stage 2
- Feasibility Analysis: A Quantity Surveying Service in perspective

GST: Planning for 1 July 2000

Some simple planning can result in savings in construction and development costs in the run up to the GST's introduction on 1 July 2000.

Commercial and Infrastructure Projects and Residential Property for sale

The planning techniques depend on the nature of the project and the GST status of the property developer. In respect of most commercial and infrastructure projects and residential properties for sale, the developer will usually be able to obtain an input tax credit (ITC) for any GST charged by the construction contractor. By claiming the ITC through its Business Activity Statement (the GST return) the developer will **not** suffer an actual GST cost. Thus, any planning is best directed at eliminating any avoidable sales tax costs and reducing the impact of GST on cash flow.

Sales tax will be charged to the construction contractor in respect of taxable building materials **removed or dispatched from the supplier's premises** no later than 30 June 2000. The typical goods subject to sales tax include certain lift and air conditioning equipment, lighting, security goods, signs, bathroom fittings and many fitout items. If the contractor can schedule construction work and ordering so that the supplier delays dispatch of sales taxable items until 1 July 2000 or later, sales tax will not be charged.

A special sales tax credit is available to the contractor for sales tax paid trading stock on hand, and not affixed to the premises, at the start of 1 July 2000. The Australian Taxation Office (ATO) has confirmed that trading stock comprising building materials on construction sites qualifies for the special sales tax credit. The prospect of that refund may encourage contractors to delay the installation of sales tax paid stock on hand in the last two weeks of June 2000. The contractor is the likely beneficiary of these sales tax planning techniques although the contract may require savings of this kind to be passed on to the developer.

To reduce the impact of GST on cash flow, the contractor needs to ensure that the contract requires payment for the works in



installments. If a valuation of work in progress at 1 July 2000 is obtained, GST would then only be payable on the progress claims for works undertaken from that date. This can provide a cash flow benefit to both the contractor and the developer. The ATO has issued a draft ruling outlining three acceptable valuation methodologies involving either values of approved progress claims or an independent valuation by a recognised person. The ATO has nominated the Quantity Surveying Profession as a professional body to undertake GST valuations.

A planning technique from 1 July 2000 will be for contractors to certify progress claims with developers before issuing the progress claim invoice. Otherwise, the contractor may have to fund a GST liability on progress claim invoices for a considerable period before the claim is agreed, certified and ultimately paid by the developer.

Commercial Property for Banks and Insurers and Residential Property for Occupation or Lease

GST planning takes a different flavour in respect of commercial property constructed for banks and insurance companies and residential property for occupation or lease by the developer. In these circumstances the developer (e.g. bank) may not be entitled to ITCs for GST charged by the contractor. The GST will become an actual cost that either must be absorbed by the developer or passed on in its lease charges or prices for other supplies it makes.

The work in progress valuation at 1 July 2000 becomes critically important. The developer will benefit if as much of the project is completed by 1 July 2000, and the work in progress at that date is given the maximum value possible. Rather than have the contractor delay installing sales tax paid items or keeping stock on hand at 30 June 2000, the developer will want work accelerated. The sales tax saved from a deferral is likely

to be dwarfed by the additional GST imposed on all the costs associated with installing those items after 1 July 2000.

This article was written by Stephen Baxter of Indirect Tax Consulting Group who can be contacted on (02) 9247 6464 if you would like to discuss GST on your property transactions.



Ralph Review Impacts: Stage 2

Reforming the capital allowances system: effects on major property types post 01/07/2000

PREPARED BY: BMT & ASSOC RESEARCH DIVISION

The second stage of the Government's Ralph review reforms of business taxation includes a further change to the method used to calculate depreciation for plant and equipment. This second stage of changes focus on the introduction of a low-value pool for assets costing less than \$1,000 and applying a rate of 18.75% Diminishing Value in year one and a rate of 37.5% every year thereafter.

This new pooling of low value depreciable assets is the second change in addition to the removal of accelerated depreciation provisions, and the introduction of a system based on the effective life of plant and equipment as discussed in the previous edition of Maverick, Issue 6, Summer 2000.

BMT & ASSOC have modeled a number of typical property investment types and included the changes stated above.

The changes to expected depreciation are clearly shown in the scenarios on the following page in the periods selected, which differs, significantly between the alternate property types.

As the examples illustrate residential investment properties benefit significantly from the 'pooling' of items with a value of less than \$1,000. The total claimable depreciation after the first five years of ownership, in both residential investment scenarios **increases**, via the 'pooling' method when compared to the effective life rates of depreciation claimable in the period from 21/9/99 to 30/6/00.

The impact of 'pooling' is less positive in retail and commercial properties. This is predominantly due to the high values of plant and equipment contained within these property types.

The impact of pooling generally declines after the first five years of ownership, as the examples start to illustrate in the fifth year. The impact 'pooling' will have on holders of investment properties will generally depend on the owners taxation position and the period for which the asset is held.

Further changes to legislation affecting depreciation allowances have been proposed to take effect on 1 July 2001. These changes specifically focus on the Division 43 Write off Allowance of a buildings structure to be based on its effective life. Further detail on this new treatment of the construction write off allowances is currently being drafted and BMT & ASSOC will keep you informed when the details become available.

THREE BEDROOM HOUSE – PURCHASE PRICE \$225,000			
YEARS	ACQUISITION DATE		
	27/2/92 - 21/9/99	POST 21/9/99	POST 1/7/00
1	10,700	9,200	8,000
2	7,000	5,500	8,400
3	6,200	4,900	7,100
4	5,500	4,500	6,500
5	4,700	4,100	5,200
TOTAL	34,100	28,200	35,200

THREE BEDROOM UNIT – PURCHASE PRICE \$300,000			
YEARS	ACQUISITION DATE		
	27/2/92 - 21/9/99	POST 21/9/99	POST 1/7/00
1	20,500	12,000	11,500
2	13,800	10,000	10,100
3	11,800	9,300	10,100
4	10,200	8,700	9,000
5	9,000	8,200	8,300
TOTAL	75,300	48,200	50,300

SMALL RETAIL BUILDING – PURCHASE PRICE \$2,500,000			
YEARS	ACQUISITION DATE		
	27/2/92 - 21/9/99	21/9/99 - 31/6/00	POST 1/7/00
1	255,000	200,000	190,000
2	175,000	142,000	165,000
3	160,000	110,000	120,000
4	150,000	89,000	98,000
5	145,000	80,000	89,000
TOTAL	885,000	621,000	662,000

MEDIUM COMMERCIAL BUILDING – PURCHASE PRICE \$7,500,000			
YEARS	ACQUISITION DATE		
	27/2/92 - 21/9/99	21/9/99 - 31/6/00	POST 1/7/00
1	525,000	368,500	330,000
2	370,000	272,500	285,000
3	302,500	241,000	263,000
4	260,000	220,000	234,000
5	220,000	202,000	221,000
TOTAL	1,677,500	1,304,000	1,333,000

We note that this document is BMT & ASSOC Pty Ltd interpretation of the Government's response to the Ralph review at 15/5/00.

Should you require any additional information or have further questions on the material presented above please contact BMT & ASSOC representative at your nearest office.

