BMT & ASSOC
Quantity Surveyors

MAVERICK™

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Becoming Depreciation Wise

In terms of depreciation, what should you consider when making an investment property purchase decision?

If you are looking to purchase an investment property, it is worthwhile asking yourself a number of questions. While many investors consider location, purchase price and tenanting ability when contemplating an investment property purchase, they often overlook depreciation as an important factor. Depreciation can help unlock the cash flow potential within an investment property, often meaning the investor will have thousands of additional dollars each financial year.

There are several factors for consideration that will enable the property owner to maximise tax depreciation benefits including:

- The age of the property: Both new and older properties will attract some depreciation deductions, although a property with an age between 1-20 years will provide higher depreciation than an older property.
- The type of property: If the property is part of a strata complex or community title development, each unit is entitled to claim common property benefits in addition to the unit's depreciation benefits.
- The amount of common property: Common property items within a strata or community title complex such as lifts and swimming pools are included in the depreciation report. The more common property there is, usually results in higher depreciation claims.
- The amount of plant and equipment: Plant and equipment are items that can easily be removed from the property as opposed to items that are permanently fixed to the structure. Plant and equipment includes items such as light shades, stoves, air conditioning systems, blinds and carpet. These items can be depreciated at a higher rate and add significantly to the depreciation claim. More plant and equipment generally means higher depreciation claims.

Once you have purchased an investment property, what can you do to increase your depreciation deductions?

In order to maximise the tax benefit your investment property will attract, you will require the services of a recognised Quantity Surveyor with specific property tax depreciation skills and experience. To ensure you claim all your entitled depreciation deductions a site inspection will need to be carried out as this will accurately identify all items of plant and equipment. These specific items attract higher depreciation rates than what is applied to the building. An over-capitalised property with more expensive fittings such as ducted air conditioning and stainless steel oven, cooktop and rangehood will have a higher depreciation claim than less expensive fittings such as split system air conditioning and an upright stove.

Example: Tiles vs. Carpet
To obtain the highest depreciation claim when removing old carpet, should it be replaced with tiles or new carpet?

Item	Value	Basic Rate	Depreciation 1st Full Year	Depreciation Over 10 Years
Tiles Division 43 (Capital Works Allowance)	$3,000	2.5%	**$75**	**$750**
Carpet Division 40 (Plant & Equipment)	$3,000	20% *(Diminishing Method)*	**$600**	**$2,906**

Note: This does not include scrapping of the original carpet.

Replacing the old carpet with new carpet in leiu of tiles will attract a higher depreciation rate of 20% using the diminishing value method, opposed to the tiles attracting a rate of only 2.5%. In both cases you will obtain depreciation but in this case it would be beneficial to the property owner to replace the old carpet with new carpet in order to obtain a higher return. BMT & ASSOC are specialists in maximising depreciation claims and can provide advice about any property scenario.

> *"Depreciation can help unlock the cash flow potential within an investment property, often meaning the investor will have thousands of additional dollars each financial year"*

Inside this issue

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Calculating Historical Construction Costs

When a quantity surveyor completes an investor's capital allowance and tax depreciation claim, two main elements are taken into consideration;

- Capital Works Allowance (Division 43) and
- Plant and Equipment (Division 40).

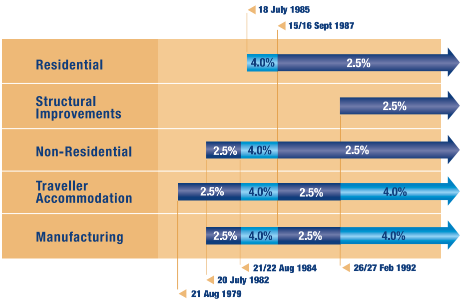
Capital Works Allowance: The capital works allowance is a deduction available for the structural element of a building including fixed irremovable assets; this is commonly referred to as the building write off. Only some properties will qualify for this allowance, depending on the age of the building.

Plant and Equipment: The plant and equipment element is a deduction available for removable assets which are identified through Australian Taxation Office (ATO) legislation as assets which depreciate at a faster rate than the building. Each plant and equipment item has an effective life and the depreciation available on that item is calculated accordingly.

Capital Works Allowance: Historical Calculations

When an investor purchases a property there is often no information available that outlines what the building originally cost to construct. To calculate the capital works allowance the ATO requires that either the original construction cost be used or an estimate of the construction cost is obtained, which will reflect the cost at the time the building was built. This is commonly called the historical construction cost.

The capital works allowance available on a property is determined from the date of commencement of the construction works. All income producing buildings, refurbishments, extensions and fit-outs that have commenced within the qualifying time periods are eligible to claim the capital works allowance.
The following graph demonstrates the qualifying dates and the rate the capital works allowance (Division 43) is claimed at.



Some buildings will not qualify for the capital works allowance due to their age. For example, as can be seen from the graph, an original residential building constructed pre 18 July 1985 will not qualify for the capital allowance. However, if a renovation or extension has been completed since 18 July 1985, the building allowance can be claimed for those works.

Rate of Building Write Off

As the graph illustrates, the date of construction of a building or renovation determines if the capital allowance is depreciated at a rate of 2.5% or 4.0%. Where the capital allowance is depreciated at a rate of 2.5%, it can be claimed for 40 years from the date of construction completion. Alternatively, where the capital allowance is depreciated at a rate of 4.0%, it can be claimed for 25 years from the date of construction completion.

Establishing the historical construction cost

BMT & ASSOC visit the site.

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Take photographic, written and measurement records.

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Contact council and other authorities to establish exact dates of original construction or renovation.

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BMT & ASSOC establish a historical construction cost for the original construction or renovation using historical costing data coupled with historical indices to establish a useable construction cost at the time the building was built.

> *"Older buildings which do not qualify for the capital works allowance will still attract a tax credit for the depreciation of plant and equipment which can be claimed regardless of age."*

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Example 1:
House Built 1986 (qualifying for Division 43)
Renovation Completed 1994 (qualifying for Division 43)
Settlement Date: 30/06/2007

As outlined previously, the 1986 original construction work can be written off at 4.0% and the 1994 renovation can be written off at 2.5% per financial year.

BMT & ASSOC estimates the 1986 historical construction cost at $160,000

Calculation: Written off @ 4.0% = $6,400 per year for 25 years

Balance: As the property was built in 1986 and the capital allowance can be claimed at 4.0% for 25 years from date of construction completion, the investor will have 4 years of capital allowance left to claim = **$25,600**

BMT & ASSOC estimates the 1994 renovation construction cost at $25,000

Calculation: Written off @ 2.5% = $625 per year for 40 years

Balance: As the renovation was completed in 1994 and the capital allowance can be claimed at 2.5% for 40 years, the investor will have 27 years of capital allowance left to claim = **$16,875**

Example 2:
House Built 1997 (qualifying for Division 43)
Settlement Date: 30/06/2007

BMT & ASSOC estimate the 1997 historical construction cost at $200,000

Calculation: Written off @ 2.5% = $5,000 per year for 40 years

Balance: As the property was built in 1997 and the capital allowance can be claimed at 2.5% for 40 years from date of construction completion, the investor will have 30 years of capital allowance left to claim = **$150,000**

It is important to remember that older buildings which do not qualify for the capital works allowance will still attract a tax credit for the depreciation of plant and equipment (Division 40) which can be claimed regardless of age.

Quantity Surveyors are recognised by the ATO under TR 97/25 as appropriately qualified to estimate construction costs of a building for capital allowance and tax depreciation purposes. As a lot of investment properties are not brand new, it is important to accurately estimate the historical construction cost in order to maximise the tax credits available.

The Application of Division 43

When calculating historical construction costs, a number of items need to be included in Division 43 calculations:

- Materials and labour used in construction;
- Head contractor's profits and overheads;
- Head contractor's preliminary costs;
- Consultant fees; and
- Local Government fees.

According to Income Tax Assessment Act 1997 – Section 43.70, there are a number of items that can not be included in a Division 43 - capital works allowance claim. The items that must be excluded from calculations include:

- Expenditure on acquiring land; or
- Expenditure on demolishing existing structures; or
- Expenditure on clearing, levelling, filling, draining or otherwise preparing the construction site prior to carrying out excavation works; or
- Expenditure on landscaping; or
- Expenditure on Depreciating Assets – Division 40.

Other exclusions include:

- Marketing costs involved in selling the development;
- Developers margin;
- Market driven intangible costs.

Capital works allowance (Division 43) calculations are complicated and should be handled by a qualified professional. A detailed knowledge of construction costing elements and the ATO's guidelines in the application of legislation is essential to maximising the potential claims available to an income producing property.

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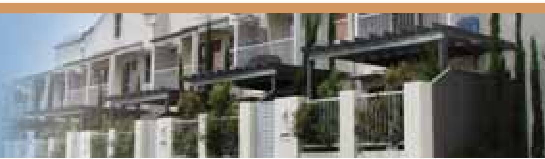


Construction Costs Per Square Metre - Sydney

Construction Type — Level of Finish

Construction Type	Low	Medium	High
Residential			
3br brick veneer project home, level block, shelf design	$954	$1,180	$1,478
Architecturally designed executive residence	$2,007	$3,087	$4,796
3br, 2 level brick veneer townhouse, including allowance for common property	$1,192	$1,385	$1,987
3 level walk-up unit complex, concrete structure ground floor parking	$1,345	$1,619	$2,101
Multi-level apartment building, including lift and basement car parking	$1,533	$1,931	$2,896
Commercial			
1-2 level open plan offices, including A/C, excluding fitout	$1,102	$1,421	$2,128
1-4 level open plan offices, including A/C & lifts, excluding fitout	$1,228	$1,443	$2,191
4-8 level open plan offices, including A/C & lifts, excluding fitout	$1,479	$1,797	$2,266
8 levels and over, including A/C & lifts, excluding fitout	$1,766	$2,033	$2,650
Industrial			
High Bay Warehouse, standard config, concrete floor, metal clad (size to 3500sqm)	$739	$801	$924
High Bay Warehouse, standard config, concrete floor, metal clad (size > 3500sqm)	$724	$781	$878
High Bay Warehouse, standard config, concrete floor, pre-cast concrete wall clad (size to 3500sqm)	$811	$899	$1,006
High Bay Warehouse, standard config, concrete floor, pre-cast concrete wall clad (size > 3500sqm)	$770	$873	$976
Retail			
Suburban shopping mall area including A/C	$1,257	$1,543	$1,819
Bulky goods centre, concrete tiltup construction, including A/C, excluding fitout	$997	$1,239	$1,380
Supermarket, including A/C, excluding fitout	$1,181	$1,284	$1,386
Specialty shops, including A/C, excluding fitout, services capped	$842	$909	$1,008
Hotels/Motels			
Single level boutique motel, including A/C guest facilities	$1,741	$2,184	$2,853
Single level tavern/hotel, including A/C, excluding loose item fitout	$1,525	$1,915	$2,090
Licensed club, including A/C, bar, lounge, rec facilities	$1,460	$1,874	$2,516
Multi-level, 3 star hotel including A/C, restaurant, bar, common facilities	$2,259	$2,922	$3,338

The Calculation of Construction Costs

The above costs are calculated based on a Gross Floor Area (GFA) rate. Typically GFA can be defined as the sum of the fully enclosed covered floor area and the unenclosed covered floor area of a building at all floor levels, measured in a square metre rate. GFA consists of two elements:

- Fully Enclosed Covered Area (FECA)
- Unenclosed Covered Area (UCA)

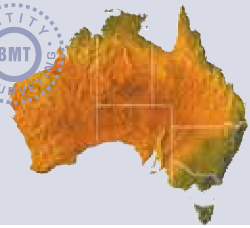
FECA:
Includes items such as:
- Basements
- Attics
- Garages
- Penthouses
- Lift shafts
- Staircases
- Columns and piers.

UCA:
Includes items such as:
- Roofed balconies
- Open verandahs
- Porches and porticos
- Attached covered walkways
- Usable space under buildings.

Costs provided are an average price for typical buildings as at the date of publication, allowing for preliminaries, builders profit and overheads. Costs can provide no more than a rough guide to the probable cost of building, as costs can vary significantly based on site conditions, level of fitout and design.

Regional Variations

Cairns	115	-	130%
Brisbane	105	-	115%
Sydney			100%
Canberra	96	-	104%
Melbourne	98	-	108%
Hobart	87	-	97%
Adelaide	98	-	110%
Perth	100	-	120%



For further construction cost details please refer to our website www.bmtqs.com.au

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