LIGHTHOUSE

Nelson Property Investors Presentation

NEW ZEALAND PROPERTY INVESTORS FEDERATION

Our Mission

Securing Kiwi's financial future.

Education

Action

Financial Freedom

Our Journey

A little history on the growth of Lighthouse Financial

2014

Started as an accounting firm in Napier April 2015 with one staff member.

2018

Renamed to Lighthouse Financial Services and the dream of a full service firm is born.

2020

Doubled group turnover and moved into new office at 41 High St, Auckland with 9 staff.

2022

Over 20 staff and quickly growing. with a book of over 4000 clients nationally and internationally.

As of September 2022

4100

Active clients both in NZ and abroad

★★★★★

Over 80 5 star online Google reviews

Some of the companies we've worked with:

Simpson Grierson

ROCKETLAB

Waitapu Group

SANFORD

engineering new zealand

xero

Matthew Harris

Managing Director at
Lighthouse Financial

Experience:

- 9 years at Inland Revenue as an investigator
- Property investor with over 30 properties
- Established property specialist
- Founder and Managing Director

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Discussion Points

- Property taxation
- Interest deductibility
- Rollover relief
- Structures
- Property as a wealth creation tool
- Retirement – What will you do?

Taxation Status

Three main factors can determine your taxation status
as a property investor

→ **Intention**
Your intention when you buy a property

→ **Transaction**
The patterns of your previous property transactions, and

→ **Association**
Your association to a builder, property dealer or developer

Intention

A key concept to the taxation of land provisions is intention.

That is, what was the person's intention at the time that they acquired the land?

Some people would probably say, how will Inland Revenue ever know my intention?

They don't have to know it, they only have to reasonably believe what your intention was to raise an assessment, then its up to you to prove them wrong!

Intention – Inland Revenues Approach

When establishing reasonable grounds to raise an assessment Inland Revenue will:

- Look at the transaction and the period of time for which the land was held;
- Look for similar transactions the person has engaged in;
- Refer to records held by third parties, and
- Review meeting minutes, loan applications etc.

A proactive approach is to ensure all relevant documentation indicates a persons private or investment intention.

Taxation of Land Provisions

Amounts derived from disposing of land will be taxable if any of the following apply:

- Acquired for the purpose or intention of resale;
- Acquired for the purpose of a business dealing in land, developing land, subdividing land or erecting buildings;
- Acquired by a land dealer, property developer or builder or an associate of a land dealer, property developer or builder and sold within 10 years (tainting provisions);
- Developed or subdivided within 10 years of being acquired and the development or division work is not minor;
- Involved in a major development or subdivision;
- Disposed of within 10 years and 20% or more of the profit derived on disposal is attributable to a resource consent or a change in zoning, and
- Acquired from an associated person and the amount derived would have been income under any of the above situations had the associated person retained and disposed of the land.

Govt Policy Changes

→ *Where we have come from*

- Intention based regime.
- No Capital Gains Tax.
- No GST.
- Historic Supply Issues.
- Historic Infrastructure Issues.
- House Price Index (HPI) - 9.8% annualised growth over the last 5 years.

→ *What's changed before now:*

- Depreciation removed from rental properties;
- Brightline Rules;
- IRD numbers for all property transactions;
- Resident Land Withholding Tax;
- LVR's up and down.

History of the Bright-line Rules

Were designed to complement the existing Intention based regime;
Intention = Subjective. Your intention when you purchase the property dictates your tax position.

3 parts:

- IRD numbers to settle property
- A bright-line test, and
- Resident Land Withholding Tax (RLWT)

Bright-line test

Property purchased and sold within a certain time frame will be subject to taxation on any gains made. This supplement's the current 'intention' based test.

- Gains are taxed at an entities applicable tax rate or an individuals marginal tax rate;
- Includes a grand-parenting provision;
- Losses are ring-fenced and can only be offset against property income;
- There are some exemptions;
- The start and end of the five year period is clearly defined, and
- The rules include an anti-avoidance provision

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What about GST

- GST threshold $60,000.
- Taxable Activity requirements.
- Accounting basis – Invoice, Payments, Hybrid.
- Time of supply.

Other GST issues:

- Apartments – Short Term Accommodation.
- Going Concern requirements.
- Zero-Rating of land transactions from 1 April 2011 (between GST registered purchasers).
- Second Hand Goods Claims.
- S&P agreements – Zero Rating – GST Clauses – GST inclusive, GST exclusive, GST if any.
- Residential Rentals – Exempt Supply.
- GST Commercial Properties – Taxable Supply.

New Rules

- Brightline Rule increased from 5 years to 10 years for in-situ houses;
- New Builds remain at 5 years;
- Interest deductibility to be phased out over a 4 year period for houses already owned that are not new builds;

New Interest Deductibility Rules

In March 2021, without warning for property investors or property professionals, the Government announced significant changes to the taxation of passive investment properties in New Zealand.

The rhetoric:

“Government needed to take steps to curb “rampant speculation” in the property market”
“Remove interest deduction loopholes for investors to dampen speculative demand and tilt the balance towards first home buyers”

The reality:

Supply and demand is not stable in New Zealand. It is very difficult to build houses in New Zealand. New legislation designed to limit demand, rather than targeting supply issues.

Interest Deductibility Cont

- Extension of the Bright-line Rules;
- Removal of interest deductions on existing dwellings purchase after 27 March 2021;
- Phase out of interest deductions for existing in-situ properties from;
- New Builds still allowed to deduct, and
- Rollover relief for certain property transfers.

⟶ **History**

Between 1 October 2015 and 28 March 2018 – 2 Years.
Between 29 March 2018 and 26 March 2021 – 5 Years.

⟶ **Now**

New Build - On or after 27 March 2021 - 5 Years.
Existing Dwelling – On or after 27 March 2021 – 10 Years.

What is a new build

To qualify for the 5-year bright-line period and interest deductibility for new builds, one of the following must be satisfied:

- For an existing new build, the person must have acquired it no later than 12 months after the code compliance certificate (CCC) was issued for that new build under the Building Act 2004 and it must have been issued on or after 27 March 2020.
- Where the person makes an off-the-plans purchase for a new build, the CCC confirming the dwelling was added to the land must be issued by the time they sell the land*.
- Where the person constructs a new build on their land, the CCC confirming the dwelling was added to the land must be issued by the time they sell the land.

Removal of interest deductions from in-situ properties

From 1 October 2021, interest cannot be claimed for residential property acquired on or after 27 March 2021.

For properties acquired before 27 March 2021, the ability to deduct interest is being phased out between 1 October 2021 and 31 March 2025

→ **What about re-financing?**

If you refinance like for like, you will still be allowed a deduction, up to the point interest is completely phased out.

→ **What about re-structuring?**

Interest deductions for any new loans drawn down on or after 27 March 2021 won't be allowed from 1 October 2021 onwards.

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What does it look like

Date Interest Incurred	Percentage of interest that can be claimed
1 April 2020 to 31 March 2021	100%
1 April 2021 to 30 September 2021	100%
1 October 2021 to 31 March 2022	75%
1 April 2022 to 31 March 2023	75%
1 April 2023 to 31 March 2024	50%
1 April 2024 to 31 March 2025	25%
On or after 1 April 2025	0%

Does not apply to

→ ***Land business***

Land held as part of a developing, subdividing, or land-dealing business, or a business of erecting buildings on land.

→ ***New build land***

a self-contained residence that receives a Code Compliance Certificate (CCC) issued under the Building Act 2004 confirming the residence was added to the land on or after 27 March 2020.

→ ***Property development***

Land that you develop, subdivide, or build on to create a new build.

Exclusions for some existing properties

- Main home – the interest limitation does not apply to interest related to any income-earning use of an owner-occupier’s main home, such as flatmates, boarders, bed and breakfast where the owner lives on the property.
- Properties used as business premises (except for an accommodation business), like offices and shops. This includes residential properties to the extent they are used as business premises (for example, a house converted into a doctor’s surgery).
- Farmland.
- Certain Māori land, papakāinga and kaumātua housing, and land transferred as part of a settlement under te Tiriti o Waitangi/Treaty of Waitangi.
- Emergency, transitional, social, and council housing.
- Commercial accommodation such as hotels, motels, and hostels (but not short-stay accommodation provided in a residential dwelling).
- Boarding establishment.
- Care facilities: hospitals, nursing homes, hospices, and convalescent homes.
- Retirement villages and rest homes.
- Employee accommodation.
- Student accommodation.

New Builds – Still deductible

New builds are still deductible, so what is a new build:

- A new build is a self-contained residence that is issued a Code Compliance Certificate (CCC) under section 95 of the Building Act 2004, confirming the residence was added to the land on or after 27 March 2020.
- A new build is also a self-contained residence acquired off the plans that receives its CCC on or after 27 March 2020 confirming it has been added to the land.
- A place only qualifies as a new build if it is self-contained. This means the new build would need to contain its own cooking and bathroom facilities and have its own entrance. The entrance could be from a shared access way, for example, a hallway shared by a block of flats in the same building.
- A new build does not have to be made of new material or constructed onsite, so it can include modular and relocated homes.

Roll-over relief

→ Family trust

Rollover relief applies for transfers of residential property to or from family trusts, provided that:

- Each transferor (in the case of transfers to a trust) or each recipient (in the case of transfers from a trust) of the residential property is also a beneficiary of the trust;
- All principal settlors are beneficiaries of the trust, and
- Each beneficiary is either a principal settlor, has a family connection with a principal settlor, or is a company controlled by a family member beneficiary or is a charity.

→ Look-through companies and partnerships

Rollover relief will also apply to transfers to or from LTCs and partnerships where the persons transferring the residential property to the LTC or partnership (or acquiring it from the LTC or partnership) and has the same ownership interests in the LTC or partnership interests in the partnership in proportion to:

- Their individual interests in the property, and
- Their cost base relative to the total cost base in the property.

How to offset the changes

→ **Review rents**

These should be raised often and follow the market.

→ **Review interest rates and loan structures**

Manage interest rates and loan structures. Ensure debt is effective.

→ **Reduce debt**

Reducing debt lifts the yield on your portfolio.

→ **Re-structure the portfolio to include new builds**

Purchase new builds, add minor dwellings, convert old dwellings into new dwellings with CCC issued.

What does it mean

- Some investors will change what they invest in;
- Some investors will sell;
- Demand for new builds will increase (to the detriment of first home buyers);
- Demand for developable land will increase;
- Demand for high yielding properties will also increase;
- Rents should increase over the next 4 years in-line with the phased out removal of interest deductions.

Common Structures

→ **_Individual Ownership_**

Low complexity, low cost. Unlimited liability, no tax planning flexibility. No separation between investor and investment.

→ **_Partnership_**

Low complexity. Partnership agreement can provide some tax planning flexibility. Partners have joint and several liability. Can be used for Joint Ventures.

→ **_Closed Company_**

Limited Liability, separate legal structure, taxed at 28%. Capital gains cannot be distributed without winding up, cannot attribute losses. Not suitable for Australian investors.

→ **_Look-through Company_**

Fiscal transparent company. Limited Liability, separate legal structure and some tax planning flexibility. Not suitable for Australian investors.

→ **_Trading Trust_**

High level of asset protection, income streaming opportunities, avoids asset testing and protects against relationship property. Cannot distribute losses, ownership is not defined, trustees personally liable for tax. Personal guarantees can reduce effectiveness.

Trust's

→ *Why trusts*

In not imposing CGT trusts dodged a major tax bullet and Inland Revenue's own research to Cullen Committee on trusts' emphasised that probably still best investment vehicle to hold private wealth. The benefits include:

- Wealth management
- Income streaming flexibility
- Asset protection
- Capital gains distribution - tax free

→ *Some things to consider*

- Contestants
- Long term stewardship
- Control of rental income for ring-fencing purposes
- Record keeping/paperwork requirements

New Trust's Act

→ Some problems we're seeing

- In practice, holding assets on 'capital account' is still done very poorly because client's do not really understand how to establish 'capital account investment' i.e. it is not enough to simply hold for 5 years.

- Not enough is done legally/evidentially by client's (and advisors) to establish 'main home', 'residential', 'rental' and 'business premises' exemptions and to avoid triggering "major scheme" and "profit making" provisions in the Income Tax Act.

→ Other thoughts

- IRD has huge body of information in relation to property transactions, be careful.
- Still no Trust register (apart from foreign).
- If Trust established and properly administered and has been in place for many years should be impossible for ordinary creditors to get access.
- Gift regularly – no CGT/no gift duty.
- Transfer material assets into trust now (when no creditors/relationship property issues on horizon).
- Parliament supports Trusts; new Act will legitimise for another 50 to 100 years.
- It is for the Settlors/Trustees to establish Trust existence and advisors to ensure maintenance of framework.

Growing Wealth via Property Investment

→ ***Buy well and add value***

Deferred maintenance, distressed sales (mortgagee etc), deceased, estate, damaged (earthquake).
and adding value through renovation (less is more), subdivision, minor dwellings.

→ ***Capital appreciation***

The above + time.

→ ***Mortgage reduction***

Principal reduction over time (P&I) and re-structuring of mortgages over time to ensure optimum interest rate.

→ ***Increase rent***

Annual rent increases. Take into account increase cost of property ownership and tax and regulatory changes.

→ ***Tax and Optimisation***

Using optimal structures, good record keeping to ensure full claim, mind other costs such as insurance.

The importance of lending

Things to consider

- All property investors need money in order to buy properties;
- The cost of funding varies depending on the lender and the activity;
- Property investors should refinance and move banks often;
- Debt increases your ROI exponentially;
- Interest rates will effect yield and this should be managed carefully;
- Moving from a Second Tier lender to a Main Bank is a good strategy, and
- Debt is just cashflows and risk, this can be managed.

The Approach

- 1. Buy;

- 2. Add Value;

- 3. Re-Value;

- 4. Go Again!

Value arbitrage is important- 40/60 at purchase, add value and then 40/60 at new value. Effectively you are trying to roll as much of your initial deposit/equity into the next property as possible.

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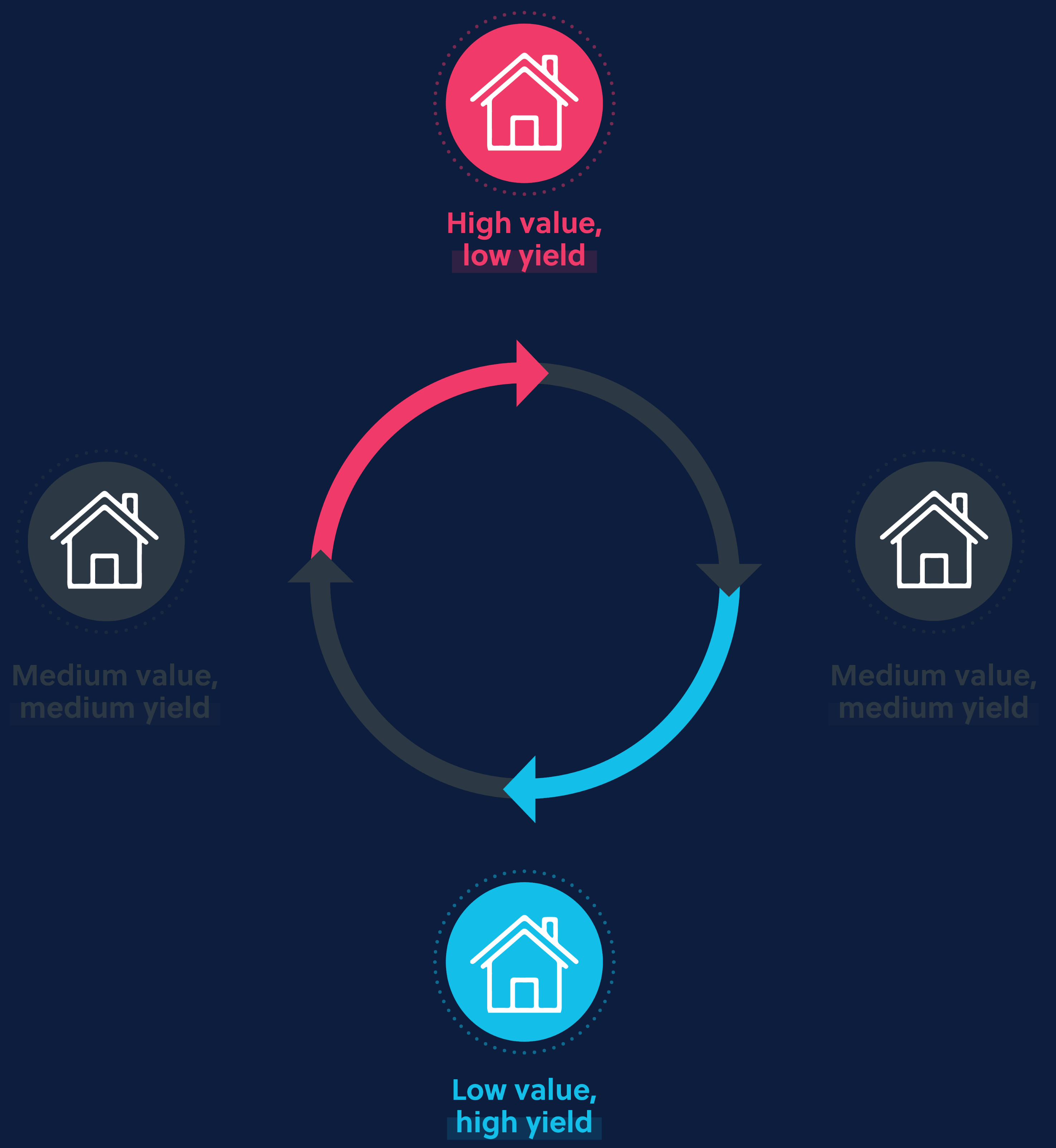
Importance of lending

Purchase	Second Tier
Purchase Price	$700,000
40% Deposit	$280,000
Loan from Second Tier	$420,000
Renovation Cost	$50,000
Total Cost	$750,000
Total Cash/Equity Required	$330,000

Re-Finance	Main Bank
Market Value	$1,000,000
40% Equity	$400,000
Loan from Main Bank	$600,000
Less Original Loan and Deposit	$420,000
Recycled Cash/Equity	$180,000
Less Original Cash/Equity Outlay	$330,000
Net Cash/Equity Outlay	$150,000
Effective Deposit	21%

Wealth Wheel



Property – Still worth it?

→ **Rents will rise**

Cost of ownership is currently disproportionate to income generated and will need to change in order to make economic sense.

→ **Landlords are still crucial**

Landlords are still responsible for providing the lions share of private accommodation in New Zealand at a fraction of the cost of the government.

→ **Long term assets are proven**

Property still a good investment. Buying long-term assets is a proven wealth creation tool.

→ **Risk management**

Consider the effects of leverage, management of risk and lack of volatility. Rate of return is not just measured in cashflow.

→ **Residential properties**

Residential investment properties are still attractive as they are low risk, well understood and largely passive.

What are good investors doing?

→ Protecting your Balance Sheet

→ Refinancing and moving to I/O

→ Releasing Security

→ Restructuring

→ Selling Properties

Retirement Planning

How much do you need in retirement?

- When will you retire?
- How much will you spend?
- Will you spend the same amount in retirement?
- Will you travel?
- How often?
- Will you downsize your home?
- Is leaving a legacy important to you?

Retirement requirement for a couple

$200k	$600k	$1m	$1.4m	$1.8m
$40k Income in retirement	$60k Income in retirement	$80k Income in retirement	$100k Income in retirement	$120k Income in retirement

Investment strategy for retirement

When your salary tap goes off. You need to turn on your passive income tap.

Are residential investment properties the best asset for retirement?

You don't want to be

Asset rich

+

Cash poor

- Not because of the return but because of the lifestyle you can live in retirement
- You can only live off the income, assuming you don't have a mortgage
- You can't erode your asset over time
- Lack of diversification
- The pain of tenants or cost of a property manager

Pros vs. Cons

Investment property

- Leverage - is this helpful in retirement?
- Strong historical returns
- Familiar
- Weekly income
- Ability to add value

Managed fund

- Diversification
- Ability to spend returns and captial over time
- Liquidity if required
- Range of funds at each risk level
- Strong historical returns

Investment Strategies

Direct Investing

"I'm not going to pay someone when I feel comfortable investing"

Active Investing

"It's important to me that someone is on the tools with expertise. I'm happy to pay a higher fee for their services"

Passive Investing

"Research says it's difficult to outperform the market after fees"

One last thing

Advice should not be to derive greater returns. The purpose of an adviser is to link the right investment to your goals and to make sure you're on track.

You are paying for peace of mind.

Have Questions?

If you'd like to speak to any of our team,
simply follow the link below to book a time

Accounting

Mortgages

Wealth