

Gold from granny flats

Boost your cash flow by adding to your home

By simply knocking together a second abode, that green expanse out the back could be earning you serious investment dollars. *Lauren Barker* takes you on a step-by-step journey to building a granny flat in your backyard

Granny flat, in-law apartment or secondary dwelling – whatever you choose to call it, it's a clever property investment strategy. And no longer just for granny.

Granny flats are popping up in backyards across the country as homeowners and investors begin to take note of their money-making potential. Whether you decide to add a detached flat to your principal place of residence to earn a little extra cash, or build a secondary dwelling on your investment property to up the rental earnings, much can be said for the flexibility a granny flat provides.

First and foremost, it's a fantastic way to generate additional cash flow through rental income as well as increase the property's value if and when you decide to sell. Particularly in a time of rising interest rates and tight budgets, a granny flat might

just provide that little bit of extra financial freedom.

The NSW government defines a granny flat as a self-contained extension of a home that is within, attached or separate from the home but on the same lot of land, and not in a strata plan or community title scheme.

Mark Moundjian, projects manager with Ian Cubitt's Classic Home Improvements, explains that a granny flat enables an entirely separate occupancy on the same block of land, without having to subdivide.

This humble abode has certainly come a long way since the days of the makeshift shack down the back; buyers today are spoilt for choice, with styles, shapes and sizes as diverse as the people who occupy them.

Ranging from simple model studios to custom-designed, two-bedroom 60m² apartments, you can choose an

option and style to suit your taste and your budget.

Cid Daher, co-founder of **Granny Flats Australia**, says people are slowly realising that granny flats are good quality, secondary dwellings and no longer just tiny bedsits or rumpus rooms. "People's perceptions of granny flats are associated with garage conversions," he says.

"What we provide ... are two-bedroom, self-contained homes with full kitchens, bathrooms, laundries, standalone hot water systems and rainwater tanks."

1 Collect your crew

First, you need to assemble your troops. If you plan to manage the project yourself, you'll need to hire licensed contractors, but if you hire a building company, they'll take care of the entire process for you, from conception to completion. Companies such as Ian Cubitt's Classic Home Improvements offer different teams of experts who can assist in areas such as design, council approval and construction.

An architect will need to draw up the building plans or you can choose



from the many kit homes available. Building companies can work with you to custom-design a flat that meets all of your requests.

“It all starts by looking at the investor’s needs,” explains Mounmdjian. “We then conduct a feasibility study on the property and look at the raw figures. Once the investor is confident with what we can do for them, we take the project into the planning and construction stages.”

Ian Cubitt’s Classic Home Improvements offers more than 24 standard designs, which vary in floorplans and finishes, as well as custom-designed options.

Daher emphasises that it’s important to use a granny flat specialist who understands all of the particular requirements and processes involved. “It’s very simple if you have the right team on board from the start.”

2 Check the requirements

There are, of course, many legal and financial issues to consider, so make sure you check the relevant requirements before you embark on your project.

Regulations regarding construction and occupancy vary from state to state and council to council, so contact your local authority for further information. Rules apply to the size and positioning of the building on the land, as well as title registration and rates payments.

The NSW government recently relaxed rules regarding the construction of secondary dwellings on properties, which means granny flats can now be built in all residential zones in the state. A State Environmental Planning Policy (SEPP) will cover all local council areas, removing the previously complicated processes and zoning requirements of Local Environmental Plans (LEP).

The NSW government’s report, *Supporting Affordable Rental Housing – Granny Flats (Secondary Dwellings)*, says the new policy aims to enable granny flats to be approved within 10 days, subject to the requirements set out in the SEPP, such as a maximum floor area of 60m² and no subdivision.

“These secondary dwellings give families the chance to use a granny flat as a source of additional income in these challenging economic times,” the report says.

Tax implications of renting your granny flat

Since the granny flat is only part of your property, you can claim only part of expenses incurred. The ATO gives a general guide here: apportionment should be made on a floor-area basis – that is, by reference to the floor area of that part of the residence solely occupied by the tenant, together with a reasonable figure for tenant access to the general living areas, including garage and outdoor areas if applicable.

Example

Michael’s private residence includes a self-contained flat. The floor area of the flat is one-third of the area of the residence. Michael rented out the flat for six months in the year at \$100 per week. During the rest of the year, his niece, Fiona, lived in the flat rent-free. The annual mortgage interest, building insurance, rates and taxes for the whole property amounted to \$9,000. Using the floor-area basis for apportioning these expenses, one-third – that is \$3,000 – applies to the flat. However, as Michael used the flat to produce assessable income for only half of the year, he can claim a deduction for only \$1,500 – half of \$3,000. Assuming there were no other expenses, Michael would calculate the net rent from his property as:

Gross rent	\$2,600 (26 weeks x \$100)
Less expenses	\$1,500 (\$3,000 x 50%)
Net rent.....	\$1,100

Non-commercial rental

If you let the flat to your relative at less than normal commercial rates, there is a limit on deductions you can claim. For example, the normal commercial rate of rent is \$180 per week. However, you only rent the granny flat out at \$60 per week. You are only able to claim rental expenses of up to \$3,120 per year (\$60 x 52 weeks). Therefore no loss can be incurred.

When you sell out your whole property

There may be a chance that you sell the property and move to another new property as your main residence. The tax treatment for the two scenarios varies.

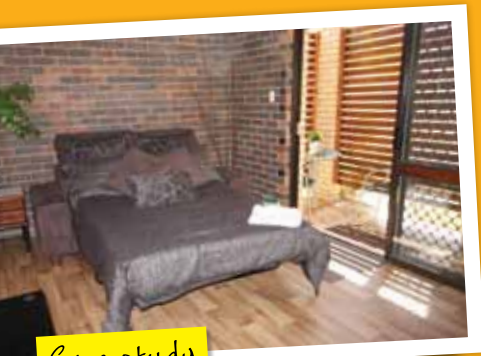
Scenario 1

You have your whole yard CGT exempted because of the main residence exemption rule. You are still the legal owner of the granny flat, and you do not rent your granny flat out for income. Therefore you are entitled to the CGT exemption.

Scenario 2

You rented your granny flat out for income in the earlier years before you sell your property. In such case you are only able to claim partial exemption of CGT for the portion you treated as your main residence. Any capital gains or loss for the granny flat should be declared. However, if you hold the yard for more than 12 months, you are able to claim the 50% tax discount for this capital gain.





Case study

Reaping rental returns in Robertson

The property

Purchase price	\$420,000
Cost of granny flat	\$7,000
Current rent	\$225/week
Future rent	\$250/week

When Amanda Hoffman and her husband bought their two-storey investment property in Robertson, Queensland back in 2003, they knew the site wasn't reaching its full potential.

Seven years later, the land also houses a fully furnished granny flat, currently fetching \$225 in weekly rent, with a waiting list of future tenants willing to put down \$250.

The experienced property investors operate Kidd House, which offers quality rental properties and share accommodation to tenants across the Sunshine State.

The couple began their renovations on the property in January last year, converting a bedroom at the back of the house into a self-contained granny flat complete with kitchenette, bathroom and courtyard.

The renovations cost \$7,000 on top of the original \$420,000 property purchase price, and have now allowed the Hoffmans to collect two separate rents from the one block of land.

"We believe that the small outlay was valuable from an increased rent perspective, as well as the capital gains aspect, as it enhances the value of the property," explains Amanda.

She says she hasn't had a problem attracting tenants so far, with a large pool of applicants and a rental waiting list for the granny flat.

"The new policy will better support opportunities for the creation of granny flats in line with the state government's actions to boost the supply of affordable rental accommodation."

Daher explains that once the building plans are drawn up, property owners in NSW can lodge the application with a private certifier, rather than going through the entire Development Approval (DA) process with council.

"The first step is to find out if your site complies with the Development SEPP – generally the block has to have a 12m frontage and be bigger than 450m². This is done by ordering Certificate 149 from your local council," he explains.

"If your block is non-complying, you can still apply through council under their development control plan, but it would be a full DA application."

3 Get finance

While some lenders may restrict the size of a loan for properties with more than one dwelling, you'll find that a number of financing options are available to bring your granny flat project to fruition.

Geoff Dalgliesh, franchise principal with Aussie Doncaster, has worked in granny flat financing for almost seven years. He advises that the addition of a granny flat is the perfect time for an owner to reassess their mortgage needs.

"The construction of a granny flat provides the customer with an opportunity to review any current home loan they have and refinance to a cheaper lender, while obtaining the required loan increase," he explains.

Otto Dargan, director of Home Loan Experts, says gaining finance for two dwellings on one title is generally viewed by lenders in a similar light to a typical home loan.

"This is because there are still plenty of people who would be happy to buy a property with a granny flat. In comparison, there's a much smaller market for people looking to buy three or four houses on one title," he explains.

"For that reason, banks tend to be relatively lenient when lending for a house and a granny flat. Even most lenders mortgage insurance (LMI) providers are happy with a house and granny flat as security."

Dargan suggests that a construction loan can be used to fund the secondary dwelling. "Granny flats can be funded using a normal construction loan, as long as a licensed builder is doing the work," he explains. "The banks will lend based on the lesser of the 'on-completion' value of the house and granny flat, or the current value of your property plus the cost of building the granny flat."

"If you're building it yourself, you'll need to have plenty of equity in your property, otherwise the banks won't approve it."

Dalgliesh suggests using that equity to fund the granny flat's construction. "Often the customer can use existing equity in the property to obtain finance. For this reason, 100% finance is often available, as the overall loan to value ratio (LVR) is acceptable to the lender."

"Regarding security, in many cases there's adequate equity in the current property to satisfy the lender. If not, an 'upon completion' valuation may be required to obtain loan approval."

Dargan recommends keeping your loan application simple – for example, including all of your costs in the building contract rather than as separate quotes – to save the lender time and effort.

He also suggests gaining pre-approval once you've decided to carry out the project, and only going for formal approval once you've collated the final building contract and plans.

"Always have spare funds," Dargan continues. "Many people go over budget and most banks don't lend against half-complete construction projects!"

4 Begin!

Once you've got your plans, your team and your approval, it's time to kick-start construction.

If you're self-managing the project, it's time to co-ordinate contractors and get the show on the road. If you've hired a building company, you can still keep an eye on progress to limit delays.

5 Connect to services

Once the flat is constructed, it's time to connect to utilities.

"The most complicated and expensive part is the connection of storm water, sewer, water and electricity

Granny flats Q&A*

Q What is the maximum size I can build my granny flat?

A The maximum size is 60m².

Q Can I build a granny flat in any local government council area?

A Generally speaking, the answer is yes. However, you will need to check with your local council to see if there are any restrictions which may prevent such a building on your block. This can usually be identified by purchasing a Section 149(2) Certificate from your local council, which costs around \$40.

Q I already have a dual occupancy on my block. Can I still build a granny flat?

A No. The SEPP only allows you to build a granny flat if there is one house on the current block.

Q I live on a battleaxe block. Can I still build a granny flat?

A Only if the access laneway to your block is wider than 3m, and the block measures at least 12m x 12m (excluding the access laneway).

Q Does the granny flat have to be separate from the house, or can it be attached?

A You can build it either attached or detached. Keep in mind that in some circumstances, it may be cheaper to build it as a separate structure, as it will not be interfering with the existing house.

Q How long will it take to get approval?

A Depending on whether your site complies with SEPP (Affordable Rental Housing) 2009, it could be as quick as 10 days through private building certifiers, or if it does need to go to council, then it could take approximately 6–8 weeks for approval.

Q Do we have to go through council for approval, or can it be done through a private building certifier?

A If your site is in full compliance, you can apply through a private certifier. If there are some elements which do not comply with the SEPP, you will need to lodge it through council.

*State and council requirements may vary, check with your local authority

Source: *Granny Flats Australia*, grannyflatsaustralia.com.au



Photo: Ian Cubitt's Classic Home Improvements

Repayments vs rental returns

The figures below give an idea of the average rental returns an investor can expect by adding a granny flat to their property.

	Building cost	Weekly mortgage repayment	Weekly rental return	Weekly cash flow
Studio	\$63,200	\$86	\$200	\$114
1-bedroom	\$76,800	\$104	\$280	\$176
2-bedroom	\$102,000	\$138	\$360	\$222

Based on median price estimates for Parramatta, NSW, and an interest-only rate of 6.5%

Source: *Granny Flats Australia*, *Your Mortgage*

to the granny flat,” explains **Daher**. “This is the part that needs to be considered even before you engage an architect.

“These are some pitfalls people fall into when they order kit cabins or pre-made homes that get transported in, and then they have to connect to these services themselves. There are many cases where driveways and paved areas need to be removed for connection of these services that haven’t been budgeted for by DIY builders.”

Complete any finishing touches, such as painting, furniture and fittings to make sure your granny flat is a tenant magnet.

6 Reap the rewards

Once construction is finished, the fittings are in and the walls are painted, it’s time to start putting your investment to work.

Experts suggest that the financial gains can be significant, with Moundjian estimating that investors can fetch between \$250 and \$600 a week in rent.

Granny Flats Australia suggests that a \$63,200 studio in Parramatta, NSW, on a loan of 6.5% interest, would cost \$86 in weekly repayments and reap \$200 a week in rent. If the granny flat

was a one-bedroom building, however, it would cost \$76,800, cost \$104 in weekly loan repayments and earn \$280 in weekly rent payments.

Daher says that investors reap financial gains through three different channels: rent, sale price and depreciation benefits. “The primary purpose of building a granny flat as an investor is for the creation of extra income for a small outlay.

“For an outlay of \$105,000 for a two-bedroom granny flat, it could generate an extra \$350 per week or more in rent, depending on the area. Over a year that’s an extra \$18,200. As a gross yield on investment, that’s 17% gross return. Where else can you get that kind of return without taking a huge risk?

“Secondly, due to the increase in yield, the value of the property has increased and appeals to a new wave of purchasers,” continues **Daher**.

“The creation of this new dwelling also adds depreciation benefits to the investor, assisting with their tax situation. Once a granny flat is complete, a depreciation schedule is ordered from a quantity surveyor, and determines how much depreciation you can claim back as an expense each year.” ■