

The granny flat revolution

Granny flat laws have been relaxed in New South Wales and Western Australia, allowing savvy investors to earn up to 20 per cent returns. API finds out why the rest of Australia is likely to follow suit and, more importantly, how investors can muscle in on this hot property action. **NATALIE POWELL**

The drive for more affordable housing in capital cities around Australia is starting to have a profound impact on the market and it's allowing some investors to turn their properties from negatively geared to cash flow positive.

Savvy investors have been quick to realise that changes, or proposed changes, to planning laws around the country may allow them to install a granny flat in the backyard of their property and, for the first time, rent it out – giving them the potential to double their rental income.

More and more councils are allowing granny flats, or secondary dwellings – until now the domain of teenagers or elderly parents – to be erected at the back of an existing home for income-producing purposes. It's a clever investment strategy and homeowners and investors have been impressed at the fantastic advances in the design of granny flats and their money-making potential.

A two-bedroom granny flat, for example, can be erected at the back of an existing home for as little as \$75,000 to \$100,000 and rented for \$250 to \$300 a week – or a yield of 15 to 17 per cent. And as the table on the next page shows, buying an investment property for \$400,000 and installing a granny flat for \$100,000 is much better for cash flow than buying a \$500,000 unit, with the granny



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flat in this instance delivering a rental return of more than 20 per cent!

New South Wales was the first state to try to address a severe shortage of affordable housing in 2009 by allowing granny flats in all residential areas.

The Housing Industry Association's Kristin Brookfield says the NSW Government passed an amendment which basically states that where there's a house you can add a granny flat.

"The policy states you can make the secondary dwelling available to a relative, a friend or, for the first time, rent it out," she says. "It doesn't have to be for grandma or a family dependant anymore."

She says the decision to allow granny flats to be rented out is one of the most significant changes to planning laws for some years and approval can be granted in as little as 10 days.

The co-founder of Granny Flats Australia, Cid Daher, says there's a strong push for other states and territories to follow the NSW policy.

"We get a lot of enquiries from Queensland, Victoria and Perth in Western Australia, but the biggest problem in those states is that it's council orientated, so that restricts what you can do," he says. "No matter where you are in NSW, if your block's over 450 square metres and you've got more than 12 metres frontage, and you build three metres from the back fence and one metre from the side fence, you don't need council approval."

"It's done through the State Government, it's all black and white, and if you meet a simple checklist it's approved."

INVESTORS ARE CATCHING ON

The head of Greenwood Garden Products in Sydney, Paul Smith, says granny flats have always been popular for elderly parents or newlyweds who can't afford a house, but the surge in demand has been in the rental market. "We had one client who recently installed a granny flat at the back of one of his properties in Pittwater for \$130,000 and he's getting nearly \$500 a week rent," he says.

"A hot area is the North Shore," he says. "We've dealt with investors in Pittwater, Warringah, Ku-ring-gai and Hornsby councils. I believe there's huge demand on the Central Coast, as well as around the Gosford area and up to Newcastle."

GRANNY FLAT TREND SPREADS TO WA

The NSW policy hasn't gone unnoticed across the Nullarbor in Perth.

The port city of Fremantle has just amended its town planning scheme to allow granny flats as investment properties.

Fremantle City Council planning spokesman Philip St John says that under the plan

BUYING A UNIT VS BUILDING A GRANNY FLAT - EXAMPLE

	Unit	Granny flat
Purchase price	\$500,000	\$100,000
Stamp duty	\$18,000	\$0
Legal costs	\$2,000	\$0
Total purchase	\$520,000	\$100,000
Rent per week	\$480	\$400
Rent per annum	\$24,960	\$20,800
Annual strata costs	\$2,500	\$0
Management fee	\$1,400	\$1,000
Net return	4.7%	20.5%

Buying an investment property for \$400,000 and installing a granny flat for \$100,000 is much better for cash flow than buying a \$500,000 unit in this scenario.

COST VS RENTAL RETURNS

Size	Building cost	Weekly mortgage payments	Weekly rental return	Weekly cash flow
1-bed	\$85,000	\$106.25	\$350	\$243.75
2-bed	\$105,000	\$131.25	\$440	\$308.75

Based on the median price estimates for Parramatta, NSW, and on an interest-only rate of 6.5%.
Source: Granny Flats Australia

most granny flats will be permissible without planning approval.

"The council amended its zoning codes to promote greater diversity and affordability with housing stock in the city," he says.

"We understand there's quite a lot of demand. I think other councils are waiting to see how this pans out in Fremantle before deciding if they will follow our model, which will have a sunset clause, so it will last five years before it's reviewed."

David Endersby from the Housing Industry Association in Perth believes it's a positive move that will provide affordable housing for single mums, young people and essential service workers such as hospital workers, police officers and fire-fighters.

He believes there are 5400 blocks in Fremantle that are suitable for a granny flat. He says the council expected negative feedback when it advertised the proposed changes, but was pleasantly surprised by the strong community support.

"I think that increasing affordable homes in some of the older suburbs in Perth will be near on impossible unless some of the councils embrace this approach," he says.

"We don't have a propensity for living in high-rise in WA, so I think this is a practical community-based solution."

"Granny flats are no longer just module boxes. There are some fantastic products out there in the market and many major builders have embraced this area of the market and are creating more innovative, stylish and functional homes."

"I expect a number of major councils will

The tax implications

If an investor puts a granny flat on a property that already has the main dwelling leased out, the tax implications won't change. Capital gains tax will apply as usual. Tax depreciation benefits from the new granny flat will be approximately \$5000 to \$6000 per annum.

For owner-occupiers who build a granny flat at the back of their current home and lease it out, there will be implications, as shown by this example:

Current house value = \$400,000
without granny flat

New valuation with granny flat = \$500,000

Therefore about 80 per cent of the property's value is made up of the home (which is tax-free) and 20 per cent represents the granny flat (which is taxable).

If the property is sold for \$700,000 five years later, that's \$200,000 growth. As 80 per cent is the house, that means \$160,000 is deemed tax-free growth, while the other \$40,000 is taxable as a capital gain at 50 per cent of the owner's marginal tax rate.

Source: Granny Flats Australia

Case study | Cash flow positive strategy

Alan Brown, 48, is using granny flats to help turn his portfolio of four investment properties in Sydney cash flow positive.



He recently purchased a home in Tregear, in Sydney's western suburbs, for \$200,000 and used the increased equity in his portfolio to borrow \$45,000 to renovate it and pay stamp duty and legal fees before renting it out for \$260 a week or a yield of 5.5 per cent. He then used the increased equity in the renovated home in Tregear to fund the installation of a one-bedroom granny flat for \$70,000.

The granny flat rents for \$240 a week, giving him a yield of 18 per cent. He says the granny flat has been easy to rent and the strategy has been so successful that he now recommends it to family and friends.

FORMULA FOR PURCHASE

Purchase price	\$200,000
Loan amount	\$190,000
Stamp duty	\$8,000
Legal fees	\$2,500
Miscellaneous costs	\$2,500

VALUATION AFTER

Renovation	\$280,000
90% loan	\$252,000
Less purchase loan	\$190,000
Difference to fund granny flat	\$62,000
One-bed granny flat	\$69,990
Deposit and costs	\$7,990
Net amount to be financed by bank	\$62,000
Shortfall	\$0

FORMULA FOR RETURNS

Total cost of granny flat	\$69,990
Annual repayments of 7% interest only	\$4,899
Annual rent at \$240/week	\$12,480
Surplus	\$7,581
Yield for granny flat	18%



Alan's Tregear flat

follow suit once they're comfortable with the community acceptance in Fremantle."

A PHENOMENAL STRATEGY

One of the strongest advocates of granny flats as investment properties is the head of Sydney-based firm Property Secrets, Paul Giezekamp. He describes it as a phenomenal strategy.

"Our clients don't want to be negatively geared anymore," he says. "They spend up to \$400,000 on an old house on a triplex block, outlay \$20,000 renovating it, then \$80,000 to \$100,000 putting in a granny flat and rent them both out.

"This strategy makes properties with a granny flat positively geared to the tune of \$5000 to \$10,000 a year, and that's without a tax cheque. It means the investor can hold

the property for no outlay until they're ready to develop the site.

"In the Perth suburb of Balga, for example, one of our clients has purchased two adjoining houses on blocks of more than 700 square metres, which makes them triplex sites. The houses cost \$350,000 each, or \$370,000 after being renovated, and with a granny flat at the back for around \$80,000 that takes the total cost to \$450,000, or \$900,000 for both. They estimate they'll be getting rent of \$1300 a week for the four properties. That's renting the front home on each block for \$375 and the granny flats for \$275, making them positively geared before taking depreciation into account.

"That allows them to hold those properties for no cost until it's viable to develop the site.

"Down the track they should get approval to build seven units when they remove the granny flats and demolish the original homes.

"In most cases using this strategy you can get yields of 11 to 13 per cent.

"We believe you can do this anywhere, but at the moment we find that Sydney and Perth are probably the best markets, as Sydney has been flat since 2003 and Perth since 2006 and we believe they'll be going

up soon. In the meantime this is a viable way to hold property without it costing any money."

Giezekamp says the planning laws in Perth are currently not as flexible as those in Sydney, but he's lodged applications for granny flats in Balga with the City of Stirling and he's not anticipating any problems as the blocks are zoned as triplexes.

"We were also watching and waiting to go into Fremantle as soon as the laws were changed," he says.

"We're also looking at areas like Westminster, Nollamara and anywhere in the northern suburbs of Perth that are 20 to 40 minutes from the CBD.

"Most investors can't believe it when told about this strategy. The renovations can be done in two weeks, the granny flat in eight weeks. It's a system that puts investors in a position of strength when they go back to the bank looking for funding to continue buying more property."

The head of Granny Flats WA, Mike Nichols, says he's been extremely busy since investors started moving into the Perth market looking for triplex blocks suitable for this strategy.

"The Perth market is ripe at the moment because prices have dropped in the past two years," he says.

"Investors are buying well, renovating and installing a granny flat in the backyard which makes the property positively geared from day one.

"Later, when it's a peak time to develop, they'll remove the granny flat to another site or sell it, demolish the original home and develop a triplex on the site.

"By using this seven to 10-year strategy of holding the property before developing it makes a lot of sense. It's quite a dynamic line of thought outside the square, but at the end of the day it's just mathematics and it stacks up."

WHAT ABOUT OTHER STATES?

Former town planner and the head of Urban Potentials in Queensland, Juergen Hanisch, believes there's strong demand for granny flats in Brisbane, but planning laws are hampering this segment of the market.

"It's allowed in all residential areas," he says. "You can have a secondary dwelling up to 70 square metres with as much deck space as you like; the only limitation is that both dwellings be occupied by a family and no more than a total of five people.

"There's nothing to stop a retiring couple building a granny flat that suits them and renting out their front home as long as it has three people or less.

"There's no minimum block size. All you

RULES STATE BY STATE

New South Wales

NSW allows granny flats and they can be approved in as little as 10 days. Granny flats are allowed in all residential zones. Minimum site area is 450 square metres. Total floor area of the flat is maximum 60 square metres with the maximum floor area of the principal dwelling and secondary dwelling being no greater than that permitted by the local council.

Comment: While you're able to build a self-contained granny flat at the rear of the existing house, you can't subdivide the property so you can sell off each house. You're allowed to rent the granny flat to an unrelated party to create a secondary source of income. If you sell the property, then you'll be selling the front house and the granny flat.

Source: Peter Bozinowski, projectfacilitator.com.au

Victoria

A 'dependant' person's unit, or granny flat, is a "moveable building on the same lot as an existing dwelling and used to provide accommodation for a person dependent on a resident in the existing dwelling".

Comment: In Victoria, once the granny flat is no longer used by a relative it must be taken away from the site. A building approval is required to remove the granny flat from the site. The granny flat can't be used for producing extra rental income.

Source: Peter Bozinowski, projectfacilitator.com.au

Queensland

The Queensland Government, through the Department of Communities, is reviewing the policy to facilitate the delivery of secondary dwellings to improve housing options. It's expected this review will be completed by July 2012.

Comment: The current rules around granny flats are that they can be rented out providing there are no more than five people in both dwellings. There are certain rules and regulations around its siting, carparking and open space. The regulations vary from council to council.

Source: Juergen Hanisch, Urban Potentials Queensland

Tasmania

In Tasmania a granny flat is known as an ancillary apartment, which means an additional dwelling unit with a floor area not greater than 60 square metres.

Comment: A granny flat requires planning and building approval, so you need to check the rules around this. They can be rented out to create another source of income. In broad terms the granny flat needs to be part of the existing home. It has to be connected to existing services of the house. Access must be maintained from the existing house to the granny flat and no subdivision is possible. As soon as you want to subdivide the block with the granny flat, you need to go through the planning approval process for a secondary dwelling on the lot.

Source: Peter Bozinowski, projectfacilitator.com.au

South Australia

Granny flats can only be installed as 'dependant accommodation' which is defined as accommodation for a dependant or relative. The dwelling must be connected to the same services as the main dwelling.

Source: Peter Bozinowski, projectfacilitator.com.au

Northern Territory

In the NT they're called a 'dependant unit' or 'dependant relative unit'. The floor area must not exceed 50 square metres. The unit must share public utility services and an effluent disposal system with a detached dwelling on the site. Only one unit may be on the site.

Comment: The granny flat, or dependant unit, can be rented.

Source: Peter Bozinowski, projectfacilitator.com.au

Western Australia

The City of Fremantle is the first council in Perth to allow the construction of granny flats for income-producing purposes. The changes to the planning laws came into force in December, 2011. The floor area of the small secondary dwelling isn't allowed to be more than 55 square metres on a lot 600 square metres or less, or more than 70 square metres on a lot greater than 600 square metres. The maximum wall height (as measured from natural ground level) isn't allowed to be more than three metres; and the maximum roof or gabled end height (as measured from natural ground level) isn't allowed to be more than 5.5 metres.

Comment: Belmont and Stirling are also considering what changes, if any, will be made to their planning laws to accommodate more affordable housing.

Source: Fremantle City Council, HIA.

need is two carparks off the street if you have a secondary dwelling.

"It's a means of providing cheap, affordable housing because there's a lot of land in backyards that's under-utilised, as opposed to subdividing new areas and adding to the urban sprawl, which costs a lot of money."

The head of Victorian Granny Flats, Rod Dawson, has been campaigning for 25 years to try to change the rules applying to granny flats.

He says 'ancillary properties', as they're called in Victoria, are allowed, but the person occupying it must be a dependant of the

owners of the primary dwelling. "You can't do it for commercial gain," he says, "and that's a blanket ruling statewide."

"So every state council, all 76 municipalities, fall under the same state legislation. It's disappointing, but it's a welfare thing in Victoria. The problem is we have huge backyards and the authorities are allowing the urban sprawl of the city to extend 70 kilometres out with all these new housing estates, but they aren't filling the inner urban areas because of this restriction."

But Giezekamp believes it's only a matter of time before councils are forced to change

their planning laws to accommodate granny flats. "I think councils have an obligation towards more affordable housing," he says.

"Councils need to have a look at these prehistoric rules and change them. Just because they're called granny flats doesn't mean they're only suitable for a relative."

"It's a win-win situation for renters wanting affordable housing and the investor getting a fair return."

"At the end of the day investors don't do this because they want to own a lot of properties. It's about improving their net worth and creating financial freedom." **api**