PREPARE FOR LIFE

InterPrac

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BUY NOW, PAY LATER

By Peter Kelly, Retirement Strategies and Solutions

Did you know that Australia's household debt nears the highest in the world[1]

While governments use retail spending as an indicator of economic 'health', the sad reality is that personal debt and the lack of savings are likely to be a major cause of mental health issues amongst individuals and families[2].

It is not all that long ago that if we wanted to buy something, we put money aside for it and when we had saved enough, we went and bought the item.

People borrowed money for a house and often for a car, however cash was used to buy everyday consumer items like furniture, electronic, clothes, and holidays.

For those that wanted to guarantee they got what they wanted, layby was used to enable payment of the goods in instalments before they could be taken home.

But then, in 1974 the major Australian banks joined forces and introduced Australia's first mass credit card – Bankcard.

Now, rather than wait until we have saved enough money, we can have instant gratification and buy now – and pay later.

Credit card debt in Australia is around $45 billion[3]. That is just on $2,000 for each man, woman and child in the country today!

But what do you do when your credit card is 'maxed out' and you simply must have that new clothing, dental treatment, electronic gadget, car repairs, or even a holiday?

You simply use one of the emerging arrays of "buy now - pay later" payment options, like Afterpay or Zip Money, to name just two.

These companies provide short-term financing (usually $1,000 to $2,000), often structured around weekly or fortnightly instalments. Short-term financing may, in some cases be interest free however fees still apply, particularly if repayments are not made on time.

The Australian Securities and Investment Commission (ASIC) recently released a report[4] into the operations of 'buy now – pay later' schemes and how this emerging trend is influencing our buying patterns, especially the younger generation.

In its report, ASIC notes that in June 2018, 1.9 million transactions were made using 'buy now – pay later' with the total amount outstanding at almost $1 billion.

While 'Buy now – pay later' arrangements offer convenience enabling individuals to purchase items without having the cash immediately available, the money has to be repaid at some stage. Like credit cards, these finance arrangements can be a wonderful servant, but a terrible master.

If planning to purchase something with any kind of credit, always check you budget first, taking into account any upcoming bills, and ensure you will have the money to make the payments as they fall due, without enduring stress.

Cutting spending, reducing debt and accumulating savings is a far more positive measure of personal financial and mental well-being. If you 'must' have that item, consider saving up before you buy it. You will feel so much better about your purchase.

> *"In June 2018, 1.9 million transactions were made using 'buy now – pay later' with the total amount outstanding at almost $1 billion."*

[1] https://www.finder.com.au/australias-personal-debt-reported-as-highest-in-the-world#compare
[2] https://ndarc.med.unsw.edu.au/blog/mental-disorders-debt-there-link
[3] www.abc.net.au – 4 July 2018
[4] ASIC Report 580: Credit card lending in Australia - Published July 2018, page 17.

LOANS AND ENCUMBRANCES

– A PENSION MINEFIELD

By Mark Teale - Retirement Strategies and Solutions Specialist, Centrepoint Alliance

For many people, being debt free at retirement is one of their long-term goals.

Others find the concept of 'good' debt in retirement less stressful. From an age or service pension perspective the correct structuring of the 'good' debt is most important to ensure any entitlement that you may have to the pension is not adversely affected.

When it comes to loans and encumbrances, the Social Security Act 1991 (Cth) is complicated and, in some cases, a little illogical. It is very important to understand that the taxation rules about debt are not necessarily the same as the social security rules.

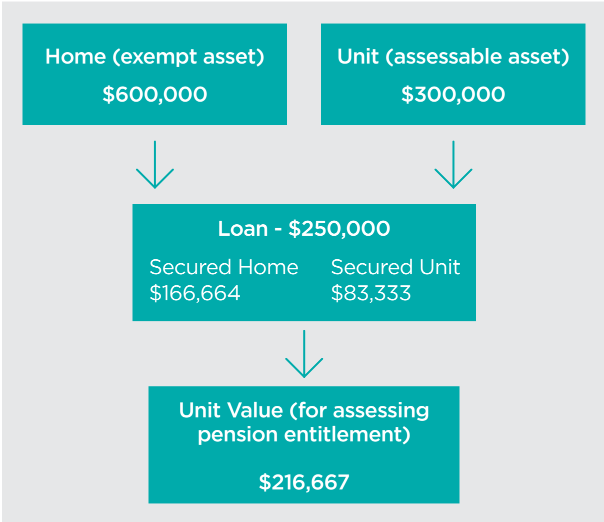
For example, real estate investments.

Say you see a unit on the market that seems like the ideal investment for you – and the opportunity to earn extra income seems too good an opportunity to miss. You visit your bank or your mortgage broker to enquire about an investment loan.

Your lender is happy to fund your investment, but they need to secure the loan against your residential home as well as the investment property.

From a taxation and a social security income perspective this is not an issue as in both cases the interest payable is deductible from the rent for the purposes of your tax and pension assessment.

However, one very important additional issue to consider is that a person's pension entitlement is also based on the value of their assets. The fact that the loan is secured against an exempt asset and an assessable asset means that the portion of the loan secured against the exempt asset – your home – is not used to reduce the asset value of the investment unit – your home is worth $600,000 and the investment unit is valued at $300,000. You need to borrow $250,000 and as you home is worth twice as much as the investment unit only one third of the loan will be offset against the value of the unit. Meaning the unit will be valued at $216,667 ($300,000 - $83,333) for the purposes of assessing your pension entitlement. Not $50,000, as you may have originally thought[1].



So, do be careful as in some circumstances, the net rental income being received may not necessarily cover the reduction in your pension.

When it comes to borrowing money to invest in shares or managed funds, the assessment is again different. The value of the shares are reduced by the amount borrowed. So, if the total portfolio is value at $100,000 and the loan secured against the portfolio is $50,000, for the purposes of the assets test, the portfolio has a value of $50,000. The hidden nasty is that for assessment under the income test, the whole value of the portfolio is taken into account (i.e. \ $100,000), and it is this value that is subject to the relevant deemed interest rates.

Unlike taxation the interest expense is not deducted from the income being deemed against the $100,000 portfolio.

When you retire and are receiving an age pension, loans can be a minefield and can have unwanted consequences. Before you dive into the world of borrowing to invest, make sure you talk to your authorised financial adviser so you understand the potential impacts and you can avoid the mines.

[1] SSAct section 1118 and subsection 1121(4) - http://www8.austlii.edu.au/cgi-bin/viewdb/au/legis/cth/consol_act/ssa1991186/

THE EIGHTH WONDER OF THE WORLD

By Peter Kelly, Retirement Strategies and Solutions

Albert Einstein once said:

> ***"Compound interest is the eighth wonder of the world. He who understands it, earns it… He who doesn't, pays it…"***

When saving for a long-term goal, such as retirement, is it better to save small amounts for a long time, perhaps saving when we can ill-afford to? Or, are we better off waiting until later and putting larger amounts aside when it is more affordable?

This question has plagued society for decades.

So, let's look at both sides of the debate and put some simple figures together.

At the outset, some ground rules:

- The rate of return used is after deducting fees, tax, and charges
- All projections are expressed in 2019 dollars
- Inflation has not been considered. However, this can be managed by increasing the amounts saved in line with inflation

Option 1 – Saving $100 per week for 40 years.

We start saving $100 per week, from age 25 through to age 65. We earn 5% per annum on our savings.

Over this period, our savings will grow[1] to $661,275 over the 40-year period.

We have saved $208,000. But, our regular savings have earned $453,275 – more than double our contribution.

Option 2 – Saving $200 per week for 20 years.

In this option, we save $200 per week, but don't start until age 45, also saving through to age 65, and earning 5% per annum.

In this instance, the amount saved will also be $208,000. However, by starting later, the earnings are only $148,229, making a total of $356,229 after 20 years.

To achieve the same outcome as Option 1, we would need to save $371 per week for 20 years, from age 45.

What if we earn 10% per annum instead of the 5% per annum in the above equations? And is 10% per annum a reasonable interest rate to consider?

Impact of interest

Between 1900 and 2017, the All Ordinaries Index of the Australian Stock Exchange returned an average of 13.2% per annum. The highest return of 66.8% was achieved in 1983, and the lowest return -40.4% was in 2008. In fact, of the 117-year period, 96 years returned a positive result and 22 years had a negative result[2].

But let's return to the results.

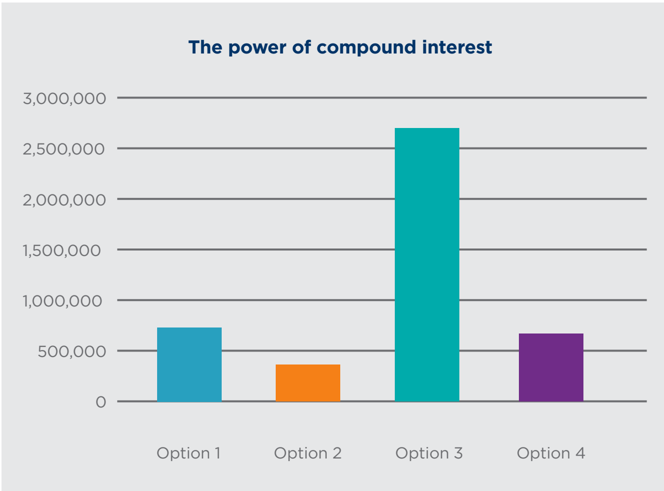
Option 3 – Saving $100 per week for 40 years, earning 10% per annum.

The total amount we have contributed is still only $208,000. However, the total amount saved jumps to a massive $2,740,434!

Sounds too good to be true, doesn't it? Don't worry, I ran the calculations a second time to check.

Option 4 – Saving $200 per week for 20 years, at 10% per annum.

With double the interest rate, saving more for a shorter period still only provides an accumulated savings of $658,120. This is still less than what you would receive in Option 1 where you saved $100 a week for 45 years at 5% per annum.



So, the verdict is in…… Saving a smaller amount for a longer period certainly seems to win out.

In the words of Albert Einstein, *"Compound interest is eighth wonder of the world."*

[1] ASIC MoneySmart Compound Interest Calculator - https://www.moneysmart.gov.au/tools-and-resources/calculators-and-apps/compound-interest-calculator

[2] www.marketindex.com.au/sites/default/files/statistics/historical-returns-infographic-2017.pdf

INSURANCE

- PROTECTING WHAT YOU HAVE

By Mark Teale - Retirement Strategies and Solutions Specialist, Centrepoint Alliance

When you're buying a car or planning a holiday, insurance is probably the last thing you want to think about. But having a good insurance policy can make all the difference to your pocket – especially if the unexpected happens and you need to make a claim.

Here are some ideas:

Shop around

Don't just accept the insurance policy that is offered. The car dealer or travel agent may be getting a commission for selling insurance policies. Comparison sites make it easy for you to compare prices. Before you commit and sign a policy, make sure you understand what is and isn't covered. Some travel insurance policies will not cover you for extreme sports (like bungy-jumping or white-water rafting). Make sure you choose the policy with the right coverage for you and your circumstances, or you could end up with hefty expenses to pay.

Think about insurance before you choose your car

If you are buying a car, check what insurance will cost. You might think that, if two cars cost the same amount to buy, they would cost about the same amount to insure. But the cost of insurance often depends as much on the type of car, as it does on the how much you paid.

Be truthful

When you apply for any type insurance, you'll have to provide lots of detail. If you are getting car insurance, you may be asked about your driving record or whether the car has been modified. Your answers will help the insurance company decide how risk is involved and therefore how much your policy will cost.

If you need to make a claim, and you have been less than truthful, your insurer may have grounds to refuse to pay. This also applied to renewals. You must tell the insurance company if your circumstances change. If you have any doubts - ask your insurer (and keep a written record of what they told you).

Home insurance – building and contents

For most of us, our largest and most important asset is our home. Are you financially prepared for a flood, storm or fire, or even minor mishaps such as broken windows, theft or appliance mishaps?

Building and contents insurance are in fact two different policies. You can purchase a combined policy, or you could purchase each element as a stand-along policy – just building or just contents. If you are renting, you will only need to purchase contents insurance as the landlord will have their own insurance to cover the building.

Be careful not to underinsure your home or the contents on the false premise of saving money because of cheaper premiums. If you find yourself having to rebuild your home, only insuring your property for 50 or 60 per cent of the rebuild cost could create an unnecessarily financial burden for you.

Don't take insurance for granted, make sure you have the right cover to protect your assets and experiences.

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