keeping an eye on finance

focus

Issue: Spring 2005

Invest Smart

For most of us, we need to invest for a happy and secure future.

However, fear of losing capital is what stops people from investing.

Upcoming opportunity

For a limited time you will have an opportunity to invest with a reputable financial institution that will offer:

- Security of your capital
- Stable income stream
- Capital growth

So if you wish to plan for;

- Children's Education
- Building Wealth
- Retirement Income

(Up to 100% finance can be arranged at competitive rates)

Act now and register your interest by calling us on 1300 880 789.

in this issue

Making a smooth transition

Until 30 June this year, individuals reaching the age of 55 effectively had two choices when it came to their retirement and accessing superannuation.

Having reached the Government's deemed preservation age, they could either retire from work, opting to take a lump sum or a retirement income stream from their super, or they could just keep on working. For those wanting to work on reduced hours, however, there was no ability to access their super, which meant a reduction in their overall income.

From 1 July 2005, the Government introduced a third option, allowing people aged 55 and over to tap into their super by taking a pension and still keep working at the same time.

Called the 'Transition to Retirement' initiative, the intention is to make it easier for older Australians – including those who are self-employed – who wish to reduce their working week as they transition to retirement. There will be no work test imposed, nor will there be a cap on the level of benefits a person can access.

Individuals choosing this option must take their benefit in the form of a non-commutable income stream, meaning it generally cannot be commuted to cash.

(Until now, this has been a strategy for the self-employed, or small business owners who could decide they didn't like retirement after a few months, and easily return to the same income earning activity – but difficult for employees who could not be sure of their position being available.)

Words of Wisdom

"Patience is a key element of success"

Bill Gates, Microsoft

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The mechanics of Transition to Retirement

Transition to Retirement is quite a simple concept. Any person who has reached preservation age (currently 55) but does not meet the Superannuation Industry (Supervision) Regulations 2004 definition of retirement, can fully or partially roll over their superannuation benefits into a "non-commutable income stream". This has been regulated in terms of a limited condition of release.

Importantly, the income stream receives the pension tax concessions:

- deductible amount
- up to 15% tax rebate
- 0% super fund tax on investment earnings

Any of the existing income stream products can be used – allocated pension, term allocated/growth pension, fixed or lifetime annuity – as long as the product has, or the product provider sets up, the required "non-commutable" restrictions.

This "non-commutable" requirement means exactly that – no cash payments in addition to the pension or annuity instalments, subject to certain exceptions, until a full condition of release is met – eventual retirement, or permanent incapacity, for example.

The limited access to cash commutations occurs where part of a person's benefits is unrestricted non-preserved – this is available for part commutations from an allocated pension.

Another exception to non-commutation, and the real beauty of the policy, is that a person is able to commute back into the accumulation phase of superannuation. One key advantage here is that it allows a person to respond to any legislative changes that may make the income stream, or any strategies associated with the income stream, detrimental.

However, where a complying pension is commenced, a person will generally not be able to commute back to accumulation phase, after six months from commencement of the complying pension due to the "complying" requirements.

Like any other retirement income stream, the amount used to commence a Transition to Retirement non-commutable income stream will be counted towards Reasonable Benefit Limits (RBL). Any commutation back to accumulation phase also will result in an adjustment of the original RBL assessment.

To find out more information about Transition to Retirement, please contact us.

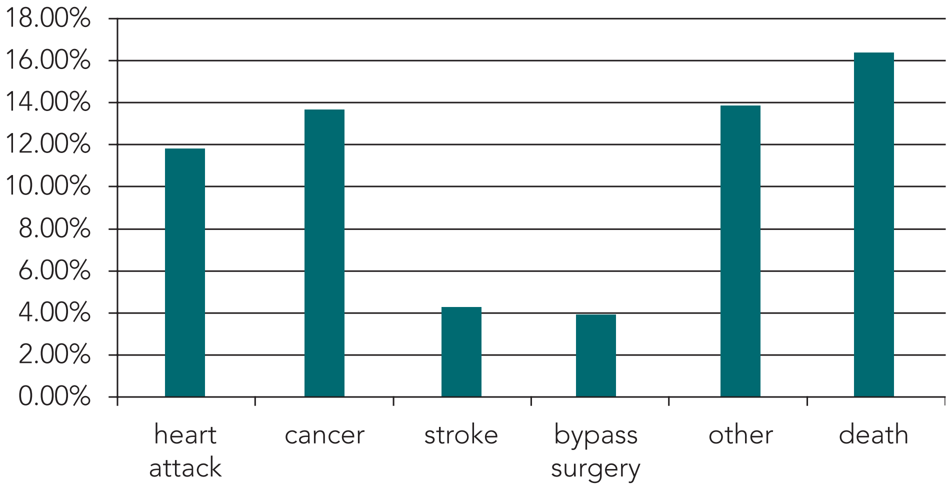
Bridging the insurance gap

How often do we say things like, "it will never happen to me" or "don't worry, we'll be ok if something goes wrong"?

When it comes to insurance it's often very easy to justify to ourselves why we don't need to do certain things, even when commonsense tells us that without having proper risk protection measures in place we are leaving ourselves and our families potentially exposed.

But how insured are you against something like a critical illness? What would happen, for instance, if you suffered an injury or illness that stopped you from working for an extended period of time? Even the most common disabilities can keep people away from work for extended periods.

Graph 1: Cumulative risk - males aged 35-65



Source: Pricing Dread Disease Insurance 1994. Report presented to Institute of Actuaries of Australia by Edward Fabrizio and Warren K Gratton

Fast Facts

Super Choice update

The introduction of Choice of Fund legislation on 1 July has given many Australians the option of changing their superannuation fund.

By 28 July, all eligible employees should have received a Standard Choice Form from their employer. Employees can choose to nominate a preferred fund or use the company's default fund. If you do change funds, your company has two months to implement the change.

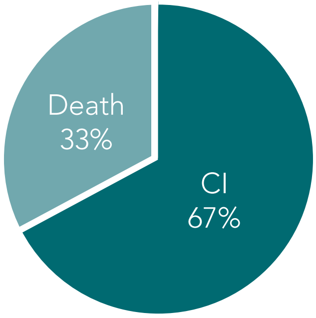
But it's not compulsory to change. If you like the fund you're already in, you need do nothing at all.

Between the ages of 35 and 64, the likelihood of suffering one of the major medical conditions covered under critical illness insurance (see graph one) compared to death is approximately:

- 3.1 times greater for females and
- 2.9 times greater for males[1]

Graph two shows that a 35-year-old male has more than twice as much chance of suffering a trauma (critical illness) compared with the risk of dying[1]. The risk of suffering a critical illness is comparable for most age groups.

Graph 2: Risk of critical illness compared with death for a male aged 35



Source: Pricing Dread Disease Insurance 1994. Report presented to Institute of Actuaries of Australia by Edward Fabrizio and Warren K Gratton

Advances in medicine mean that your chances of surviving a serious illness are much greater now than they were even a decade ago. But while your survival rate has increased, your quality of life may still be significantly reduced if you don't have adequate protection.

Social security, sick leave, workers' compensation and superannuation provide no financial guarantee for problems associated with suffering a major medical condition, which could significantly impact upon the quality of your life.

Consider the loss of your income on your lifestyle and family. Could you meet all your regular financial commitments and other costs? You may have to reduce your working hours, pay for medical care or have to adapt your house to make your day-to-day life easier. A critical illness plan could help all of this and more.

Critical Illness Cover is an insurance plan that pays out a guaranteed cash sum if you're diagnosed as suffering from a specified critical illness, within the term of the plan.

You can add critical illness protection to your existing life insurance plan at an additional cost, to help financially protect your family against the possibility of you suffering a critical illness.

This means if you are diagnosed as having a specified critical illness during the term of the plan, you'll receive the lump sum you agreed at the start of the plan. This could help you and your loved ones during a potentially financially difficult time.

Having the right insurance will provide you with extra financial peace of mind should the unexpected happen.

The cost of your cover will depend on the level and period of cover you select as well as your personal circumstances.

Please contact us to talk to one of our advisers about Critical Illness Cover.

Case study

Paul, 45, was the owner of a plumbing business in Melbourne, and his wife Joan, 43, a high school teacher. They have two children – John, 18, and Skye, 16. One night, Paul suffered a severe stroke and was rushed to hospital. The stroke left him paralysed and unable to speak, which meant a three month stay in hospital followed by six months in rehabilitation. As a result, Paul's plumbing business ceased trading and Joan was forced to take leave of absence from her job to care for Paul.

Luckily, Paul had taken out a critical illness cover option on his life insurance earlier, resulting in a total payment of $1.1 million. Although he can now function independently to a point, Paul still needs constant care.

The lump sum insurance payment enabled Joan to retire and provide full time care to Paul, without financial hardship. The insurance money also allowed Joan to remodel their house, so Paul could gain access and support himself more easily. She was also able to purchase a van that better accommodated Paul's transport needs.

1 Pricing Dread Disease Insurance 1994. Report produced by the Institute of Actuaries of Australia by Edward Fabrizio and Warren Gratton

Understanding the property space

Having some exposure to the property market should be part of any well diversified investment portfolio.

However, when considering property investments, it's important to understand that there's not only different types of property assets but a whole range of ways of investing in the property space.

Taking the indirect route

Holding direct, physical property – either in the residential, commercial, industrial or retail sectors – is only one way. If you choose this option, there are a numbers of issues to consider, ie you are dependent on the tenants and you have concentrated a large amount of capital in one type of investment.

Not everyone can spend $300,000 buying an investment property, so if you only have $10,000 to invest, it's a much easier option to get that exposure via a Listed Property Trust (LPT).

An LPT allows investors opportunities to invest indirectly. With LPTs, while the underlying assets are still physical buildings, you are not actually buying property directly but buying shares – mainly in commercial office buildings or shopping centres.

One of the benefits of listed property over direct property is liquidity. Like any shares, listed property can easily be purchased or disposed of at any time should the need arise. It's also possible to partially sell your investment holding. For example, if you had $20,000 invested in a listed property trust, but needed $5,000, it's easy to sell a quarter of the investment and redeem your funds. On the other hand, if you own a direct property, you can't sell part of it – a room for example – to redeem $5,000. You need to sell the whole property.

Perhaps one of the downsides of listed property securities – which can also be a positive – is that because they're listed on the share market they're prone, just like any other listed stock, to the ups and downs of the stock market and investor sentiment. When there is confidence about investing and stock prices are expected to rise, prices can be pushed above their net tangible asset value. This results in the value of the listed security being higher than the value of the underlying property assets. As a result, the securities can be vulnerable to a price correction and the price may move lower.

The other structure that sits in between the direct and the listed space is unlisted property. While really a form of direct property, unlisted property is often bought through investment syndicates that could own one property or multiple properties. So instead of having to invest large sums of money, an investor can gain access to a more expensive property such as a commercial building by buying a share in the venture. A downside is that because the property shares are not listed, there is not an open market to sell your holding. So if you want your investment back, it can't always be done quickly. This is because there is often a set term of investment for six to 10 years, for example before the assets are sold and there is any capital return.

A managed approach

One way to gain broad exposure to the property market is through managed property funds. Fortunately there are a range of different funds available to investors. The majority are property security funds that invest into a range of listed property securities selected by the fund manager. There are also diversified property funds that invest a portion of their total assets into listed trusts and a proportion into direct property. There are also direct property funds where your investments go into direct properties only.

Going into a unit trust structure gives you liquidity and a daily unit price so you can buy and redeem at any time. While you are paying an ongoing management fee, the benefit is having a team of people working on your behalf and reviewing the underlying assets all the time.

To discuss your property investment options in more detail, please contact us.

Fast Facts

Tax changes update

From 1 July, along with a range of various superannuation legislation changes, the Government also lowered individual income tax rates and tax thresholds.

For higher income earners, the 42 per cent tax threshold will increase to $63,001, and the 47 per cent threshold will increase to $95,001.

For individuals with salary sacrifice arrangements in place, including novated car leases, the new taxation framework means that it may be worth revisiting your current salary packaging structure.

This is because Fringe Benefits Tax is still levied at a rate of 47%, so if you're now in a lower tax bracket than before you may be paying more tax than you need to.

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