



Practical property investing

Interest rates have been heading north for some time – and economists are predicting they’ll keep climbing in the near future. Obviously this affects all homeowners, but it also clouds the benefits of investment properties – are they still attractive?

In most states the housing market has either levelled off or declined slightly. The only exception is Western Australia – in Perth, house prices rose 35.4% from 30 June 2005 to 30 June 2006.¹ The demand for new housing has also dropped – Australia-wide, monthly building approval

levels bottomed out in December 2005, down by around 19% from the September 2003 peak, and in June this year monthly approval levels were only 2% higher than December 2005.

Foreclosures (mortgagee sales) have also soared, with many Australians finding themselves over-committed. In fact, media reports indicate that the number of people in Sydney, Melbourne and Canberra forced to sell their homes has increased by 50%².

So, is an investment property still a good investment? Yes and no... it largely comes down to the area in which you buy. Some states or suburbs may go down while others may go up and it can be hard to make an educated ‘guess’ at the next boom area.

¹ ABS

² *The Australian*, 28 August 2006

To make an investment property work, you need:

- **rising house prices;**
- **high tenancy rates;** and
- **relatively low interest rates.**

The problem is, these things can’t be guaranteed.

You should also look at the real yield – that is, the income and capital growth you’ll get at the end of the day, taking into account loan repayments, building insurance, rates, tax, etc.

Some potential disadvantages of an investment property are:

- **Lack of liquidity** – it’s harder to sell a house than to sell, for example, shares.
- **Lack of diversity** – if you put a large sum into an investment property and don’t put money into other types of investments, you are over-exposed to the property market.
- **Overall fit** – does the investment property fit in with your overall financial plan?



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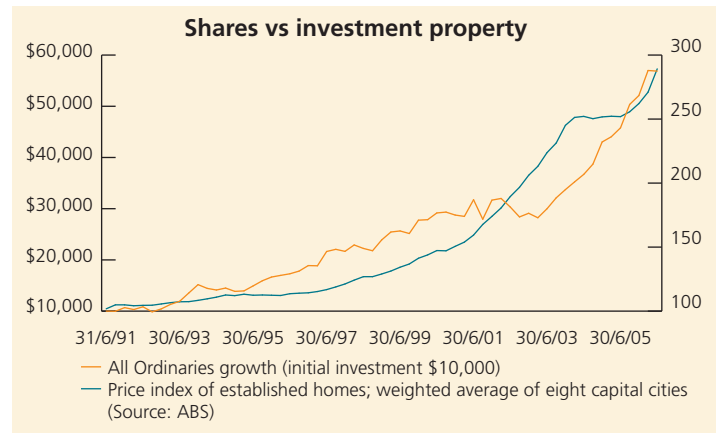
Practical property investing (continued)

An alternative – shares

Investing in shares (including borrowing money to invest) can have advantages over buying an investment property. For example, if you already own property (e.g. your home) it's wise to diversify with a share portfolio. You can also get into the market with a much smaller investment and shares are easier to sell than a house.

Of course, you'll also need to compare the returns! The graph on the right shows the growth of shares (based on the All Ordinaries) versus the growth of housing prices, over the last 15 years.

So, are you looking at property through rose-coloured glasses?



Looking for a loan: part 2



Last edition we gave you an overview of the different types of loans and introduced you to Steve and Lisa, a young couple about to purchase a home. This edition we'll look at a lending solution for them.

Steve and Lisa are married and in their early 30s. They have a young daughter and while Steve is a stay-at-home Dad, Lisa works full time as a solicitor earning \$95,000 p.a. Steve and Lisa have \$50,000 saved for a deposit and have found a \$500,000, three-bedroom house in Melbourne's eastern suburbs.

From a lending point of view, half of their savings would be used as a 5% deposit and the remaining \$25,000 can be put towards

government fees and charges. This means Steve and Lisa would be borrowing \$475,000, which represents a 95% loan to-value-ratio (LVR). Mortgage insurance is generally required when you borrow more than 80% of the value of the property, and in this case Steve and Lisa should look at including the \$11,175 insurance premium into the loan (otherwise, they'd have to fund the premium from their own savings).

The other costs involved in this purchase would be stamp duty of \$25,660, registration of \$75 and transfer fees of \$1,322 (Victorian estimated cost). However these costs would be partially offset by the First Home Owners Grant (FHOG) and the First Home Buyers Bonus, which total \$10,000 (Steve and Lisa are first home buyers).

As Lisa is a solicitor, we recommend a Professional Package, which has a number of attractive features and benefits. For example, it offers a substantial discount of up to 0.7% of the current standard variable rate (7.82% p.a. as at September 2006), and includes a credit card and a savings account/offset feature. There is an annual fee that generally ranges from \$300 to \$495 covering costs such as application fees, valuation fees, etc.

A number of lenders could provide this loan for Steve and Lisa, including the major banks.

Next edition we'll look at the importance of adequate risk insurance when buying a home.

Looking for a loan? Genesys can help you source the right loan for your needs, doing all the research for you and applying our experience and knowledge to find the best loan for **you**.

Converting your super to pension

Imminent retirement is usually an exciting time – finally all those years of hard work are nearly over! So, will you travel, spend more time in the garden or play golf every day? Whatever your ideal retirement lifestyle, there's also the practical to consider.

First you must make sure you've got enough money to fund your desired lifestyle – there's nothing more practical than that! And a few extra years in the workforce could be the difference between living your retirement dreams – or not.

One of the other practical elements is where your retirement savings 'sit'. While some people own property, direct shares, managed funds, etc. **outside** of super, for most Australians the major source of income during retirement will be investments that sit within a superannuation fund – especially when super funds receive such beneficial tax treatment. These superannuation investments will probably include shares, managed funds, and even property (e.g. through listed property investments or direct property held via a self-managed super fund).

When you retire, you'll need to convert your existing superannuation savings into an income stream. That is, instead of paying money into your super fund (through employer contributions, salary sacrificing and/or personal after-tax contributions), you'll be drawing an income. To do this, your super fund will need to be converted into a pension fund.

There are two ways to convert your super fund into a pension fund. Firstly, you can sell the assets in your super fund, close the fund and then open a pension plan/fund. The only drawback of this method is that selling the investments can have tax implications, such as capital gains tax.

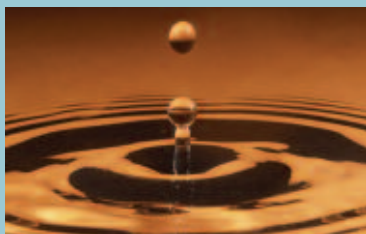
The other alternative is a simple conversion – many super products have the ability to convert your super into the pension phase of the fund, without requiring you to sell the underlying investments. This will give you a much smoother transition.



Time to renew

It's hardly breaking news that eventually our 'traditional' energy resources, such as natural gas and coal, will run out. And a limited supply isn't the only problem – fossil fuels are also major contributors to greenhouse gases, which are damaging our ozone layer.

Scientists and environmentalists have been working for years to find better and cleaner methods of producing electricity. So, what are the options? We've been relying on the earth (e.g. oil and coal)



for years, but what about the other three elements – water, wind and fire?

Water – hydropower uses the energy created when water falls or is moved (e.g. by a water wheel).

This form of power has been around for a long time, with water wheels in use since the Middle Ages. Nowadays, the most common form of hydropower is hydroelectricity from dams. In 2005, hydroelectricity made up 19% of the world's electricity supply¹.

Wind – wind power is becoming more popular in Australia – you may have seen wind turbines dotted around the countryside. In 2005, this modernised form of the classic windmill accounted for 1% of the world's electricity, but made up 23% of Denmark's electricity supply². Here in Australia, wind turbines are a contentious issue. On the plus side wind energy is never-ending, renewable and squeaky clean... but the turbines do negatively impact the landscape.



Inheritance woes?

An inheritance should be a welcome boost but the effects of tax and social security issues can be a blow. Below are some common assets that may be passed down and how they will be treated. However, this is an extremely complex area so it's best to seek financial advice before making any decisions.

The family home

Many long-held family homes have increased significantly in value since they were originally bought – and this means the capital gain is substantial.

Fortunately, the ATO provides a grace period of two years in which no capital gains tax (CGT) is payable as long as the inherited family home is sold or becomes the home of the recipient. You're also allowed to rent out the home during this period without triggering a CGT liability.

An investment property

For an investment property bought from 1985 onwards, there will be a CGT liability when sold, and the original purchase cost will be used in calculating the capital gain.

If the property was purchased before CGT was introduced in 1985, the CGT liability triggered on sale is determined using the market value at the date of death for the cost base.

It's important to note that each state has different rules on property taxes.

Superannuation

A superannuation portion of an inheritance can be received in a variety of ways, with different tax consequences. Inheriting assets (including super) can also affect a person's entitlement to the age pension, but there are ways the entitlement can be protected.



Shares/managed funds

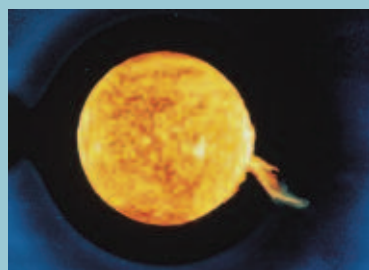
Any shares or managed funds purchased after 1985 will be liable for CGT when sold. The original purchasing price will be used to calculate capital gains.

If the shares/managed funds were bought pre-CGT (1985), there will still be a CGT liability triggered on sale. The cost base will be the market value at the date of death.

Cash assets

Cash is not counted as income for taxation purposes when inherited; however any earnings on cash investments (i.e. interest) will/shall be counted for income tax purposes at tax time.

Note: In all of the above cases, any gain made on an asset that has been held for at least 12 months can be reduced by 50% before capital gains tax is calculated. Special rules apply to determining the 12-month period for deceased estates.



Fire – the fire element is captured by the sun, which is pretty much one big fireball! Solar power uses light from the sun to create energy – usually electricity. While it has been used in Australia for many years, our uptake is well behind other countries

(last year solar power contributed 2MW to our national grid, compared to Germany's 700MW)³.

Of course, we're not limited to the four elements... not in today's nuclear world. Nuclear power is a hot topic in Australia at the moment, with an inquiry initiated by Prime Minister Howard currently underway. **Nuclear power** is most commonly produced from nuclear fission (when the nucleus of an atom splits) and radioactive decay (the emission of radiation from unstable particles). Nuclear power accounts for 17% of the world's electricity, although France sources

80% of its electricity from nuclear power⁴. Will Australia's energy future be nuclear?

Everyone can play a part when it comes to electricity and our environment – simply switch off that light!



Renewable energy in Australia

Australia currently has over 450 operating renewable energy generators. These are mostly generators powered by water, wind and the sun, but also include other renewable energy sources⁵.

¹ Wikipedia

² Wikipedia

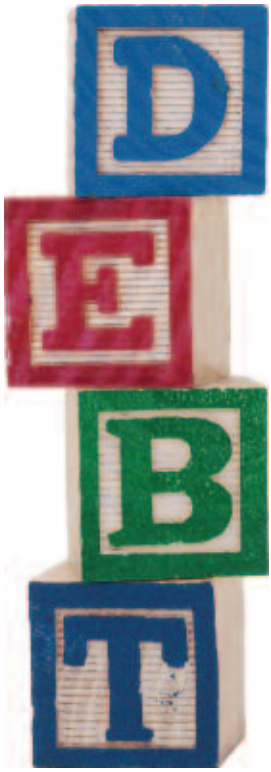
³ *The Age*, 14 September 2006

⁴ Wikipedia

⁵ Australian Greenhouse Office

Change your debt!

Sometimes a little financial re-arrangement can make the world of difference to your overall financial situation. It sounds simple – and it is.



You may have heard of 'good' debt and 'bad' debt. Basically, good debt is debt that's being used to help you increase your overall wealth (e.g. a loan to buy shares) and bad debt is debt on items that decrease in value, such as a car (luxury, collectible cars excluded).

Another indicator of good or bad debt is tax deductibility. For example, while in many ways your home is good debt (it will generally increase in value over time), it's not tax deductible. So, can you turn your good debt into 'great' debt? Yes!

Great debt

Felicity and Alex have a home loan of \$200,000 on their \$400,000 house and own shares worth \$100,000.

Strategy: Felicity and Alex sell their shares* and deposit the \$100,000 into their home loan.

They then split their home loan and

establish a line of credit within the original loan and re-purchase shares to the value of \$100,000. For taxation purposes, Felicity and Alex will then have a \$100,000 personal non-deductible loan (the house) and a \$100,000 tax-deductible investment loan (the shares). This is because interest on investment loans is tax-deductible.

* Selling shares may result in a capital gains tax liability, and it's important that you consider your overall capital gains tax situation before taking any action.

This strategy will also work if you establish two separate loans (a home loan of \$100,000 and a line-of-credit loan for \$100,000). Ideally, the line-of-credit loan for the shares should be an interest-only loan and you may use the dividends from the shares towards paying off the loan interest, depending on your cashflow requirements.

Most lenders can split loans or provide a separate line of credit loan. Either way, you should receive two separate statements – which you must have for taxation purposes.

Before

- \$200,000 non-deductible home loan

After

- \$100,000 non-deductible home loan
- \$100,000 tax-deductible investment loan

What's the downside?

If you're going to adopt this strategy, you should be aware:

- of the cost of buying and selling shares;
- that borrowing to invest can increase your gains but can also magnify any losses;
- of the potential cost of re-negotiating or re-arranging your loan; and
- that capital gains tax may be payable when you sell the shares in the future.

Is it for you?

To discuss this strategy's suitability to your situation, please give us a call.

80 years ago

(it just had a sound track), *Don Juan* starring John Barrymore. This film was the pre-cursor to the first part-talkie (*The Jazz Singer*, 1927), the first full-talkie (*Lights of New York*, 1927) and the first full-talkie, all-colour movie (*On with the Show*, 1929).

The 20s was also a time of gangsters – highlighted by a 1926 shoot-out in which 12 cars full of gangsters opened fire on the headquarters of Al Capone. Miraculously, only one of Capone's men was wounded.

1926 also saw Turkey switch to the Gregorian calendar, the Irish Minister for Justice appoint the Committee on Evil Literature, the launch of the first liquid-fuelled rocket in Massachusetts, the birth of the famous Route 66, the mysterious disappearance of Agatha Christie (she turned up nine days later), and Gertrude Ederle became the first woman to swim the English Channel.

It was an amazing year for births: Jerry Lewis, Dame Joan Sutherland, Hugh Hefner, Queen Elizabeth II, Harper Lee, Miles Davis, Marilyn Monroe, Mel Brooks, Tony Bennett, Fidel Castro, John Coltrane and Chuck Berry. Wow, what a year!

Of course there were also a few famous deaths, including Harry Houdini and Claude Monet; and Mussolini was almost on this list after a failed assassination attempt in April.

It's the roaring 20s and life is good! Skirts are short, jazz is in and the stage is about to be set for talking movies (and some said they'd never take off!). Warner Brothers led the way in 1926, with the release of the first film to have any sound



News bites

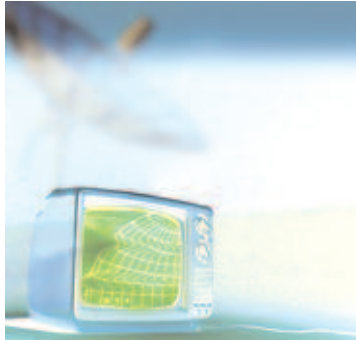


No more RBLs

If you're planning to retire soon, your life got a whole lot simpler with the 2006 Budget, which abolished Reasonable Benefit Limits (RBLs) from 1 July 2007.

Don't ask Dazza

Have you seen the 'Don't ask Dazza' TV ads? This advertising campaign aims to raise awareness of the importance of professional financial advice and is an initiative from Australia's financial planning industry body – the Financial Planning Association of Australia (FPA). The ads take a comical look at what can go wrong when you follow Dazza's advice rather than seeking professional help. Keep your eye out for the ads.



Special disability trusts

On 20 September new legislation came into effect regarding Centrelink's treatment of special disability trusts. Now, up to \$500,000* of assets within a special disability trust are exempt from the assets test, and income from the trust received by the beneficiary is exempt from Centrelink's income test. (A special disability trust is typically set up to provide financially for a disabled child in the future.)



*This amount will increase each year, in line with the Consumer Price Index (CPI).

Blue chip stocks

Did you know that the term 'blue chip' is derived from the game of poker? This is because blue chips are more valuable than white or red.



Australians rely on the lotto

Are most Australians financially literate? Apparently not! In July, the Investment and Financial Services Association (IFSA) released results of a financial literacy survey it commissioned and the results were surprising. Below are some interesting stats:

- 74% of Australians say their financial goal is to retire comfortably at an age they nominate...
- But 15% of Australians listed winning the lottery as part of their retirement strategy!
- 43% of respondents did not know how much their employer was legally required to contribute to their super fund (it is 9%)
- Even excluding their mortgage, 37% felt that they had more debt than savings

The government's Financial Literacy Foundation aims to promote financial literacy and educate Australians. Genesys is also committed to raising awareness across a range of financial topics – from super and retirement planning to risk insurance and loans. If you have a question on any financial topic, give us a call.



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