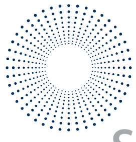

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Additional Information Flyers

Cashflow & Debt Management

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Set and maintain a budget

A key to building wealth is saving. Setting a budget is about finding a balance between income and expenses and deciding what's important so you have money left over to save.

Benefits

- Setting a budget can help improve your cashflow and increase your savings capacity.
- Taking charge of your money can help you feel more secure and in control.
- A budget allows you to plan ahead to help meet your goals.

How it works

The best way to start taking control of your finances is to do a budget (or expenditure plan). A budget is simply a tool to help you identify your income and expenses. It shows if you are spending more or less than you can afford, and it can help you determine your capacity to save for future goals.

There are two sides to a budget – income and expenses. When putting your budget together, you should try to identify all regular payments over a full year.

- **Income** payments include salary, pension income, dividends, distributions, rental income and interest. You can use the after-tax amount of income or you can include an allowance for tax in your expenses.
- **Expense** payments include mortgage repayments, rent, bills, car costs, public transport costs and general living expenses.

To help identify your income and expenses, it can be useful to look through your pay slips, bank and credit card statements, bills, receipts and even your shopping dockets. Use your best guess if there's anything you can't find or if amounts vary across the year. Your budget will probably need to be adjusted over time until all income and expenses are captured.

Budget results

Once your budget is complete, you can identify your disposable income. Your disposable income is the total of your income less the total of your expenses.

- If your disposable income is negative, it means you are spending more than you earn. You should review the expenses side of your budget to see if there is anything you can cut back on or cut out altogether. Talk to your financial planner about strategies to help reduce your expenses.
- If your disposable income is positive, it means you have capacity to save. You could consider setting up a regular savings plan with your surplus income to increase savings for your future goals.

Even if you have surplus income it might be worth looking for further savings. The budget gives you an opportunity to look through your expenses and identify which items you need for basic living and which are extras that you could cut back on to increase savings. It is important that you don't cut out all of your extras because a budget that's too rigid won't work.

For your budget to be effective, it should be used in conjunction with a regular savings plan. The savings plan should direct your disposable income into a savings account as soon it comes in and before it is spent.

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Ongoing budget review

Your budget should be reviewed on a regular basis (this might be every 6 to 12 months) to ensure it continues to reflect your current income and expenses. It should also be reviewed if there are significant changes to your income or expenses, such as changing jobs, or buying a new house or car. Regular reviews will help your budget stay on track and help you achieve your savings goals.

Consequences

- Starting a budget for the first time can be difficult but it does get easier as you along. Once your budget is set up, ongoing updates are much easier.
- ASIC have an online budget planner that you can use located at MoneySmart.gov.au.

Date: 1 April 2018

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Debt management

Reducing your debt provides savings because you pay less interest. Once your debts have been repaid, you will be able to increase your wealth by saving the repayment amount.

Benefits

- You will have potential to increase wealth once debts have been repaid.
- You will pay less interest over the life of your loan.
- Your financial burden will be reduced.

How it works

The cost of debt includes the interest you pay over the life of the loan and loan fees. Reducing these costs can provide you with significant savings which can help you reduce your debts quicker and increase your capacity to save.

Strategies that can help to reduce the overall cost of debt include making additional repayments, consolidating your debts, repaying debts with higher interest rates first and repaying non-deductible debt before deductible debt.

Additional repayments

Making extra repayments on your loan can help eliminate your debt faster and save on interest costs. Even a small increase in your repayments can provide you with significant savings over the life of your loan. Any lump sums you receive, such as tax refunds or bonuses, could be directed to your loan.

Putting your additional repayments into an offset account or redraw facility gives you the benefit of the reduced interest cost plus the security of knowing you can access the money again if you really need it. If your loan doesn't have an offset account or a redraw facility, it may be worth checking with your provider to find out if this feature can be added to your existing loan.

Consolidate your debts

Consolidating your debts into one loan can save you costs because you will only pay account fees on one loan account. You will also save on interest costs if your higher interest rate loans (such as credit cards and personal loans) are consolidated onto your home loan which has a lower interest rate.

To implement the strategy, you will need to increase one loan facility (such as your home loan) and use the funds to repay your other debts. It is important that you continue making the same overall loan repayment on the remaining loan after consolidating otherwise it may take you longer to repay the debts and you could end up paying more interest over the life of the loan.

It is also important to ensure you use a budget so you don't reaccumulate any other debts.

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Repaying high interest rate debt first

If you have more than one loan, chances are that the interest rate applying to each loan will be different. As a general rule, credit card loans have the highest interest rate, personal loans next, then your home loan. Focusing on repaying the loan with the highest interest rate can create savings compared to repaying all of the loans at the same time.

It is important that you continue making the required repayments on all the loans whilst using surplus income to repay the higher rate loan first.

Repay non-deductible debt first

The interest on loans that are used to buy an income-producing asset (such as shares or an investment property) is tax deductible. This is called 'deductible debt'. The tax deduction effectively reduces the cost of the debt, with the value of the deduction being higher if you are on a higher marginal tax rate.

'Non-deductible debt' is a loan which has been taken out to buy a non-income producing asset, such as your home or car, or to pay for personal expenditure, such as a holiday. You are not eligible for an income tax deduction for the interest on these loans so these debts should be repaid as quickly as possible.

To accelerate the repayment of your non-deductible debt:

- use your surplus income to make additional repayments
- halve your monthly repayments and repay this amount fortnightly instead – this results in you making 26 repayments for the year, equating to 13 months instead of only 12
- change the repayments on your deductible debt to interest only to increase your surplus income and direct this income to repay your non-deductible debt more quickly.

Consequences

- Before making any changes to your loan, you should check what fees and penalties may apply.
- Some loans do not allow additional repayments to be made. You should check with your loan provider whether additional repayments are allowed and whether any penalties apply.
- You should have adequate life insurance to help meet loan repayments if your income stops because of death or illness.
- You should check with your accountant before making changes to investment related borrowings.

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Salary packaging (non-superannuation)

Salary packaging is an arrangement where you agree to give up part of your future cash salary in return for benefits of a similar value.

Benefits

- Salary packaging can increase your cashflow and your savings capacity because you pay some of your usual expenses with pre-tax income.

How it works

When an employer pays an employee with a benefit other than cash, the benefit is generally classed as a ‘fringe benefit’ and attracts fringe benefits tax (FBT) at the top marginal tax rate. For many employees, this means salary packaging will result in the same or more tax being paid.

However, salary packaging can be worthwhile where either the employer or the benefit receives concessional FBT treatment.

- If you work for an **FBT exempt employer**, you may be able to package benefits up to a specified threshold without being subject to the FBT. These employers include public benevolent institutions and some hospitals.

- If you work for a **rebatable employer**, you may be able to package benefits up to a specified threshold and only be subject to approximately half the rate of FBT. This is because rebatable employers are entitled to a rebate on FBT up to the specified threshold. Rebatable employers include certain religious or educational institutions and charities.

- You may be able to package **exempt items** that do not attract FBT if they are purchased primarily for use in employment. Exempt items include portable electronic devices, computer software, protective clothing, a briefcase and tools of trade.

- You may be able to package specific items that receive **concessional FBT** treatment. These items include a car or a car parking space, where only a portion of the value has FBT applied.

Packaging agreement

You need to confirm with your employer that you are able to salary package because it is not compulsory for employers to offer packaging arrangements. If your employer does allow salary packaging, you should also check what they require to put the arrangement in place.

It is recommended that you set out the terms of your salary packaging arrangement in writing. You should ensure that your agreement includes confirmation that your other entitlements (such as superannuation guarantee (SG) and termination payments) will not reduce as a result of your salary packaging arrangement.

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Reportable fringe benefits

The grossed up amount of packaged benefits that exceed $2,000 are reported on your payment summary. This reportable amount is not included in your assessable income, but it is included on your tax return for the purpose of determining your obligations or entitlement to certain benefits or concessions, including:

- The Medicare Levy surcharge
- Personal deductible superannuation contributions
- Superannuation co-contribution
- Spouse contributions tax offset
- Senior Australians and Pensioners Tax Offset
- Compulsory HELP and financial supplement repayments
- Child support assessments
- Income tested government benefits (such as Centrelink payments)

Consequences

- An employer is only obligated to calculate your SG entitlement on your cash salary. As salary packaging reduces your cash salary, it can also reduce your SG entitlement unless your employer agrees to maintain the same level of SG contributions.
- You should confirm with your accountant that the salary packaging arrangement is appropriate for your overall tax situation.

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Redraw facility

A redraw facility allows you to withdraw any additional home loan repayments you have made when necessary. Paying any extra money you have available into your home loan can be an easier decision when you know you have the ability to get these additional payments back at a later date. A redraw facility is usually available on most variable rate loans but is not available on fixed rate loans. Please contact your financial institution to find out.

Benefits

- Putting excess funds into your home loan means you are effectively earning the interest rate of your loan account for your savings. The interest you are being charged on your home loan is likely to be higher than the interest rate you are able to achieve on any cash savings account.
- Even though you are effectively earning a higher interest rate than if your money was in a savings account, you do not have to pay any tax, whereas interest earned in a savings account is considered income and may be taxable.
- Redrawing on your home loan can be cheaper than using your credit card or personal loan as there is generally a lower interest rate.
- A redraw facility gives you the 'peace of mind' of knowing you may have a flexible source of funds sitting in your home loan account for any planned or unexpected events

How it works

Putting additional repayments into a loan account with a redraw facility gives you the benefit of the reduced interest cost in addition to the security of knowing you can access the money again if required. Making extra repayments on your loan can help eliminate your debt faster and save on interest costs. Even a small increase in your repayments can provide you with significant savings over the life of your loan. Any lump sums you receive, such as tax refunds or bonuses, could be directed to your loan.

First of all, you need to check with your provider whether your loan account has a redraw facility or eligible for having it and apply for it. Secondly, you need to make loan repayments above the minimum. If you have mortgage repayments of say $1,000 a fortnight and you pay $1,500 a fortnight, i.e. an extra $500 off each time, the extra $500 can go into redraw facility and you will be able to access it later if necessary. It will reduce the balance of your loan initially hence reducing interest charged by the bank. Additional amounts are calculated by the bank and called accrued extra payments available for redraw. You then can apply to draw on these extra payments. You will need to contact your financial institution to organise and check the terms and conditions for the redraw.

Consequences

- Redrawing additional payments you have made will reduce the benefit of making additional repayments.
- There may be a fee for having a redraw facility.
- The number of free redraws and maximum number of redraws per year can be limited.
- There may be a fee per redraw.
- There may be a minimum or maximum redraw limit available.

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Debt recycling

Debt recycling is the process of replacing mortgage debt (non-deductible), with investment debt (deductible).

This strategy enables you to start building wealth while you are still paying off your home mortgage. You effectively take out equity from your home and invest somewhere else, where you can potentially achieve a high level of income and growth. Income from these new investments can be used to further reduce the mortgage balance, while the growth component contributes to wealth accumulation.

Benefits

- You are able to invest immediately rather than waiting for the mortgage to be paid off. It allows the power of compounding to start working earlier.
- By directing investment and other available income into a home loan, there is the opportunity to reduce it faster and therefore save on interest.
- Borrowing to invest can provide tax effectiveness through the deductibility of interest. This will reduce the cost of capital. The higher your marginal tax rate, the more profitable this strategy is.
- You will be invested in a larger investment portfolio than available without borrowing.
- The funds invested via the gearing strategy are for the long term; however they can be accessed at any stage unlike superannuation providing flexibility.
- Gearing provides for a diversified approach to create wealth for your retirement. It can reduce the risk of adverse legislation changes regarding your retirement savings inside superannuation.

How it works

This strategy involves transferring your non-deductible debt of a home loan into a tax deductible debt of an investment loan. The primary objective is to reduce the non-deductible debt faster than just making regular repayments, while accumulating wealth. Additional exposure is created through increasing tax efficient investment debt.

All surplus cash flow, after the interest is paid on the investment loan (line of credit), is used to reduce a non-deductible home loan, thereby more rapidly increasing equity in the home. Home loan repayments are 'Principal and Interest' while the investment loan payments are 'Interest Only' to ensure that non-deductible debt repays earlier and deductible debt works to the maximum. All investment earnings, franking credits, tax refunds and other surplus cash flow, after paying the investment loan interest, should be used to further reduce the home loan and increase equity in the home. Over time, amounts equivalent to the increase in equity can be drawn down and invested in growth investments further, if desired (depending on your life stage and objectives). The above process is repeated over future years in a disciplined manner to reduce the non-deductible home loan more rapidly, whilst increasing investments into growth assets.

To commence a debt recycling strategy, you need to ensure you are able to achieve a desirable loan structure, please contact your financial institution to discover further details. A loan facility allowing separate sub-accounts is preferred, with the ability to choose between principal and interest and interest only repayments. As some of the investment debt will have deductible interest costs, these amounts should be kept separate.

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Consequences

- Debt recycling works best when the investment generates income in excess of the interest cost and helps pay down the non-deductible debt even quicker. Careful consideration of the investments is required.
- Debt recycling can lead to compounding losses when markets experience a downturn.
- Interest rates associated with loan facilities used in debt recycling strategies are often higher than the standard variable mortgage rate.
- Debt recycling is not recommended for anyone with an investment timeframe of less than five years.
- It is a risky strategy and only suited to investors with a reasonable risk tolerance and a secure income source.

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Mortgage Offset Account

An offset account is attached to your mortgage and works like a regular bank account, as you can deposit your salary into it and withdraw money for everyday purchases using a debit card that you will receive from your financial provider.

An offset account is 'offset' against your home loan balance, reducing the amount you pay interest on. You can have your salary paid directly into an offset account – which will immediately count towards the amount of interest you pay.

Generally, offset accounts are only offered with variable loans. Fixed rate loans they generally don't offer the option of an offset account.

Benefits

- Offset accounts can potentially save you a significant amount of interest on your mortgage.
- Offset accounts can reduce the term of your mortgage.
- Offset accounts generally offer a higher interest rate than general everyday access savings accounts.

How it works

Let's say you have a $500,000 home loan balance over a 30 year term at an annual interest rate of 5.4% (variable) repaid monthly.

If you were to retain an average balance of $10,000 in an offset account for that 30 years, you would save approximately $36,000 in interest costs and 1 year off the term of your mortgage.

See below for the full set of assumptions.

What should you look for in an offset account product?

- **An account where 100% of your balance is offset against your loan, calculated daily**. This will ensure you receive the maximum benefit from the strategy. Some accounts only calculate on the lowest monthly balance or the average monthly balance, so it's important to get an account that calculates savings when the balance is also high.
- **An equal interest rate to your mortgage**. This is a common feature of most mortgage offset accounts, but you should ensure the rate will move with your home loan. That way, any interest earned by the money in your offset account will also offset your mortgage interest thereby helping you pay off the loan capital faster.
- **A credit card with a low interest rate**. Often you can get a credit card with a lower interest rate than standard credit cards.

Consequences

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- Some lenders may have minimum transaction amounts and withdrawal fees if you decide to redraw money from your offset account. These fees could end up costing you more than the interest you would save.
- While offset accounts often pay higher interest than standard everyday savings accounts, interest rates are still low compared to other types of investments.
- Fees may apply to establish or maintain an offset account. These fees must be weighed up against the interest you are saving by utilising the overall strategy – otherwise the strategy may not be worth it.
- Not all home loans offer an offset facility.

Assumptions used in the above example

1. Loan repayments are assumed to be made at the end of each month.
2. One year is assumed to contain exactly 26 fortnights or 12 month i.e. a year has 364 days rather than the actual 365 or 366.
3. The loan interest rate you enter into the calculator is assumed to be the annual nominal rate of interest, compounded per the loan repayment frequency. For example, for a loan interest of 6.00% p.a. and monthly repayments, the calculator assumes the interest rate charged is (6.00% / 12) = 0.5% per month, compounded monthly.
4. The loan interest rate is assumed to remain the same over the entire term of the loan.
5. The average offset balance is assumed to not change.
6. The loan repayment amount is calculated assuming a standard home loan where both interest and principal is repaid over the loan term.

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