Personal Wealth Adviser

Managing your personal finances

ISSUE 5

HLB MANN JUDD
ADVISORY AND ACCOUNTING

Our Sydney personal wealth management team provides you with a simple solution for your personal wealth needs. We have specialists in wealth management, superannuation, self-managed superfunds, estate planning, debt advisory and insurance services.

THIS ISSUE ALSO INCLUDES ARTICLES ON:

- Four tips for dealing with higher interest rates
- Should I prepay the mortgage or make extra contributions to super?
- NSW first home buyers given choice between stamp duty and annual property tax
- Deceased estates and selling the family home
- Look beyond one year investment returns
- Centrelink Concession Cards Post The 2022 Budget: New Income Thresholds

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MICHAEL HUTTON
Partner, Personal Wealth Management

FOUR TIPS FOR DEALING WITH HIGHER INTEREST RATES

With interest rates increasing dramatically over the last nine months with the RBA increasing the official cash rate from 0.10 in April 2022 to 3.10 in December 2022, this is leaving some borrowers strapped for cash.

With interest rates on the rise, anyone with a loan would be concerned about how to deal with ballooning monthly payments. Thankfully, there are ways to take control of the situation before it's too late.

Mortgage holders have seen their interest double from about 2.5 per cent to around 5 per cent per annum. Monthly repayments are becoming significantly larger.

Pointing out that interest rate increases are starting from a very low base provides little comfort for borrowers, since each rate increase has a significant impact on cash flow regardless of the starting point.

Rate rises can also affect all types of loans, not just large mortgages, including credit cards, personal loans and car loans.

So, what can borrowers do to alleviate the impact of these increased loan payments and not be overburdened with debt? Here are four things they can do.

1. Know the difference between good and bad debt

Not all debt is bad. In fact, debt can be quite a good thing in certain cases.

For example, any loan used to finance something that can offer a positive investment return is good debt. A debt that is tax-

(CONTINUES PAGE 2)

deductible and/or low interest can also fall under the category of good debt.

On the other hand, bad debt could mean a debt for an investment providing a negative return, a debt that is not tax-deductible and/or a debt that is at a very high interest rate.

Generally, the worst types of bad debt are credit cards and payday loans, and it's important that they are paid off first.

If possible, aim to pay these off in full every month.

2. Understand discretionary spending

A short-term solution to handling higher loan repayments is by assessing and listing your discretionary spending.

Start the list with any money that has been paid for rent or the mortgage, then add details of where money has been spent in the last month. Evaluate whether it has been spent on "wants" rather than "needs".

A want might include a purchase of the latest smartphone or other gadgets and luxuries. Needs include paying the rent or mortgage, utilities and groceries.

This exercise will provide a good overview of where hard-earned money is going and will be a useful benchmark for setting a monthly household budget.

It will also identify areas where you could cut spending or shop around for better deals, including:

- The weekly grocery bills
- All monthly subscriptions (including entertainment and gym/fitness)
- Internet, electricity and gas deals
- Health cover (maybe reduce extras cover or increase the excess)
- Reviewing personal insurances (although most are under-insured).

3. Review the lifestyle that enables the spending

Handling higher loan repayments for the medium to long term may require some hard choices in terms of changing your lifestyle.

That includes resisting the urge to buy takeaway or eat out at restaurants when a home-prepared meal can suffice, or reviewing holiday plans by going for activities that cost less money, such as going to beaches and parks.

Now is a good opportunity to declutter the household by selling things that are no longer being used. Not only will it result in some much-needed extra cash to facilitate higher loan payments, it's also a sustainable practice and good for mental health.

Car expenses such as petrol, servicing and registration can also have a negative impact on the monthly budget. If the borrower owns two cars, perhaps consider selling one of the cars and getting by with just one instead.

If lifestyle allows, it might even be more economical to subscribe to an on-demand car rental service rather than owning a car.

4. Shop around for a better deal

Lastly, there is no law that locks borrowers into their current mortgage for the full 25- or 30-year term.

Shop around and find an alternative provider that can offer a lower rate.

Even a 1 per cent reduction can make a huge difference in terms of reducing the monthly loan payment.

However, it's worth seeing a mortgage broker, as they are equipped to find the best deal as well as assess whether it's worth taking on the costs of changing providers.

Michael Hutton has a monthly opinion piece in the Australian Financial Review. This article first appeared as part of this series on 5 December 2022.

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LINDZI CAPUTO
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SHOULD I PREPAY THE MORTGAGE OR MAKE EXTRA CONTRIBUTIONS TO SUPER?

Many people question why they should make extra contributions to superannuation when their spare cash could be used to pay down the home mortgage.

With interest rates rising, mortgage prepayments may appear more attractive, but it is worth considering the benefits of additional super contributions to your overall wealth planning.

Making extra mortgage repayments can be a good strategy to reduce the amount of interest paid over the term of the loan and the number of years required to repay a home loan.

Extra repayments result in a guaranteed return equivalent to the interest rate of the loan and is risk free.

Investing spare cash elsewhere would need to generate an after-tax return greater than the interest rate of the loan to be more appealing than mortgage prepayments.

The disadvantage of extra mortgage repayments is the opportunity cost of not investing the cash available. Generally, where the mortgage represents less than 50% of the value of the home, consideration could be given to alternative ways to invest spare cash, such as adding to superannuation.

Extra concessional (deductible) contributions can be a tax effective way to boost an individual's superannuation balance to allow for a more comfortable retirement. Given restricted contribution limits individuals need the benefit of time to build up their superannuation balance. In retirement the most tax effective place for investment wealth to be is within superannuation.

Consider the example of Steve a professional earning a salary of $200,000 with a home mortgage of $850,000 at a variable rate of 5.67%. Steve has spare cash available each year of $6,000.

If Steve uses the $6,000 each year to make additional repayments on his mortgage ($500 per month) he'll receive a return of 5.67% and pay down his mortgage 4 years earlier.

Alternatively, Steve could invest the $6,000 per year into superannuation by salary sacrificing $500 per month. This would result in an annual tax saving of $1,920 including the 15% tax paid on the contribution made to superannuation. This is a 32% return on the $6,000 invested, already putting him ahead of the extra mortgage repayment strategy.

In addition, the investment in superannuation would boost his balance and generate annual earnings. Assuming Steve invests in a growth style portfolio with 80% in growth assets and 20% in secure assets he would likely achieve the hurdle rate of 5.67% a year after-tax over the long-term.

While paying down non-deductible debt should be the priority, it is worth considering the benefits of additional contributions when the mortgage represents less than 50% of the home value. A multi-strategy approach to wealth building can allow individuals to grow both their lifestyle and investment assets.

Things to consider:

- Access to superannuation is restricted until at least age 60. Individuals must be prepared for extra contributions to be inaccessible and invested in superannuation long-term.
- The annual concessional contribution limit is $27,500 and includes superannuation guarantee paid by an employer, salary sacrifice, and contributions claimed as a personal deduction.
- The tax benefit is immediate where contributions are made via salary sacrifice.
- Contributions above the annual limit of $27,500 may be possible where the individual has carried forward concessional contributions available for those with a super balance under $500k.
- Superannuation contributions rules are complex, so it is a good idea to seek advice on the best strategy for you.

BETTY PRESHAW
Director, HLB Debt Advisory

NSW FIRST HOME BUYERS: STAMP DUTY VS ANNUAL PROPERTY TAX

As parents, we all want our grown-up children to do well in life and achieve their goals, whether that's climbing the career ladder, starting their own business or buying their first home.

Sadly, there are many obstacles standing in the path to homeownership for young Australians these days – the biggest of which is housing affordability, despite current market conditions.

Property prices might be falling, but so high was the recent peak, they would have to fall again by more than 20% to wipe out the gains they saw over the boom, according to recent Domain calculations.

So, the downturn hasn't really chipped away at the size of the deposit your child needs to get on the property ladder.

Take Sydney, which had a median house value of $1.257m in October 2022, according to CoreLogic. That means your child needs to find more than $250,000 for a 20% deposit.

On top of that, they'll also have to save for the associated purchase costs, such as stamp duty, conveyancing fees, home loan application fees and property inspections.

Of these upfront costs, the biggest is stamp duty.

It's great news that first home buyers in NSW are being given the choice between a large upfront stamp duty fee or a much smaller ongoing annual property tax, for properties worth up to $1.5 million, after landmark legislation passed the state parliament in November 2022.

This is known as the First Home Buyer Choice (FHBC).

When does FHBC begin?

FHBC came into effect on 16 January 2023.

However, any eligible first home buyers who purchase a property from 12 November 2022 until 15 January 2023 can get a refund on their stamp duty if they choose to opt into the tax by 30 June 2023.

How does the FHBC work?

FHBC lets first home buyers opt out of paying stamp duty upfront in exchange for a smaller annual tax of:

- $400 plus 0.3% of the property's land value for owner-occupiers
- $1,500 plus 1.1% of land value for investors

To give an example, let's imagine your child is buying a house in Sydney for $1.5 million with a land value of $900,000. They can now choose between paying:

- Upfront stamp duty of $66,700; or
- The annual property tax – which, in 2022-23, would be $3,100

What about existing first home buyer stamp duty concessions?

There will be no changes to existing stamp duty concessions for first home buyers (which are available on purchases up to $800,000).

Will your child be better off paying stamp duty or a property tax?

Unfortunately, there isn't one answer, as it depends on individual circumstances, so it's a good idea to seek independent financial advice.

The NSW state government also has an online calculator to help first home buyers assess their options.

That said, in the above example, your child would need to pay the annual tax for 29 years before they'd equal the cost of the upfront stamp duty paid, according to NSW Treasury modelling. Bear in mind that the median holding time in NSW is 10 years.

As a result, many first home buyers will pay less tax overall if they opt for the smaller annual tax rather than stamp duty as the table below shows.

As always, it is good to speak to an adviser about your individual situation.

Stamp duty comparisons

	MARKET VALUE	LAND VALUE	STAMP DUTY	PROPERTY FEE (YEAR 1)	PRESENT VALUE OF PROPERTY FEE (10 YEARS)	PRESENT VALUE OF PROPERTY FEE (20 YEARS)	BREAKEVEN YEARS
HOUSE	1,500,000	900,000	66,700	3,100	28,014	50,275	29
TOWNHOUSE	1,500,000	750,000	66,700	2,650	23,948	42,977	36
UNIT	1,500,000	525,000	66,700	1,975	17,848	32,030	63
HOUSE	1,250,000	750,000	52,950	2,650	23,948	42,977	26
TOWNHOUSE	1,250,000	625,000	52,950	2,275	20,559	36,895	32
UNIT	1,250,000	437,500	52,950	1,713	15,476	27,773	52
HOUSE	1,000,000	600,000	20,090	2,200	19,811	35,679	23
TOWNHOUSE	1,000,000	500,000	40,090	1,900	17,170	30,814	28
UNIT	1,000,000	350,000	40,090	1,450	13,103	23,516	43
HOUSE	800,000	480,000	31,090	1,840	16,628	29,841	21
TOWNHOUSE	800,000	400,000	31,090	1,600	14,459	25,948	25
UNIT	800,000	280,000	31,090	1,240	11,206	20,110	36

DISCLAIMER

All material contained in this presentation is written in general terms and should be seen as broad guidance only. No material should be accepted as authoritative advice and any person wishing to act upon the material should first seek considered professional advice that will take into account the specific facts and circumstances. No responsibility is accepted or assumed for any action taken by anyone in reliance on the information in this presentation.

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PETER BEMBRICK
Partner, Tax Consulting

DECEASED ESTATES AND SELLING THE FAMILY HOME

While selling the family home is in nearly every situation tax-free, the tax treatment of selling their home can often become more complicated when someone dies.

Capital gains tax (CGT) can still be eliminated or significantly reduced, but some planning may be needed both when the owner draws up their will and in the way that their Estate is administered.

The most important rule is that the sale of the home is tax-free when sold within two years by either the Estate or the beneficiaries if it was the deceased's main residence just before their death. The ATO has the ability to extend the exemption period and will often do so when there are clear reasons for the delay that were outside the control of the taxpayers, most commonly where the Will has been the subject of a legal dispute preventing the sale.

Even where the two-year limit is breached, the sale will be tax-free where the home is at all times following the date of death the main residence of:

- the deceased's spouse;
- another individual who has a right to occupy the home under the Will; or
- the beneficiary who inherited the home under the Will.

With the second category this may apply where, for example, a house is inherited equally by a daughter and two sons from their mother and one of the sons is allowed to remain living in the house for five years before it is sold. If this is the family's intention, provision for this situation must be explicitly included in the terms of the mother's Will.

If by contrast this was simply an informal agreement between the three siblings, while the one-third interest of the son living in the house will be tax-free, the share of their brother and sister will be subject to CGT. Broadly, the capital gain would be calculated based on the increase in market value from their mother's death to the date the house is actually sold.

Another increasingly common variation is when the deceased has moved into aged care and their home is sold some years later after their death. In those cases, the "absence rule" can be applied to treat the home as their main residence even after they physically move out. The exemption period is limited to six years if the home is rented out, but there is no limit if no rent is received.

If the absence rule can be applied for the whole period, the home will retain the full benefit of the CGT main residence exemption and the normal rules as discussed above will apply. If, however, rent has been received and the six-year absence period is exceeded, there is a pro-rata exemption available based on the percentage of "main residence days" over the total days held.

For example, Phoebe owned her house for exactly 19 years, and it was sold exactly one year after her death. For the last nine years before she passed away Phoebe lived in a nursing home and received rent from her house. She can treat six of the nine years as exempt, but three of them will be treated as "non-main residence days", as would the entire period from her date of death until sale.

This means that the house will be tax-free for 16 out of the total ownership period of 20 years, but 20% of the total capital gain (i.e., 4 out of 20 years) will be taxed to the Estate.

In summary, while selling the family home is usually tax-free, the devil is in the detail when inherited from a deceased estate and careful planning can make a big difference to the overall tax outcome.

JONATHAN PHILPOT
Partner, Personal Wealth Management

LOOK BEYOND ONE YEAR INVESTMENT RETURNS

'A terrible year for investors' will be hitting the headlines as you are enjoying a morning coffee on a beautiful summer morning – don't let it spoil your day.

2022 will be a negative year for many super balances, even though the Australian share market was only just into negative territory – you can thank fossil fuels for that result, as the rest of the world share markets were far greater into the red.

You know that you have had a tough year when even the fixed interest fund managers, that are meant to provide security when shares falter have also had a down year.

But does last year's return really matter?

If you were only investing for one year it does, but I would hope nothing further than a one-year term deposit was considered. Most of us are long term investors and in fact investing not only for our lifetime, but a legacy for our children and grandchildren. However, that emotional roller coaster of investing often leads us to look at the short-term results and then make decisions – normally the wrong one.

Is three, five or ten year past returns a good guide for what may occur in the future? While the longer the timeframe, the 'smoothing' of the investment return profile shows the benefits of staying the course, unfortunately even the last 10 years returns can be poor guide for the next 10-year returns.

If a share market has had a particularly poor 10-year period - such as the 1970's in the US and Australia - the 1980's was very strong for share markets. The gap between 'good' decades and 'poor' decades has lessened since, however, it is particularly useful at this point, with US technology sector having a tremendous run since the end of the GFC in 2012 all the way up to the end of 2021. Facebook, Apple, Amazon, Netflix and Google became the biggest companies in the world, but in 2022 fell about 40%.

The small disclaimer that 'past returns are not a guarantee of future returns' is reluctantly used by fund managers as they are, in fact, marketing their past returns. This disclaimer should be in big bold letters with 'NOT' highlighted.

The point of all this is, simply, don't make investment decisions based off last year's investment returns, it is an emotional decision that normally turns out to be the wrong one. It is the 'fear' and 'greed' factors that are taking over, and these never match up with long term investing.

Investment decisions need rational thinking — if a market is cheap, buy more and vice versa when a market is expensive sell more. You will never pick the top or bottom of a market but realising you are in the cheap or expensive territory and making decisions based off that will help.

Unfortunately, there is a lot of unhelpful noise, most of the time wanting us to hit the panic buttons from the so called experts, but you know better than them!

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Information based on historical performance is often not a reliable indicator of future performance. You should not rely solely on this material to make investment decisions.

PRUE CHEESEMAN
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CENTRELINK CONCESSION CARDS - NEW INCOME THRESHOLDS

Seniors with up to $4M in super and other investments may now be eligible for health concession cards.

The Age Pension & associated Pensioner Concession Card is the most comprehensive Centrelink benefit for seniors.

- The assets test is now $935,000 for a homeowner couple or $622,250 for a single homeowner (excluding the home but including any account based pensions and other assets held).

But for those with assets above this level, the Commonwealth Seniors Health Card (CSHC) and potentially even the Low Income Health Care Card (LIHCC) may be available depending on how much income you are earning and the level of your financial assets including super.

Commonwealth Seniors Health Card (CSHC)

The CSHC provides benefits such as cheaper medicine under the Pharmaceutical Benefits Scheme and, based on which state you live in, may also provide discounts on electricity & gas, property & water rates and motor vehicle registration.

You must meet the following criteria to qualify for a CSHC:

- You have reached your Age Pension eligibility age (currently 66.5)
- You're not eligible to receive any payment from the Department of Human Services (including the Age Pension) or from the Department of Veterans' Affairs
- You're an Australian resident and you live in Australia (or you hold a special category visa as a New Zealand citizen living in Australia)
- You satisfy an annual income test (different thresholds to the Age Pension income test).

In the recent 2022 budget, the Government significantly increased the limits to support older Australians who rely on income from deemed financial investments, e.g., superannuation income streams (as well as the pension) to deal with the rising cost of living.

From 4 November 2022, the income limit changed. If you earn no more than $144,000 a year for a couple combined or $90,000 for a single - being your adjusted taxable income as well as deemed income from your account based pensions – you are now eligible.

Note that the card is automatically renewed each year. It is cancelled if you leave Australia for longer than 19 weeks.

Low Income Health Care Card (LIHCC)

The LIHCC provides similar but not identical benefits e.g., one-off Government assistance payments or extra discounts.

It is worthwhile seeing if you are also eligible for the LIHCC and applying for both cards where you can.

You must meet the following criteria to qualify for a LIHC:

- Be 19 years of age or older
- You're an Australian resident and you live in Australia (or you hold a special category visa as a New Zealand citizen living in Australia)
- You satisfy an annual income test of less than $1,166 per week for a couple or $680 per week for a single – being your employment & rental income plus salary sacrifice and any allowances plus deemed income from your account based pensions and other financial investments such as bank accounts and shares.

Centrelink will assess the gross income you earned in the 8 weeks before you submit your claim.

You need to apply for renewal after a year and you must also not go over an income limit while you have the card. It is cancelled if you leave Australia for more than 6 weeks.

How to calculate the deemed income from your account based pensions:

The first $46,800 of each of your own and your share of joint financial assets has a deemed income of 0.25% per year. Anything over $46,800 is deemed to earn 2.25%.

To illustrate, suppose that Mr Smith has $1.3M in account based pensions, and Mrs Smith has $1.3M in account based pensions. They are both aged 67. Total combined account based pensions of $2.6M would result in deemed income to be reported of:

(93,600 * 0.25%) = 234

(2,506,400* 2.25%) = 56,394

Total Deemed Income = $56,628 p.a. ($1,089 p.w.)

* $46,800 x 2
** $2,600,000 - 93,600

If Mr & Mrs Smith had no other income or assets, they would be eligible for the Commonwealth Seniors Health Card & the Low Income Health Care Card.

Please note: that your personal circumstances may affect your eligibility. If you think you might be eligible, the best place to start is the Centrelink website or a Service NSW branch. Feel free to contact us if you have further questions to discuss.

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