WEALTHMATTERS
YOUR PERSONAL GUIDE TO WEALTH CREATION

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INSIDE

Richards & Co

A DIFFERENT PERSPECTIVE

Family breakdown and estate planning

Family breakdown and blended families are becoming increasingly common in Australia, raising a lot of complications when it comes to estate planning.

There are two important things to consider when accounting for your various assets in estate planning. First, you need to think about what assets you have. Second, you need to think about who you would like to inherit your assets, and who you may need to protect them from.

In order to effectively plan for the treatment of your assets after you pass away, you need to understand the ownership structures of your assets, as this will affect how they are considered under the law. For example, are all of your assets recorded in your name? Are any held in a partnership? Do you still have any joint accounts with an estranged spouse?

It is not uncommon for couples have a long period of estrangement before finalising a divorce. In such circumstances it is advisable to be aware that if you have not amended your will, your estranged spouse will still be your main beneficiary in the event of your death. Likewise, in the case of blended families, especially where both partners have children from previous marriages, estate planning documents need to be kept updated to ensure that your assets are distributed correctly.

One of the most difficult assets to account for in estate planning, and one that often goes overlooked, is your superannuation. Superannuation is not automatically transferred to your estate upon your death, and is treated differently to other assets for legal reasons.

Many people do not realise that unless there is a binding death benefit nomination (BDBN) in place, a trustee may distribute superannuation to any dependants in any proportions, as they see fit. In the case of family breakdown and blended families, this may mean that your superannuation, which is likely to be one of your biggest assets, is not distributed as you would have wished.

In order to ensure that your wishes for the distribution of your estate are realised, you should consider discussing your situation with a legal professional.

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Understanding investment risks

Investing is a risky business: the bigger the risk you're willing to take, the juicier your potential reward will be.

Or so the conventional wisdom goes. In fact, there are a number of things that investors can be aware of that will help them to make robust investment decisions. It is impossible to eliminate risks in investing, however, being aware of specific risks will mean that you are making more informed, and hopefully wiser, choices. Detailed below are three key risks that can befall investors:

Insufficient diversification

Investment portfolios that lean too heavily towards a particular industry or asset class have the potential to result in significant losses. Should there be a downturn in the asset basket that you have put all of your financial eggs into, then your entire portfolio will suffer.

If you are over-invested in a single area or asset, then even a small downturn can spell trouble. You may also care to consider spreading your portfolio between domestic and international investments, in order to protect against any national or regional downturns.

Interest rate changes

Interest rate changes can be particularly problematic for investors who have borrowed to invest. Australian interest rates have extremely been low for an extended period of time, and this has made taking on debt to invest especially attractive. However, you should do a range of calculations to ensure that if the RBA hikes the interest rate up, you will still be able to cover the loan repayments.

If you are relying on low-interest rates to service your debt, you should consider looking at smaller investments.

Liquidity

Having a certain portion of your investments invested in liquefiable asset classes, meaning that they can quickly be turned into cash, can offer you a valuable buffer in the event of a market downturn.

If all of your investments would require a significant time period for disposal, for example residential property or collectables, then you may find yourself facing an emergency cash crunch. Options for easily liquidated investments include shares, cash and precious metals.

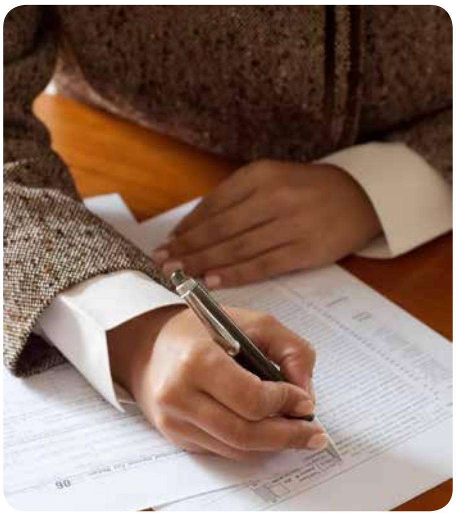
Tax effective income splitting

Where your partner pays tax at a lower marginal rate than you do, there may be some attractive tax benefits to putting an investment or asset solely in their name.

It is possible to transfer assets into your partner's name, and you can also reinvest income from investments in their name. This way, you will reduce the amount of tax that you pay on the income derived from the asset, and also reduce your CGT bill if you decide to dispose of the asset.

Assets can also be placed in the names of other low income earning family members. However, you should be aware that income earned by children under the age of 18 can be taxed at an exceptionally high rate if the ATO suspects that a tax avoidance strategy has been employed.

Anyone considering a tax effective income splitting strategy is advised to speak with a professional advisor in order to make sure that benefits are maximised, and their actions are compliant.



The nuts and bolts of unit trusts

A unit trust is a popular asset ownership structure that allows people to pool their resources together in order to improve their investment leverage.

In the trust, the property is divided into a number of defined shares, or 'units'. Beneficiaries of a unit trust purchase these units much as shareholders will purchase shares in a company.

Income earned from assets and capital growth are subsequently distributed to the beneficiaries of the unit trust. Beneficiaries are remunerated in proportion to how many units they hold.

The main benefit of a unit trust is that you will have access to asset classes and diversification that would have been impossible in the absence of pooled funds.

Furthermore, investors in unit trusts can determine their own risk profile, and benefit from having their investments managed professionally.

Unit trusts that are established by a financial institution will be run by a professional fund manager, who will make decisions about where to invest the pool of cash. This is generally a cost-effective way to ensure that your investments are benefiting from the oversight of professional advice.

One of the main disadvantages to investing in a unit trust is that the sale value of units will fluctuate. This reduces your liquidity, because you may lose out if you need to sell your units quickly to raise some cash.

Therefore, generally speaking, investment in unit trusts is better suited to parties looking for a longer term investment option.

Maximising the value of your renovations

When it comes to making decisions about what areas of a property to renovate, there are some options that may deliver more value for money than others.

Considering the value returned on renovations is something that property investors and homeowners should be acutely aware of. Especially considering that there is a growing shortage of skilled tradespeople in Australia, which is likely to see the labour costs associated with renovating continue to increase.

Here are a couple of tips to help you choose renovations that deliver value for money by boosting your final sale price:

Don't spend more than you can afford.

More importantly, don't spend more than your potential buyers can afford! For example, putting a lagoon pool in the backyard of a working class suburb is unlikely to be appealing to the socio-economic demographics who are looking to buy your house.

Spending too much money on renovations is known as overcapitalising, and it can end up costing you dearly.

Think about the masses

Remember that you are going to be presenting your property to the general public, so it is generally better to err on the side of caution when it comes to making bold architecture or design choices. You and your partner may think that flamingo print feature walls are a winner, but you might have trouble finding a lot of people who agree with you.

Know your target market

Think about the demographic composition of the suburb in which the property is located. If it's a suburban family area, a second storey with additional bedrooms might be a great investment. However, in an inner city suburb made up of young professionals, your funds may be better directed towards other improvements.

Kitchen and bathroom are king

Generally speaking, improvements to a kitchen and bathroom will push up a sale price. If you have the money to spend, these are usually safe renovation investments. Renovators who are strapped for cash, should at least make sure that the kitchen and bathroom are presentable and functional.

Hire a quantity surveyor

A quantity surveyor is a construction professional who can come to your property, value your renovations and write up an according tax depreciation schedule. A tax depreciation schedule details the specific amounts that you will be able to claim as the annual depreciation in the value of your renovations. You can use the value of these depreciations as deductions

against any taxable income earned from the property. Property investors who are planning on retaining a property to earn rental income may be able to make significant savings on their tax bill by claiming a variety of renovation related deductions against their rental income.

Look to the little things

The difference that a little attention to detail on a property can make is amazing. A new paint job or some simple landscape gardening can change a buyer's impression dramatically. Pay extra attention to the street view of the property. Remember: first impressions are everything!

Make the most of transitioning to retirement

As of July 1 2014, there have been some changes to the concessional superannuation contributions cap, which is welcome news to the over 55s.

The higher $35 000 concessional superannuation contributions cap, which was previously only available to people over the age of sixty, has now been extended to anyone over the age of fifty. This means that the taxation benefits of the transition-to-retirement scheme just got a little bit more enticing!

The transition to retirement scheme allows Australians over the age of 55 to begin drawing a pension from their superannuation, regardless of whether or not they have changed their working arrangements. The scheme is designed to allow people to slowly ease into retirement, without suffering a decrease in their weekly income.

However, financially savvy over 55s can do extremely well out of this situation if they continue to work the same hours that they were before their superannuation became available to them.

By salary sacrificing the full concessional contributions cap (up to $35 000) and replacing the lost portion of income with a pension paid from your superannuation fund, you can make some impressive savings on your tax bill.

For Australians under 60, this superannuation pension is taxed at a concessional rate, and for those over 60 it is completely tax-free. People under the age of sixty should sit down with their accountant to calculate the exact amount that they should draw from their super to maximise tax savings.

Not all super funds offer transition to retirement, so if you are interested in taking advantage of this scheme you should check to see if your fund is participating. If you are a member of an SMSF, you will need to confirm that your fund's deed allows for transition to retirement pensions.

Making sense of property data

A lot of the information about the property market that is presented to potential investors and owner occupiers is numerical.

Following on from a weekend of trading there is a slew of numbers to make sense of: auction clearance rates, median prices and vacancy rates by suburb. Once you add looking at the trajectory of these same data sets over the past decade to the equation, it is easy to see where people become confused or overwhelmed.

Here is a brief explanation of what different sets of property data mean, and, more importantly, how you can best interpret them when looking to buy.

Auction clearance rates

Auction clearance rates refers to the percentage of properties that have been sold before an auction, under the hammer, or by midnight on the same day.

While the auction clearance rate is important, experts tend to emphasise that a lower clearance rate can actually indicate that vendors have set unrealistically high expectations on the back of a hot market.

Conversely, a high clearance rate can indicate that more agents are willing to settle pre-auction, meaning that the market may be cooling off.

Instead of interpreting the clearance rate at face value, it may be in your best interests to ask around and attend a few auctions as a spectator, to try and get an idea of the story behind the numbers.

Median house price

Median house price for an area is a great way to get a feel for the suburb's overall performance. You should always look at the current median house (and/or unit) price, along with how the median house price has performed over the last few years. These numbers can serve as a useful guide for potential buyers.

However, you should remain aware that they are, at best, only vague indicator of how a particular property will perform. One pitfall that can beset people who are over confident in the relevance of median house prices is failing to realise that the house they have purchased is unusual for the area.

Vacancy rates

Vacancy rates are one of the most important figures for property investors (people planning to rent their property out), referring to the number of properties that are currently on the rental market but do not have tenants.

Generally speaking, the higher the vacancy rate, the more downwards pressure there will be on rental prices.

However, a low vacancy rate is not necessarily bad news. Where a suburb has strong potential for capital growth, savvy property investors will rush to buy up available properties. When these investment properties enter the rental market, there is an increase in the supply of rentals. Subsequently, there is often an increase in vacancy rates, and a decrease in rental prices.

Therefore, slightly higher vacancy rates may actually indicate that you are following in the wake of knowledgeable investors. Buying a property in the expectation of capital growth is something that you should only do if you are confident that you will be able to cover the mortgage repayments, even if you experience a decrease in your rental income.

All in all, there is only one hard and fast rule for interpreting property data: always aim to contextualise the numbers to the specific property that you are considering, and your own personal circumstances.

Risks associated with secure investment

Australia's cash rate is down to 2.25%, which is bad news for people who are highly reliant on interest from cash savings.

Post GFC, Australian banks were offering returns of anywhere up to 8% on term deposits, depending on how long investors were prepared to part with their cash. These days, 3% returns are closer to the norm for term deposits, with experts predicting this is likely to fall even further.

This is a tricky situation for many people, especially retirees, who enjoy the security that comes with holding cash as their main asset class. Soon it is likely that the interest earned on term deposits will scarcely manage to keep abreast of inflation.

Diversifying your investment portfolio to chase higher yields comes with an increased risk profile; there is no real way to escape this.

Therefore, individuals who are considering moving some of their cash into other asset classes should carefully weigh their options. A deciding factor may be how much of their weekly income is currently derived from interest on cash. If it is a lot, it may actually be a riskier choice to leave the money in the bank.

Investment options that are considered low risk and are likely to offer better yields than cash include conservatively diversified share portfolios, annuities and property trusts.