
FINANCIAL PLANNING NEWSLETTER

# When starting a family, plan early

It is estimated to cost more than $1 million to raise the average Australian family of 2.7 children up to age 24. [1]

So the more financially prepared you are for the patter of tiny feet, the more you will be able to cope as they grow into their size 11 boots.

Preparation needs to start even before you are pregnant – private health insurance will not cover childbirth until a year after you have joined the fund. [2]

Once pregnancy occurs, you need to work out your current financial situation, how long you plan being away from work and how you can afford to live on only one salary.

At this stage, it is important to find out whether any insurance you have through your super will continue while you are on maternity leave and not making superannuation guarantee contributions.

It might also be a good idea to negotiate with your employer whether you can salary sacrifice the cost of childcare once you return to work.

Now that the family is growing– it is also appropriate to check if you have the right insurance cover, particularly if the sole breadwinner were to lose his or her job. Amending, or preparing your will is important too.

Of course there is government assistance for many Australians. Paid parental leave will provide $606.50 a week before tax for up to 18 weeks any time in a child's first year. [3]

From January 2013 fathers and partners can claim two weeks' pay ($1200 approx in total before tax) in parental leave for those earning less than $150,000. [4]

Or you can take advantage of the baby bonus if your estimated combined taxable income is less than $75,000 in the six months following the arrival of the child.

This entitles you to $5,000 for your first baby, payable in 13 fortnightly instalments, $846.20 for the first fortnight and $346.15 a fortnight for the subsequent 12 fortnights. The bonus for the second child is proposed to reduce to $3,000 from July this year. [5]

You cannot benefit from both schemes and it is generally accepted that paid parental leave is the better option. [6]

Note: to be eligible for a government payment, you must meet specific eligibility criteria.

Continued next page

1 'Bringing up baby is a maturing investment', 23 October 2011, The Sydney Morning Herald, http://www.smh.com.au/money/planning/bringing-up-baby-is-a-maturing-investment-20111022-1mdqm.html

2 'Waiting periods', Australian Government Private Health Insurance Ombudsman, viewed 14 December, http://www.privatehealth.gov.au/healthinsurance/howitworks/waitingperiods.htm

3 Maternity Leave Australia, viewed 14 December 2012 http://www.maternityleaveaustralia.com.au/payment_amounts_3.html

4 Misha Schubert, 'Parental leave to keep dads at home with newborns', The Sydney Morning Herald, 4 September 2011, viewed 3 December 2012, http://www.smh.com.au/national/parental-leave-to-keep-new-dads-at-home-with-newborns-20110903-1jrhz.html

5 'Baby bonus', Australian Government Department of Human Services, viewed 14 December 2012, http://www.humanservices.gov.au/customer/services/centrelink/baby-bonus?utm_id=10

6 'Having a baby', Australian Securities & Investments Commission, viewed 14 December 2012, https://www.moneysmart.gov.au/tools-and-resources/life-events/having-a-baby

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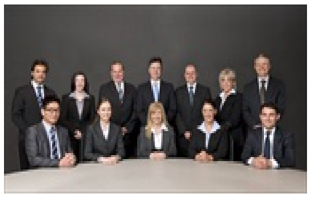

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# When starting a family, plan early continued

## Education costs

After all the excitement of a new child, the next major hurdle is the cost of education.

Figures show that secondary school education will cost $34,990 at a government school, $121,244 at a Catholic school and $272,522 at an independent school. [7]

Clearly, the sooner you prepare for these sorts of costs, the better. Multiply these costs by two or three children and it can increase substantially.

There are several ways you can put money away for your children's education, particularly as the money has a reasonably long investment horizon.

If you are on the top marginal tax rate, you may consider an insurance bond. Once you have held the bond for more than 10 years, it is capital gains tax free, although an internal tax rate of 30% is still applied to income (less imputation credits) earned throughout the investment period.

However, a managed fund that is structured to achieve a return adequate to meet education expenses as and when they fall due, generally provides more investment choice and overall flexibility.

Of course, should you have adequate savings on hand, you could pay for the education upfront, locking in current prices.

As well as the considerable fees, you need to consider all the extras – uniforms, excursions and extracurricular lessons.

## A case in point

Lucy and James have two children aged two and five who they want to educate at a private secondary school. Assuming the cost is $15,000 for years 7-9, $20,000 for years 10 and 11 and $25,000 for year 12, how much money would they need to cover the basic fees?

The couple went to a financial adviser to help put together a plan. The adviser calculated that to cover the cost, the couple would need to invest $1,208 every month for the next 15 years with a seven per cent annual return.

While this may sound like a lot, it is comparable with lease payments on an upmarket car – and money spent on your children's future is a much better investment than money spent on a depreciating asset.

To achieve the seven per cent return, the money was invested in managed funds, split between the more conservative fixed interest and a growth fund investing in shares.

All the returns were reinvested in the funds, and every year the proportion would be rebalanced to continue to meet their risk profile.

With a plan now in place, the couple knew their children's education expense was secure and they would be able to provide them with a private secondary education.

Bringing up a child is certainly not cheap. But if you plan carefully, it will be one of the most rewarding investments in your life.

7 Lucinda Schmidt, 'Doing the sums – does a private education add up', The Sydney Morning Herald, 30 March 2012, viewed 13 December 2012 http://www.smh.com.au/lifestyle/doing-the-sums--does-a-private-education-add-up-20120327-1vw9g.html

# Sacrifices now may pay off later

The choice between spending now or later will always depend on an individuals' circumstances. But for anyone close to retirement, there are definite advantages to consider making sacrifices to put more into superannuation.

The money invested within the superannuation system carries with it tax benefits which if used properly can result in a substantially higher capital balance and income in retirement.

Someone on the highest marginal tax rate who puts pre-tax dollars into superannuation is investing 85 cents of every dollar earned rather than 55 cents of every dollar earned.

In addition, any income generated inside superannuation is also taxed at 15 per cent, rather than at the individual's marginal tax rate.

Once a person reaches age 60 and retires, or age 65 if they haven't retired, they can withdraw money from their superannuation account free of tax.

The government trade-off to the tax advantages of saving for retirement in superannuation has been to restrict access to superannuation savings until retirement and to limit the amount of pre-tax dollars that can be contributed each year.

## Exercise caution to avoid penalties

From 1 July 2012 the cap on concessional contributions is $25,000 a year for everyone, irrespective of age.

In previous years those aged over 50 could contribute up to $50,000 a year, which may have made it easier to save more in superannuation a few years out from retirement.

Anyone contributing above the new concessional cap will be subject to penalty tax rates, regardless of whether it was an innocent mistake. Seeking advice from a financial adviser on your superannuation contribution strategy can help to ensure that you remain within the contribution caps.

Concessional contributions can come from the employer compulsory Superannuation Guarantee, additional salary sacrifice contributions and personal contributions where a tax deduction has been claimed – such as the self employed.

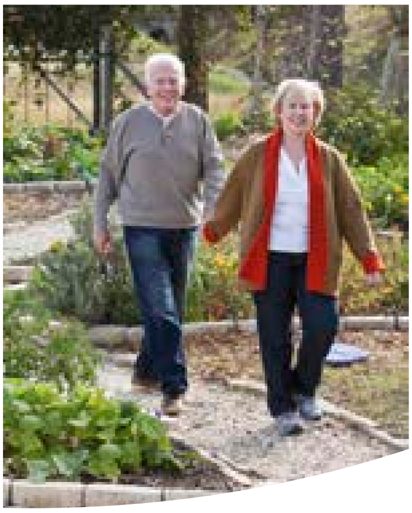
Contributions can also include an employer paid portion of an employee's insurance premium held in superannuation or payment of insurance premiums by an individual for insurance only superannuation products.

People aged 50 and above who already had in place salary sacrifice arrangements with their employer, based on the previous $50,000 cap, should be particularly mindful of the changes. They will need to change their existing contribution levels to ensure they do not breach their contribution caps and they should speak to their adviser about alternative retirement saving plans.

Contributions to superannuation can be made from after tax dollars, but there are also limits around this. Generally an individual can make non-concessional contributions of up to $150,000 each year or $450,000 in a three year period up until age 65.

Anyone who is unsure whether their concessional or non-concessional contributions may breach the annual caps should speak with their adviser.

# Will you be eligible for the age pension



Close to 75 per cent of Australians over the age of 65 currently receive either a full or part government age pension . As the superannuation system matures and account balances grow, fewer people will rely solely on the age pension but most retirees will still qualify for some level of government support.

Even if you expect to be a self-funded retiree, chances are you could still qualify for a part age pension and other benefits.

## Pension eligibility

The qualifying age for the age pension is 65 for men and currently 64 for women, rising to 65 by 2014 . But this is set to change. The government plans to gradually increase the age to 67 for everyone over the next decade.

To be eligible for the pension you must meet certain criteria, including being an Australian citizen or a permanent resident for 10 years, at least five of them consecutive. Once you qualify, you may also be eligible for other benefits, such as rent assistance and the pension supplement to help with household bills.

## How much can I get?

The maximum rate of the age pension for single retirees is currently $772.60 a fortnight, including the pension supplement, and these rates are adjusted for the cost of living each March and September. Couples receive up to $1,164.80 a fortnight combined, including the supplement.

The amount of age pension you actually receive will depend on whether you are single or part of a couple, your income and assets and whether or not you own your own home. The assets test in particular is surprisingly generous.

Single retirees with their own home can earn up to $1,697.20 a fortnight, have up to $707,750 in assets and still receive a part pension. Couples can earn up to $2,597.60 a fortnight and have assets of $1,050,000!

## Income and assets tests

When determining age pension eligibility, two tests are applied. Centrelink determines the pension based on the test that produces the lowest pension — either the assets test or income test.

The amount of pension you are entitled to reduces by 50 cents for every dollar of non-pension income you receive. This includes income from part-time work, certain superannuation pension income and deemed income from bank interest and other investments.

Single people can receive $152 a fortnight before they begin to lose any pension, while couples can receive up to $268 combined.

Your pension entitlement will also decrease by $1.50 for every dollar of assets above a certain threshold. Assets include cash in the bank, superannuation and other investments, holiday homes, boats, caravans and household goods, all valued at current market price. Some assets are exempt, such as pre-paid funerals and asset test exempt (ATE) complying income streams, such as complying pensions and termallocated pensions (TAPs)a.

A single homeowner can have assets worth up to $192,500 and receive a full age pension while couples can have up to $273,000 combined. Non-homeowners can have even more – up to $332,000 for singles and $412,500 for couples.

## Take the case of John and Carol

John and Carol are 67 and 65 respectively and are about to retire after working part-time in their business, which they sold a year ago.

They ask their financial adviser if they will be eligible for a part age pension or other benefits and concessions.

They own their own home worth $780,000, they own their car which is worth $15,000, they have a day-to-day bank account with $5,000 in it and superannuation of $510,000 combined.

Their adviser says they should be eligible for a part age pension of about $786 a fortnight, as well as a Pensioner Concession Card.

John and Carol leave feeling more confident that they will be able to lead a fairly comfortable retirement.

## Concession cards

If you are eligible for the age pension, you will also get a Pensioner Concession Card. This entitles you to reduced cost medicines and discounts on a wide range of goods and services, such as rates, energy bills, car registration and public transport, depending on the state or territory you live in.

States and territories also offer a Seniors Card to people over 60 who are no longer working full time. This entitles holders to discounts on anything from public transport to restaurants and lawn mowing. Just flash your card at service providers and ask what is on offer.

Self-funded retirees are not completely left out either. Single retirees with income below $50,000, and couples with income below $80,000, may be entitled to the Commonwealth Seniors Health Card. This provides discounts on prescribed medicines, health services and transport.

So the message is clear. Even if you think you don't qualify for the age pension it is worth setting aside some time to assess your financial position and to seek advice about what may be on offer.

1 Reforming the Age Pension, Rice Warner Touchstone Newsletter, August 2012, p. 5

2 Department of Human Services, 2012, viewed 12 December 2012, http://www.humanservices.gov.au/customer/services/centrelink/age-pension

3 Your Life Choices, 2012, viewed 12 December 2012, http://www.yourlifechoices.com.au/news/how-do-i-know-which-concession-card-i-am-eligible-for

# Hold onto your pay in sickness and in health

The biggest financial asset for most people is not their family home, their superannuation or a car but the ability to earn an income. But while most Australians have car insurance, only 39 per cent have life insurance and even fewer - 23 per cent - have income protection. [1]

Insuring your salary will provide a monthly income if you are unable to work due to sickness or injury. In the past, policies typically paid 75 per cent of a salary for two years. These days, many products offer longer benefit periods up to age 65, with up to 75 per cent of your salary paid monthly (80 per cent of your salary if superannuation guarantee payments are covered).

A 35-year-old male on the average wage can expect to earn $2.5 million up to retirement age. [2] But if he suffers a prolonged illness or disability that prevents him from working, who will pay his mortgage and support his family?

The Federal Government provides a limited safety net in the form of the disability pension but this would not meet more than the most basic of living costs.

On such a pension, a permanently incapacitated 35-year-old would receive a total of just $700,000 until he retired compared with up to $2 million if he had bought income protection.

## An adequate safety net

One way to work out how your family would cope with the loss of the main breadwinner's income is to add up your cash savings and holiday and sick leave entitlements. It is estimated that 19 per cent of Australians could only manage to get by for a month and 11 per cent would not last a week! [3]

Workers' compensation insurance may come to the rescue if you are an employee and are injured at work, but it does not cover accidents or illnesses unrelated to your job.

Plus, it is difficult to predict the amount you might receive even if you do succeed with a claim.

Workers' compensation is designed to provide weekly payments in lieu of wages or a lump sum to compensate for permanent impairment. The exact payout amount depends on the state you live in and often involves a lengthy claims process or legal intervention. [4]

To preserve your family's way of life at a guaranteed level of income, it is crucial to have an income protection policy. Some superannuation funds offer this cover but the benefits can be limited. However, if you are short of cash, the premiums for an income protection policy can be paid through your super fund with the money in it.

## Tax advantages

Income protection benefits are taxable, but premium payments for cover outside super are personally tax-deductible. Say you earn more than $80,000 and pay a tax rate of 37 per cent, you could save the equivalent of 37 per cent of your insurance premiums after claiming a deduction.

You can also reduce the cost of premiums in other ways. You can extend the waiting period before claims are paid, reduce benefits or reduce the maximum period that benefits are payable. The cost of cover also depends on your age, gender, occupation, health and smoking status.

Income protection is purchased on either an agreed-value basis, where you set the benefit level when you take out the policy, or an indemnity basis, where the benefit is determined by your income in the lead up to your disability.

Agreed value cover is rare among super funds, under regulation the amounts that a super fund can pay out to a client for a protection claim is aligned to an indemnity definition (income at the time of disability). However, it is the preferred option for everyone, especially when income may fluctuate.

If you are self-employed, run your own business, or are a professional who relies heavily on your ability to work, then failing to protect your income is a risk you can't afford to take.

## Martins' story

Martin, 35, was a product manager at a major retail chain earning $65,000 a year. His wife, Melissa, had recently returned to work part time when their youngest child started school.

The couple had a mortgage of $300,000 and hoped to send their two daughters to a private secondary school.

Then one day, their lives were turned upside down when Martin was thrown from his surfboard and injured his spine. He spent six weeks in hospital and was unable to return to work for nearly 12 months while he had intensive rehabilitation.

Luckily, Martin had taken out income protection insurance when Melissa gave up full-time work to care for their girls. Under his policy, Martin received 75 per cent of his pre-injury salary, or $4000 a month after a waiting period of 30 days. His insurer paid him $48,000 in one year and he could have continued receiving payments until age 65 if he was unable to work again.

1 Lifewise, 2012, viewed 10 December, 2012, http://www.lifewise.org.au/today-from-lifewise/are-australians-risking-it-all/

2 Lifewise, 2012, viewed 10 December, 2012, http://www.lifewise.org.au/insurance-101/your-income-your-greatest-asset

3 Lifewise, 2012, viewed 10 December, 2012, http://www.lifewise.org.au/today-from-lifewise/are-australians-risking-it-all/

4 http://www.business.gov.au/BusinessTopics/Occupationalhealthandsafety/pages/Workerscompensationinyourstateorterritory.aspx



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