MST ADVISORS
Financial Business & Tax Advisory Services

Market St. Market Mix

SEPTEMBER 2022

ABOUT THIS NEWSLETTER

Welcome to the MST Advisors monthly newsletter, keeping you on top of the issues, news and changes you need to know. Should you require further information on any of the topics covered, please contact us via the details below.

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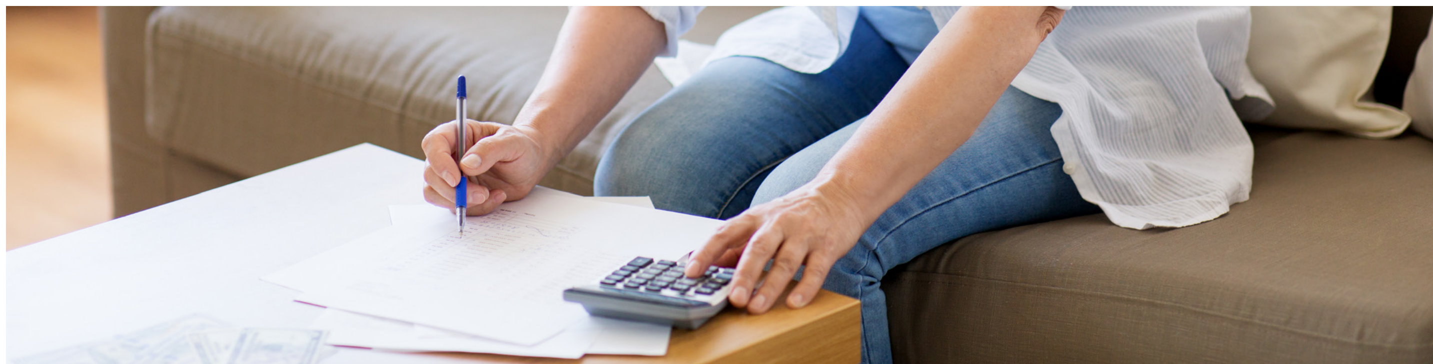
What is your debt-to-income ratio & why does it matter?



Applying for a home loan can take on almost mystical proportions, with most Australians unsure of just how much money they can borrow. As a result, they often make the mistake of trying to secure too much money, only to be knocked back.

Most people understand they need a deposit, usually 20 per cent or more of the purchase price, and to provide details of their income and credit history to secure a loan. Still, too often, they overlook the bank's need to conform to certain set debt ratios.

These formulas have been developed over time to determine what is and is not a safe level of debt for an individual or couple to take on, given their income and overall outgoings, and so ensure banks don't make the mistake of extending too much credit to someone wanting to buy their own home.

Consider Charles and Holly, for example.

They are a young couple who have been saving for a deposit for several years. They feel confident they are in a good position to secure the loan needed to help them buy the home of their dreams.

To confirm this, they need to determine their debt-to-income ratio by adding up their total monthly obligations and then dividing this by their gross monthly income.

They calculate they earn a total of $6,000 a month before tax and spend $400 on Holly's car repayments and $1,000 on Charles' car loan.

Their total monthly repayments of $1400 are divided by their gross income of $6000, leaving them with a debt-to-income ratio of just 23 per cent.

They could reduce this even further if they decided to get by with just one car and sell the other.

While banks all have their individual ratios, most financiers want a debt-to-income ratio of less than 36 per cent. If you are refinancing an existing mortgage, no more than 28 per cent of your total gross income is to be used to service your existing home loan.

Banks will also consider your debt-to-credit ratio.

Credit agencies compare all your credit card account balances to the total amount of credit you have available.

So, if Holly owes $4,000 on a credit card with a credit limit of $10,000, their debt-to-credit ratio is 40 per cent.

The closer you are to maxing out your credit cards, the higher the score and the harder it is to obtain new finance. Often, having received a credit-to-debt ratio score from a credit rating firm, financiers will approve a loan on the condition that you either close a credit card entirely or reduce your credit limit.

The other key ratio you should be aware of is your loan valuation ratio.

Your bank will arrange an independent valuation of the property you are hoping to buy. Then, depending on the type of property it is, the bank will impose a loan valuation ratio.

This often confuses people for two reasons. First, the independent valuation is a conservative valuation of what the bank can be confident of achieving for a property in a fire sale situation. That is if you default on the loan and the bank needs to sell the property quickly to get its money back. Often the valuation can be substantially below the purchase price.

It also excludes the costs associated with buying the property. For example, a property might sell for $900,000, but there will also be other costs, such as the solicitor's fees for handling the change of ownership, or conveyancing and stamp duty costs.

Typically, the bank will only lend a percentage of their valuation. For example, where a property is valued at $850,000, the bank will be willing to lend $680,000. The homebuyer is then expected to provide the remaining funds needed to buy the property.

The loan valuation ratio will also vary according to the type of property. A farm or large acreage could have a loan valuation ratio as low as 50 per cent, reflecting the high risk attached to such properties.

Charles and Holly, though, are hoping to buy a small suburban house in a good location and have been told their bank will apply a loan valuation ratio of 80 per cent, reflecting the bank's confidence that they could get a reasonable price for the property, even in a default situation.

Some financiers will lend at an even higher ratio of 95 per cent of the independent valuation if you take out mortgage insurance. While you pay for this insurance, it is actually there to protect the banks and not yourself.

Lenders' mortgage insurance will only cover any losses incurred by the banks, should they find themselves in a situation where you default on the loan, and the bank is forced to sell the property on your behalf. Home buyers often misunderstand this and wrongly believe it is there to cover their financial interest in the property or cover the deposit they may have paid to secure the property in the first place.

Charles and Holly now look at their financial situation differently and, given their better understanding, decide to sell one car, use the proceeds to extinguish Holly's credit card, and set themselves up to get the best home they can.

6 Steps to a Happy New Financial Year

**The new financial year provides an opportunity for a fresh start for your finances.
Make this the financial year you get on top of yours… for good!**

We've broken it down into six bite-sized, manageable steps for you to tackle over six months, because real change takes time!

The below is a suggested path to a New Financial You, however, you can choose your preferred order and pace.

July: Goal Setting

What is it that you want?
I mean REALLY want?

As with any goal, your financial goals should be SMART – Specific, Measurable, Achievable, Relevant, Timely.

Whether you're wanting to build an emergency fund, get out of debt, or save for a specific goal, write down your goals in detail and then revisit these regularly to remind yourself of what you're working towards.

August: Set your Budget

A budget helps you see what's coming in, what's going out and most importantly how much you have to allocate towards your goals.

There are plenty of free templates online so find one that works for you and add in your personal income and expenses.

Tip – Go through your last three months' bank statements to get details of your spending.

September: Set up a Savings Plan

You can do this by working out how much money you need for a particular savings goal and by when, then breaking it down into regular amounts to be set aside.

Example - If you want to save $2,000 for Christmas by December 1st, you'll need to set aside $154/week from September 1st.

Tip – Automate savings by setting up a regular transfer.

October: Super Check

It's time to health check your superannuation:

- Contact Details

  Make sure your contact details are up to date to ensure you're not missing out on important correspondence.

- Beneficiary Nomination

  Do you have a current beneficiary nomination in place? A valid beneficiary nomination will direct your super fund on how you would like your super benefits to be paid, if you were to pass away.

- Fees

  How much is your super costing future you? There are a whole range of fees that might be funded from your super, including administration, investment, and adviser service fees, all of which will have an impact on your retirement savings.

- Investment

  Do you know how you're super is invested? Is it Conservative or Growth? How well has it performed over the long term? Some important things to consider when choosing an investment option include your life stage, investment horizon and comfort for risk.

November: Insurance Review

There are a range of insurances that offer financial security for you and your family, including:

- Life
- Total & Permanent Disability
- Trauma, and
- Income Protection

This month, get to know your current insurances and consider whether the types and amounts are suitable for your needs.

December: Estate Planning

Estate Planning involves documenting what you want to happen in the event you pass away or become incapacitated. It might include Wills, Powers of Attorney, Health Directives and Guardianship nominations.

If you don't have these in place already, it's time to build out your Estate Plan. If you do, it's time to dig these out for a review.

Congratulations, you made it!

If you'd like some extra support on your journey, reach out to a Financial Adviser today for help with achieving your financial goals!

You can break the pay-to-pay cycle

Now and then, Jodi borrowed $100 from her parents. She's good for it, and always paid it back, but her situation was not uncommon.

5.9 million Australians live pay-to-pay

A study by Deloitte between November 2021 and January 2022, surveyed over 14,000 Millennials (born 1983 – 1994) and Gen Zs (born 1995 – 2003) worldwide.

The results were alarming: over 30% of respondents indicated that they did not feel financially secure, while 47% of millennials and 46% of Gen Zs lived paycheque-to-paycheque.

All said cost of living was their number one concern – ahead of climate change and unemployment.

Easy to assume these are people earning lower wages, but that's not always the case.

For Jodi, despite earning a good salary as an I.T. specialist, pay-day didn't always align with the due dates on her bills. This resulted in the occasional week when she needed a little extra to tide her over.

Jodi didn't have a lavish lifestyle, but she enjoyed a monthly facial treatment and having her nails done. She also had two streaming subscriptions and a gym membership on monthly payment plans.

Physiotherapist Aaron had a cashflow issue. He loved technology and couldn't resist any new gadget, even if he didn't need it. Additionally, he had an active social life involving weekends away, dining out, theatre and concerts.

Consequently, Aaron's credit card was maxed-out and he had lost track of his buy-now-pay-later (BNPL) plans.

After making his minimum monthly repayments, Aaron was forced to live on credit until next payday.

When his clapped-out car died it needed replacing. It was a wakeup call when the finance company rejected Aaron's loan application.

Aaron felt trapped with no way to break the pay-to-pay cycle. The worry kept him up at night and began affecting his work.

According to mental health support organisation, Beyond Blue, financial worries impact our physical and mental wellbeing, potentially leading to further financial stress.

Jodi's parents introduced her to their financial adviser who identified areas for savings and developed a realistic budget.

She suggested Jodi cancel one streaming subscription, saving $15 per month ($180 pa), and reduce her monthly facial to bimonthly, saving $140 every two months ($840 pa).

The money was placed into a savings account that Jodi could access if necessary, and within the first year, she'd accrued nearly $1,000. Further, Jodi hadn't needed to borrow from her parents.

Now, she plans to use her savings on studies that will qualify her for a work promotion.

Aaron's situation was slightly different. As debt was his main concern his financial adviser suggested he sell his unused gadgets online. This alone, raked in enough for Aaron to pay off his PNBL plans.

His adviser then developed a debt-reduction strategy: if Aaron sacrificed three nights out per week and the occasional weekend away, he'd be debt free within three years – one year if he never left the house!

But any plan must be workable. The pair agreed that meeting half-way would be best, so Aaron's adviser recommended a weekly spending budget which would see Aaron debt-free in 18 months – provided he curb his passion for gadgets.

The simplicity of internet shopping, despite good intentions, means it's easy to rack up debt without realising it. Any wonder Finder.com.au reports that 46% of Australians live from pay-to-pay!

If you're trapped in the pay-to-pay cycle, reach out to a qualified financial adviser and remember that no situation is so dire that it can't be fixed through budgeting, planning and professional advice.

Could your best friend be the key to getting into the property market?

As it seems that home ownership moves beyond many peoples' reach, the option of co-ownership is seeing many Australians achieve their own Great Australian Dream.

Co-ownership refers to a single property owned by two or more parties. Geared towards people unable to purchase a property independently, it involves pooling resources with others in the same boat, and getting a foot on the property ladder.

Co-ownership has proven popular among:

• first home buyers;

• single parents;

• single-person households;

• households comprising multiple generations; and

• those looking for a sense of community.

Intrigued?

Don't start scrolling through your contacts list just yet. Consider these precautions first:

Legal structure

Property ownership in Australia is categorised two ways:

• Tenants in common

Two or more people own a share of a property. They may own different percentages of the property and may bequeath their share to anyone upon their death.

• Joint tenants

Two or more people own a property jointly and upon one person's death the property ownership passes to the surviving owners.

A joint tenancy is the most common arrangement for couples, however is probably not the most appropriate arrangement if you're embarking on a co-ownership arrangement.

You'll need to be clear about these structures when seeking finance and purchasing your property.

Co-ownership agreement

You and your bestie may be 100% committed to a co-ownership arrangement, but circumstances change. If down the track one of you wants to sell and the other doesn't, what then?

It's only possible to partition ownership if the property can be divided – painting a line through each room doesn't count.

Who is responsible if the property requires unplanned and/or expensive repairs? What happens in the event of unemployment, bankruptcy or death?

There are examples of co-owners settling disputes like these through litigation; a stressful and costly exercise easily avoided by a Co-ownership Agreement.

It's vital to speak to a solicitor or property conveyancer for advice and guidance prior to making any co-ownership decisions.

Financials and other practicalities

Obviously you'll discuss the amount you'll each contribute to the deposit, mortgage, insurance, rates etc., but what about utilities and wi-fi? Will you have a joint bank account, a maintenance fund? Will you share food and living spaces?

Dual-occupancy properties resolve many of these issues, however it's vital that all co-owners have a very clear understanding of their obligations, and their expectations of each other.

Again, a Co-ownership Agreement will cover these issues – and others – so that all parties are fully aware of the commitment they're making.

The advantages

So far we've discussed the legals and financials, let's now consider the benefits.

Co-ownership can:

• provide access to the property market;

• break the rent cycle (owner occupiers);

• start a property portfolio (investors);

• purchase a better home than you could afford alone;

• purchase a fixer-upper and improve its value by pooling resources and skills; and

• provide a community (think single parents sharing child-minding, etc.).

Co-ownership may be the solution you're looking for; you may even find you qualify for a government first-home-buyer package!

However, there's an old saying about the risk of mixing money and friendship. As with all financial decisions, risk can be minimised through professional advice and well-informed decision-making. Your solicitor and/or a property conveyancer will be best placed to answer all your questions.

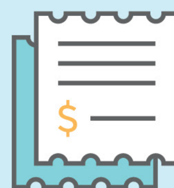
FINANCIAL CHECK-UP

Do you pay all your credit cards off in full by their due date?

YES ◯ NO ◯

Do you sleep easy knowing all your bills will be paid when they fall due?

YES ◯ NO ◯

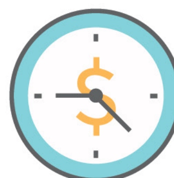


Do you have a budget, and do you stick to it?

YES ◯ NO ◯

Are you making all your loan repayments on time?

YES ◯ NO ◯

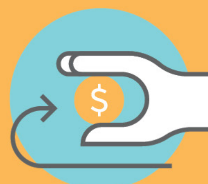


Do you know exactly how much your home loan is today?

YES ◯ NO ◯

Do you know what you would do if you lost your job tomorrow?

YES ◯ NO ◯



Are you confident about your children's financial future?

YES ◯ NO ◯

Do you have life and total and permanent disability insurance in place?

YES ◯ NO ◯

Do you have income protection in place?

YES ◯ NO ◯

Do you know how much you have in super?

YES ◯ NO ◯

Are you and your partner in agreement about your finances?

YES ◯ NO ◯

Do you feel confident about your overall financial position?

YES ◯ NO ◯

If you answer NO to any of the questions on this list, you should make time to discuss your financial situation with a qualified financial planner.

The sooner you do, the closer you will be to achieving peace of mind regarding your financial position.

Avoid an inheritance headache

It was the overwhelming silence that hit Judy, the first time she visited her family home after her mother's passing, and with that thought, the slow, deepening realisation that she was going to have to cope with a lot more than the heart-breaking grief.

As she sat alone, surrounded by the possessions her mother had accumulated during her long, happy life, Judy felt completely lost as to how she was going to deal with packing up her mother's house, much less sorting through the other assets.

Judy of course, is not alone. More than $120 billion in assets were inherited by family members during 2018 and the Productivity Commission believes this number is set to double to $224 billion by the year 2050.

Judy found herself at the office of her mother's solicitor a few weeks later.

They began by going through her mother's Will and setting in motion the legal requirements to close her mother's bank accounts, credit cards and so slowly, settle her mother's Estate.

As an only child, Judy's mother had left her everything, so at least there were no issues surrounding the Will and what would happen next, but Judy was clearly lost, which prompted her mother's solicitor to reach out to her.

"As terrible as today is, every day will slowly get better until there comes a day when you will think of your mother and be filled with happy memories," he said. "She was so proud of you, she would really want you to make the most of this inheritance, so let's make sure you do."

He then suggested three things.

Make a list of what needed to be done, work through that list as slowly or as quickly as felt right for Judy and then, he recommended a caring financial planner and accountant who could help with the rest.

As Judy progressed along this journey, she learnt she would inherit her mother's Estate tax free and that she had two years to sort through her mother's assets, sell what needed to be sold and transfer other assets to her name.

Once this time passed, transferring assets would 'trigger' a capital gains event and she would have to pay tax on any gains in the value of assets that would be transferred after that time.

Her new accountant and financial adviser walked her through what had to be done.

The biggest asset was her mother's home. As Judy had her own home and didn't want to move, it needed to be sold. The thought of keeping it and renting it out, just seemed too painful and full of complications.

During one of their early meetings, Judy said in a guilty voice that she would like to use some of the money left to her to buy a new car and would this be ok? Her accountant thought that was a very good idea and even suggested Judy go on a short holiday just to clear her mind.

It would help her prioritise what she wanted to do long term with the money from the sale of her mother's home and the other assets left to Judy. It was good advice. Judy needed time to think things through.

When she returned from her break, with her accountant's help, she developed a strategy. She would use most of the cash from the sale of her mother's home to pay out her own mortgage. Judy knew her mother would be very pleased with this decision.

After paying for her new car, Judy decided the rest of the money would slowly be moved into her superannuation account, when and how the contribution laws allowed, and where it could sit in a tax benign environment building to secure her future.

And slowly, she started to focus more on the happy memories she had of her mother.

Estate planning is a team effort. For more information, please speak with your Accountant, Solicitor and Financial Adviser.

Downsize your home, upsize your super

Over 60? Thinking of selling your home? Since 1st July 2018 you may be eligible to contribute up to $300,000 ($600,000 for a couple) from the proceeds of the sale of your home to your superannuation fund.

This incentive, known as the ‘downsizer contribution’, is part of a federal government program to improve housing affordability. It offers a further opportunity for some home sellers to benefit from the tax advantages associated with superannuation. On the downside it may adversely affect eligibility for age pension.

Rules apply

Of course, it wouldn’t be a super contribution without lots of rules, and the main ones are:

• You must be 60 or older when you make the contribution. This could affect decisions on the timing of a sale. For example, Anne (65) and Rod (59) are thinking of downsizing. As only Anne can make a downsizer contribution they may want to delay selling their home until Rod turns 60 so he can also make one.

• You or your spouse must have owned the home for at least 10 years prior to sale; it must be your main residence; and cannot be a caravan, houseboat or mobile home.

• You can only use this concession once. You can’t use it with subsequent home sales.

• The contribution is limited to the lesser of $300,000 each or the total proceeds from the sale of the home. In the case of couples, contributions don’t need to be evenly split. Take Tom and Stephanie. They sold their house for $500,000. Rather than contribute $250,000 each, Stephanie contributes her $300,000 maximum. Tom’s downsizer contribution must then be no more than $200,000.

• The contribution must be made within 90 days of receiving the proceeds, though an extension may be granted in limited cases.

Curiously, given the name of this initiative, you don’t need to physically downsize your home. If you have the funds available you could buy a bigger or more expensive abode. In fact, you don’t even need to buy a new home at all.

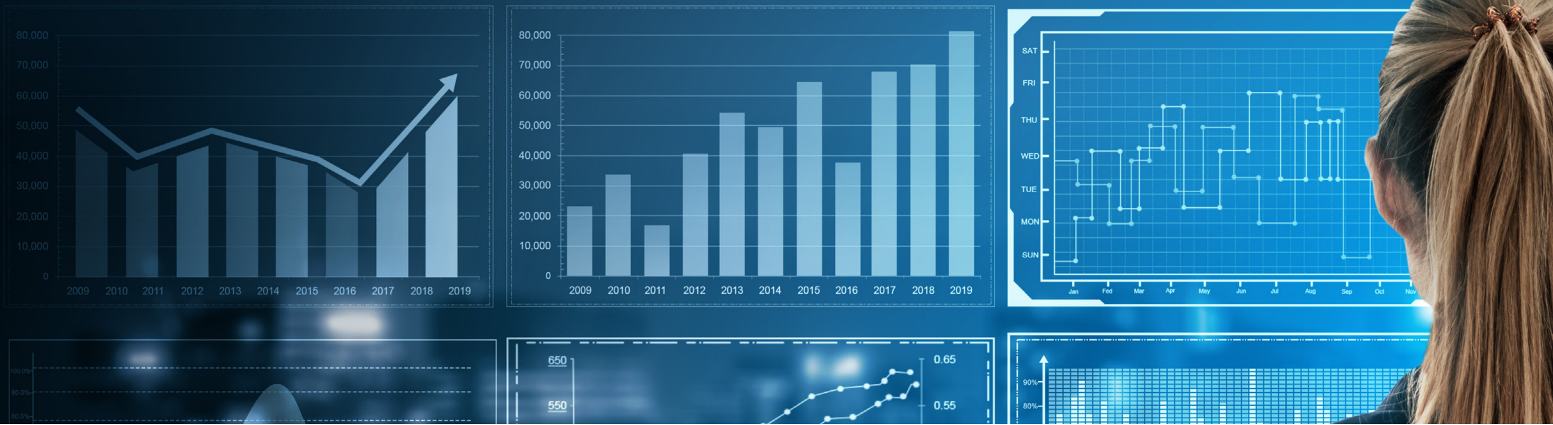
The effect on super

On the superannuation side, you can make a downsizer contribution if your total super balance exceeds $1.7 million. However, the contribution will count towards your transfer balance cap (i.e. the cap on the amount you can use to establish a tax-free superannuation pension). Even so, it may still be advantageous to hold these funds in the concessional (15%) tax environment applicable to the super accumulation phase.

And what about the age pension?

Anyone thinking of downsizing needs to consider the impact on eligibility for age pension. A main residence is exempt from the assets test, but if its sale frees up money – for example through buying a cheaper home or renting – those funds will be assessed under both the income and assets test even if they are used to make a downsizer contribution. This may result in a reduction or loss of age pension.

The extent to which you can benefit from making a downsizer contribution depends very much on your individual situation. And it isn’t just a financial issue; lifestyle considerations are also important. Before making a decision it’s important to consider all the angles, so talk to your financial adviser about whether a downsizer contribution is right for you.



Low income earners: 6 super hacks to retire richer

While it's easy to be discouraged by superannuation and fear you will never have enough money saved to stop working, remember even a modest superannuation balance can make a big difference in retirement.

For every $100,000 saved in superannuation, you can expect these funds to generate a return of 6%, or $6,000, a year. When this is paid out as a pension, it equates to $500 a month tax-free. Of course, this is doubled if both you and your partner have $100,000 each in super. Depending on your overall financial situation, this can be paid in addition to you receiving a full age pension.

Here are six super hacks to help you maximise your super balance:

Hack 1.
Consolidate your accounts

Consolidate all your superannuation accounts into one account best suited to your needs. The Australian Tax Office says some 6 million Australians have multiple super accounts, wasting millions of dollars in duplicated charges.

These unnecessary fees will needlessly erode your super balance. Consolidating multiple accounts is easy. Simply log on to the ATO's website and with one click, choose one account to accept all your funds. This alone could save you thousands of dollars.

Hack 2.
Review your super contributions

Check your employer is contributing the right amount to superannuation from your wages each week. If you believe there is a shortfall, contact the ATO to investigate on your behalf.

Hack 3.
Take advantage of co-contributions

If you earn less than $57,016 a year, consider making additional after-tax super contributions to take advantage of a matching contribution from the government, called a co-contribution. Under this scheme, you can contribute up to $1,000 of after-tax money and receive a maximum co-contribution of $500. This is a 50 % return on your investment.

The government will determine how much you are entitled to when you lodge your tax return, and if you are eligible, the government will then pay the co-contribution directly to your fund. You don't need to do anything more than make the original contribution from after-tax savings.

Hack 4.
Benefit from spouse contributions

Review whether you can benefit from making additional contributions to your partner's super. If you do make contributions to your partner's super and they are on a low income or not working, you may be able to claim a tax offset of up to $540 a year.

Hack 5.
Contribute any long-term savings to super

There are rules concerning how much you can contribute to super, and when, but any savings put into superannuation will be held within a tax benign environment.

While your fund is in accumulation mode, these assets' income and capital growth are taxed at 15%, rather than your marginal tax rate. Once you start receiving an income stream, these assets are held within a tax-free environment, making your superannuation your own personal tax haven.

And, if you are thinking of selling your family home to downsize to a smaller property, you can take advantage of the downsizer contribution rules, enabling you and your partner to contribute up to $300,000 each to superannuation. This one step can make a significant boost to your superannuation balance just when you need it, as you enter retirement.

Hack 6. Seek professional guidance

Of course, there are a raft of rules around superannuation that you must be aware of. To maximise your retirement nest egg, be sure to seek expert advice from a financial adviser or qualified accountant.

While it is never too early to start making additional contributions to super, it is also never too late. Even small steps towards the end of your working life can and will make a difference to the way you live in retirement.

HAPPINESS =

INCOME $100 - EXPENDITURE $99

To get ahead we need to spend less than we earn

INCOME

This one is easy. How much do you earn?

EXPENDITURE

The next step is to know where your income goes. How do you spend it and is the spending really necessary?

HAPPINESS

Once you can measure your spending you can start to manage it.

Master this and you're on the path to financial freedom (and happiness!)