CASE STUDY

Package with big potential

Susan Hely helps smooth a success story's rough edges

NAME: Bianca Polinelli, 49
STATUS: Married with 17-year-old twin boys
QUESTIONS: What is the best way to set up my family for the future, particularly retirement? How can I expand my packing business and pay off $800,000 of property debt?
SOLUTIONS: Lock in a portion of your loan to hedge against a rise in interest rates. Repay the principal on the home loan, not just the interest. Build super by saving $1000 a month and benefit from tax deductions. A business plan could include higher fees, marketing, a website and cash flow.

NICK CUBBIN

Bianca Polinelli's successful packing business, Mrs Packer, grew out of her work as a costume designer for the film industry. People started asking her to help pack up their beautiful clothes and unclutter their wardrobes. Her reputation for taking the stress out of moving spread by word of mouth.

"I like the trust factor," she explains. She energetically packs up and unpacks homes and decorates homes to be sold as well as getting rid of clutter.

Bianca employs a team of helpers plus all the tradespeople whose services are needed to assist in a move: cleaners, removalists, storage, handymen, painters, smart box and rubbish removalists. But her cash flow is sporadic as the bulk of her work is in spring and summer when, typically, people sell their homes and move. "Should I be thinking outside the square?"

Bianca and her husband, musician David, didn't clock up any employer superannuation because they were freelancers. In fact, together they have only around $20,000 in super.

Instead they put their faith in the capital growth potential of local property. In 2003 they bought an investment property which is now worth around $650,000 and brings in a healthy income stream that gives them net positive cash flow.

In 2009, a couple of streets away, they bought an apartment where they live; it is now worth around $850,000. But their property debts are close to $800,000. They have had to switch to a 12-month, interest-only loan on their home to fund the extra levies for capital works on both apartment buildings.

Can they ease their financial commitments? Is property their best investment strategy for their retirement?

Cut expenses, boost super

JOANNA McCREERY

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Bianca and David are just entering a stage in their life when they have the opportunity to start growing their retirement savings faster. Not only do they both have businesses that have potential to increase revenue, but also the kids will be leaving home soon. Kids are great, but they are definitely not a positive factor when it comes to wealth creation!

With limited super and no current savings plan, David and Bianca feel like they are not getting ahead. However, a couple of good financial decisions in the past 10 years have set them up well for continued wealth creation.

Ten years ago they decided to borrow funds and buy an investment property. They now have a good amount of equity in the property and it generates a net positive income stream for them. Like many Australians, they chose residential property as their investment and have seen its value rise by 45% over the past 10 years (3.8%pa). Although there's been volatility, it has actually been a good 10-year period for many growth investments – the Australian sharemarket increased by 61% or 4.9%pa over this period (10%pa if you include dividends) and hedged global shares have returned 9%pa, including dividends.

The other thing David and Bianca did right was to borrow within their means to buy a home. They have also seen this investment grow in value. So with the success of borrowing to invest in property behind them, what is the next step?

With Australian house prices very expensive by world standards, we caution our clients that the past rate of growth may not continue. However, David and Bianca don't need high growth for their current investment strategy to deliver results. To their advantage, they have a relatively low overall gearing ratio (53%) and they earn a net positive rental yield from the investment property.

There are still risks – a fall in house prices, unexpected property expenses and increasing interest rates being the main ones – but locking in an interest rate on a portion of their loans will help reduce interest rate risk.

We looked at the option of selling the investment property and using the proceeds to pay down their home loan but, while this strategy is safer, it significantly reduces potential future net assets if you assume house prices will rise. If their property's price rises at 2%-3%pa, its value would grow from an estimated $650,000 now to $870,000-$1 million in 15 years.

If interest rates rise back to 7% it would, however, be worth reassessing this strategy.

To build their retirement savings, it is hard to beat making tax-deductible contributions to super. Because they are self-employed, David and Bianca have not been forced to add 9% to their super each year, but we highly recommend that they start doing this as soon as cash flow allows.

If Bianca (as she is on the higher tax rate) can save $1000 a month towards super, she will increase her tax deductions. After tax, this contribution should only reduce her cash flow by $650pm. If Bianca increases this contribution by 3%pa and earns 7%pa in her super, she could have $400,000 in super in 15 years.

We also encourage repaying principal on their home loan (but not the investment loan). Ideally, they should aim to pay if off over a minimum of 15 years if they plan to retire in 15 years. A 15-year repayment plan at current interest rates would require an additional $1900pm – a 20-year plan would require an additional $1260pm.

These strategies do require a reduction in expenses or a boost to income or both. But with businesses that have good growth potential and the prospect of an empty nest soon, an increase in their available cash is achievable.

Manageable chunks

JON DALE

Jon Dale has been running Small Fish Business Coaching for seven years, helping people audit, formulate and implement a plan to improve their business. www.smallfish.com.au

Bianca has a business with potential. She should commit to it, focus on it and drive it where she wants it to go. Of course, a business coach is a valuable ally to help you figure out what to do, stick to it and avoid the temptations to step off your chosen path. I would help Bianca work through her cash flow concerns and make her accountable for all the marketing activity she needs to do to grow her business to an annual turnover of $250,000 and be an asset that ultimately she can sell and help fund her retirement.

Bianca has done no marketing to get this far – relying on her customers telling their friends and referrals from a handful of real estate agents and a storage company. She has no business systems – she flies by the seat of her pants; she employs experienced (film industry) friends as freelancers.

I would start by making a plan based on the big scary goal and then break it down into manageable chunks that Bianca can get her head around and then, for each chunk, write a list of jobs. Then pick one at a time and get stuck in. If she approaches it calmly and with a bit of methodical discipline, it's not as hard as it may appear.

> Bianca flies by the seat of her pants

Many of Bianca's competitors charge double what she does, so the plan would very likely include a significant price increase. She could be turning over $250,000pa without significantly increasing her team or testing her organisational skills too much. She'll have to create and document systems (which is easier than she might think), get serious about her accounting and look after her people properly.

I recommend a significant focus on marketing and building relationships with real estate agents, removal businesses and more storage facilities – investing in a strong customer referral program.

Bianca's website is little more than a marker page with a "contact us" form. For $2000 she could set up a decent website including photos of happy customers and their comments about how much easier Bianca made their move. Social media (probably Facebook, in this instance) are also good ways to reach people.

Cash flow is always going to be a problem for Bianca – and she needs to consider what she'll do in the lean months. Perhaps a staged retreat from her film work is a good plan.