CASE STUDY

It's a tough juggling act

Susan Hely helps a single mum refine her investment strategy

NAME: Kelly Baker
STATUS: Mother of two boys, 8 and 9
QUESTIONS: How do I grow my finances? How do I go about subdividing my block of land? Is my superannuation on track? Should I use some of my savings to pay down my investment property loan?
SOLUTIONS: Use your investments to create some regular income. Consider downsizing your home to unlock some capital for investing for income. Cut back on your substantial insurance premiums, which are eating up your super contributions. Find a private town planner for advice on subdivision.

YIANNI ASPRADAKIS

Kelly Baker's focus is on making the right financial decisions for her two young sons, Eli and Ishi. "I feel a great responsibility to preserve and protect the money from my divorce settlement and advance it," she explains.

Her first move was to buy a house on a large suburban battleaxe block, about 20 minutes from the city, where she works, with a view to subdividing it one day. Her next step was to visit a financial planner at her bank to see if she was on track. On his advice she bought life, total and permanent disability (TPD) and income protection insurance. She pays premiums of $5640 a year, a commission of 10% on top of a fee that amounted to 110% of the first year's premium. He also recommended that Kelly move her superannuation out from her industry fund to a retail fund managed on a wrap platform and invest it in seven managed funds representing seven asset classes, from cash and fixed interest to and listed property and hedge funds. The planner placed some savings in a portfolio of managed funds too.

When the Sydney property market started to heat up, Kelly didn't want to miss out on the strong gains. "I love property," she explains, not only for the potential capital gains but because she is forced to save. So she has put a deposit on a small investment property and owes $612,000. She has an interest-only loan that is covered by the rent. Should she use her savings in managed funds to pay down the debt or leave it invested? Kelly would like to subdivide her property but how does she go about this? Is it more profitable to build a house on the new block or sell off the land? What are the capital gains tax implications?

Kelly is a time-poor mother who works full time and would like to cut down her incidental spending on eating on the run. How can she keep track of her spending and avoid wasting money? What government benefits is she eligible for? Are there any estate planning issues she should be considering?

Even though retirement is about 25 years away, she is thinking about her super balance of $67,000. "I never had held much stock in superannuation but now I am focusing on it." Is she on track?

Create the life you want

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Since the divorce settlement, Kelly's priorities have clearly been doing what she thought was best for her children and ensuring she preserves the value of her settlement. By buying a home, investing in a high-growth portfolio of managed funds and borrowing further funds to invest in another property, Kelly is invested for long-term growth. She has no maintenance payments, her investments pay her no net income, so she does the single-mum juggle and works full time.

There's nothing wrong with Kelly's investment strategy – it is relatively high risk but it should also deliver long-term growth in her assets. But is it the right one for Kelly?

Ideally, she would like to spend more time with her children. But with all her cash tied up in long-term investments, she needs the regular income of a full-time job. However, with her assets, Kelly has the means to change this situation.

> Kelly can increase her available income and create a cash buffer

Rather than investing solely for growth, she could create an additional income stream to supplement her salary. Step one in this process would be to restructure her investment portfolio with the aim of generating a tax-effective income stream.

Step two would be to boost her net investment assets by downsizing her house. If Kelly can buy a house for less than the proceeds from selling her current one, she could: place some of the proceeds in an offset account on the investment loan to increase her net rental income; or add some of the cash to her investment portfolio to increase the income from this portfolio; or both.

In taking these steps, Kelly can increase her available income and create a cash buffer to smooth out her employment income if needed. If this additional income allows her to work less and have more time for herself and her children, she may find that savings also flow from being more in control of her life.

The government offers families a large range of potential benefits but they are due to be changed in the current budget. Based on Kelly's situation, she could be eligible for: family tax benefit (which also makes you eligible for some smaller payments like the schoolkids bonus); the childcare benefit and childcare rebate; the carer allowance; and the single income family supplement.

A great place to check what you might be eligible for is www.humanservices.gov.au/customer/subjects/payments-for-families.

As well as getting the life Kelly wants now, it is important to know that the future is on track as well. Kelly has two investments that should grow over time – her investment property and her portfolio. But relying solely on investment growth for future wealth is relatively risky. Some saving is also needed and the most tax-effective way to save for your retirement is through super.

Currently, Kelly's only savings strategy for super is through the super guarantee contributions paid by her employer. However, with her new life insurance premiums, these contributions will be almost completely absorbed. If Kelly wants this insurance, she should plan to make salary sacrifice contributions into her fund to at least cover these premiums but ideally she should contribute more than this.

If there were no cost to insurance, then the more the better, but there is a cost, so you need to weigh this up with needs. Kelly's new insurance premiums cost a fair chunk of her income. This level of premium will substantially impact her ability to save for the future.

Given Kelly has a relatively high level of assets and income protection to age 65, I think she could reduce her TPD insurance to cut costs. Life insurance may not actually be needed at all given that her children have a father with good means.

One further issue for Kelly to investigate is whether her current "level" premiums are right for her. They make insurance expensive now and by the time the savings kick in in about 15 years she probably won't need her life and TPD policy. I suggest she check if stepped premiums might work better for her.

A win-win situation

BOB ANDERSEN
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First, congratulations Kelly on having the foresight in originally acquiring a property with further value-adding potential – the ability to subdivide.

You mentioned that you are time poor and I would assume you have little or no development experience. Just as you use a mechanic to service your car and an electrician to fix an electrical fault, there are also experts who for little cost can deliver your subdivision.

While the local council can explain what might be possible under its planning scheme and give you a copy of its subdivision code, it cannot give advice.

A private town planner can but even better in the case of a small subdivision is a consulting surveyor – more like a cross between a regular surveyor and a town planner. You can find them simply by googling consulting surveyors in your suburb.

They will know the code backwards, the process and who to deal with at the council. Initially they can confirm the subdivision potential. They will perform an initial survey, prepare a proposed subdivision plan, an accompanying compliance (town planning) report and lodge and track the development application through council. Finally they can peg the new allotment.

That's easy. Now comes the hard part. Do you sell the newly created lot vacant? Do you build a house on it? If so, do you keep or sell the house? Well, it really comes down to the numbers. Check with your finance adviser or broker and ascertain if you can afford to build a house. Visit a builder's display village to get a handle on prices. If the finance is shaky, problem solved – sell the vacant lot.

If finance looks good, the decision really comes down to your personal circumstances. Do you want cash? If so, sell it. If you prefer to hold for long-term growth, don't sell it. As always, getting the correct finance and tax advice is essential.

It's a win-or-win experience. Enjoy the ride.