Newsletter - February 2023

Welcome to the latest edition of our client newsletter,

Our articles cover a range of topics which we hope you will find interesting. We aim to keep you informed of changes as they happen, but we also want to provide ideas to help you live the life you want – now and in the future.

In this edition we discuss Understanding fixed, variable and split rate home loans and provide you with information on How to use tax return to build a stronger financial future and Understanding insurance in your super.

If you would like to discuss any of the issues raised in this newsletter, please don't hesitate to contact us.
In the meantime we hope you enjoy the read.

All the best,
Planet Wealth

Planet Wealth
18 Boronia Dr Glen Waverley Vic 3150
P 1300 004 254
E info@planetwealth.com.au
W www.planetwealth.com.au
Facebook Planet.Insurance.Australia
Twitter alisplanet

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Understanding fixed, variable and split rate home loans

Should you fix your interest rate, opt for a variable one, or do both? We explain the benefits and considerations of all three options.

Of all the decisions that need to be made when choosing a home loan, finding the best interest rate is one of the most important. After all, a rate that's even 0.5% lower could save you thousands of dollars over the life of your loan.

On top of that, it's important to consider the type of interest rate that best suits your circumstances – fixed, variable, or split, which combines elements of both. Below we explain the pros and cons of each.

What is a fixed-rate home loan?

A fixed-rate home loan has a defined, unchanging interest rate during the fixed-rate term.

Interest rates can be locked in for a period of time, generally one to five years, and will depend on things such as the total amount borrowed and the loan term.

At the end of the fixed-rate term, you can then choose to fix your rate again, or move to a variable interest rate.

Advantages of a fixed-rate home loan

One major benefit is that the home loan interest rate won't fluctuate during the fixed-rate term.

This has two advantages – one, it may help you to budget more accurately (as your loan won't be susceptible to changes) and two, it could help you avoid potentially higher monthly repayments should interest rates rise unexpectedly during the fixed-rate term.

Other considerations with a fixed-rate home loan

There are things to take into account if you're thinking about a fixed-interest rate.

For instance, while you won't be subject to an interest rate rise, a reduction in interest rates also won't be applied to your loan.

A fixed-rate loan also doesn't typically give you the flexibility to make additional repayments above the required amount, should you wish to pay off your loan faster.

In saying that, there are some fixed-rate home loans that do allow this, but only to a specified amount. For example, you may be able to contribute up to $10,000 in extra repayments per year on some fixed-rate home loans.

Additionally, any changes to a fixed-rate loan, such as exiting it before the loan ends, could attract break costs, which may be substantial, so make sure you read the fine print.

What is a variable-rate home loan?

A home loan with a variable rate may see the interest rate you pay over the life of your loan change, as the interest rate could go up or down, depending on a number of circumstances.

When determining the current interest rate on a variable-rate loan, banks will consider a number of factors, including the RBA cash rate, the cost of various forms of funding available to the bank, such as retail deposits and wholesale funding, and other market conditions.

Advantages of variable-rate home loans

If your home loan provider drops its interest rates, you'll benefit from lower interest charges.

A variable-rate home loan also allows you to make additional repayments on your home loan at any time without penalty and if you do take advantage of interest rate reductions, you could put what you save into your loan, which may allow you to pay off your loan sooner.

Generally, you'll have access to any additional repayments you've made on top of your minimum repayments via a redraw facility as well, which most variable-rate home loans offer.

Many variable-rate home loans also offer access to one or more offset accounts, which you can link to your variable-rate home loan.

This could provide cost benefits, as money in an offset account will be subtracted from your home loan when interest is calculated. This reduces the interest payable, as well as the term of your loan.

Other considerations for variable-rate home loans

As interest rates are subject to change, increases in interest rates may also apply to your variable-rate home loan, meaning your minimum monthly repayments may go up.

As such, a variable home loan might be more difficult to budget for, as it can be hard to predict whether interest rates will go up or down over the life of your loan.

What is a split-rate home loan?

If you want to take advantage of the features offered on both variable-rate and fixed-rate home loans, you could consider splitting your rate, where a fixed interest rate applies to part of your loan and a variable rate to the other part.

What are the advantages of a split rate?

A split-rate loan allows you to have rate and repayment certainty on one portion of your borrowing, while potentially taking advantage of any interest rate reductions on the other portion.

You also get to decide how much of your loan you want to take as a fixed rate and how much you take as a variable rate. For example, you might fix 70% and have the remaining 30% as variable.

What are the considerations with a split rate?

There could be additional fees payable for managing both accounts, so be sure to check the terms and conditions with your lender.

If you need help with saving for a home loan deposit, contact us today.

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How to use your tax return to build a stronger financial future

Not sure what to do with your tax refund? Strategic financial decisions for your tax return begin with a strong plan.

Plan the best ways to use your tax refund in 3 easy steps

1. Write down your financial goals in a clear plan
2. Do a financial check-up, assessing debt and expenses
3. Invest your tax refund in growing your future wealth

Whether you breeze through tax time or dread the extra admin, receiving a tax refund makes the effort worthwhile. For many of us, getting a financial boost will be even more welcome this year, and you might be looking around for the best ways to spend it.

These simple actions can help you figure out ways to use your tax return for a stronger financial future. And if you're looking for inspiration on how to spend it, we suggest some ideas to consider, too.

Plan how you'll spend your tax refund wisely

Never underestimate the power of a well-crafted plan – it's easy to watch funds dwindle when you haven't given them a clear direction. Recent research has revealed that 87% of us admit to splurging an average of $2,172 annually as a result of comfort spending, a figure that has increased for one in three Australians since COVID-19 hit[i]. Additionally, 37% of us are struggling to repay debt[ii].

Like any goal, your ambitions for this year's tax return can be more easily realised if you have a concrete plan in place. In fact, studies have found that taking the time to write down your goals and plans can actually improve your chances of making them happen[iii].

Once you've lodged your tax return, you should be able to estimate your tax refund. Use the time before you receive the extra cash to give yourself a financial check-up: understand your current financial position, assess major life changes, set financial goals and budgets, reassess debt and look at your savings accounts, including the money in your super fund.

When you have a clearer picture of your finances, decide exactly how you plan to use your tax refund to avoid excitement spending once it lands in your account. This includes any money you're hoping to use for a holiday or other splurge – work it into your financial plan to avoid spending beyond your means.

Anticipate your upcoming living expenses

When making your plan, you might want to consider your upcoming living expenses, particularly any large, irregular bills such as car insurance and registration costs, utility bills and general home maintenance.

Putting aside some of your tax refund as a cushion for upcoming expenses or into an emergency fund for unexpected expenses helps you avoid reaching for other financial support – such as personal loans and credit cards – when the bills start to build up.

Pay off debt

If you have some debt to repay, you're not alone: the average Australian household debt-to-income ratio is around 190%, meaning we owe almost twice as much as we earn each year[iv]. Putting your tax return towards any outstanding debts, including mortgage repayments, personal loans and any credit card debt, may help reduce any interest charges.

Invest to build wealth

If you don't need the money for immediate expenses, paying off debt or the occasional luxury, you might be looking to make a long-term investment with the extra money. You might consider saving for retirement by investing some or all of your tax refund to boost your super contributions, or adding it to a term deposit or savings account.

More of us are considering investing in our homes, with studies showing that $1072.5 million of residential alterations and additions were approved in March 2021, a growth of 7.3% on the previous year[v]. If you're thinking about home improvements that will add value to a property, experts say that repainting rooms, upgrading flooring, updating the kitchen and adding a bathroom are among the most profitable upgrades and home improvements.

Make tax-deductible purchases

If you've been holding off buying specific equipment for work, such as a new laptop or desk, now could be a good time to make the purchase. For purchases over $300, tax deductions are calculated on the depreciation of the 'effective life' of an item[vi]. If you purchase them at the beginning of a financial year, the item has almost a full year to depreciate before you do your next tax return.

Donate to a charity

Although this has been one of the most difficult years in living memory, Australians have shown extraordinary generosity by donating to bushfire appeals, flood reliefs and other charities – in fact, 81% of us are charity donors[vii]. If you plan to support a charity or not-for-profit organisation, don't forget that any donations over $2 to eligible organisations in Australia are tax deductible[viii]. Just remember to keep a receipt for any charitable donations when you start preparing next year's tax return.

i Mozo (January 2021): Mozo's comfort spending report 2021

ii ABC (2019): Australians' record debt is making us work longer, spend less

iii Forbes (2018): Neuroscience explains why you need to write down your goals if you actually want to achieve them

iv Reserve Bank of Australia (2021): Graphs on the Australian economy and financial markets – household sector

v Mozo (2021): More Aussies renovating homes: 3 expert ways to get value for your money

vi Australian Taxation Office (2021): Decline in value of depreciating assets - individuals

vii Statista (2021): Financial donors among adults who give to charity in Australia as of January 2021Australian

viii Taxation Office (2021): Gifts and donations

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Understanding insurance in your super

Insurance in super aims to help provide for you and your loved ones if something happens to you or you can't work because of illness or injury.

It's usually offered through your employer's sponsored super plan as cover they've negotiated for you and their other employees (called a group insurance policy) which is generally considered the number one way for Australians to access affordable insurance without needing underwriting[i].

How insurance in super works

Your insurance premiums get paid out of the money in your super account. This can be good for your budget, because the cost doesn't reduce your take-home pay, and super is generally taxed at a lower rate than income tax (so you're saving there too).

But it also means the balance in your super account will be reduced if you don't keep making super contributions (this is a good thing to keep in mind if you ever take a long-time off work). But you may not want to be too hasty with cancelling your insurance – it can be hard to get the same insurance at the same price later down the track and you may need to answer health and lifestyle questions (known as underwriting).

Benefits of insurance inside super

- The costs of insurance premiums come out of your super account, so you won't be dipping into your take-home pay.
- If premiums are automatically deducted, your insurance may be easier to manage.
- It could be tax-effective[ii] because you pay for the insurance from your super contributions instead of your take-home (your take home pay is taxed at your marginal tax rate, which could be a higher rate than what your super is taxed at).
- After joining your employer's default super plan, you may be able to apply for a higher level of insurance cover within a limited time, without needing to answer health and lifestyle questions.
- Insurance in employer super plans are generally more competitively priced than insurance outside super because it's provided as group insurance in bulk.
- If a claim is rejected by the insurer, it will go to the trustee of the super fund to be reviewed again.

Considerations for insurance inside super

- Cover through super often ends when you reach a certain age (usually 65 or 70). That's generally different to cover that's outside a super account.
- It's a good idea to make sure your super balance isn't being reduced more than it needs to be, by your insurance payments. This is called insurance erosion[ii].
- If you have two accounts with the same type of insurance, you may be paying for insurance you don't need. In particular, for Temporary Salary Continuance (TSC or Income Protection), you'll most likely only be able to claim up to 75% of your pre-disability income (offsets may apply), regardless of how much you're insured for or whether you hold it in two accounts.
- Where insurance benefits are paid to people who aren't your dependants, they'll be taxed according to their marginal tax rate.
- Taxes may be applied to Total and Permanent Disablement (TPD) benefits depending on your age.
- Claim payments may take longer, as the money is normally paid by the insurer to the trustee of the super fund before it's paid to you or your dependants.

Who can get insurance in super?

Well, anyone can apply for insurance in their super if their super account offers it. But there are often benefits available for eligible members in an employer super fund.

For people who sign up to their employer's super plan, insurance is often provided automatically to eligible members. Eligible members won't have to answer any questions about their health and lifestyle (known as underwriting questions) which can mean insurance costs more or has specific exclusions based on health or lifestyle factors.

Not everyone is eligible. This is because super laws are there to make sure people want and can afford this insurance. Before the laws were brought in many people didn't realise they had insurance or that they were paying for it via their super.

To be eligible to receive automatic (default) insurance through your employer super plan you must:

- be 25 years old or over,
- have a balance of at least $6,000 in your super account, and
- have had a contribution put into your account within the last 16 months.

In most cases, as soon as you meet these eligibility rules, insurance will be applied automatically.

On the flip side, if you want insurance in your employer plan but are not eligible yet, you may be given a window of time to opt in for insurance when you start your job.

Speak to us to ensure you have adequate insurance cover for your needs.

i 'Fiscal Impacts of Removing Insurance in Superannuation' Rice Warner 2018

ii An inactive account is a super account that has not received any contributions or rollovers for 16 months. Learn more at https://www.amp.com.au/insights/grow-my-wealth/protect-your-super-package

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