PLANET WEALTH

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Newsletter - July 2022

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 “Rising home loan interest rates explanation” and provide you with information on “How to budget as interest rates rise” and “Super changes effective 1st July 2022”.

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,
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Rising home loan interest rates explained – what you need to know

The economic impact of COVID-19 has been keeping a lid on interest rates in recent years. But they were on a downward trajectory even before the pandemic, with the last increase coming in late 2010. In fact, interest rates have been so low, for so long, that a generation of Australian home buyers have grown up with no experience of rising rates.

But sadly, all good things must come to an end. Interest rates have begun to rise following the Reserve Bank of Australia's (RBA) decision to increase the cash rate for the first time in over a decade. And with high household debt levels, it could make life difficult for millions of Australians as regular mortgage repayments start to increase.

But the good news is, there are ways you can structure your home loan and adjust your spending to help with rising repayments as the new rate landscape takes shape.

What's the official cash rate?

The official cash rate sets the interest rate for overnight transactions between banks. It's a tool used by the RBA to influence economic activity and manage inflation.

An increase in the official cash rate generally means arise in the cost of borrowing money. So, when the RBA changes the official cash rate, the banks tend to follow suit and change their lending rates.

How do banks set interest rates?

The official cash rate isn't the only factor that influences bank lending rates, but it's one of the most important.

To make money, banks need to lend money out at a higher rate than they borrow – this is why the interest rate you receive on your savings account tends to be lower than the interest rate you pay on your home loan. So, an increase in the cost of borrowing money can affect you in different ways, depending on whether you're a saver or a borrower.

If you have a savings account or you're thinking of taking out a term deposit, you could start to receive more interest on the money you've lent to the bank. But if you have a home loan you could start to pay more interest on the money you've borrowed from the bank.

Why are interest rates rising?

The RBA is looking to control inflation in a bid to stabilise the Australian economy, which is seeing higher prices, lower unemployment and signs of potential wage growth.

What do rising rates mean if you have a home loan?

If you have a variable rate loan, or your fixed rate loan is about to reach the end of its term, you may find your repayments increase and you have less discretionary income to spend on other things.

What can you do to reduce the impact of rising interest rates?

1. Tailor your home loan to suit you

The way you structure your home loan could help you pay less interest in the long run and take years off your mortgage. As we see rates start to increase, it's a good idea to think carefully about what type of loan best suits your needs – fixed, variable, or split. It's a big decision and could have a significant impact on your future repayments and household budgeting as rates rise.

Fixed rate loans

A fixed rate loan has a set rate even if interest rates rise.

- You can lock in your interest rate for a period – generally one to five years – depending on factors such as the total amount borrowed and the overall loan term.
- You can choose to fix your rate again at the end of the fixed-rate term, or let it roll to a variable rate.

A fixed rate home loan not only gives you the certainty in your repayments, but it could also help you manage your household budget more easily. However, you usually don't get the flexibility to make extra repayments so you can't pay off your loan faster by making additional repayments. And you might also be up for break costs if you want to make any changes such as exiting your loan before it ends.

Variable rate loans

The interest rate you pay over the life of your loan can change as banks vary their lending rate. So, if rates rise, so will your repayments.

A variable home loan can be more difficult to budget for, but tends to be more flexible so you may be able to:

- make extra repayments to pay your home loan off faster
- access these extra repayments via a redraw facility
- open an offset account, which you can link to your home loan to reduce your interest.

Split loans

A split loan can help to manage the risk of higher repayments by letting you fix some of the loan and leave the rest variable. This could give you the best of both worlds, as a split-rate loan allows you to have rate and repayment certainty on the fixed-rate loan, while taking advantage of the flexibility on the variable-rate loan.

2. Check your spending

Creating a budget could help you get across how much income you've got coming in, how much you need for the essentials and where the rest of your money might be going.

This will help you identify if there's any room for movement and if you could potentially add a little bit extra to your repayments. AMP's Budget calculator could help you crunch the numbers.

How to budget as interest rates rise

With rising rates putting pressure on household finances, it could help to look at ways to save more and spend less

So…the era of rock bottom interest rates is finally coming to an end.

The Reserve Bank of Australia's (RBA) decision on 3 May to raise the official cash rate by 0.25% to 0.35% is the first increase since late 2010.

With Australia one of the most highly leveraged countries in the world[i] and the average mortgage for owner-occupied properties standing at almost $600,000 – an increase of 18% over the past year[ii] – any increase in home loan repayments could see millions of householders scrambling to pay the bills.

Fortunately, there are ways you can help to relieve the stress on the household budget.

If you have the flexibility, you could adjust your home loan – either by fixing part of your mortgage to reduce the impact of further rate increases, or by reducing your repayments if you're paying more than the minimum required (although bear in mind this means you'll take longer to pay the loan off and pay more interest over the life of the loan – so, in the long run, this may not benefit you).

Or you could look at where you might be able to make other savings in your household budget.

Three steps to creating a budget

Spend less, save more. It sounds easy. But it can be tough to find ways to cut back, particularly when you need to allocate more of your income to mortgage repayments.

The best way to start is by creating a budget.

A budget is a great way to set down how much you're spending (your outgoings) and how much you're getting in income (your incomings).

1. Calculate your income.
Include everything – any money you earn from an employer, any money you receive from the Government and any money you earn from investments.

2. Work out your expenses.
Look at what you spend and don't miss anything out – you might be surprised at what you could cut back on.

3. Use an online budgeting tool.
AMP's Budget Planner Calculator or MoneySmart's Budget planner can help you work out where your money is going.

Ways to cut your spending

You could divide your spending into different buckets – **essentials** like home loan repayments, grocery bills, utilities, transport and medical expenses – and **discretionary spending** like eating out, travelling and leisure activities.

Whether it's regular payments or your entertainment spend, there could be ways to save more as interest rate rises start to bite.

- Could you **shop around** for a better deal on utility bills like gas, electricity and water?
- Could you **drive a bit less** or even consider whether you need a second car if you have one?
- Could you shop at a **more affordable supermarket** or buy in bulk to make savings?
- Could you cut back on **paid subscription services** in favour of free TV-on-demand services like ABC iView?
- Could you take advantage of **cheaper deals when going out** like midweek specials at local cinemas and restaurants?
- Could you look at **cancelling memberships** you're not using in favour of cheaper options – instead of the local gym you could take up cycling or running.
- Could you **manage any other debts** better by consolidating them into a single loan so you're paying less interest?

We understand that even with a strict household budget, it can still be difficult to make ends meet, particularly if your home loan repayments are increasing.

We are here to help.

i OECD, Household debt 2022

ii Borrowing big: Australia's average mortgage size is now just shy of $600,000. Mozo. 19 Jan 2022

Super changes that could affect you from 1 July 2022

A number of changes to the super system could create opportunities for Australians of all ages. Here's a rundown of what you need to know.

Last month, the Federal Government legislated a number of proposals that it previously put forward in its May 2021 Federal Budget. The changes announced will come into effect on 1 July 2022.

Here's a snapshot of what will change, with further details below.

- More people will be eligible for contributions from their employer, under the Superannuation Guarantee (SG), as the minimum income threshold of $450 per month will be removed.
- Work test requirements for those aged 67 to 75 will be softened and only apply to people who want to claim a tax deduction on voluntary super contributions they may be making.
- More people will be able to make up to three years' worth of non-concessional super contributions in the same financial year, with the cut-off age increasing from 67 to 75.
- More people will be eligible to make tax-free downsizer contributions to their super from the proceeds of the sale of their home, with the eligibility age reducing from 65 to 60.
- First home buyers, who meet certain criteria, will be able to withdraw an additional $20,000 in voluntary contributions from their super, to put toward a deposit on their first home.

How you could benefit from the changes

Compulsory (SG) contributions from your employer

Under the government's Superannuation Guarantee (or SG for short), you currently need to earn at least $450 per month to be eligible for compulsory super contributions from your employer. However, from 1 July 2022 that minimum income threshold will be removed.

This means that even where an eligible employee earns less than $450 in a calendar month, there is now an obligation on the employer to make contributions.

The work test

Currently, people aged 67 to 74 can only make voluntary contributions to their super if they've worked at least 40 hours over 30 consecutive days in the financial year, unless they meet an exemption.

From 1 July 2022, the work test will no longer apply to contributions you make under a salary sacrifice arrangement with your employer, or personal contributions that you don't claim a tax deduction for. The work test however will still need to be met if you wish to claim a tax deduction on personal contributions.

Under the new rules, the work test can be met in any period in the financial year of the contribution. This is different to the current rules, where the work test must be met prior to contributing.

Non-concessional super contributions

Currently, those under the age of 67 at the start of the financial year can make up to three years of non-concessional super contributions under bring-forward rules.

From 1 July 2022, the cut-off age will increase to 75.

The bring-forward rules allow you to make up to three years of non-concessional contributions in a single year if you're eligible. This means you could put in up to three times the annual cap of $110,000, meaning you could top up your super by $330,000 within the same financial year.

How much you can make as a non-concessional contribution will depend on your total super balance as at 30 June of the previous financial year.

Downsizer contributions

The age Australians can make tax-free contributions to their super from the proceeds of the sale of their home, which needs to be their main residence, will be reduced from 65 to 60. (Note, there is no upper age limit for downsizer contributions and no requirement to meet the work test.)

The maximum downsizer contribution amount of $300,000 per eligible person and other eligibility requirements remain unchanged.

For couples, both spouses can make the most of the downsizer contribution opportunity, which means up to $600,000 per couple can be contributed toward super.

The First Home Super Save Scheme (FHSSS)

The First Home Super Saver Scheme (FHSSS) aims to provide a tax-effective way for eligible first home buyers to save for part of a deposit on a home.

Under the scheme, you can withdraw voluntary contributions (plus associated earnings/less tax) from your super fund, with the current maximum withdrawal broadly $30,000 for each eligible individual.

From 1 July 2022, this withdrawal cap will increase to broadly $50,000 for each eligible individual.

Other important things to note about your super

- If you exceed concessional and non-concessional super contribution caps, additional tax and penalties may apply.
- The value of your investment in super can go up and down, so before making extra contributions, make sure you understand, and are comfortable with, any potential risks.
- The government sets general rules around when you can access your super, which typically won't be until you reach your preservation age (which will be between 55 and 60, depending on when you were born) and meet a condition of release, such as retirement.

There may be lots of things to consider when it comes to these superannuation changes, and it may affect what you choose to do this financial year. We're here to help