Strategy Paper: Financial Planning for Generation-Y

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Overview

- When it comes to money, what steps should you take now to set yourself up financially for the future?
    - For those just starting out in the workforce, it's very easy to adopt a "live today, worry about finances later" attitude.
    - But the reality is when you are young with fewer responsibilities you often have the greatest potential to start building a strong financial foundation for the future.
- This doesn't mean you have to forgo all the luxuries such as going out, clothes or holidays - it's just a case of finding the balance
    - Modifying your spending a little can help you free up a small amount of cash so that you can start to accumulate savings.
    - It's important to remember that it's not what you earn, but what you learn and do with your money that will determine where you end up financially.
- For those at the beginning of their working lives, there are a number of areas that need to be looked at in order to devise the most effective way of achieving their goals and objectives. These include, amongst others:
    - Budgeting
    - Getting out of Personal Debt
    - Paying off your HELP Loan
    - Saving for your First Home
    - Harnessing the Power of Compound Interest
    - Using Dollar Cost Averaging to your Advantage
    - Income Protection
    - Superannuation
- In this Strategy Paper, we explore each of these areas in brief detail.

Budgeting – It really works!

A budget is a powerful tool you can use to help you take control of your money.

Some people say they can't budget. They say it's too complicated or they don't know where to start. Or they think they've got enough money and don't want to be restricted by a budget because it might mean going without.

The truth is everybody who does a budget can see how it pays off. Basically, it helps you understand where your money goes so you can take control. A budget helps you decide what you want and plan how to achieve it.

How do you get started?

You can start a budget by simply writing down what you spend over a couple of months. Remember, your budget is your personal tool and you can choose how much detail you want to include. When you are starting out, you may find it helpful to put your spending into categories - such as groceries - rather than keeping tabs on individual items such as shampoo, breakfast cereal and pet food.

Think about what categories you would like to use. Some people find it helpful to work with two groups of expenses:

- Essentials - bills you must pay to keep your household and family running, such as utilities (electricity, gas and water), housing (rent or mortgage), groceries, health, transport (car or public transport to travel to work or school), education and so on.
- Extras - the other expenses in your life such as entertainment, holidays and gifts.

There are no hard and fast rules for creating a budget. What is important is that it is easy for you to understand. Remember to keep the list of categories simple and useful to you. And be flexible. You can change the categories you use if you find they don't work for you.

How do you stick to a budget?

If you want to stick to your budget you may need to look at your expenses. If you need to trim your spending, look at cutting down your extras list first. Don't cut them all out. If your budget is too tight, it will be harder to stick to.

How do you manage unexpected expenses?

Some people worry that an unexpected bill will derail their budget. The best way to prevent this is to plan for it. Try to save enough to give yourself a small buffer you can use in emergencies.

Getting out of Personal Debt

The average credit card debt for Generation Ys is $8,200. Work hard and clear your debts sooner rather than later. While this is easier said than done, it will serve you well in the long run.

If you have credit card debt, you might be paying interest as high as 20 per cent. This only increases your outstanding debt and adds unnecessary stress to your finances. There are many ways to get that balance down without extra financial stress to your budget.

Ensure you have the right credit card

There is no need for anyone to be paying as high as 20 per cent interest on their credit cards. Due to the increased level of competition in the credit card space, many are offering much lower interest rates and deals.

When doing your research, make sure you read the fine print, as cards offering low or zero interest rates on balance transfers, do so for a limited time only whereas other cards might offer a low interest rate for the life of the transfer.

Card free

Once you have selected a low interest rate card to transfer your balance, make sure you don't use that card for any new purchases until you have paid off the full amount from the initial transfer. The best way to do that is the old fashioned way – cut your card up and throw it away!

Repaying your HELP Debt

Anyone who has deferred any higher education fees payable to the Commonwealth Government will have a Higher Education Loan Programme (HELP) debt.

HELP incorporates:

- HECS-HELP - Provides a loan to cover part or all of an eligible student's contribution. It is eligible for students who are enrolled in Commonwealth supported places.
- FEE-HELP - Provides a loan to cover the full amount of an eligible fee paying student's tuition fees, up to certain limits, at an approved higher education provider or Open University.
- OS-HELP - Provides a cash loan to cover certain expenses, such as accommodation and travel, for eligible Commonwealth supported students who are undertaking overseas study towards their Australian higher education award.
- VET FEE-HELP - Provides a loan to cover the full amount of tuition fees up to certain limits. This is available to eligible full fee paying students undertaking Vocational Education Training, accredited, advanced and graduate diplomata or certificates with an approved provider.

Compulsory repayment of HECS-HELP debt is required once assessable income exceeds the minimum repayment threshold. For the 2016/17 financial year, the minimum income amount is $54,869 and repayments are calculated as a percentage of income. The higher the level of income, the higher the repayment percentage.

Currently and until 1 December 2016, if you make a voluntary HELP repayment of $500 or more you are eligible for a 5% discount. **However from 1 January 2017 the voluntary bonus will no longer apply.**

Buying your First Home

The First Home Owners Grant

Unfortunately, for contracts entered into on or after 1 July 2013, eligibility for the Grant will be limited to buyers of new homes.

For contracts entered into on or after 1 July 2013 to build or purchase a new home, a payment of up to $10,000 is available for eligible first home buyers. For contracts entered into prior to 1 July 2013, a payment of up to $7000 is payable to eligible first home buyers. This grant is not means-tested nor is it restricted by the price of the property for contracts entered into prior to 1 January 2010.

For contracts entered into on or after 1 January 2010, the grant will only be payable where the price of the property or construction of the home does not exceed $750,000. An exception to this requirement is where the contract relates to a home that is on, or to be built on, primary production land.

Please note that different regulations do apply in each State and Territory.

Reduction of Stamp Duty for Eligible First Home Buyers in Victoria

If you are an eligible first-home buyer who buys a new or established home, you will receive a 50 per cent reduction of duty if:

- Your settlement date is on or after 1 September 2014,
- The property is your principal place of residence, and
- The total house and land value is $600,000 or less

If you satisfy the eligibility requirements for the First Home Owner Grant (FHOG), you are automatically entitled to the first-home buyer duty reduction. This is the case even if your circumstances prevent you from actually receiving the FHOG.

For example, your first home purchase may be an established/existing home (as opposed to a newly built home) with a contract date on or after 1 July 2013. The FHOG is no longer available for established/existing home purchased after that date. Even so, you will receive the first-home owner duty reduction if you meet the eligibility criteria for the FHOG.

Harnessing the Power of Compound Interest

Compound interest is a basic concept; it's simply interest on your interest, which ultimately means you have more money on which to earn more interest.

Example

At the start of 1995, Michael invested $20,000 into a 15-year term deposit paying 8% per annum. He had a choice: either to have the annual interest payments paid directly into his savings account or to re-invest this money in the fund. Have a look at the different scenarios upon maturity of his investment at the end of 2009.

End Year	Interest Paid Out Option		Interest Re-Invested Option	
	Capital	Plus Interest Paid Out	Capital	Plus Interest Re-Invested
1995	$20,000.00	$1,600.00	$20,000.00	$1,600.00
1996	$20,000.00	$1,600.00	$21,600.00	$1,728.00
1997	$20,000.00	$1,600.00	$23,328.00	$1,866.24
1998	$20,000.00	$1,600.00	$25,194.24	$2,015.54
1999	$20,000.00	$1,600.00	$27,209.78	$2,176.78
2000	$20,000.00	$1,600.00	$29,386.56	$2,350.92
2001	$20,000.00	$1,600.00	$31,737.49	$2,539.00
2002	$20,000.00	$1,600.00	$34,276.49	$2,742.12
2003	$20,000.00	$1,600.00	$37,018.60	$2,961.49
2004	$20,000.00	$1,600.00	$39,980.09	$3,198.41
2005	$20,000.00	$1,600.00	$43,178.50	$3,454.28
2006	$20,000.00	$1,600.00	$46,632.78	$3,730.62
2007	$20,000.00	$1,600.00	$50,363.40	$4,029.07
2008	$20,000.00	$1,600.00	$54,392.47	$4,351.40
2009	$20,000.00	$1,600.00	$58,743.87	$4,699.51
Total Interest Credited		$24,000.00		$43,443.38

Interest Paid Out Option		Interest Re-Invested Option	
Total Return upon maturity	Total Return upon maturity	Plus Interest Paid Out	Capital
Capital	$ 20,000.00	Capital	$ 58,743.87
Interest Credited	$ 24,000.00	Interest Credited	$ 43,443.38
Total Return	**$ 44,000.00**	**Total Return**	**$ 102,187.25**

Simply by re-investing his interest and utilising the power of compounding, Michael has come out ahead by $19,443.38 in terms of interest credited. If he had chosen to have his interest paid out, after 15 years, he would have made 120% on his initial investment but, by reinvesting his income, he multiplied his initial investment by five!

It's important to remember that the longer the period of time, the greater the benefit, so it's good to start early!

Using Dollar Cost Averaging to your Advantage

If you could consistently buy low and sell high, you'd have plenty of money for anything you choose. A more workable investment strategy, based on the same ideal, is called "dollar cost averaging" It's a discipline that helps investors invest more efficiently.

Dollar cost averaging means you invest a specific dollar amount in your investment portfolio regularly. This could be every month or quarter. By doing this, you're investing systematically, regardless of what the market is doing at that point in time.

How Dollar Cost Averaging Works

With dollar cost averaging, you commit to invest a set dollar amount on a regular basis and stick with this approach through both good and bad markets. This discipline is easy to maintain.

When market prices are falling, you automatically buy more units in the funds with each subsequent investment. When prices start to rise, you buy fewer units. Because you're buying more units when prices are lower and fewer when prices are higher, the average cost will be below the average market price of all the units.

Dollar cost averaging is especially well suited for a long-term investment goal. It can't guarantee a profit or protect you against a loss in declining markets. However, a commitment to dollar cost averaging does reduce the odds that you will invest a large sum when the market has just hit a high point. Perhaps the best thing about dollar cost averaging is eliminating the emotional factor from an investment program.

Reducing Risk with Dollar Cost Averaging

Let's assume that you put $100 per month into an investment for 12 months.

Month	Investment	Unit Price	Number of units bought
January	$ 100.00	$ 10.00	10.00
February	$ 100.00	$ 9.76	10.25
March	$ 100.00	$ 9.30	10.75
April	$ 100.00	$ 9.76	10.25
May	$ 100.00	$ 9.30	10.75
June	$ 100.00	$ 8.89	11.25
July	$ 100.00	$ 8.00	12.50
August	$ 100.00	$ 9.30	10.75
September	$ 100.00	$ 10.00	10.00

October	$ 100.00	$ 10.53	9.50
November	$ 100.00	$ 10.26	9.75
December	$ 100.00	$ 10.00	10.00
TOTAL	**$ 1,200.00**	.	**125.75**

The overall results are as follows:

- Average Unit Price: $9.59 ($115.1/12)
- Average Unit Cost: $9.54 ($1200/125.75 units)
- Current Unit Price: $10.00
- Current Value of Investment: $1,257.50

This compares with an investment of the total $1200 you would have purchased 120 units. The value of those units in December would be $1200.

Income Protection

A regular income gives you financial freedom but what if you can't work? Sick leave will cover you for a short while. Maybe you have annual leave you can take but then you will be dipping into savings or maxing out the credit card just to buy groceries. How will you pay the rent? Moving back in with Mum and Dad may not be an appealing prospect!

Income protection insurance can keep you in your own place and pay the car loan and the groceries until you recover.

How does Income Protection work?

If you suffer an illness or injury and are unable to work, income protection insurance can pay you a monthly benefit (typically of up to 75% of your pre–tax income) to replace lost earnings.

You can generally claim the premiums as a tax deduction, which can reduce the after–tax cost by up to 46.5%. Also, any benefits received are usually assessable as income for tax purposes.

You can choose from a range of "benefit payment periods", with maximum cover generally up to age 65. Most income protection policies also offer a range of 'waiting periods' before your insurance benefit starts accruing (with options normally between 14 days and two years).

As a general rule, the shorter the waiting period and the longer the benefit period, the more the insurance will cost. Where cash flow is limited, it is generally better to choose a longer waiting period rather than shortening the benefit period.

Superannuation

At this stage, you are probably not too worried about getting old and you're certainly not thinking about it. But the truth is that you will get old eventually, so the earlier you start making the most of the opportunities that are available within super, the more time you will have to watch your money grow, so… maybe you should consider contributing more now?

Consolidating

If you've had more than one job, chances are you have more than one super account. And, if that's the case, you are most likely paying more than one set of fees, eroding your super savings. It's time to get it all into a fund and one that suits your needs best.

Consolidating your funds will save you from paying multiple fees and charges. And, you'll only have one super account to keep a track of!

Also, the chances are that your money is invested in the 'default' option that's selected by your super fund. With time on your side, this may not be the most effective option for you.

Boost your super with the Government's Co-contribution

Simply by making personal (after tax) contributions to your super, you could qualify for the Government's Co-contribution. If your salary (assessable income and any fringe benefits) is less than $50,454 and you contribute up to $1,000, the Government's Co-contribution could add up to an extra $500 to your super each year.

It really is that simple!

Although retirement seems a long way off, remember that your super strategy could have a huge impact on how much you'll have for your retirement. A little bit extra now, could make a huge difference later.

So where to from here?

Now that you've made the first step of finding out what financial planning is about, how do you move further down the path to financial security?

All of our clients begin with an initial consultation where we gather together all of the information we need to understand your current situation. This may include details about your assets and liabilities, income and expenses, superannuation, property, investments and insurances. This helps us understand where you currently are at in a financial sense.

We then look at what your specific financial goals might be whether they be short or long term, temporary or permanent.

We also take into consideration any concerns you may have regarding your financial situation and other financial issues there may be for example - your tolerance to risk or your ethical investment concerns.

Once we have identified where you are, where you want to be, and the way you hope to get there, we then move on to preparing a Statement of Advice for you that includes any strategies that may be recommended and explains what is involved in implementing them.

Now that you have read your Statement of Advice, it's up to you to decide whether to implement the recommended strategies or not.

Once your initial strategies have been implemented, we review the financial plan on a regular basis to ensure your strategy is in keeping up with changes in your life, work, relationships and goals.