RICHARD WHITFIELD

CASE STUDY

Is it time to cash in?

The profit from the sale of an investment townhouse would boost a young family's finances at a key stage in their lives

NAME: Josephine Sargent
STATUS: Married with two small children, Margot, six months, and Teddy, two years.
QUESTIONS: Should I sell my investment property in Ballina and put the profit into our mortgage? Or is it a good investment and worth hanging on to? What is the best way to take out life and TPD insurance?
ANSWERS: Sell Ballina and reduce your mortgage. You will save $600 a month (including $80 from the Ballina property expenses). Reduce your interest rate – 4.7% is too steep. Get it down to 3.8%. Pay attention to your super now you have two dependants and a mortgage. Ask your industry super fund how much life and income protection insurance you need.

When the market heated up in 2006, Josephine Sargent started to search for a property to buy. Having grown up in northern NSW, she chose a two-bedroom townhouse in the riverside town of Ballina, near Byron Bay. She paid $260,000 and received the NSW first home owner grant of $7000.

It was a big financial commitment for the then 23-year-old. The interest rate on her loan of $218,000 was 8% at the time. The Ballina rent didn't cover her mortgage repayments but thankfully Josephine's own living costs were low as she was living and working in the Queensland country town of Warwick, so she was able to make up the difference. However, when Josephine moved to Sydney and her rent skyrocketed she had to take a second job in a cafe to make the repayments.

Twelve years on, interest rates are much lower and the rent almost covers the mortgage repayments. It costs her around $80 a week for strata and council fees.

Josephine has married and, with her husband, bought a house on the Gold Coast. Both 35, they have two kids, Margot, six months, and Teddy, two years.

Josephine is working part time and her husband is studying and working part time. They would love to pay a chunk off their mortgage. One way is to sell the Ballina investment property, estimated to be worth $340,000, and put the gains towards their mortgage, reducing their debt by 25%.

But Josephine wonders if it is better to hang onto the townhouse as it is in demand, renting for $330 a week and covering the mortgage repayments. "I am currently paying an interest rate of 4.7%. Is there a better rate?"

Josephine is also concerned that interest rates could rise and the housing market could cool. Is it a good time to sell?

Josephine and her husband don't have life and total and permanent disability insurance. As they worked overseas for a number of years, their superannuation balances are low.

What should they do about insurance now they have dependants?

COMPILED BY SUSAN HELY

Reduce the burden now

MARGARET LOMAS

Margaret is founder and director of Destiny Financial Solutions and author of several property investment books

If a couple have an investment property and then buy a home in which to live, it's always going to be a question of whether they should sell the investment to reduce the personal mortgage. In this case, Josephine is understandably worried that she will sell off an investment that later goes up in value, and that's a valid question where finances are in abundance and there are two working people.

But once dependants come along and cash flow becomes tighter, it's my opinion that the financial bottom line today is a far more important consideration than what might happen at some indeterminate time in the future.

And so the logical and appropriate decision would be to reduce the financial burden today by rolling the equity you have in Ballina into your own home. But to help you see the wisdom in this decision, here is what you should consider.

If you could sell Ballina for, say, $340,000, you would be left with around $110,000 after costs. The actual gain assessed by the tax office will be somewhere around $58,000, half of which attracts capital gains tax. Assuming you're in the 30% bracket, you will pay around $9000 in CGT.

The balance of $100,000 would then reduce the home loan repayments by about $520 a month. You would also have in hand the $80 a week from the current expenses on Ballina to make as an extra repayment on your own home, bringing the total to more than $10,000. So, in addition to the principal repayment of $100,000 initially, if you were able to leave your loan repayments at their current rate, and add this $80 a week to it, you would potentially pay off your mortgage years sooner!

This all means that Ballina would have to increase in value by around $15,000 a year, every year, to make the outcome of keeping it the same as putting that money into your own home (given that the $15,000 a year increase would attract CGT), and more than that to make it better to keep than sell.

This doesn't take into account the fact that you're paying off your own home faster and owning it more quickly – and its value would be going up at the same time.

I think it's unlikely that you would see that result in Ballina, which is a sporadic market that doesn't have the growth drivers to give it this kind of return for you.

At the end of the day, though, the result is about making your finances easier at the time when you need it most – while your kids are small. As you gain equity in your own home, through growth and that accelerated loan repayment that becomes possible when you sell Ballina, you can then think about using that equity and buying a better-performing investment property, with a good cash flow, that enhances your future.

The last piece of advice I can give is that, yes, 4.7% is far too high! Renegotiate your loan rate, because you should be able to get about 3.8% in this environment. That alone will reduce your repayment by a further $50 a month, adding to your savings even more.

Insurance is a top priority

JOANNA McCREERY

Joanna has 25 years' finance experience and is an independent financial planner and founder of the boutique planning group Majella Wealth Advisers, specialising in tax-effective wealth creation and management. majellawealth.com.au

While superannuation is probably not top of mind at present, at some time in the future you will look at the balance and realise it's becoming one of your biggest assets. Spend a bit of time now making sure it is ticking along nicely. That means:

- Finding out where all your super is invested.
- Choosing a fund you like best (check fees and options).
- Consolidating to one fund if possible (check if there's insurance in the fund before closing).
- Looking at how it's invested and deciding what strategy is right for you.

Once all that's done, don't completely forget about it. At least check your annual statement to stay on top of it.

At this time in your life, making regular additional contributions to your super is a low priority. Being able to repay your mortgage at a higher rate than the minimum is more important.

However, two contributions you may want to consider now are:

- A personal, tax-deductible super contribution for Josephine in the financial year you sell your investment unit, if you sell it. This should help reduce the capital gains tax payable.
- A $1000 personal contribution that you don't claim as a tax deduction. Do this if you earn under $36,813 to access the federal government's co-contribution scheme and receive an extra $500 in your super.

Then within the next 10 years you will need to increase your regular super contributions above the super guarantee rate (9.5% at present). Consider salary sacrificing at least 5% of your salary as soon as it's feasible.

As for insurance, with dependent children and a mortgage to repay, personal cover should be a priority. We all think it won't happen to us; we won't be the one who's hit by a car and be unable to work for weeks; we won't be the one to get cancer and be unable to work for months. But, unfortunately, it can happen to anyone.

You should have at least enough life and total and permanent disability insurance to repay your mortgage and also provide a lump sum that can generate enough income to support your family while the children are dependants. Income protection insurance is also very important. This offers a monthly benefit to replace your salary if you are unable to work due to sickness or accident.

You can usually take out these three insurances through your super fund and the premiums are tax deductible to the fund. But I would also compare the costs and benefits with taking out a policy directly through an insurance company. You get more comprehensive income protection policies outside super that typically offer more opportunities to make a claim (such as an accident benefit or a broader definition of total disability). Sometimes the cost is higher than it is via super due to the extra benefits but not always. In either case, it's important to know what you're covered for.

Another optional insurance that I recommend to most clients is crisis recovery/trauma insurance. This policy pays you a lump sum if you are diagnosed with a serious illness (such as cancer, heart attack or stroke). You can't take this out via super but at your age it is not very expensive (as a guide, under $30 a month for a $100,000 benefit).