Six common misconceptions on new super rules

JAMES KIRBY
WEALTH EDITOR

The government has made a uniquely lame effort at explaining the changes that are looming for superannuation rules on July 1.

With less than four months to go, there is widespread misunderstanding of how the rules will work. After chairing a series of Q&A sessions on the issue over recent weeks and with help from a range of advisers — especially Andrew Heaven at WealthPartners — a clear picture is emerging.

Here are the six most common misconceptions held by investors:

1. Misunderstanding the $1.6m balance cap

It's an individual cap, a per capita cap ... a sum of $1.6 million is allowed for each person entering retirement as the amount with which they can fund a tax-free pension. Advisers say this is the single most common misunderstanding — for some reason the government has not articulated the rules are to be applied per head.

Most DIY funds have at least two members — most commonly a married couple — and the rules mean for the typical fund the balance cap is effectively $1.6m times two, a total of $3.2m.

Similarly, if the two members have $1.6m each in institutional funds, they will both be allowed to run tax-free income in parallel. What's more, you are only tested once on the $1.6m — you are not assessed against this cap yearly.

2. Underestimating the SGC contribution

Also known as the "pre-tax" cap, this is the commonly used allowance where you can make contributions directly out of your pre-tax salary.

The process is known as "salary sacrifice". In this area the rules have not actually changed but the numbers have.

The amount you are able to contribute pre-tax from July 1 will be $25,000 for anyone at any age. In making this contribution your SGC of 9.5 per cent is included (Superannuation Guarantee Contribution is the portion of your salary your employer puts into your super).

So if you make $100,000 a year, your SGC is $9500. Now, allowing that the $9500 has already been taken into consideration ... your effective maximum amount of "voluntary" pre-tax contribution is $25,000 minus $9500, which is $15,500 — in other words the SGC must be subtracted to get an accurate number.

3. Assuming the tax-free fund can be topped up

You cannot top up the initial starting balance that funds your tax-free income, never ever.

When you retire the dollar amount you start with is final ... it cannot be added to five years later should you come into more money or should the fund dwindle to very low levels.

The maximum you can place in this fund is the balance cap $1.6m. If you have more than $1.6m you can still leave it in the super system, in what is known as "accumulation" where the tax on earnings is 15 per cent.

4. Believing retirees have no tax-free alternatives outside super.

Oh yes, they do. The way it works, our personal tax system (commonly known as marginal tax) applies to all ages.

Under the ATO personal tax rules the first $18,201 is tax free, and this is before we add the range of offsets available to almost every retiree, which will comfortably bring the tax-free total above $20,000 in most cases. And remember that is for earnings. Using the assumption of 5 per cent average earnings on investments (which is how they devised the $1.6m balance cap originally), then each individual retiree could have an extra $400,000 in funds effectively funding a tax-free retirement income.

To extrapolate further, if you add that $400000 to the $1.6m balance cap, an Australian resident retiree can have $2m funding a tax-free retirement income under the adjusted tax system from July 1.

What's more, these calculations are done only on the headline tax free rates. Andrew Heaven suggests that if you apply the SATO (Senior Age Pension Tax Offsets) the actual tax-free income per couple is $28,974 per couple or $32,279 for singles.

5. Assuming you will be penalised should you lose a member of the fund.

Industry statistics suggest there is an average of 2.2 members in each DIY fund — typically a married couple. Most couples make arrangements that if one dies the other get the money in the fund.

Now, from July 1 that means some people may find that an inheritance from their deceased spouse has pushed the amount in their fund over $1.6m.

Strictly under the rules this places the fund in breach of the $1.6m cap. But the government has allowed a 12-month grace period to allow surviving members of couples to rearrange their affairs before the cap laws apply to them.

This is, of course, unless the beneficiary has already used up the $1.6m balance cap.

6. Expecting the 'work tests' no longer apply.

In its original announcements on the changed super rules in the May budget last year the government gave the distinct impression that the controversial and unpopular "work tests" would be scrapped.

If you are aged 65 to 74 and you want to keep contributing to super — you must have worked for at least 40 hours over 30 consecutive days in the financial year you make the contributions.

It is often assumed that since the issue was aired by the government it had become a reality. Unfortunately, they never scrapped these rules — they still apply.

Fund gives small investors exposure to big disrupters

Loftus Peak counts on disruption to make money

GLENDA KORPORAAL

Alex Pollak started life as a finance journalist before an extended career at Macquarie Bank. He now runs Loftus Peak, a global fund manager focusing on listed disruptive businesses.

You invest in disruptive businesses. What are they?

We invest across the board — retail, banking and finance, transport, energy, media — anywhere disruptive change is happening. But for risk and liquidity issues, we only buy listed companies. The companies in which we invest have a median market cap of $US80 billion, so we give small investors in Australia the opportunity to hold positions in the companies we believe are driving the future — something that they would find hard to do themselves.

Do your companies have to be technology companies?

It's not about technology, it's about disruption. There is a company called Dollar Shave Club which sells razors and personal grooming products that they deliver to your door. It doesn't do any TV marketing. Its razors sell for about $10 for a pack of four. It's not a tech company, but it has been disrupting Proctor & Gamble, which makes Gillette shavers. Unilever recently took it over after a bidding war with P&G, paying $US1bn.

Or take Uber and the taxi industry. The transport outcome is the same — a person gets a ride, it's not hi-tech — but Uber is successful because when you book it you have the knowledge that the driver is coming, and the driver has the certainty of payment. Same outcome in terms of the ride, but the information in the network changes the whole proposition. That's the reason Uber has disrupted the taxi industry.

Your personal favourite stock?

One of my favourite stocks is Alibaba. It's the Chinese version of Amazon and is a very large play on retail, banking and logistics in a market with significant growth in the middle class.

When you moved into financial services you become a media analyst. How did that shape your thinking?

It gave me a box seat in an industry which was being seriously disrupted. I could see the trends happening. In 2002, we went to see the chief executive of Fairfax to warn of the potential challenges of internet-based companies to the company's traditional "rivers of gold" in employment and real estate ads. Fairfax said they were on top of it. I said "no problem". The next year we floated Seek and a little later Carsales. The rest, as they say, is history.

How big is the fund?

It is under $30 million. We are still a relatively new company, although building a strong following of people who share our views of the future. From the time we started until now, we have recorded 18.6 per cent return a year with 7 per cent outperformance annually.

What stocks does the fund own?

Well, we own Apple and Google, for example, but we don't hand out a list of our investments. Investors who pay us to manage their money wouldn't appreciate us giving it away for free.

Do you own any Australian stocks?

No. Our investments are mainly in the US and a bit in Europe and Asia. We are providing access to companies that are more difficult to research and invest in as an Australian investor.

How do you search out the companies you invest in?

We read a lot and follow some key people. We attend industry conferences. There is a lot of rich content out there if you know where to look.

What about the banks? Do you like them or are they about to be disrupted by fintech?

Banks have done well by pushing online banking to their customers, which has allowed them to take massive costs out and increase efficiency. The next wave of disruption for the banks was staved off by the GFC, which gave them essentially 10 years to get their houses in order. There was a big flight to quality after the GFC and no one really challenged the banks.

Now the capital markets have settled down. There are some big players out there with some big ideas getting ready to challenge the banks. We are going to see a lot more action in the fintech space. History shows that very few companies have been able to successfully disrupt themselves. But that's not to say the banks couldn't. The big banks are hoovering up all the data scientists, and they understand the risks.

How about your own personal investments?

I have generally made money investing in areas I understand — I have rarely been "lucky". Timing is also important.

Could you describe what investors do wrong ... what they should not do?

There is too much focus on short-term issues, such as small changes in earnings or lines of stock being sought or sold. But it is important to not rush either way. You only really get two chances to make a return — by buying or selling well. Buying or selling poorly cuts in half those chances.

Alex Pollak says Loftus Peak invests across the board — anywhere that disruptive change is happening

HOLLIE ADAMS

We have just been advised by our private health fund that our premiums are going up by more than $300 a year to about $6000, effective April 1. We are seriously considering cancelling the cover as we don't see value in the ever-increasing expense of cover. We have two teenage children. My wife and I both work and our combined family income is about $220,000. What do you think?

In February, the federal government approved premium increases to private health funds of 4.8 per cent. While inflation is around 1.5 per cent, the cost of healthcare has apparently increased at three times this rate.

Notwithstanding the obvious risks in cancelling any insurance, you would need to be mindful of the tax consequences of electing to cancel your private health insurance.

If you do cancel it, you will become liable for the Medicare Levy Surcharge. The levy is payable if you elect not to have private health cover and your family income is greater than $180,000. Family income of $180,001-$210,000 attracts a levy of 1 per cent against total family income. Family income of $210,001 attracts a levy of 1.25 per cent. Family income in excess of $280,001 attracts a maximum levy rate of 1.5 per cent. The threshold increases by $1500 for every child after the first child. Note family income includes taxable income, fringe benefits and reportable super contributions.

Based on your family income you would pay a levy of 1.25 per cent, or approximately $2750. Therefore the impact of the Medicare Levy Surcharge would offset the premiums saved by cancelling your private health cover.

Before making any decision, I would recommend you shop around as there are a range of private health insurance providers available in the market who may offer you lower-cost cover. Costs will vary depending on a range of features and benefits you may or may not need.

I would recommend you determine what cover you need and what areas you would be likely to claim for. You may have a choice of hospital benefits ranging from basic hospital to premium hospital cover. The level of luxury may vary but also the procedures covered. With an older family, hip replacements may have greater importance than fertility treatment! So ensure the level of hospital cover and procedures reflect your needs.

You may be able to reduce costs by increasing the excess on hospital stays, which should work towards reducing your premium. You typically will have a choice of between $0, $250 and $500 excess on hospital stays.

Review the range of ancillary benefits you currently have. Ancillary benefits may include dental, physio and chiropractic but they may also include remedial massage, acupuncture and dietitians. If there are ancillary benefits you are unlikely to use, look to tailor your cover to your particular areas of need. Alternatively, cancel this form of supplementary cover.

If you change health cover providers, ensure you are aware of the terms and conditions, especially any changes to qualification times for cover or the treatment of pre-existing conditions.

Check that the premium quoted includes the Australian government rebate. Assuming you are both under 65 and based on your income, the rebate should be 8.9 per cent.

If after shopping around you are still determined to cancel your cover, you will always have the public system available to you. Under the public system, some procedures may require you to be waitlisted. If you are not prepared to wait you may face the financial burden of funding the costs yourself. The cost of "self-insurance" may be substantially higher than the costs of private health insurance premiums in the long run.

Visit the Wealth section at www.theaustralian.com.au to send your questions to Andrew Heaven, an AMP financial planner at WealthPartners Financial Solutions.

Listen carefully ... that's the sound of the property market tipping over

ROGER MONTGOMERY

It has begun. The much maligned prediction of a sell-off in property prices is beginning to come true.

Of course, you wouldn't know it looking at the headline-grabbing median prices and the ridiculous prices being paid for shoe boxes in Sydney — "Hey," says the buyer, "what's an extra million when the additional interest is $45,000 a year."

And that is the point. We know the boom in property prices has little to do with anything other than historic low interest rates, which appears to have made paying an extra million at auction as insignificant as an impulse purchase of a bar of chocolate at the supermarket checkout.

I have now heard every possible explanation for surging house prices and the only one that matters is interest rates being lower than at any time since Captain Cook.

Surging house prices have nothing to do with a shortage of land. Hong Kong has less land and a much higher density of people per square kilometre and that has not prevented falling property prices. Moreover, surging dividend incomes, retiring baby boomers and Chinese fondness for our climate and air quality are all "weight-of-money" arguments that have never prevented falling prices.

Sydney, Melbourne and Brisbane property buyers are merely pawns in a global game of Central Bank Chess whose end has arrived.

As central bank bond buying, also known as quantitative easing, pushed government bond yields lower, investors were forced to seek higher returns elsewhere. Corporate bonds were next to surge, then junk bonds, equity and property. And record prices for art, low digit numberplates and collectable cars came soon after.

But keep in mind, few investors have any experience navigating a sustained secular increase in interest rates and inflation and even less would know anything about "credit events", which long-duration assets are always susceptible to.

Property income yields are at historic lows and yet property buyers couldn't be more enthusiastic. Buyers who tell me that they don't mind buying on a yield of 2.5 per cent because they will get a capital gain need to understand that the capital gain will only come when a buyer is willing to accept an even lower yield.

And yield's cannot fall much further when your oversupplied property is vacant and your yield is zero — as many leveraged Brisbane apartment owners are about to discover.

The end of every bubble is marked by the appearance of the greater fool principle: betting a bigger fool will come along and accept an even worse return. It's speculation, pure and simple.

Nobody will escape

Am I going too far? Think of this: record levels of household debt to GDP, household debt to income and record levels of credit card debt means that when bond interest rates rise — and they've already started rising — investors will be able to least afford the additional costs thanks to having previously paid and borrowed too much.

Within five kilometres of Brisbane's CBD, 5500 apartments were completed and available to be moved into by owners or tenants in the nine months to September last year.

During the same period, vacancy rates rose from 2.7 per cent to 4.7 per cent — a near doubling — 5km-15km from the CBD. Landlords who purchased a flat that has no tenant need to deeply discount their rent or accept zero income. And that puts financial stress on the landlord even if they haven't lost their job.

Most worryingly, another 13,300 new apartments will be completed within 5km of the CBD before September this year.

Meanwhile, some financial planners have reported to me being cold-called by developers with offers of 7 per cent commissions to market properties to their clients. This inducement comes on top of the free holidays, free cars and free frequent flyer points being offered as incentives to property buyers.

As supply increases, (see graph) these discounts will become more aggressive, ensuring lower prices. Reports of some apartments being revalued 30 per cent lower than 18 months ago will not help.

Financial stress occurs when AMP and CBA, Westpac and others, tighten lending restrictions on particular types of loans or blacklist your suburb, thereby pulling the rug out for any new buyer of your desperate-to-sell property.

Many believe their suburb will be immune. Many believe the falls won't impact houses and will be quarantined to apartments. Many believe their property won't be affected because it has some special quality. Such beliefs are nothing more than head-in-the-sand wishful thinking.

My bankers have told me all of their smartest and most successful property investors have sold up or are getting out, and they cannot lend them a cent — they won't take it.

Drop a pebble in a pond and the ripples will eventually impact the entire pond and everything in it.

Why should Tweed Heads and Bowral prices be nine or 10 times incomes when thousands of similarly-sized towns around the world — and the same distance from capital cities — can be purchased at half the multiple? It doesn't make sense and it isn't sustainable. And neither are low interest rates. Hold on tight.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund. www.montinvest.com