Budget for a secure future

A daughter's education costs and increased savings are top of the list

NAME: William York.
STATUS: Father of Martha, 18 months.
QUESTIONS: What is the best way to set up a budget, increase my mortgage payments, establish financial goals and save? What are the savings options to fund my daughter's future education? Am I on track for retirement? Is income protection insurance the most appropriate?
ANSWERS: Pay off your mortgage as fast as you can. Rather than setting up a plan to pay for Martha's education, draw down on your mortgage. Budget by using different bank accounts for your goals. You need to increase your income protection cover either with AustralianSuper or a retail product that provides cover until you are 70 if you want to work that long.

CASE STUDY


William (right) and Angelo with Olive and Bentley.

YIANNI ASPRADAKIS

Reviewing your financial products and services is a smart plan at any age. Are they still a good deal or have they been superseded by ones that have better features such as lower interest rates? Often they have. William York recently saved some serious money by shaking up his finances. He changed his credit card to one that includes free travel insurance; re-mortgaged his house, cutting his home loan interest rate from 4.2% to 3.88%; moved energy providers, slashing his electricity bill by 26% and gas by 16%; and switched super funds from MLC to AustralianSuper to reduce fees. He shops at Aldi instead of higher-priced supermarkets.

William wants to save more of his income and pay down his mortgage faster. He says his lifestyle isn't lavish but he and his partner, Angelo, are feeling cost-of-living pressures and he isn't saving as much as he would like. William wants to set aside funds for his young daughter's education.

He has never had a budget but believes now is the time. What is the best way to set one up, increase his mortgage payments, establish financial goals and save?

William owned a successful professional photographic agency for 12 years, closing it in 2012 because of increasing competition. In 2015, the sad news that his mother had cancer prompted him to take time out of work and move into the family home to care for her.

As a result he had to reorganise his finances and sell his office. He changed careers and now has a good job with a reasonable wage. He owns a home in the inner city with a mortgage of around $190,000. What is the best strategy for paying down his debt?

In a clever decision, William contributed substantially to a super fund when he was self-employed and now contributes at the standard rate. Is he on track to fund his retirement or should he contribute more? He has income protection insurance but is it the best type of cover for his needs?

COMPILED BY SUSAN HELY

Income needs to be secure

ROY AGRANAT

Roy has 36 years' experience assisting people with their insurance needs and is director of Fairbridge Financial Services, which specialises in personal and business insurance and corporate super.

In taking stock of his financial wellbeing, William needs to protect one of his biggest assets – and that is his ability to earn an income. If this income comes to an abrupt halt due to a disability caused by sickness or an accident, how would he then be able to cover his living expenses and, importantly, assist with funds to raise and educate Martha?

William's income is expected to be in excess of $2 million over the next 15 to 20 years of his working life. His current income protection cover with AustralianSuper pays $6000 over the next two years. This wouldn't come close to meeting his needs. Irrespective of whether the decision is to insure through AustralianSuper or another provider, the benefit amount needs to be increased in line with his needs.

It is important to ensure the income protection cover is "fit for purpose". In other words, if William was to be disabled he wants to be confident he can fund his income needs for the next 15 to 20 years and not be forced to sell assets or draw on his super fund and savings to fund income needs.

To simply rely on the income protection via AustralianSuper will, in all likelihood, not perform as expected and once something unfortunate has happened it is too late after the fact to put the correct covers in place. William should look beyond the cover provided by his super fund.

There are hundreds of income protection products available to William, so which one would be most suitable? When choosing income protection, the approach cannot be the same as choosing a utilities or mortgage provider. A cheap price will long be forgotten after a bad experience. There are a range of products and options that could be considered within William's budget, and they are a vast improvement on the AustralianSuper cover and will meet his expectations.

If William does decide to fund his income protection via AustralianSuper for a monthly benefit of $8000 (more in line with needs) on a 30-day wait benefit period to age 65, the premium would be $270 per month. If this is too costly he could extend the waiting period out to 60 days and reduce the premium to $211.

There are other more qualitative product options available to William that are rate competitive with the AustralianSuper income protection and also offer superior definitions, as well as the option to be insured to the age of 70. It may pay to extend the waiting period to 90 days, reduce the cost and have the comfort of a more effective cover in the long term.

The terms under AustralianSuper are not unusual and can be found, in one form or another, under most super fund insurance offerings. Superannuation is designed to fund for retirement and not to provide insurance benefits, so there shouldn't be an assumption that the cover will perform the same as a personal insurance policy.

William should seek advice from a risk insurance specialist to ensure that his insurance needs will be met and he will be able to rely on the product to perform its intended function in the event that he ever needs to claim.

Pay down the mortgage ASAP

CLAIRE MACKAY

Claire is an independent financial planner as well as a chartered accountant, lawyer and self-managed super expert. She is a business owner and director of Quantum Financial.

William, your experience with your mum sounds difficult and sad. It's a reminder that our life and financial circumstances can be overturned in an instant where we re-evaluate what is important to us.

I think you've already identified many of your primary financial goals. Like many of my clients, you want to financially support your lifestyle and plan for retirement.

It's good to see that you have already reduced your expenses. Shopping around for better deals can be a difficult and daunting process initially but is worth the effort. Put a note in your diary to do it again in 18 to 24 months to keep your providers on their toes.

How you budget depends on your personality. Engineers and accountants tend to use spreadsheets. Most people would rather visit the dentist for root canal surgery. Start with the big picture: what you earn after tax assuming no tax deductions.

Next, calculate how much you've spent. The quickest way is to review 12 months of bank statements, take the opening balance, add your after-tax income and subtract your closing balance.

Within that amount may be one-off expenses and repayment of the principal of your mortgage which may not truly reflect your ongoing expenses. The self-employed also need to identify work and personal expenses as this affects after-tax income. Once you know how much you have spent, you need to know what you spent it on. If spreadsheets are not your thing, there are apps to help you identify and quantify expenses into categories.

A budgeting process gives you information and a sense of control. You can then make informed decisions on how much you want to save next year, which will tell you how much you can spend and on what. Creating separate bank accounts with regular deposits to build cash for big plans (like holidays) is helpful.

I've never been a fan of investments for education costs. It's like buying flowers – once you mention "wedding" the price goes up. With investments, if there is an emotional element involved (eg, your kids) the embedded fees can be higher and rules for access can be tricky.

Paying down your mortgage faster and using free cash flow later to fund education can be the simplest and most efficient approach.

You've given yourself peace of mind around your income via insurance. You've taken some proactive steps around funding for your retirement with your AustralianSuper account. I've long been a fan of low-cost industry funds. Check that your investment option meets your attitude to risk and return and investment time frame. If you can't access super for 20 to 30 years, consider growth-oriented options.

I'm a fan of reducing your mortgage as fast possible with an almost religious-like zeal. By average Australian standards, a $190,000 mortgage is manageable, so well done.

Ignore the minimum payments set by your bank and pay off as much as you can as fast as you can. My most successful clients reduce their mortgage to near zero (it can be handy to keep it open with a small balance so you can use it to redraw). A debt-free home in retirement is a big advantage, so prioritise this in the short term, then ramp up super contributions when your mortgage is repaid.