Media hype on banks is over-rated

Noel Whittaker

No one can predict rate movements but you can adopt strategies to pay more off the mortgage so that you worry less.

AS they say at the racetrack, "there's no such thing as a dead cert", and so it came to pass in the economic world last week, when the Reserve Bank failed to cut interest rates despite a plethora of predictions that they would.

Naturally we were subjected to the usual media hype when the decision was announced.

There was footage of borrowers who would lose their homes, due to a rate cut that didn't happen, and of retailers who would go to the wall without the expected stimulus.

It was all a beat-up. The average mortgage is around $300,000, on which repayments would be close to $500 a week.

A cut of 0.25 per cent is a saving of just $15 a week on a $300,000 mortgage – I doubt if a family who can afford to pay $500 on their mortgage are going to lose their home, or change their shopping habits, just because they are being charged $15 a week less interest on their housing loan.

Worse still, one of the big banks copped flak for not notifying their borrowers that they had the option of reducing their repayments after the rate being charged on their loan dropped after the last rise.

The bank should have been commended, not criticised.

Falling interest rates give borrowers a chance to shorten the term of their loan. This is why I have always recommended that you maintain your current repayments whenever an interest rate cut is announced.

Keeping the payments at their present level does more than shorten the term of the loan – it also gives you a safety buffer if rates rise, or you find yourself in a tough financial situation because of unemployment or sickness.

Remember, even though interest rates appear to be in downtrend now, it is a fundamental principle that interest rates move in cycles. There is no guarantee that interest rates in two years will not be higher than they are today.

Just last week both ANZ and Westpac announced small rises on variable rate home loans.

The big question now is whether you stick with the variable rate, or move to a fixed one.

This is something you'll have to decide for yourself, based on your own assessment of where the rate cycle is heading, but the general consensus of those in the know is to stick with the variable rate.

By switching to a fixed rate you are making a wager with the bank that you are a better judge of interest rate movements than they are.

You also need to understand what the term "comparison rate" means. This is the rate that lenders are required to disclose, and is intended to make a potential borrower aware of any hidden charges.

Unfortunately it is only a starting point. Even though it includes the basic costs such as set-up fees, interest rates and ongoing charges, it does not include bank fees that are only charged in certain circumstances.

These include fixed loan early termination fees and redraw fees.

Go to ratecity.com.au, where all rates are displayed, and look at the difference in the comparison rates between variable and three-year fixed loans.

The average variable rate is around 6.3 per cent with a comparison rate of 6.44 per cent, which looks reasonable. However, there is a much wider gap when you look at fixed rates – the headline fixed rate of just 5.94 per cent loses a lot of appeal when you notice that the comparison rate is 7.01 per cent.

But there is more to a loan than the interest rate and the fees and charges. One of the most important things to consider is flexibility.

What happens if you decide to move house, or borrow some money for renovations or investment, or need to reduce your repayments as the kids are at high school?

If you have one of the no-frill loans it generally won't have a redraw facility and you may be required to take out a second mortgage for the extra money.

Rates will come and go, but your main focus should always be to live within your means and get that home loan paid off as soon as you can. The smaller the debt, the less movements in interest rates matter.

Noel Whittaker is a co-founder of Whittaker Macnaught Pty Ltd. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. His email is noelwhit@gmail.com

GAMBLE: The general consensus of those in the know is to stick with the variable rate.

Q In what circumstances can I claim gym membership on my tax return?

A The basic principle is that gym membership fees are claimable if they are necessarily incurred in producing taxable income or if you are required by your occupation to maintain a high level of fitness. However you will need to be guided by your accountant as the tax office has issued a number of conflicting rulings about the subject. For example, a trapeze artist would be allowed a deduction for gym fees, if the purpose of going to the gym is to maintain their level of fitness but not to maintain their body shape. A policeman doing normal work would not be allowed a deduction even though they are required to be fit, but a member of the emergency squad or the diving squad might be able to claim their fees if they could prove that their job required a level of fitness that was above the norm. You may wish to consider joining a health fund that allows you to claim part of your gym fees as a package bonus.

Q I want to retire from my government job in January 2011 at age 64. I would like to take my super as a lump sum payment to pay out a mortgage on my beach house. Will tax be deducted from my expected payout of approximately $200,000? Will that payout be classed as income at the end of that financial year?

A Provided the fund is a funded fund, which is highly probable, the lump sum will be tax free as you are over 60. It will not affect any of the income you earn in that financial year. If the fund is an untaxed fund then you would pay maximum tax rate of 16.5 per cent (including Medicare levy).

Send your questions to noelwhit@gmail.com

Judge, and if found wanting, switch to new fund

By **ANNETTE SAMPSON**

AUSTRALIAN shares are the biggest driver of most people's super fund returns, largely because we have a higher exposure to shares than any other OECD country. But some funds still fail to earn their keep, generating equity returns below those of the index after fees and taxes.

According to SuperRatings, the value added by the average Aussie share option depends very much on what time frame you're looking at.

Last year was a shocker no matter how you look at it. The average super option fell by 9.6 per cent, though at least it outperformed the S&P/ASX200 Accumulation Index (which includes dividends), which was down 11.4 per cent.

Over the past three years, both the funds and the market have fared better, with the index producing an annual return of 7.6 per cent – beating the average fund return of 7.3 per cent. Over the five years to December 31, the median share option fell 1.3 per cent versus minus 2.3 per cent for the index.

Volatile investment markets have also resulted in share options underperforming the more diversified balanced funds over the past five years. But as those healthy three-year returns show, when the good times roll, the more money you have in shares, the better.

In practice, the SuperRatings quantitative manager, Kirby Rappell, said most fund members stuck with the balanced option in their super funds, which typically hold about 30 per cent of their assets in shares. He says two-thirds of super fund assets were in balanced funds last year, with less than 3 per cent allocated to dedicated Australian share funds.

But the performance of these share options commonly reflects how well a fund is managing its shares within the wider balanced portfolio.

Rappell said Australian share options largely tracked the market between 2006 and the GFC but had underperformed slightly over the past three years.

But the problem with median figures is that they are the middle ground. They fail to give due credit to funds that have outperformed and hide the failure of the bottom dwellers.

Over the past five years, share option returns have ranged from 1.8 per cent to a loss of 5 per cent a year. Over the past three years, the range was even greater. The best performer, NGS Super, produced a return well above the index at 12.6 per cent a year. But the minimum return in the SuperRatings study was more than 10 percentage points below that – a mere 1.2 per cent. Even over the past year, returns ranged from minus 4.7 per cent to minus 14 per cent.

Importantly, many names top the league charts over all three time frames, suggesting investors can boost their chances of finding a better-than-average share fund. Hostplus, Catholic Super, Perpetual WealthFocus, Telstra Super and REST Super all make the top 10 over all three periods, while NGS Super, OSF, LUCRF, Statewide Super and FuturePlus make two out of three.

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