NEWSLETTER

July 2017

Edgeworth Partners

Introduction

Happy new financial year to you!

As you will see in this month’s newsletter, the financial year that has just ended treated investors well. Average share market returns were around 14% - which will have a flow on impact on superannuation benefits as well as have an obvious impact on direct investors into the equity market.

In this edition of our newsletter, we don’t just review the past month of share market returns – we have a look at the last five years. We also discuss an interesting phenomenon in the housing markets around Australia. Finally, we discuss the changes to superannuation taking effect from this week – and show you how they may affect you.

Did You Know… the month of July

July has always been an important month in Australian history. It has been a particularly important month for going it alone: in 1841, New Zealand detached from New South Wales and became its own colony. Victoria did the same exactly ten years later. In 1945, John Curtin died in office as the Prime Minister. He was briefly replaced by Frank Forde, and then more permanently by Ben Chifley – making it three Prime Ministers for the month. Japan surrendered the next month and the Second World War was over. Finally, in 2000, the Goods and Services Tax was introduced by John Howard – approximately fifteen years after then treasurer Paul Keating told his Labor cabinet that a ‘broad-based consumption tax’ would be a good idea.

Peter Dugan
02 9476 6700
pdugan@edgeworthpartners.com.au
www.edgeworthpartners.com.au

MARKET UPDATE

Property Update

The proportion of properties being sold to first home buyers has fallen in most parts of Australia.

Property advisers CoreLogic released a report in late June which detailed the percentage of purchases that have been made by first home buyers during the first four months of 2017. On a national level, the proportion has fallen to just 14% (less than one in six). This is the lowest it has been since at least 1991.

The fall has not been standard across the country. Western Australia, for example, saw 28.4% of its housing being purchased by first timers – about 1% more than it's long-term average of 27.4%.

The fall was most pronounced in the NSW market, where the percentage of first home buyers was only 8.4% - or one in twelve purchasers. This is a huge fall from the long-term average of just over 20% (obviously people change houses more in NSW than they do in WA – the relatively high long-term average for first home buyers in the West indicates that people tend to hold onto their first home for longer).

South Australia was not far in front of NSW, and Tasmania was not far ahead of South Australia. This has caused some consternation as to the cause of the sharp reduction in first home buyers. Housing inaffordability is nowhere near as much of a problem in South Australia and Tassie as it is in other states, and yet the reduction in first home buying has been quite pronounced in both of those states. This complicates the most tempting conclusion for the reduction overall: that housing inaffordability is hitting hardest those people who do not yet own a home.

Such a conclusion makes good sense. When house prices rise in general, people who already own a home enjoy a capital gain. This leaves them better able to afford to purchase another home than someone who has not enjoyed the same capital gain; second and subsequent home owners are better able to participate in rising markets than new home owners.

And this conclusion is supported by the high rate of first home buying in Western Australia: prices in the west have been flat or declining for a few years now, and that state is the only one in which first home buying is better than the long-term average.

What all this really tells us is that Australia is made up of multiple housing markets – which makes sense given we are the largest island in the world. This poses a huge problem for the economists whose job it is to drive monetary policy (interest rate policy) in Australia. The Sydney market dominates the overall market, but it's economy is quite different to that of other states. Setting policy to address the dominant Sydney market can have unwanted impacts elsewhere. This is one of the reasons that interest rates have remained low in recent years, even as Sydney (and to only a slightly lesser extent Melbourne) has seen a sharp increase in the price of housing: spending in other parts of the country needs the boost that lower interest rates provide.

So, it is all very interesting and it will be even more interesting to see what comes next. Certainly, there are a lot of factors impacting on the property market. In early June the NSW state government announced an exemption on stamp duty payable by first home buyers. Will that

encourage them back into the Sydney market? If so, what impact will that have on the broader market? (The full exemption is only available for houses valued up to $650,000, and there are further discounts available up to a limit of $800,000). History would suggest that measures designed to assist first home buyers end up assisting people who are selling properties to those first home buyers, as the assistance just leads to higher prices. The exemptions take effect from 1 July, so now is probably a good time to be selling a Sydney property valued at around $600,000 – a price rise to $650,000 would not be unexpected.

Share Market Update

Nothing happened in the share market in June. Absolutely nothing. The ASX 200 started the month at 5,738 points, and ended it at 5,728 – a change of only 0.1%. Here is how Google reported it:

Of course, things are not as simple as that. The market actually rose by 1.7% in the first two weeks of the month, and then fell by 3% in the third week. The fourth week saw it meander its way slightly upwards.

June marks the end of the 2016/2017 year. For the twelve months to June 30, the market rose from 5,233 points to finish on 5,728 – a rise of 9.5%. Add an average dividend yield of around 4.5% and the market produced an average return of around 14%.

That makes it a good year, by any stretch. We needed a good year: during the previous 2015/2016 year, prices in the market fell by 5.3%. This is offset by dividends, but the year was still a slightly negative one for the average investor. The year before that saw basically no capital growth at all.

If you want to go back slightly further, the five years to 30 June 2017 saw overall capital growth of 37.8%. This implies an annual growth rate of around 6.6%. Again, add an annual dividend of 4 to 4.5% to that figure and you get an average return of around 11% per year for the past five years.

The point of all this: you needed to be in the market for the whole time to achieve this very good return. Had you invested for shorter periods within the five-year period, you may have done better – but you might also have done worse. Creating wealth via investment is a long-term process.

Superannuation changes from 1 July 2017 – Part 2

Published on our website: 9 June 2017

The 2016 Federal budget introduced a number of changes to superannuation. Many of these changes take effect on 1 July 2017. This week's article follows on from our article of a fortnight ago. We continue to explore the coming changes and how you can ensure you are prepared for them.

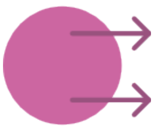
In our blog article two weeks ago, we examined some changes to superannuation contributions that are scheduled to take effect from 1 July. In this article, we continue the superannuation theme, discussing changes to pension arrangements and how you might respond to them.

Superannuation pensions

There are two ways for people to withdraw money from superannuation (at least, while they are still alive!) Where a person chooses to retain most of their benefits within superannuation, and draw a relatively small amount from their superannuation fund each year, that is known as a 'pension' or 'income stream.'

The alternative to an income stream is a lump sum withdrawal. The government tends to dislike lump-sum withdrawals, given people's propensity to spend what they have withdrawn from their superannuation. Superannuation is intended to reduce people's reliance on government benefits such as the Centrelink aged pension, and for that reason, there are generally incentives for retaining benefits within superannuation and withdrawing only a relatively small amount as an income stream each year.

Transition to retirement pensions



A transition to retirement pension allows a person who has reached 'preservation age' to start drawing income from their superannuation benefits while still working. The original preservation age was 55, but this is increasing gradually and by 2024 it will have increased to 60.

The idea of a transition to retirement pension is to discourage people from completely leaving the workforce. As an incentive to stay in work, when transition to retirement pensions were first introduced, they came with a real kicker: earnings on assets used to finance the pension would not be taxed. Super funds basically became tax-free investment machines for anyone who had reached preservation age.

This was a generous incentive and in the 2016 budget it was decided that it was too generous! As of 1 July 2017, earnings and capital gains on assets used to finance a transition to retirement pension will no longer be tax-free. They will be taxed in the same way that earnings and capital gains are taxed prior to the commencement of a pension – 15% on earnings, and 10% on capital gains for assets that were held for more than 12 months. (Capital gains on assets held for less than 12 months are also taxed at 15%.)

These changes will reduce the appeal of a transition to retirement pension for a lot of people. Basically, the only people for whom such a pension will still appeal are people who really need the money – for example, people working on a very part-time basis.

The changes mean a loss of a tax advantage for many people. But it is difficult to argue that the change is not fair: many, indeed most, people still working beyond their preservation age were simply establishing a transition to retirement pension for the sole purpose of negating tax within the super fund. Indeed, in many cases, the amounts withdrawn from superannuation were simply re-contributed back in in what is called a 're-contribution strategy.'

So, transition to retirement pensions will become much less popular from 1 July. However, as we say above, they still do suit certain people. If you are aged 55 or over, or will be soon, and think that a transition to retirement pension may suit your circumstances, please get in touch with us as soon as possible.

Retirement pensions

People aged over 60 who have fully retired, and people aged over 65 regardless of their employment status, can create a pension from their superannuation fund. Earnings on the assets used to finance that pension, including capital gains, are tax-free.

However, from 1 July 2017 this tax-free status will be subject to a limit of $1.6 million worth of assets. People may still retain more than $1.6 million in superannuation, but they can only access the tax exemption on that level of assets. Earnings on assets in excess of $1.6 million are taxed at the standard superannuation rates (15% for income, 10% for capital gains on assets held for longer than 12 months).

To give a simple example, if you have $2 million invested and you generate a 5% income return, then that is a $100,000 return altogether. The return on the first 80% (or $80,000) will not be taxed ($1.6 million is 80% of the total $2 million). The remaining $20,000 will be taxed at the standard super tax rate of 15%, or $3,000. (We have simplified this example to highlight the tax treatment. The two amounts of $1.6 million and $400,000 actually need to be kept within separate accounts within the super fund).

For people whose superannuation benefits are less than $1.6 million, the change has no real effect. For the relatively few people with assets above this threshold, they may now have to pay tax where previously they did not (depending on whether they earn an investment return on the excess amount).

The tax rates that apply to superannuation earnings are still relatively light – but they may exceed tax that would be payable on earnings generated outside of superannuation. If so, it may make sense to remove some money from superannuation.

2017 Budget – Winners and Losers

Published on our website on 23 June 2017

As we have said before, we like to wait a few weeks before going to press with our thoughts about the annual Commonwealth Budget. This year has been no exception: we had scheduled our 2017 Budget special for this week.

The problem is, compared to previous years, the 2017 Budget was a bit of an anti-climax! In previous years, there have been a number of big-ticket changes – such as the big changes to superannuation that we have been discussing in recent articles. But this year there have simply been a whole lot of small changes, some of which will be of benefit and others will represent a small loss.

In this article, we examine those changes that are most likely to affect our clients. So, have a read of our thoughts and decide for yourself whether you're a budget winner or a budget loser.

Budget Winners

Disabled people

The government announced that the National Disability Insurance Scheme is now fully funded – the remaining funding has been raised by an increase in the Medicare levy (see below).

Home owners aged over 65

One potential winner – although see the recent article in our June newsletter – are older Australians who own their own home. Those people will be able to sell the home, and contribute up to $300,000 of the proceeds as a non-concessional contribution into their super fund. Couples can contribute up to $300,000 each. This $300,000 will not be subject to the standard limits on non-concessional contributions. It is hoped that this change will encourage older Australians to downsize their family home. That said, relatively few people are likely to see any advantage in this change.

Medicare rebates

For the past number of years, Medicare rebates paid to doctors and other health professionals have been frozen. This has caused many health practitioners to charge a gap for seeing them. From next year, they will begin to be unfrozen (thawed?), with the process taking three years to complete.

First Home buyers

First home buyers will be able to use their superannuation fund to help save for a house deposit. They will be able to contribute up to $15,000 in a particular year, such that the total contributions are no more than $30,000. They will then be able to withdraw these contributions to fund a house deposit.

Small businesses

For a number of years, small businesses have been able to access an immediate tax offset on expenditures of up to $20,000. This has been extended for at least another year._

Budget Losers

Medicare levy

The Medicare levy is going to increase from 2% to 2.5% of taxable income. This increase is slated to help fund the National Disability Insurance Scheme and will take effect from 1 July 2019. Basically, all taxpayers will now pay 0.5% more tax.

The banking tax

In our newsletter earlier this month, we discussed the introduction of a new levy that will be imposed on Australia's five biggest banks. You can expect that this levy will flow through to increased bank costs for some, if not all, bank customers. So, if you're a borrower of any kind, you're probably going to see your borrowing costs being higher than otherwise they would be.

University fees

Two changes are happening to university fees. The first is a simple increase in their amount. By 2022, university fees will have risen by 7.5%.

The second change is a lowering in the threshold income above which university loans need to be repaid. At the moment, the threshold is $55,000 – meaning that a person does not need to start repaying their student loans until the taxable income crosses this threshold. From 1 July 2018, the threshold will drop to $42,000. People will still need to repay the same amount – but they can expect to need to start repaying it sooner.

Non-residents

There will be some changes for non-residents. Only Australian citizens will be able to apply for a Commonwealth supported university place – the kind in which the Commonwealth pays the fee and the student then later repays the government as discussed above. At the moment, permanent residents and New Zealanders have been eligible for Commonwealth supported places.

Non-resident homeowners will have to pay capital gains tax when they sell their principal place of residence (unlike resident homeowners, for whom the family home is capital gains tax exempt).

Edgeworth Partners

The Legal Stuff

General Advice and Tax Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances. All strategies and information provided on this website are general advice only.

We recommend you seek personal financial, legal, credit and/or taxation advice prior to acting on anything you see on this website.

Contact Details

Address	Suite 1, Lvl 1, 22-28 Edgeworth David Ave Hornsby NSW 2077
Phone	02 9476 6700
Website	www.edgeworthpartners.com.au
Email	partner@edgeworthpartners.com.au

Licencing Details

Peter Dugan is an authorised representative (380321) of Avana.

Avana

AFSL 516325 | ABN 67 631 329 078 | Level 1, Suite 8, 51-55 City Road, Southbank, VIC 3006