

Mark & Julie Keenan

13/06/2017

Note open: 11:32 am

- Mark: Born Nov 59, therefore currently above superannuation preservation age. This entitles him to a lump sum withdrawal within low rate cap, tax free up to \$200k (next year, FY18).
- Mark: Upon retirement, after-tax cost of debt rises from about 2.5% to approx. 4.27% (as value of tax deduction reduces to ~\$3.1). Effective tax-free threshold is about \$20.5k p.a.; therefore with rental income of \$33.4k p.a., maximum tax deduction attained with deductions of \$12.9k. At current interest rate = approx. \$275k debt (\$440k less than current liabilities of \$715k).
- Mark: Upon retirement (if before 60), consider using low-rate cap \$200k to pay down investment debt.... This will reduce mortgage repayments to around \$24.2k, resulting in net cash flow of about +\$9.2k (taxable income). To make up the difference (bring income to \$25k) convert \$320k super to account based pension and draw 5% (\$16k). This will bring total income to \$25.2k. With tax offset on super no income tax will be payable.
- Mark: At age 60, commute remaining super to account based pension. Commence strategy of drawing out capital to (1) reduce mortgage debt, and (2) re-contribute to superannuation as cash contributions. Consider making some of these to Julie's account to help equalise estate. This will reduce prospective tax on estate proceeds for his children (assuming they are well and truly adults and independent by the time Mark/Julie die).
- Mark: Consider whether any value in salary sacrifice following retirement. Some very small benefit (about 6%) for portion of income within first tax tier.
- Julie: Born May 62, retired but not yet at preservation age. Upon reaching preservation age, consider re-contribution strategy (withdraw super then re-contribute) in order to adjust the tax components.
- Re-Contribution (general): subject to legislation remaining, upon Mark turning 60 and being fully retired, consider drawing capital from super and using it to contribute to new super accounts for Mark and Julie. Immediately following Mark's 60th, \$600k can be used to make two contributions of \$300k into each of their super accounts. Potential tax saving for beneficiaries = \$90,000. On current super balance of \$1.28m, net \$715k mortgage repayment, remaining super est. \$565k. On \$565k tax savings = \$84,750.
- Julie: If the investment properties are all in Mark's name, consider using a number of small annuities (with 15 year liquidity options) to generate tax-free cash flow. Note that with interest rates likely to rise the face value of annuities are likely to fall.
- Review need for insurances: are these policies really needed? Looks like an old CBA CI policy - check which model, some have questionable coverage for CI.
- Life Insurance level: \$25k p.a x 35 yrs @ R1% real = \$735k. / existing investment NAV = \$1,365k / funding surplus (shortfall) = \$630k. Life cover not required.
- Critical Illness level: estimated cost of care (high range; serious chronic illness) = ~\$150k upfront + \$5k p.a. each, 7 year reduction in life expectancy (single household income = 67% dual), est. costs = \$214k each, \$311k both. Plus "normal" retirement expense of \$735k = \$1,046k. Existing investment NAV = \$1,365k / funding surplus (shortfall) = \$319k. Critical illness insurance not required (also note: existing level of \$80k each is approx. \$134k below

- what is needed to cover serious CI event).
- Investment objectives/expectations: reasonable. 1-2% above inflation; consistent with stated risk tolerance.
 - Investment strategy – implement property hedge: Mark & Julie have substantial proportion of assets in property; est. $\$780k/\$2,080 = 37.5\%$ (ex home/personal assets), $1,480/2,810 = 53\%$ (ex contents). Investment LVR 34%. Look to hedge property exposure through: debt reduction (reduce interest rate exposure), minimise exposure to banks/financials (credit growth & property valuation), increase exposure to infrastructure & consumer staples (earnings more resistant to economic downturn, inflation). Property exposure if cash used to repay mortgage = $780k/1,365k = 57\%$. Quarantine portion of remaining cash to support retirement cash flow (possibly tax exempt source such as liquid annuity?); this will protect them in the event of an extended period of vacancy in their investment properties.
 - Investment strategy – risk asset timing: review asset allocation within super. C. $\$1.2m$ super; worthwhile using ALM framework to reduce risk. Given current economic and market climate, model impact of risk pre-pricing on portfolio (from “9 to 12” model). Note that without ALM this has the potential to reduce investment NAV (ex property) by $>30\%$.
 - Investment structure: look to minimise and simplify structures. Current arrangements: Mark (1) PLUM – est admin fees $\$3.6k$ + ICR c. $\$1k$ + invest fees c. $\$5.4k = \$10k$; (2) LUCRF $\sim \$1.16k$, Julie (1) CBA – depends on structure, allow $\$1k$. Total investment & management costs expected to be $\$11.5k - \$13.5k$ p.a. None of their existing structures are particularly goo. Review costs. Should be able to reduce fees by $\sim \$3k$ p.a. while improving functionality, however beware of tax implications. May be better to wait until converting to pension in order to avoid capital gains tax (can then commute pension to alternative structure, or transfer assets across through re-contribution strategy).
 - Investment strategy – tax: if reviewing investment strategy, find out from PLUM and LUCRF how they manage/allocate trades and fund flows. Do they have rules/policy around FIFO or LIFO? Are gains/losses quarantined in separate fund accounts, or do funds hold notional exposure to sector-specific mandates (in which case tax events should be triggered less often).
 - Update of Wills. Check key beneficiaries. Check superannuation accounts have Non-Lapsing Binding Death Benefit Nominations in place.
 - Estate planning – manage distribution of assets to minimise tax: What plans do they have (or would like to have) in place for passing of assets; review tax implications. I.e., impact of transferring ownership of a property to children now, as opposed to 30 years down the track. For cash flow, ownership could be transferred with an agreement for M&J Keenan to “manage” the property for an annual fee, say $\$30k$ p.a. We could also consider holding property through SMSF as a means to avoid future Capital Gains Tax, however the ongoing costs of this strategy would need to be considered.
 - Aged care: Due to level of assets both Mark and Julie would be required to pay maximum MTCF (allow $\$150k$ total). Sufficient assets to meet accommodation fees (RAD) @ $\sim \$600k$ each, though will require liquidation of some assets. Assets could support DAP while taxable assets are sold to minimise tax. Due to age/health this is unlikely to be an issue for 25+ years.

- Shares: are these Exxon shares? Escrow or other conditions apply?
- Health: both ok.
- Note: perhaps explain that these moves (particularly reducing debt) will increase the amount of tax payable; however the objective is not to reduce tax, it is to maximise the outcome (return). In this case, paying an additional \$3k tax on a strategy that increases returns by \$10k makes sense. Example; after retiring a \$500k reduction in a debt that is costing 4.7% (\$23.5k gross) results in a net reduction in cost of about \$20k (4%). The stable and unrelenting nature of interest obligations makes it comparable in nature to alternative fixed income assets. Therefore the question becomes whether we can get an after-tax return of 4% elsewhere, with a similar level of risk. Apply this to the superannuation environment (15% tax on earnings, fees around 1%) we would need a fixed interest return of about 5.71% to breakeven. This is not available in the current market. Therefore it is preferential to reduce debt, even though this will - on the surface of it - reduce the amount of tax payable. A further consideration is that rates are likely to go higher in the medium term; if this happens the cost of debt will increase (increasing the value of the debt-reduction strategy) while reducing the value of fixed income assets held (as Bonds are priced from a fixed-coupon rate, an increase in rates reduces the price of Bonds). Naturally the opposite is also true: a reduction in interest rates may make the retention of higher levels of debt a more attractive strategy, though the likely cause of lower rates would be lower inflation which increases overall risk present in asset pricing.

Note close: 2:58 pm

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