Spring 2005 Edition 3 *A Client for Life*

Spring has sprung and with the new season comes our much anticipated Catalyst newsletter. This season brings us one of the most important occasions of the year, *The Melbourne Cup*.

FREE $10 BETTING VOUCHER

We want to wish you a **Happy Melbourne Cup Day** and so to help you get into the racing spirit we have organised $10 betting tickets for all of you. You can use these tickets at any TAB, just take them in, tick off your nominated winner and cross your fingers!

To claim your ticket all you need to do is call or email cassie@catalystfinance.com.au and a ticket will be posted out to you. For those of you who are planning on heading to Ascot on the day, we hope to see you out there.

INVESTORS: MORTGAGE INSURANCE – A DIRTY WORD?

Most investors when buying investment properties strive to borrow less than 80% of its value in order to avoid paying Lenders Mortgage Insurance (LMI). LMI is a one-off up front fee paid by a borrower when establishing a loan, if their borrowings exceed 80% of the value of the securities they offer. LMI can be quite expensive, so, this is understandable.

I will use the example of a client of mine who has now purchased four investment properties over the space of two years, paying mortgage insurance on all four. My client had modest equity in his home, approximately $100,000. We needed an aggressive investment strategy that would allow him to become highly geared and get the maximum leverage out of his existing equity.

We set up a line of credit for $80,000 on his existing property, which would serve as deposit and fees for four investment properties, which in this case happened to be land and construction. As some banks will now allow investors to deposit 5% on an investment property and add the mortgage insurance to the loan (essentially borrowing approximately 97%), this was enough to cover four such investments.

Over two years, he then built four properties, ranging in cost from $240,000 to $300,000. The deposit and fees on the $240,000 property were approximately $18,000 plus mortgage insurance of $4,200. On the $300,000 property the fees and deposit came to $20,000 plus mortgage insurance of approximately $5,200.

So, my client now has four investment properties that have been enjoying one of the most buoyant periods of capital growth in WA in recent times, but at the cost of paying LMI of approximately $20,000.

The equity now held in the four investment properties is in excess of $400,000. Keeping in mind we used $80,000 worth of equity from the clients' owner occupied property, and spent $20,000 in mortgage insurance, leaving a net positive equity position of $300,000.

BRIDGING THE GAP

With the real estate market showing little signs of slowing, some of our customers have expressed their concern over the ability of their adult offspring to enter the property market. The rising price of property is continually moving home ownership out of reach.

One option that is gaining in popularity is where family members with equity in either their owner occupied or investment property assists by bridging the deposit gap and the associated fees by providing a limited guarantee in support of their child.

There are several benefits to the borrower:

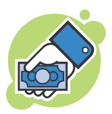
- Has the ability to enter the property market.
- A wide range of home loan options to choose from.
- Ability to maximise the amount that they can borrow - up to 100% of the purchase price plus costs such as stamp duty and legal fees.
- Reduces or avoids paying Lenders Mortgage Insurance.

Benefits to the guarantor

- Guarantor/s nominates a specific amount, i.e. the guarantee is limited.
- Guarantor/s can request to be released from the guarantee at any time: (standard credit policy applies in regard to the loan amount against the remaining property).
- Guarantor can use the property for more than one loan.

Take the following example:


Purchase Price
$300,000


80% purchase price
$240,000


Deposit & fees
$75,000

By family members providing a limited guarantee for $75,000 the borrower has the ability to enter the property market without having to save the required deposit and fees.

Diane Nicol

WEBSITE UPDATE

FINALLY we are in the process of updating our website and we want to put you on it! If you have any newly built homes that we helped finance, please email your pictures to cassie@catalystfinance.com.au. **Or if you would like to write a testimonial about how great we are, then please feel free to email us those too!!**

BRAINTEASER

Each of the clues make up a type of flower; for example - "small container + to allow" would be "vial + let", or "violet."

Can you figure out these four?

1. An implement + flesh around mouth
2. To wed + a soft yellow element
3. A false statement + be deficient in
4. Indicates an alternative + child

Email your answer to cassie@catalystfinance.com.au; all correct answers will go into the draw to win a $50 Liquor Barons voucher.

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Had my client discounted the opportunity to pay LMI, and just borrowed to his 80% potential (like most investors do), he would have been able to build only one property, for growth in equity position of approximately $30,000.

Some might argue that the same investor, after property #1 was built, could then use the equity in that property to borrow again up to 80% and begin property #2. Of course he could have taken this strategy, but remember my client required an "aggressive" investment strategy, which meant to wait a year between investments (ie the building time frame) would have cost him more money in two ways: a) increase in costs to buy house and land AND; b) decrease in time the properties were held, meaning less capital growth.

Please note that this is not a strategy I am suggesting our investors take. The point of the article is to open the possibility that investors can consider paying LMI, as the benefits may far outweigh the costs involved.

Matt Rigby

SPRING TIPS

Phew I hear you say, winter is over! It's now time to come out of hibernation, get out in the sunshine and be active again. Here are a few tips that can help you get started.

- Dust off the BBQ and refill the gas bottle.
- Stock your medicine cabinet with hay fever tablets.
- Weed and mow that lawn.
- Clean those windows.
- Flea treat your precious pets.
- Clean your air conditioner dust pads.
- Dig out your hammock and place in tranquil position.
- Plant some seedlings for some spring colour.
- Plan an outdoor Footy Grand Final party!

OFFSET ACCOUNTS VERSUS REDRAW FACILITIES

People get very confused with offset accounts & how they differ or compare to loans with redraw facilities. Some people may tell you they have the same effect on your mortgage but in fact there are subtle differences that can be important to clients.

Offset accounts are separate accounts "linked" to your mortgage account that save you interest on your mortgage depending on how much is in your offset account balance. As an example if you had a $100,000 loan with an offset account balance of $20,000 then interest on your loan would be based on an outstanding balance of $80,000 (taking the $20,000 away from the $100,000).

Redraw facilities are where, upon making additional payments into your loan over & above the minimum, you can gain access to or "redraw" those additional payments at any time. Interest is calculated on the lower balance so if you had a loan balance of $100,000 & paid a lump sum of $20,000 into it, the balance would be $80,000 with $20,000 redraw & interest charged on the new balance.

In both examples above the interest is charged on $80,000 with the $20,000 being accessible either in the offset account or as redraw. The main difference between the two is how the ATO views each set up.

With the offset account your loan balance is preserved at $100,000 because the offset account is separate from the loan. Thus from the above example if you withdrew the $20,000 from the offset account the loan balance is still $100,000, regardless of how much is in the offset account. This means that if the loan is tax deductible then you are preserving the tax deductible debt by storing your additional funds or savings in the offset account.

In the case of the loan with a redraw facility the balance is physically reduced to $80,000. The ATO views this (& rightly so) as a lump sum repayment so if the $20,000 is redrawn from the account & the loan is tax deductible then the deductibility only applies on the $80,000, unless the client can show that the $20,000 is used for the same deductible purpose as the original loan (ie if these funds were for repairing an investment property when the original loan was for the purchase of this property).

Given there are a lot of property investors out there you need to make sure that your finances are set up as flexibly as possible to maximise tax deductibility. Many clients choose an interest only "basic" or "no frills" loan for investment purchases which have redraw but any lump sum repayments affect future deductibility. Few if any of these loans have full offset facilities that may better suit your needs.

Most professional package loans at a variable rate have full offset & similar rates to basic loans; these may prove better options for investors.

The most typical case here is if you have a loan for your current residence which is non tax deductible but are considering upgrading to something else & keeping it as an investment property. With an offset account you can minimise the interest paid whilst living in the property but when you come to shift out you can withdraw the funds from the offset account (as cash) & use this as a deposit on your new residence. This has a double-edged sword effect because you are then preserving the loan balance on what used to be your residence but is now tax deductible & using a cash deposit on your new non-deductible residence.

Of course if the property you are purchasing is another stepping stone to your next residence then similarly you may want to have it set up with offset also for the same reasons as above.

Another thing to consider is that many lenders charge $20 to $50 for redraw on a Basic or No Frills account whereas offset accounts can normally be accessed for a nominal cost & with greater flexibility.

For tax advice consult an expert on these issues such as your accountant or financial planner.

Jason Cheetham

NETWORKING GROUP – Circle of Trust

Have you ever needed the services of a professional ie. Cabinet maker. So you've looked one up in the yellow pages, only to find that they've let you down in some *frustrating* way. Well here at Catalyst we have decided to create our own Networking Group. The only way that people can be a part of our networking group is if we have used their services and have not been disappointed. In fact we have been ***very impressed*** and now we would like to recommend them to you. So if you need any of the following professions please don't hesitate to contact us and we can pass on their details

- Commercial Interior Designers
- Home Improvement Builder
- Settlement Agents and Solicitors
- Financial Planners
- Insurance Brokers
- Accountants
- Business Brokers
- Property Developers
- Quantity Surveyor
- Residential Builder
- Real Estate Agents
- Various Tradesmen

SCRUMPTIOUS SPRING RECIPE – SURE TO DELIGHT

From Anna at EBM Insurance - Pear and Rocket Salad

Base
2 Pears sliced into slithers about 2mm thick
3 Tablespoons of coarsely hand grated Parmesan cheese
Enough Baby Rocket leaves to fill a large salad bowl

Dressing
2 Tablespoons of extra virgin olive oil
1 ½ Tablespoons of White Wine vinegar
1 ½ Tablespoons of Lemon Juice
Salt and Pepper

Combine all dressing ingredients in a small glass, whisk with a fork until they turn a frothy cloudy colour. Combine pears, rocket and parmesan in a large salad bowl then pour dressing over the top.

- Crumbled Blue cheese can be used instead of parmesan.
- Roasted walnuts could also be added.