

building capital



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CONTENTS

Disclaimer	3
How a modest savings plan can accumulate long-term wealth	4
How to establish your current financial position	5
How to overcome the common problem - never having money to invest	7
The magic of compounding	9
Reducing your credit card balance	13
Don't forget tax savings	14
Investing in your mortgage	15
Finding the best way to repay a mortgage	17
Choosing the home loan that is right for you	18
Reducing your home loan	21
Dollar cost averaging	22
Regular savings plan	24
How your personal circumstances influence your choice	26



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how a modest savings plan can accumulate long-term wealth

If you're like most people, you may not get around to putting aside regular payments to build money for investing.

It's easy to build capital — all you need is a plan. That's what this lesson is all about - providing you with a simple, painless step-by-step way to find the money to get started. And the earlier you start on your investing plan the more benefits you will get from the “compounding” of your investment returns.

You can choose from a huge variety of ways to build capital — perhaps through any one of a vast range of life insurance plans, through shares and different types of share “products” such as unit trusts, cash management, trusts and listed investment companies. Some of these will be just right for you now; some of them may be right at another stage in your life.

Building capital from income requires investments where income and capital gains can accumulate. When capital accumulates the interest is automatically reinvested with the capital, not paid out and used up in paying your bills.

And don't forget your mortgage. Look on it as yet another type of enforced saving — one which puts the power of gearing (using borrowed money) to work for you.

All it takes to be an investor is the same discipline that you're already putting to work in paying off your mortgage. Getting organised to do this in a systematic, step-by-step — and painless — way is what this lesson is all about.

Thanks to the power of compounding, just a bit of effort now will result in an enormous payoff in the future — the difference between “just getting by” and being able to enjoy real wealth.

In this lesson you'll learn:

How to assess your current financial position and why “paying yourself first” is a key element in getting started to financial independence.

- How to build up a short-term fund with ready access.
- Which bank account can help you achieve your savings goals faster.
- How your personal circumstances and tax position influence your choices.
- How to make your mortgage cost-effective.
- How to use the technique of regular investing.
- Why an investment in your own home may be the most tax-effective investment you'll make.
- How a modest savings plan can accumulate long-term wealth
- How to select the right investment method from the vast array on offer for both low risk and capital growth.

If you try and save more than you can afford, you will usually have to stop — and sometimes the financial consequences can be severe.



how to establish your current financial position

Many investors do not get started on the road to financial independence simply because they do not know how to begin the journey. The first step is to determine your current financial position. You are then in a position to develop a financial plan and set realistic goals. Unless you understand how to prepare your own financial statements you will have no way of measuring how successful you are at achieving the goals you have set yourself.

There are two main types of personal financial statements:

A balance sheet which describes the assets you hold, the debts you owe and your net worth at a given point in time.

An income and expenditure statement which keeps track of income earned and expenditures made over a given period of time — usually six or 12 months.

You need personal financial statements to give yourself feedback on your financial progress. At regular intervals you must compare how your actual results are stacking up against your plans. This is called financial tracking.

The Balance Sheet - A snapshot of your financial position

A balance sheet summarises your financial position at a particular point in time. On one side of the balance sheet you have assets — the things you own. An item is classified as an asset regardless of whether it was purchased with cash or borrowed money. So even if an asset *T* such as your house — is not fully paid off, it is considered to be owned by you and should be included as an asset in your balance sheet. An item that is leased is not shown as an asset as it is actually owned by someone else.

All assets should be included at their current market value, which may differ significantly from their original purchase price. The market value is either the actual value of the asset — such as money in a bank account — or the price you would reasonably expect to get if you sold the asset.

On the other side of a balance sheet are liabilities, which represent an individual's or family's debts.

Table 1 shows a typical balance sheet. Notice that there is an item called “net liquid assets”. This is how much you would have if you sold off all your assets and paid off all your debts. It is a measure of your net wealth at a particular point in time.

A personal balance sheet shows your current financial position. It is indispensable in establishing, monitoring and revising your financial plans.

how to establish your current financial position

Table 1 – Asset and Liability

Title:	Name (A):	Surname:	DOB:
Gross Income: \$	Other Income: \$	Occupation:	Period:
Title:	Name (B):	Surname:	DOB:
Gross Income: \$	Other Income: \$	Occupation:	Period:
Address:			Period:
Ph: Work	Home:	Mobile:	Fax:
Dependent Children:	Number:	Ages:	

ASSETS:					VALUE:
Ownership of Home	Joint	(A)	(B)	Other	\$
Investment #1	Property	Location:	Rental \$:		\$
Investment #2	Property	Location:	Rental \$:		\$
Vehicle #1		Year:	Model:		\$
Vehicle #2		Year:	Model:		\$
Cash/Savings					\$
Furniture					\$
Superannuation	(A) \$		(B) \$		\$
Other Assets	Details:				\$
TOTAL ASSETS:					\$

LIABILITY:	With	Limit	Rate	Term	Minimum payment	Actual payment	BALANCE:
Home Mortgage							\$
Inv. Mortgage							\$
Personal Loan							\$
Hire Purchase							\$
Other Loan							\$
Credit Card #1							\$
Credit Card #2							\$
Store Account #1							\$
Store Account #2							\$
TOTAL LIABILITIES:							\$

ASSET TOTAL minus LIABILITY TOTAL	\$
NET LIQUID ASSETS FOR INVESTMENT (Home not included)	\$

how to establish your current financial position

Your income and expenditure statement — where you earn money and where it goes

An income and expenditure statement summarises the income you received and the money you spent over a given period of time. This statement is prepared on a cash basis — that is, the only transactions recorded are those involving actual cash receipts or actual cash outlays.

If an item — for example an asset — is bought partly with borrowed money, only the actual amount paid out is included as an expenditure. You only include interest payments as an expense when they are made. So if you make a purchase on credit this is shown initially as an asset or liability on your balance sheet. Once you make a payment this is shown as an expenditure on your income and expenditure statement.

Table 2 gives an example of an income and expenditure statement. Notice that the final item is “cash surplus (or deficit)”. This simply means that if your income is greater than your spending you have a cash surplus. If your expenditures are greater than your income you have a cash deficit.

When you have a cash surplus you can use it to buy investments, acquire other assets — such as a car — or reduce your debts, such as your home loan or credit cards.

Generating a cash surplus is desirable as it adds to your net worth and provides a basis for your investment plans.



how to overcome the common problem — never having money to invest

The usual problem many people find when they do an income and expenditure statement is that they either have a cash deficit — so they are actually eating into their assets — or the cash surplus is so small that they do not see any point in developing an investment plan.

But there is a way around this problem - pay yourself first and then spend what's left over. You then use the amount you pay yourself to invest. What you decide to pay yourself will vary from person to person. But as a rough guide you should try to pay yourself between five and 10 per cent of your after- tax income to start your investing plan.

For example, suppose you are on an average weekly wage in Australia of \$50,000 and pay income tax of around \$12,000. Your after-tax yearly income is \$38,000. Five per cent of this is \$1,900 or \$36.50 per week. Ten per cent of this is \$3,800 or \$73.00 per week.

Naturally, to be able to save this amount every week you might have to cut back your spending on some items. But unless you have the discipline and will-power to do this you will never take the first step on the road to financial independence.

how to overcome the common problem — never having money to invest

Table 2 – Income and expenditure statement example

Name(s):		
For the year ending:		
INCOME		
Wages and salaries	Name:	\$
	Name:	\$
Bonuses and commissions:		
Investment Income	Interest received	
	Dividend received	
	Rents received	
	Sale of investment	
	Other	
Other income		
	(A) TOTAL INCOME \$	
EXPENDITURES		
Housing	Rent/mortgage payment (include insurance, water and council rates)	
	Repairs, maintenance, improvements	
Power	Gas, electricity, water	
	Phone	
	Pay TV and other	
Food	Groceries and eating out	
Cars	Loan payments	
	Registration and insurance	
	Petrol, oil, repairs, tyres, maintenance	
Medical	Health insurance	
	Disability insurance	
	Doctor, dentist, hospital, medicine	
Clothing	Clothes, uniforms, shoes, etc	
Insurance	House	
	Contents	
	Life	
Taxes and charges	Income	
	Bank charges	
Appliances, furniture, and others	Loan payments	
	Purchases and repairs	
Health and hygiene	Laundry, cosmetics, hair care	
Recreation and entertainment	Vacations	
	Other recreation and entertainment	
Other expenditure		
	(B) TOTAL EXPENDITURE \$	
	CASH SURPLUS (or deficit) (A) – (B) \$	

the magic of compounding

Once you have started your savings plan you immediately get the benefit of compounding. Table 3 shows how much per month you would need to put aside to achieve a particular savings goal.

The basic step in any savings plan is to discipline yourself to save a set amount each month.

Your initial step is to build up a short-term fund of money which will help you break out of the no-savings habit you currently have.

Building up a short-term fund with ready access. Whatever your personal circumstances, your first aim will always be to build up a short-term fund. It needs to be absolutely secure and easily accessible. This short-term fund will make you less reliant on borrowing in an emergency.

It will also mean you can save the high cost of borrowing or credit card interest when you make an expensive purchase, like buying a new car or furnishing a new home. Taking a loan or using credit cards may cost up to 20 per cent interest a year, or even more.

No matter how much capital you may eventually build up you will still need to maintain a short-term fund giving ready access to your money.

You'll have four requirements in mind when choosing the most appropriate place to deposit your short-term funds:

1. You'll want your money to be absolutely safe.
2. You'll want to get the highest rate of interest available.
3. You'll want to get your money back quickly without penalty if you need to.
4. You'll want bank charges to be kept to a minimum.

An at-call account with a bank, building society or credit union will give you what you need. But there are so many different accounts these days you need to carefully consider which one gives you the most interest with the least cost.

Bank accounts which offer bonus interest. Several banks are now offering regular savers a bonus if they make regular deposits and no withdrawals during a month.

To take full advantage of accounts which offer bonus interest you need to keep these accounts separate from your day-to-day transaction account. With most of these accounts you can arrange automatic deposits from your salary to another bank account.

Table 3 – Savings Planner

	Months					
Savings target	6	12	18	24	30	36
\$3,000	\$495	\$244	\$161	\$119	\$94	\$77
\$4,000	\$660	\$326	\$214	\$159	\$125	\$103
\$5,000	\$825	\$407	\$268	\$199	\$157	\$129
\$6,000	\$990	\$489	\$322	\$238	\$188	\$155
\$7,000	\$1,155	\$570	\$375	\$278	\$220	\$181
\$8,000	\$1,320	\$652	\$429	\$318	\$251	\$206
\$9,000	\$1,484	\$733	\$483	\$357	\$282	\$232
\$10,000	\$1,649	\$814	\$536	\$397	\$314	\$258

Assumptions:
Calculations are based on an interest rate of 5% paid monthly and exclude any bank fees. The interest rate is for illustrative purposes only. For example, this shows that if you wanted to save \$10,000 in two years (24 months) you would need to save \$397 each month.

How to keep bank fees and charges to a minimum. To ensure that you make the most of your savings it is essential that you pay as little as possible in bank fees. The first step is to find out what fees and charges are levied on your savings account before you open it. Table 4 lists the type of features you need to compare when choosing a bank account.

Table 4 – Comparing bank accounts

	Example	A	B	C
Minimum opening balance	\$2,000			
Cheque option	x			
ATM withdrawals	✓			
Telephone or internet access	✓			
Tiered interest	✓			
Interest calculated	Daily			
Interest credited	Yearly			
Free withdrawals per month	8			
Account keeping fee (if balance is below \$500 at end of any day in each month)	\$			
Other fees				

The way fees are charged — and the level of these charges — varies considerably from bank to bank. But the following points will help you minimise the damage bank fees will have on your savings:

Unless you are careful a substantial portion of your savings can be eaten up in banks fees and charges.

the magic of compounding

Most accounts levy high fees when your monthly balance falls below a certain level — usually \$500. So make sure your account is always above this level.

Instead of having several accounts with small balances in them it may be easier to maintain a minimum monthly balance above \$500 if you combine several accounts into one.

Many financial institutions charge higher fees if you do not use their own Automatic Teller Machines (ATMs).

Stay within the fee-free withdrawal limits.

Plan your banking – try to withdraw fewer times in slightly higher amounts, rather than making a lot of withdrawals for small amounts.

Don't give your bank free use of your money

Find a bank cheque account which pays interest. Many banks pay interest on cheque accounts although in some cases the rate is low. So check whether you are getting interest and, if not, move your account.

How much to invest in a short-term fund. How much you can invest will partly depend on how much you can afford. Certainly \$100.00 per month will build up into a useful investable sum in a relatively short period of time, some savers put away \$200 per month or more.

How big the short-term fund with easy access should become again depends on your circumstances. Don't worry if your fund grows to \$2,500 or even higher, although at this level you will probably find it worthwhile switching to a different account which pays a higher rate of interest.

You don't usually get a high rate of interest until you have at least \$1,000 to invest. Also, many banks charge hefty monthly fees if your account balance falls below a certain level.

The most convenient accounts are those which allow you to write cheques to either pay bills or withdraw money. But make sure you are not paying too much for this convenience.

You should not concern yourself unduly at this stage with the return from your short-term fund. It will in any case be partially reduced by tax on the interest and by inflation eating into the value of the capital. Remember this is your emergency fund from which you can obtain money fast when you need it.

Other types of savings accounts

Once you have accumulated around \$2,000 in your “ordinary” savings account you can then consider switching some of it into either a savings investment account or a fixed-term deposit.

Investment savings accounts. Investment savings accounts generally require a minimum \$1,000 deposit and have a tiered interest rate structure. The higher the balance in your account the higher the interest rate you earn. Make sure that this higher interest rate is paid on your entire balance, not just on the extra amount you have deposited. The major advantage of savings investment accounts is that your money is still “at call” — but again be aware of bank charges that apply if you make a lot of withdrawals.

Fixed-term deposits. The range and flexibility of fixed-term deposits have increased significantly over the past few years. It used to be that you had to lock your money away for one, two or three years to get the benefit of higher interest rates. This was fine if interest rates fell. But if interest rates rose you would not get the benefit of these higher rates.

the magic of compounding

These days many banks offer fixed-term deposits which allow you to withdraw some of your money before the term expires or “trade up” to a higher rate of interest.

Before you invest in a term deposit shop around for one that offers flexibility to either withdraw some of your money early, or allows you to switch to a higher rate of interest. As with all financial products, make sure you understand all the conditions applying to these accounts.

Savings and borrowings

Savings and borrowings are the reverse of each other. The more savings you have turned into capital, the less you need to borrow.

Generally, the interest you pay on money you borrow is a great deal more than the interest you receive on money you have saved. What’s more, you have top tax on interest you receive — unless you don’t earn enough money to pay tax. The interest you pay on borrowings to buy everyday items is not tax-deductible.

So using savings top off your credit card, rather than increasing your borrowing, is often tax-efficient as well.



reducing your credit card balance

Having worked out how much you can initially afford to save each month into your short-term fund with ready access, consider a moment before you go out and open an account.



Do you have a credit card? If so do you pay off the balance in full at the end of each month? If you don't, first use that \$50 a month to reduce the outstanding balance on your credit cards. That way you will immediately be saving yourself interest of around 20 per cent a year. In contrast, if you put this \$50 into a bank account you are only getting around three per cent interest, and then you have to pay tax on this interest income.

If you have more than one credit card, pay off the ones which charge higher interest first. These are usually credit cards linked to a particular store, or offering an interest-free period if you pay off the entire amount owing each month.

It is a very good habit to learn to live on one credit card with a limit of \$5,000. Remember it is the thinking of saving rather than spending that will make you richer.

Only when you are in a position to pay off your credit cards in full each month are you ready to start undertaking regular savings.

don't forget tax savings

With all investment decisions, you need to consider how much tax you will be paying. Investments for building capital out of income are no exception. Remember it is not how much investment income you earn that's important — it's how much you keep after tax.

Make the most of your tax-free threshold. If you have a job you are unlikely to be a non-taxpayer. You can only be a non-taxpayer if you have a low income which is below the tax-free threshold.

Tax is your largest investment expense

A basic knowledge of how the tax system works will help you save thousands of dollars in tax over your lifetime. It's not how much your investments pay you that's important - it's how much you actually keep. Tax planning is an essential part of any long-term investment plan.

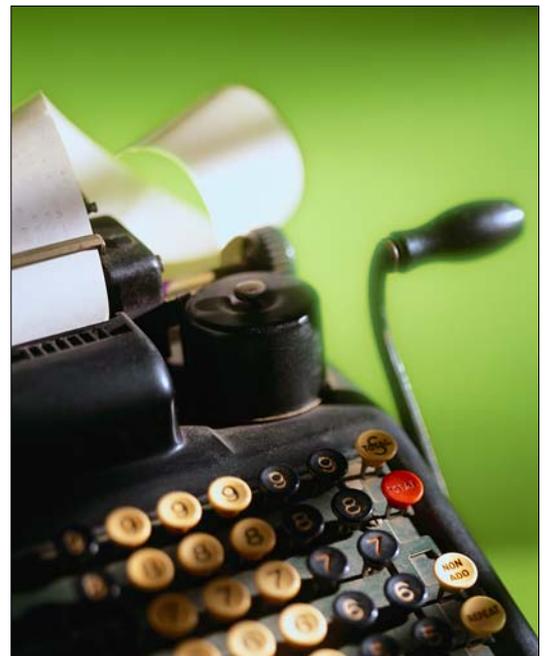
Everyone has their own tax-free threshold — and any income below this level is exempt from tax. You may make use of these tax-free zones to help build capital out of income much more safely and efficiently, especially if you are paying tax at a high marginal rate.

Independent taxation. A spouse's income, whether from investments or earnings, counts as their own. Suppose your spouse has young children and no earnings. If, as an example, interest rates were at 10 per cent and you had \$34,000 to invest, you could put it in a building society account in your spouse's name only. All the income received — \$3,400 a year — would not be taxable.

Children's taxation. Just as your spouse may be a non-taxpayer, so may your children. What's more, their personal tax allowance starts when they are born.

Children over the age of 18 at 30 June of a financial year are considered adults and are taxed according to the prevailing income tax scales.

If you divert income to these children, the same tax advantages apply as if you had split this income with your spouse. Make sure you obtain qualified advice in this area.



investing in your mortgage

As has already been explained, borrowing is the reverse of saving. In terms of investments, it is only worthwhile if the value of what you invest in gives a greater after-tax return than the net interest rate you are paying on the loan.

A mortgage to buy your own home is an exception to this rule because there are good reasons for buying, rather than renting, a home other than just monetary ones — such as security of tenure, better quality of accommodation, more control over your own environment.

Buying your home is regarded as one of the best investments you could make. There are four main reasons:

House price rises have consistently exceeded rises in the cost of living. This does not mean that house prices cannot fall. But over a five to 10 year period you are likely to receive a substantial capital profit on your house.

Inflation actually helps pay off your loan. For example, if you borrow at 10 per cent and inflation is three per cent, the “real” interest rate you are borrowing at is seven per cent.

Mortgage interest rates are generally lower than for other forms of borrowing, such as personal loans and credit cards.

If you make a capital gain when selling your house this gain is completely free of Capital Gains Tax.

Variable mortgages

If you are thinking about a variable-rate mortgage ask your lender to calculate how much you would pay per month if interest rates rose by three percentage points — eg from nine per cent to 12 per cent. If your finances are tight you must know if you can afford higher mortgage payments.

The early 1990s saw an unprecedented collapse of confidence in the residential property market. Prices fell sharply in many areas and, unlike previous post-war experience, there was no sharp rebound in prices.

The mistake that many people made in the late 1980s was that they thought house prices were going to rise forever. They also overcommitted on their borrowings. This meant that when home loan interest rates rose from 13 per cent to 17 and 18 per cent many people could not afford their loan repayments and were forced to sell — often at a significant loss. As with any other investment, it is wise to have a “margin of safety” when borrowing to buy your home.

investing in your mortgage

Not only can you have a mortgage for 20 years or more, you do not really know how much interest you will pay over this period. These days you can save thousands of dollars by managing your mortgage — rather than simply being content to pay it off every month.

Investing in property has its risks

Although your home is exempt from Capital Gains Tax this does not mean that you cannot lose money when investing in your own home. Buying a house for an unrealistically high price during a property boom has proved to be disastrous for many people.

The upfront and ongoing costs. When comparing mortgages from different lenders you need to take into account both the interest rates and other fees and charges. Remember that upfront fees are exactly that – you must pay them when you take out your loan rather than paying them off over the term of the loan.



finding the best way to repay a mortgage

There is nothing mysterious about cutting the costs of your mortgage. The first step is to ask your home lender to print out a repayment schedule which shows the amount of principal and interest you pay off your loan each year. You'll notice from this that you pay mostly interest in the first 10 years of a 20-year loan. It is only in the last five or six years that you actually start repaying a large amount of principal. Assuming your loan does not have any special early repayment penalties, you can slash the interest costs of your home loan by making extra payments in the first five years.

Because of all the tax changes and new products introduced by banks and other home lenders, much of the traditional advice on the best way to repay a mortgage is now incorrect.

Advice on accelerated repayments on a mortgage only applies if you don't have other forms of borrowing, such as credit cards. If you do, then these other borrowings are almost certainly at higher interest rates than you will be charged on a mortgage. Repay these before you tackle your mortgage.

Home loan costs	Lender A	Lender B	Lender C
Application fee	_____	_____	_____
Valuation fee	_____	_____	_____
Conveyancing	_____	_____	_____
Mortgage insurance	_____	_____	_____
Mortgage insurance application fee	_____	_____	_____
Title search fee	_____	_____	_____
Stamp duty	_____	_____	_____
Settlement or closing fee	_____	_____	_____
Lender's inspection fee	_____	_____	_____
Other	_____	_____	_____

Comparing mortgages	Lender A	Lender B	Lender C
Loan criteria			
Mortgage (\$)	_____	_____	_____
Term of loan (years)	_____	_____	_____
Rate (fixed or adjustable)	_____	_____	_____
Rate %	_____	_____	_____
Fees	_____	_____	_____
Monthly payments (\$)	_____	_____	_____
Total cost of loan (\$)			
(principal, interest, closing costs)			
5 years	_____	_____	_____
10 years	_____	_____	_____
15 years	_____	_____	_____
20 years	_____	_____	_____
30 years	_____	_____	_____

choosing the home loan that is right for you

Before signing up for a home loan it is wise to not only shop around for the one with the lowest costs and interest rate, but also to consider the various options available which can make home loans an even more tax-effective investment.

Managing your mortgage can save you thousands over the life of the loan.

Most home loans fall into one of the following main categories:

Introductory loans: This is where you are offered a special low interest rate for the first 12 months. Thereafter your interest rate reverts to the lender's standard interest rate — which is normally at least two percentage points higher.

Don't be fooled by a "honeymoon" interest rate

If you take out a home loan with an "introductory" or "honeymoon" interest rate for the first 12 months, it is wise to make repayments as if you are on the higher, second-year interest rate. In this way you will be able to judge whether you can really afford the repayments.

Standard variable home loan: The interest rate varies over the term of the loan. These loans usually have other features such as mortgage offset accounts, overdraft facilities, redraw facilities and the ability to borrow to finance other items, such as renovations, by adding to your home loan. You can usually consolidate other debts — such as personal loans and credit cards — into your home loan to take advantage of the lower interest rate. In some cases your home loan essentially becomes a bank account as you can have your salary paid into it. Usually you can switch out of this type of loan without any bank penalty charges.

Basic home loan: This is like a standard variable-rate home loan but with all the additional features missing. Often referred to as "no-frills" loans. In return you get a lower interest rate. Check to see whether you can make extra repayments. Penalties usually apply if you want to switch to another type of loan in the first three years.

Fixed-rate loans: These loans fix the interest rate for a set period — up to five years. By doing this you know exactly what your home loan will cost you. But you do not get the benefit of a decrease in home loan interest rates. Normally you cannot make extra repayments with fixed-rate loans. Penalties are high if you want to get out of fixed-rate loans. Most lenders now allow you to split your loan into part fixed and part variable.

choosing the home loan that is right for you

Home equity checklist

Loan criteria	Lender A	Lender B	Lender C
How large a credit line will you extend to me?	_____	_____	_____
How long can I take to repay this loan?	_____	_____	_____
What are the minimum and maximum withdrawals I can make?	_____	_____	_____
Do I access this loan with cheques or credit cards?	_____	_____	_____
Does this loan have a fixed interest rate?	_____	_____	_____
- if so, what is it?	_____	_____	_____
- what is the annual percentage rate?	_____	_____	_____
Does this loan have a variable interest rate?	_____	_____	_____
- if so, what is it?	_____	_____	_____
- what is the annual percentage rate?	_____	_____	_____
- is this loan convertible to a fixed interest rate?	_____	_____	_____
Are there any continuing costs?	_____	_____	_____
- any annual fees?	_____	_____	_____

Refinancing your home loan

Term of the old loan	_____
Term of the new loan	_____
Existing mortgage payment	\$ _____
New mortgage payment	\$ _____
Payment savings	\$ _____
(Old payment minus new payment)	\$ _____
Total upfront cost to refinance	\$ _____
Months to break even	_____
(Total cost divided by payment savings)	\$ _____

choosing the home loan that is right for you



The pitfalls of borrowing against your house. Borrowing by using your house as security has the benefits of a lower interest rate than other loans and the convenience of only having one repayment to make each month. But there are some drawbacks. Firstly, if you cannot repay your debt you could lose your home. Secondly, although the interest rate you pay is lower, if the time you take to pay off the debt is longer you could end up paying more interest.

Be careful not to convert short-term debt into long-term debt by using your home loan. You could end up paying much more interest.

refinancing your home loan

According to recent figures, about 20 per cent of home loan business comes from dis-satisfied customers switching their mortgage to a more competitive financial institution, or switching from a variable-rate to a fixed-rate mortgage with their current lender.

Part of this switching phenomenon has been the emergence of cheap non-bank home lenders such as Aussie Home Loans. It also reflects increased consumer awareness that you can save thousands of dollars in interest over the life of your home loan if you can reduce the interest rate you are paying by one or two percentage points.

But there are substantial costs involved if you want to switch your mortgage. Generally there are two rules to help you determine whether it's worthwhile to refinance your home loan:

1. Your new interest rate should be around two percentage points lower than the rate you are currently paying.
2. You should be able to recoup the changeover costs of refinancing in two, or no more than three, years.

Most variable-rate home loans charge an exit fee of one month's interest. Fixed-rate loans have exit fees of up to three months' interest. Also, the interest charges are often based on the original amount borrowed, not the amount currently outstanding on the loan. You may also have to pay stamp duty.

Then there's the cost of taking out the new loan. You could be up for application fees of between \$500 and \$1,000, as well as stamp duty, mortgage insurance, survey costs and building reports. It's not unusual for the total cost of refinancing to add up to \$3,000.

Finally, you need to be confident that the new lender will maintain a lower interest rate than your existing lender over the life of the loan.

Apart from taxation, paying off your home loan is usually your largest expense. So anything you do to reduce the overall cost of your home loan can save you thousands of dollars. This money can then form the basis of your wealth-creating investment plan. Just as it is unwise to buy shares and forget about them, you need to manage your mortgage to make sure you are not paying any more interest than is absolutely necessary.

The technique of regular investing

The technique of regular investing has three main advantages:

It helps you to remain calm when markets are unsteady.

You automatically become a contrarian investor. When prices are low you buy more. You don't panic and sell up if there's a crash. You carry on buying.

You don't have to cope with deciding whether the sharemarket has reached its lowest point. No one can be sure of doing that.

dollar cost averaging

Now let's look at dollar cost averaging, a way of buying shares that yields profits over time even when markets are falling. It is an especially effective way of making money following bear markets, when prices begin to move up again.

It does, however, demand patience and — at times — an iron nerve. As you will see, you will be buying shares even when the price is falling.

Thanks to the working of the laws of averages you will still profit, but you may have to forego the use of the money for some time. It is thus suitable only when you are free of the “constraint” of time.

Elementary maths also works against holding dropping shares because you will need a gain greater than the loss to bring you back to where you started. If a share drops 20 per cent it will have to gain 25 per cent for you to break even.

Cut your losses as early as you can. Averaging down is a self-delusion.

In contrast, cost averaging exploits a mathematical principle that enables you to buy, over time, shares at an average price of the share.

It is most suitable for use with the shares of fundamentally sound blue-chip companies that have history of fluctuating within a certain range.

Cost averaging can be especially effective because:

- It forces you to stick to a re plan by committing funds at intervals. So it combines a forced savings plan with investing.

- It keeps you investing during bad times as well as good. Whether the market is going up or down you still benefit equally.

Suppose you have \$100 a month to invest. In one given year the share you have chosen ranges from a low of \$1.30 in March to a high of \$2.15 in July.

By investing the same amount every month — in this case your \$100 — you buy more shares when the price is low and fewer when the price is high. This is what you would have bought — note how the average price you paid is less than the average price of the share.

dollar cost averaging

Month bought	Price per share (c)	Number of shares
JAN	180	55.55
FEB	140	71.43
MARCH	130	76.92
APRIL	160	62.50
MAY	170	58.82
JUNE	180	55.55
JULY	215	46.51
AUGUST	210	47.62
SEPT	205	48.78
OCT	205	48.78
NOV	210	47.62
DEC	190	52.63

Total no. of shares bought	672.71
Average price at which shares bought:	\$1.78
Average price of shares during year	\$1.82

Note that when the price of the shares falls, your \$100 buys more and vice versa when the price rises. The above example is for illustrative purposes only — no stockbroker would allow you to buy shares in \$100 lots or in fractional parcels. By using this simple technique you have entirely removed the factor of emotion from your investing decision-making!

Two further forms of “averaging” are constant ratio averaging and variable ratio averaging.

Constant ratio averaging enables your purchasing program to reflect the balance you choose between aggressive and defensive investments. Suppose you have chosen to balance it perfectly. Half of your investments will be in defensive assets designed to give you secure income while the other half is more aggressively positioned for capital growth.

Both strategies are usually a losing game and invariably the mark of an amateur. If a share is going down, the chances are you are throwing good money after bad. And if it is going up, you are merely reducing your average profit per share by buying more at a higher price. When the price turns down you will lose even more

Variable ratio averaging. If you use variable ratio averaging you also begin by splitting your total portfolio into shares and liquid assets. But if share prices rise by a certain amount, some shares are sold which shifts the ratio. If share prices fall by a particular amount, shares are bought, again changing the ratio.

Avoid less successful strategies

Don't confuse cost averaging with “averaging up” or “averaging down”. These are two investment strategies often used by novice investors. Both involve chasing a share by making more purchases. If it is going down, the rationale is you will cut your losses by creating a lower average. If it is going up, the hope is that more of a good thing will prove even better.

regular savings plans

Now you're ready to choose from the following investments. Some are designed for you to make regular direct payments from your salary or bank account each month.

Unit trust savings plans. The main problem with unit trust savings plans is that the charges are high. Most unit trusts have an initial upfront fee of up to six per cent.

Unit trusts provide a wide choice of investments, such as those investing in individual foreign countries or specific types of shares, such as mining and oil companies. You may feel spoiled for choice and find it difficult to decide which is best. Equity trusts invest mainly in shares, so the lessons that you'll learn on understanding economic trends and the sharemarket will help you to decide which unit trust might be the right one for you.

Not all unit trusts have regular savings plans. One fund manager which does have this facility is First State. The way this manager's system works is that after making an initial investment of at least \$1,000, you can have regular monthly contributions of \$100 or more deducted directly from your bank account.

Before entering into a unit trust regular savings plan make sure you understand what costs you will be paying, whether you can stop making payments at any time and whether there are any exit fees if you withdraw your money.

Share prices can fall dramatically

All share-based investments are best regarded as a long-term home for your savings. The initial costs are high — particularly if you buy units in a unit trust and the cost of getting out suddenly could be disastrous if it happened to be during a period when the market was depressed

Unit-linked life insurance savings plans. Generally speaking these plan offer worse value for money than unit trust savings plans because they have higher charges. But they do include life cover. Be aware that the value of these plans can rise and fall depending on the investment performance of the units you have invested in. Before making any investment decision it is crucial to find out where your money is being invested and what rate of return you are likely to get.

With-profits savings plans. In theory such plans are subject to the same high costs incurred on unit-linked life insurance, but with-profits contracts also benefit from the profits made by the life insurance company on the unit-linked contracts.

Because this investment is also a life insurance policy, you must be in reasonably good health, and you may be asked to have a medical if your premiums are high.

The other snag is that you are committed to a fixed monthly or yearly amount for at least 10 years and you will lose out heavily if you want to reduce it or stop early. But starting with a small premium and then taking out extra policies is no answer because small premiums incur higher charges.

The proceeds of these policies are tax-free provided the contract was originally for 10 years or more. But the insurance company pays tax on both the income and capital gains on the investments.

The disadvantages of this form of regular saving probably outweigh the advantages.

regular savings plans

Buy term insurance and invest yourself. The main problem with traditional life insurance products such as whole-of-life and endowment policies is that the person who gets the most benefit is often the life insurance agent. Most of these policies have a “forced” savings element. But the reality is that you are paying the insurance company handsomely to force you to save.

A much more sensible approach is to buy term life insurance cover — which costs a fraction of the cost of a whole-of-life policy — and invest the money you save by doing this yourself. Term insurance simply gives you death cover over a specified period - usually 12 months.

The principal benefits of doing this are that you are not paying excessive fees to the insurance company and you have much greater flexibility on the design of your savings plan.

Also, if you want to cash in your policy during the first five years, much of your savings and any investment return will be eaten up in commissions and fees.

Many people who claim they do not have enough money to invest could find their situation was greatly improved if they replaced their high-cost traditional life insurance with term insurance. The money you freed up by doing this could then be invested where it best suited your current needs.

Consider cashing in your traditional life insurance policies. If you are already contributing to traditional life insurance policies it could be worthwhile investigating whether you should cash in these policies and invest your money elsewhere. Depending on how long you have had the policies you might not get back all that you have contributed. But remember the old saying about “throwing good money after bad”. You may be better off cutting your losses and getting a higher return on your money by investing it yourself.

Alternatively, you can borrow money against the surrender value of your life insurance policy. Usually life insurance policies — other than term insurance — have a surrender value after two years. If you use these funds to invest and receive taxable income, you will be able to claim the interest you pay as a tax deduction.

Term insurance is the cheapest way of buying insurance cover.

Cashing in your life insurance policy and using the proceeds to pay a lump sum off your home loan could be a more tax-effective investment. If you do decide to cash in your policy there is now a market for “second hand” life insurance policies where you will generally get a higher payout than you would if you surrender the policy to the life insurance company.

Saving plans to avoid

Life insurance companies also market a range of “savings” plans. The main attraction of these plans is that they force you to save by making re usually monthly, contributions. Sometimes these savings plans have a particular objective in mind — such as your children’s university or high-school education. But once again the drawback of these plans is that they have high fees and charges — frequently it is not obvious what these fees are.

Also it often takes these plans five or six years to break even. So if you withdraw within this period you may get back less than you contributed.

These days there is no reason to have to pay a financial organisation hefty fees to manage your savings plan. You can arrange this yourself by having a direct debit from your salary into a bank or building society account.

how your personal circumstances influence your choice

You'll need to take many factors into account before deciding on which capital-building strategy is right for you.

You'll see how the investment objectives you've already learned affect the decisions you'll need to make at different times.

Here's a quick reminder of some of those objectives which are relevant to building capital from income:

- Safety
- Ease of management
- Liquidity
- After-tax return
- Inflation hedge.

You've also seen the importance of determining your own investment goals.

Over the page are some examples divided into three likely stages in your life:



how your personal circumstances influence your choice

Stage	Overall objectives	Specific possible goals
1. Age about 20-35	<ul style="list-style-type: none"> • Safety of capital • Foundation for the future • Home ownership • Family • Car 	<ul style="list-style-type: none"> • Deposit on a house • Cover for a temporary drop in income (e.g. when starting a family or a new business)
2. Age about 36-50	<ul style="list-style-type: none"> • Building on existing capital for current use and the future • Higher returns from investment (less concerned with risk) 	<ul style="list-style-type: none"> • School fees • Home improvement • Holidays
3. Age about 51 to retirement	<ul style="list-style-type: none"> • Security of capital • Maintain life style • Planning for income 	<ul style="list-style-type: none"> • Retirement • Capital to pass on to heirs.

In addition you'll have to take into account personal factors which are to do with you as an individual.

The stages of your life

Above are three examples of different types of investments depending on the stages of life and a variety of lifestyles and objectives. It may help you to decide from among the various choices available for building up your own capital.

As life goes on you will pass from one stage to another, and your circumstances and goals alter. The time when you change from one stage to another is particularly crucial for investment planning. But it's a gradual process, so it's easy to let time slide by without making a plan. In each example you'll see types of investments which might be suitable. Refer back to the more detailed discussion of each of these earlier in the lesson, to test their suitability for you in the light of what you have read since.

Stage 1. At this stage you might be in your mid-twenties, perhaps married but with no children. If you're married, one of you may have your own small business. Such a business could profitably be operated from home, though perhaps not ready to expand by taking on its own premises and staff.

You may be planning eventually to be in the business together but meanwhile you need the security of at least one regular salary from a large company.

You have virtually no capital, and any savings you had accumulated have been invested in launching the business.

If you're self-employed, your business overdraft is tax-deductible, which reduces its effective cost. It will not be cheap — at least three per cent over bank base rate — but tax relief will cut the true cost. At this stage the only other sensible form of borrowing is the mortgage.

Your main priority may be to build up a safe and readily available cash fund for use in an emergency when you are no longer able to rely on your business overdraft.

how your personal circumstances influence your choice

Stage 2. If you're at this stage in life you may be in your late thirties. You may by now be married and have young children. Perhaps at this stage your first aim is to pay for the children's education, starting five years from now.

Both of you may work full time. One of you may be a higher rate taxpayer. You may both belong to your employers' superannuation schemes. You'll probably have taken out life cover on both your lives.

You may have a unit trust monthly savings plan for capital growth but with a risk of a short-term capital loss — also in the name of the taxpayer on the lowest tax rate, because the accumulating income is liable to income tax.

You'll have to decide how to divide your savings between safe and risky investments — perhaps equally, or put three quarters into the riskier ones.

Your investment plan should reflect your financial situation and attitude to risk.



Stage 3. If you're near retirement, you'll be looking for the best way to maximise your eventual retirement income.

You may be expecting to receive a good superannuation payout and may remain a higher rate taxpayer even after you retire. So both before and after retirement you're looking for tax-efficient investments.

You may already invest almost the maximum you are allowed in a number of tax-efficient methods of building capital out of income.

Review your investment plans regularly

It's essential to review your investment strategy regularly, just as you would for lump-sum investments. Every three to six months may be enough. But some people reassess their investments every month or even every week.

If you are saving regularly into an investment trust or unit trust savings plan, you might want to consider raising your monthly investment when share prices have fallen and reducing it as they rise. Often the sharemarket tends to see a short sharp rise or a short sharp fall — and much of the rest of the time there is little action. So after a sharp rise consider cutting your monthly contribution and after a sharp fall raising it.

This strategy exaggerates the effects of dollar cost averaging, and needs a conscious effort on your part. You will have to devote a little time to it.

how your personal circumstances influence your choice

If you invest a constant amount, you will benefit automatically, if less dramatically, as you saw in the section on dollar cost averaging.

Your action checklist

- Identify how much you can afford to save each month.
- Review your current bank or building society accounts. Do you have too many accounts? Would you pay fewer bank fees and charges if you consolidated your accounts?
- Check first whether you have borrowings which could be reduced before you start saving. In particular review your use of credit cards. Are you paying unnecessary interest?
- How much do you owe on your home mortgage? What interest rate are you paying? Could you afford to pay off your mortgage quicker?
- If you have traditional life insurance policies, consider whether you would be better off to cash them in and invest the money better elsewhere.
- Decide whether you want a safe or a risky investment or a combination.
- Always consider what's likely to happen to inflation and interest rates during the life of your investment. Make sure you are not locked into a fixed-rate investment if you think a steep rise in either is likely.
- Bear in mind how future changes in your tax rate could affect your net after-tax returns.



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What does APIN offer ?

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Why is that most people aren't taught how to be rich or happy? We are trained to do most things in our lives, in order to do them well enough to get by. We are taught how to read and write, how to cook, how to drive. We are taught how to do incredibly complex and challenging tasks like designing and building bridges over wide spaces, how to cure diseases, to fly airplanes, yet when it comes to creating personal wealth and happiness, we're left to find out for ourselves.

There's another, more subtle reason why most people don't achieve wealth and happiness. Deep down they don't believe that there is a choice to be made between being rich and being happy. They believe that somehow you can't have both, which is why in the end they don't get either.

The money that slips through your fingers could make you wealthy if spent more wisely.

Our free seminars and information evenings will provide you with leading edge valuable and up to date information. As a bonus you will be able to meet other like minded people who are either starting out on the road to success or are avid investors sharpening their investment knowledge. As a further advantage we encourage you to meet and freely talk with our alliance

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Education

It's true what they say "the difference between the rich and poor is what they know and what they do". Property is more than houses and unit investing. Do you know how to buy a property using an option, how about knowing all the ins and outs of being your own "DIY Developer"?

There are many ways to make money in real estate and with the correct tools and strategies you too can play with the best.

TIME x INTENSITY = SUCCESS.

You can't expect to get results in life if you have all the information but fail to apply the principles needed to succeed.

Our programs, e-book, books and home study kits will give you the ability to learn and gather what you need at your own pace in your own time. We encourage you to learn from our expert alliance partners all that you can, so when you are ready to act you will have the education to get into your first investment or do your own JV building renovation makeover.





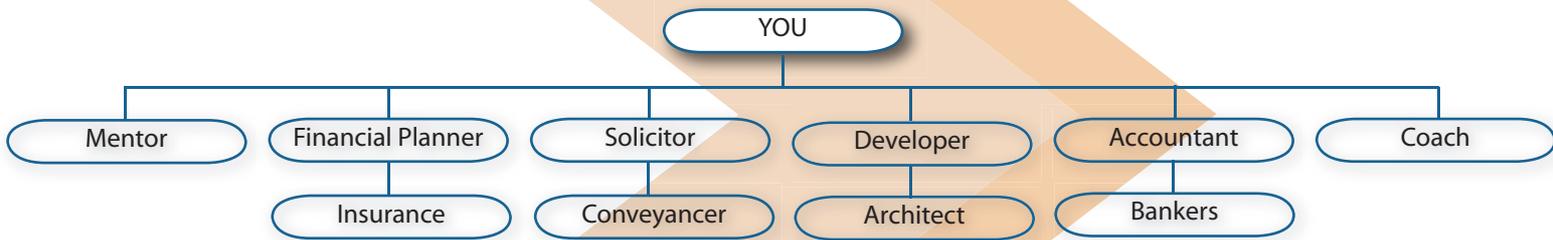
On going Support

Through APIN's Alliance Partners and Discussion Forums you can fortify your ideas and gain strength by exchanging information. Creating alliances generates business opportunities increasing your network and of course - your cashflow.

We have a mentoring service for those that are not quite ready to take those steps without guidance, extra information and some affirmation. Helping you to create a "safe" environment for your first steps.

Who is on your team?

When looking at people who are successful, you will notice they have a hand selected group of people to support and advise throughout the journey to success.



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Through our Australia wide network we select opportunities that "stack up". We use an independent Research company (Guardian) who are licensed financial planners and real estate agents to use our pre selection due diligence program. From investment properties, development sites, future land subdivisions, building makeovers to even golf course resort projects.

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