

Should you be a KiwiSaver?



KiwiSaver is here and we believe all New Zealanders should seriously consider whether taking part is a good idea for them. We can give you all the details (in simple terms), but keep in the back of your mind the following benefits (all of which are subject to certain conditions):

- A \$1,000 kick-start to your savings account from the Government.
- If you are over 18 you will receive a matching contribution of up to \$1,042.86 per year paid directly into your account at the end of June each year.
- You also receive \$40 per year to offset your investment management and administration fees, which are already discounted.
- If saving via PAYE, your employer must contribute into your account (starting at a minimum of 1% in April 2008 and rising to 4% by 2011). Up to 4% of this will be tax free (assuming you match their contributions). Note this is still subject to legislative approval.

- There is a further potential tax saving. The maximum tax you will pay (assuming the scheme you select is a 'portfolio investment entity' or PIE) is 33% in the 2007 tax year and only 30% from 1 April 2008. (It could be 19.5% if that is your marginal tax rate).

- After five years you may withdraw part of your savings to put a deposit on a house.
- You may also be eligible for a first-home subsidy of up to \$5,000 after saving for five years.

It should be remembered the incentives the Government has provided in the 2007 budget, namely the matching contribution and the mandatory employer contribution, are still subject to legislative approval. If these go ahead, they make the scheme extremely attractive as an investment.

For example, if you earn a gross salary of \$45,000 per annum and contribute 4% of this, even with no employer contributions and zero investment returns, your return on capital invested is likely to be at least 116% for the first year¹. In subsequent years the return is around the same level, once the employer contribution kicks in.

According to the excellent KiwiSaver calculator on the Retirement Commissioner's website www.sorted.org.nz, an individual with this level of income who began contributing 4% of their gross salary at age 35 would have over \$220,000 saved by the time they turned 65, and more than \$310,000 if they contributed 8%.²

Some of the people we have talked to about KiwiSaver have told us they are concerned about having their savings locked in, meaning they can't access it when they need it. The good news is that:

- You don't have to have KiwiSaver as your only means of saving (in fact we encourage you to save into another fund or cash account as well, where you can

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*Creating, Managing and
Protecting Your Wealth*



access funds if you need them).

- If you tend to spend all your income, it may not be a bad thing to have some of that income locked away for your retirement!
- Those who are saving towards their first home may be able to get assistance with this (see above).

Another thing to remember is that KiwiSaver is not just for the young. If you are approaching retirement, it could be a great idea to open an account to access the potential benefits outlined above. KiwiSaver is locked in until the age of entitlement for NZ Super (currently 65) or five years, whichever is the later. So if you are over 60 and join, you can access all the benefits (assuming you invest the minimum amount) and receive a

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lump sum including all of your contributions and the Government's, after only five years.

It's also worth considering enrolling your children and grandchildren (i.e. those under 18) in the scheme. This means you would need to have a direct relationship with one of the KiwiSaver providers and contribute at least the minimum amount (for example, this is \$400 per year for ING's scheme). Unfortunately, those under 18 cannot access the Government's matching contributions until they turn 18, but they will get the \$1,000 kick start and it is a great way to encourage young people to begin saving. (Do you remember the old Post Office Savings Bank accounts?).

KiwiSaver is here and it is going to revolutionise savings in this country. It's our view that those who commit now will reap the full benefit of this savings scheme later. Talk to us today about whether KiwiSaver is the right option for you.

¹ Please note that this figure is calculated by working out the closing balance in the first year (including the Government contributions) compared with the dollar amount the employee invested (i.e. 4% of gross salary). It should be remembered that your funds are generally locked in until the age of eligibility for NZ Superannuation, which is currently 65.

² The calculation assumes that: Pay increases at 3.5% per year and contributions increase in line with pay rates. All contributions will grow at 2.5% after tax (33%) and inflation of 2% per year. No contributions holidays are taken.

Is Bridgecorp a warning sign of systemic issues with finance companies?

The fallout from the widely publicised Bridgecorp receivership may result in relatively small finance companies (those mainly exposed to property development, consumer and car finance industries) coming under considerable pressure. However, it needs to be emphasised that there are some very strong finance companies with sound balance sheets, excellent profitability and with investment-grade ratings issued by independent mainstream rating companies. What the Bridgecorp situation will do is re-emphasise that:

- Smaller finance companies with poorly diversified loan books should be avoided, especially when the economic conditions weaken as hinted by many economists. There will be a 'flight to quality' in terms of the fixed interest investments.
- We need more independent mainstream high-quality researchers, such as S&P, rating non-bank finance companies (NBFCs).
- The NBFCs need to provide more regular and higher-quality financial information, and auditors and trustees need to look at the role they play in terms of checks and balances.
- The Government is working on regulating financial product providers such as the NBFCs. As a result, the Government has already signalled it is considering compulsory credit ratings. This will be a positive development for investors and the industry.

Please call us if you have any questions or concerns regarding your own portfolio.

How to protect yourself in the property market (part two)

In our last newsletter, we began providing you with tips to help you manage the risks associated with investment in the property market. It is important – particularly now, with several commentators saying that the residential housing sector is overvalued – that you carefully manage the risks of investment in this sector. Here are some more helpful tips to assist you with this:



1. Don't over-leverage yourself. Although banks are increasingly keen to lend up to 100% of the value of a property as a loan for an investment property, you are far better to save a deposit of 20% or higher and use that.

2. Regularly inspect your property to ensure it has been adequately maintained.
3. If possible, ensure the tenants of your property sign a lease agreement.
4. Find quality tenants and keep them happy.
5. Be smart about the conditions on your sale and purchase agreement. The main ones are finance, a LIM report, a building inspection, a valuation and the requirement to find a tenant if unoccupied.
6. Keep in mind there are several types of property investment other than residential. These include commercial, industrial and retail properties (which typically provide longer leases and higher yields).
7. Consider investing in listed property trusts, which can provide a strong dividend yield, new tax advantages, strong diversification, and mean that professionals take care of all the hassle for you.
8. Get quality tax advice over the most appropriate means of owning your property investments.

9. Wherever possible, buy in quality areas or those where your research indicates a strong possibility of capital gains in the future.
10. Find out about the potential impact of proposed zoning changes, council work in the area, access to schools and amenities, etc. Ask yourself what will change in the next 5, 10, and 15 years?.
11. Avoid flashy property seminars and 'get rich quick' schemes.
12. Ask yourself 'what do I see in this property that others may have missed?'

Above all, if you have any doubts or questions, don't be afraid to give us a call. We are here to help you.

life's tip #1:

When choosing between two evils, I always like to try the one I've never tried before – Mae West.

Why a revolving credit loan can put trustees into a spin

If you have a trust that owns a property with a revolving credit mortgage or loan facility – beware, as you may be creating a gift duty liability without even realising it.

Splitting mortgages between a fixed rate mortgage and a revolving credit facility has become an increasingly popular trend over recent years. These facilities work by allowing customers to deposit money as it is received and withdraw it as required (providing flexibility for those who are disciplined with their spending).

However, you need to be aware that every deposit made to a revolving credit facility operated within a trust can be assessed as a gift (unless it is documented otherwise). Gift duty becomes payable when total gifts from an individual exceed \$27,000 per year. For those already involved in gifting their existing assets to the trust at this rate, care needs to be taken as it's likely that any deposit into the facility will mean the \$27,000 threshold is exceeded (resulting in there being a gift duty liability to pay).

For example, Don and Helen are both on salaries of \$60,000 per annum. They are currently gifting their property to a trust at \$22,000 each per year, and depositing their net salaries into the trust's revolving credit facility. If they do nothing about their salary technically being regarded as a 'gift', their combined gift duty liability could be as high as \$11,865 and the liability will accrue harsh penalty interest until paid. This figure is calculated by working out how much Don and Helen had each 'gifted' over and above the \$27,000 they were each already gifting to the trust (according to a formula from Inland Revenue).

According to trust expert, Mark Maxwell from Integrity Trust, in addition to the gift duty risks raised, trustees may also find they are providing exactly the type of evidence someone needs to challenge the trust.

Paying a salary into a trust's revolving-credit facility is not the best way to structure financing. Structuring borrowings to have part of the facility outside the trust is more robust, but regardless of what structure is chosen, documentation will be required. This involves formal trustee resolutions and Deeds of Acknowledgement and Forgiveness of Debt. If this situation affects you, we strongly recommend getting specialist advice from an experienced trust management professional.

Strange but true!

1. Men are six times more likely to be struck by lightning than women.
2. A person uses approximately 57 pieces of toilet paper every day.
3. Like fingerprints, everyone's tongue print is different.
4. More Monopoly money is printed in a year than real money is printed throughout the world.
5. Recycling one glass jar saves enough energy to watch TV for three hours.
6. A sneeze travels out of your mouth at over 100 miles per hour.
7. Fingernails grow nearly four times faster than toenails.
8. Every time you lick a stamp you're consuming 1/10 of a calorie.
9. The Mona Lisa has no eyebrows.



life's tip #2:

*You make a living by
what you get.
You make a life
by what you give
– Winston Churchill.*

Why trauma insurance could be critical for you

Have you or someone you care about ever been diagnosed with a life-threatening disease or illness? It is undoubtedly one of the hardest things a person can face in their lives. Then after the shock of the diagnosis, there is the harsh financial reality of treatment plans, medical bills and the likelihood of a loss of income.

One increasingly popular solution is trauma or critical care insurance. Essentially, trauma insurance pays a lump sum to you upon diagnosis of a critical illness. It is important to note that all insurers will have a different definition as to what diseases are included and it's crucial you understand what is covered and what is not in the insurer's policy document.

The one thing that trauma insurance does provide is choice. If you have a lump sum available to you, you can make your own choices about which of your expenses has first priority. When you have the financial resources, it's your call.

A few examples of conditions that may be covered include heart attack, paraplegia, invasive cancer, multiple sclerosis, Parkinson's disease or a stroke.

Your premium is based on criteria such as your age, gender, and the amount of cover you choose. If you're a non-smoker you'll also pay less.

So why is it important? We know the chances of suffering a critical illness are higher than you would expect and people are living longer following diagnosis. The following statistics highlight this:

- Over 50% of people with cancer will be long-term survivors.³
- Each year there are approximately 7,600 strokes in New Zealand. In 1950 the survival rate from a stroke was 11%, but by 1998 this was 66%.⁴
- For a 35 year old, there is a 20% chance of suffering a critical illness before reaching age 65.⁵
- 1 in 7 males and 1 in 6 females will be diagnosed with cancer between the ages of 30 and 64.⁶

If you want to discuss whether this option is appropriate for you, please call us.

³ New Zealand Cancer Society
⁴ Stroke Foundation of New Zealand
⁵ Davies Financial and Actuarial (Information as at 2003)
⁶ Davies Financial and Actuarial (Information as at 2003)

summing
up

- If you have a trust which has a revolving credit mortgage, be careful with your gifting
- Trauma insurance can take care of the financial stress if you suffer the misfortune of being diagnosed with a critical illness

Thank God for insurance

This newsletter already mentions the importance of trauma insurance. After I received my payout for a trauma claim in February this year, I invested the money. I was fortunate I was able to continue to work while I was undergoing chemotherapy, but six months after diagnosis we noticed the financial impact of my cancer on our business.

I wasn't able to do as much as I could before. Sometimes I would say to people on the phone "I'm sorry, I can't see you that day as I'll be sick". Chemotherapy is about planning when you will be sick. After six months the trauma payout was useful because there has been an inevitable drop in our business income. I'm grateful to have had the cover.

Can you have level premium insurance?

From my experience you have a higher likelihood of having a trauma claim from age 50. Premiums increase significantly. We recommend you talk with us about converting your premiums into 'level premium'. This is where your insurance remains the same price right up to age 65. Yes, it does cost more, but if you look at the graph showing how insurance premiums increase from age 50 (and if you do not elect to go with level premiums), you will be delighted that I suggested you move over to level premiums. Please call us on 04 471 0662 for a quote for level premium trauma cover.

What about medical insurance?

Last December I had a mastectomy. Southern Cross paid for this surgery with one of Wellington's top breast surgeons. I could have had a registrar in a public hospital perform this surgery but I appreciated being able to choose to have one of the best and most experienced surgeons perform this operation.

When you have a large grade 3 lesion (as I did) it is inevitable that chemotherapy will be recommended. Surgeons will not recommend breast reconstruction at the time of a mastectomy for these sorts of cases. If you do not have a breast reconstruction at the time of a mastectomy the Government will not pay for you to have a reconstruction at a later date. Tough! If you get the wrong ailment in our public health system you miss out, unless you pay for private surgery.



My estimate for my breast reconstruction arrived from the plastic surgeon this morning. There will be two operations in November. These will total an estimated \$28,660. Three months later I will need two more operations which will inevitably cost a further \$10,000.

What a huge cost it is when you get a breast cancer diagnosis. The emotional cost is heavy because our first reaction was that I had been given a death sentence. We became aware of the financial cost several months later.

When you are diagnosed with a life threatening disease the last thing you want to think about is how you are going to cope financially. The original operation cost just under \$10,000. All up the medical costs for my cancer surgery will total around \$48,000. This would put a dent in anyone's retirement plans. But luckily, my medical insurance is covering all these costs.

If I had needed to take the drug Herceptin, as 25% of women diagnosed with breast cancer do, I would have been up for a minimum of \$100,000 to pay for this drug. My trauma insurance could have covered this cost. Alternatively, if I had been insured with ING Life I would have been covered with this under health insurance.

Imagine if I had no insurance and needed to take Herceptin, my retirement account would have been decimated by \$150,000 or more. I would have been kicking myself for having chosen not to have the appropriate insurance in place.

If you would like to review your insurance programme, please telephone us to arrange an appointment on 04 471 0662.

life's tip #3:

*We choose our joys and sorrows
long before we experience them
– Kahlil Gibran.*

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