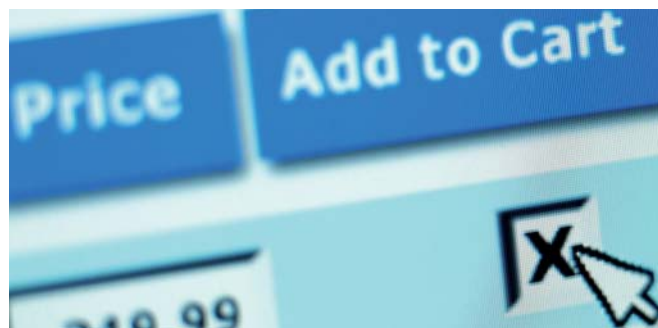


# Spending Money to Make Money



Many Australians delay taking control of their finances because they don't have the time, they find it too daunting or they may just not know where to start. The reality is though the sooner you take charge the sooner you can start working towards achieving better results, especially in the long term.

To assist you in this process CPA Australia has developed *30 Ways to Build Your Wealth* - a series of five fact sheets to get you on the path to good money management. This fact sheet provides helpful tips on spending money to make money. The other fact sheets cover creating good money habits; being tax savvy; becoming financially literate; and maximising your entitlements - all of which can be downloaded at [www.cpaaustralia.com.au/links?30wayskit](http://www.cpaaustralia.com.au/links?30wayskit)

While the information highlights some factors to consider and how these may impact your finances, it does not replace the need for ongoing financial planning advice that is tailored to your specific needs.

## 1. Insurance – do you need it, how much, where from?

*Risk is something that we all face; the question is whether you are prepared to take on that risk yourself or would rather take out insurance and pass that worry on to someone else.*

We face financial and non-financial risks everyday, but many do not even give it a second thought. Sure, the chances of your house burning down may be slim – but what if it happened, how would it impact you?

The first thing you need to think about is what risks you may face. This will include thinking about the obvious, such as your home, contents and car. But what about you and your family? For example if you had an accident and you are the sole income earner for your family, could your family cope without your income? With each risk, you need to consider the financial impact if that occurs, together with the likelihood of the event occurring.

Secondly, you need to consider how you want to deal with that risk. Your two main options are to bear the risk yourself, or transfer it to someone else, such as an insurance company. If an event is likely to happen (e.g. a car accident) or will have a significant impact even if the chances of it happening are remote (e.g. house burning down), then you probably need to consider insurance.

There are two types of insurance; general and personal. General insurance covers your assets and includes home, contents, car, boat and more. Personal insurance covers you as an individual and includes life insurance, total and permanent (TPD) disability insurance, income protection insurance, trauma insurance and health insurance.

The last thing to consider is how much cover you need. The aim of insurance is to ensure that you are in the same financial position after an event as you were before. When considering general insurance this should cover the cost to replace the asset, not necessarily its current value. For example if your home is currently worth \$400,000 in the market place, with the land valued at \$200,000 but to rebuild will cost \$250,000, you should insure your home for \$250,000 – as this is what it will cost to replace your home. When considering personal insurance you should take into account factors such as your mortgage, ongoing expenses and future expenses such as the children's education.

There are many insurers now in the marketplace, so shop around. Also web sites like [www.insurancewatch.com.au](http://www.insurancewatch.com.au) can provide more information. By combining policies, you may also be able to receive a discount on the premiums, for example home and contents or life insurance and TPD. Check your options with your insurance company.

Remember to review your insurances on a regular basis as costs and values increase due to factors such as inflation. If you want professional advice about your insurance needs and strategies to protect you against these risks, then a qualified financial adviser will be able to help.

## 2. Gearing

*Where a property or investment portfolio has borrowings, it is considered to be geared. The borrowings will magnify any capital losses as well as capital gains. This means that you may risk not getting high returns, and you could lose the amount you borrowed, but still have to repay the borrowings. Gearing is complex and should only be considered after seeking professional advice.*

Gearing essentially means borrowing to invest – not necessarily in property. You can borrow to invest in shares, managed funds or other investment options as well.

Positive gearing is where the return on the investment covers the cost of borrowing the funds to invest, such as loan repayments. Negative gearing is where the costs of borrowing the funds to invest are more than the return you are receiving on the investment. That is, it is costing you more to borrow for the investment than you are making in return.

While losses can be claimed on tax, it is important to realise negative gearing means you are spending more money on the investment than you are receiving, so you're making a loss on your investment. The only way to recoup this loss is through capital growth on the investment if the underlying value of the investment increases over time. However, the value of this growth is only received when you finally sell the asset.

Before considering gearing as a possible strategy, it is important that you realise the risks involved. Gearing not only magnifies any gains, it also magnifies the losses. So unless you are comfortable with these risks, you should not pursue this option. You should seek professional advice before considering this as an investment strategy, from someone who can not only explain the risks, but also provide input into interest rate management, debt structuring and insurance cover that may be needed.

### 3. Keeping fit and healthy

*By spending a little in the shorter term on keeping fit and healthy, you could save thousands in medical expenses in the longer term.*

Keeping fit costs money; be it a new pair of runners, gym membership or a personal trainer. But the money and effort you invest in keeping yourself fit and healthy could save you thousands in the long term. Even with private health cover, serious illnesses and poor health can become extremely expensive with ongoing doctors bills and medicines.

Establishing good habits early will hopefully see you reap the rewards down the track, both physically and financially. And if you're a member of a health fund, you may be able to claim back some of the expenses you incur along the way in keeping fit and healthy.

### 4. Use credit cards to your advantage

*Plastic money can be incredibly convenient as a way of purchasing while benefiting from frequent flyer schemes and interest-free periods. However, if you don't pay the card off in full every month, it is an incredibly expensive way of taking out a loan.*

The key to using credit cards to your advantage is being able to repay the balance in full every month. That means you get maximum use of your funds, for example, in reducing mortgage repayments if the card is linked to a home loan. However, if you go past any interest-free days, the interest may be charged from the end of the statement period, or even the date of purchase rather than from the end of the interest-free zone. If you're two days late, you may be paying up to a month's interest! You may want to use a direct debit from your bank account so it is paid off automatically with no risk of forgetting.

Check what the interest free days are and the ongoing interest rate. What is the annual fee? Do you pay extra for rewards? Will you use those rewards? Are they worth more than the fee? Is there a late payment fee? You can compare card features at [www.infochoice.com.au](http://www.infochoice.com.au). Make sure you have a credit card that is right for you so that the plastic is a slave to you rather than you being a slave to the provider.

If you find you are not disciplined in paying off the balance in time, an alternative is a 'debit card' which draws the balance from your savings. And before making big purchases, find out whether you can get a better discount for cash; this may be more beneficial than any rewards attached to your credit card.

### 5. Get good advice

*It's worth paying to get good financial advice to make sure you're on the right track and up to date with all the latest rules and regulations.*

A good adviser will explore where you are now financially, where you want to get to and your options to get there. They will help you plan for the ups and downs in life as well as helping you to organise your funds to pay your debts, grow your wealth and achieve your goals.

Check that you have a qualified financial adviser who is tailoring advice to your needs – not someone interested only in selling an investment product. Don't just listen to the latest great deal from someone who tells you they have 'made a killing'. If it sounds too good to be true, it probably is!

An adviser may find ways to reorganise your finances immediately to help your finances but a big part of planning is less about enormous changes and products, and more about taking small steps that lead to the goal.

Like any service, there is a cost for good advice; whether it is paid for in fees or in commissions. Make sure you know what it will cost you before you commit and be wary of the quality of the advice if it is linked to the sale of a product. You should pay for good advice, regardless of whether you decide to act on that advice and make an investment or not.

### 6. Renting versus buying

*While it's possible to calculate whether renting or buying will be best for you based on current conditions, most people dream of owning their own home, making it a decision driven by emotional rather than financial reasons.*

Buying your own home is one of the biggest financial decisions that many people will make in their lifetime. Don't try to make the decision based purely on what will provide the best financial outcome. There are many important motivations for buying a home, such as achieving a dream or a sense of personal security that should be taken into account when deciding whether to rent or buy.

The annual cost of owning a home is normally much more than the cost of rent; there are mortgage repayments, rates and ongoing repairs. However, you hopefully have the benefit of a tax-free capital gain on your asset, provided there have been positive gains in the market between the times you buy and sell.

Another important factor to take into account is the cost of buying and selling, which can run into the tens of thousands with stamp duty, real estate agents fees, removalists etc.

**To locate a CPA Financial Planning Specialist who can assist you with your financial planning needs, visit <http://www.cpaaustralia.com.au/links?findafp>**

*Note: Information is current as at 1 May 2006.*

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