CASE STUDY

Single mum's challenge

Three teenagers make trying to save tough, writes Susan Hely

NAME: Kayley Harris
STATUS: Single mother with three teenagers
QUESTIONS: Am I overinsured? How can I reduce my mortgage? Any savings go on bills – what can I do about this so I can afford to replace my old car and pay for overseas school excursions for my kids? What is the best way to support my kids?

Kayley Harris is a single mum who lives with her three teenagers and elderly mother. She has a substantial mortgage and wisely has taken out insurance to cover her home, health and, in the event of a serious accident, life and disability. Her mother has funeral insurance too. All up, Kayley spends $820 a month ($9840pa) on insurance. This is a big outlay and she wonders if she is overinsured.

To ensure she pays her bills on time, Kayley signed up with MyBudget three years ago for personal budget management. She directs all her pay and her mum's pension to MyBudget and in return MyBudget pays all her bills. This gives her great peace of mind. She admits she does not save. "I have never been a good saver. As soon as I have extra money with MyBudget, I seem to have another bill to pay with it," she says.

One of her main goals is to increase her home loan repayments and reduce her mortgage. When she was made redundant last year, she saw the bank and changed her repayments to interest-only for three years, though she has since found another job. She dreams of reducing her home loan to fewer than six figures – how can she do this and how long will it take?

In the short term, Kayley needs a new car as her old one has clocked up 300,000 kilometres. "I don't want to spend any more than $15,000 but I will wait until my car literally dies," she says.

Kayley would like to buy a computer for her younger son Nick (she has been leasing one). Her elder son John went to India and she would like Nick and her daughter Rachel to go too but needs $3000 for each. "I would like them to also have this opportunity in the next two to four years so I need to save for this," says Kayley.

John finished school last year and Kayley wants to know how much money she will need to support him through university. She would also like to give each of the children $5000 towards buying their first car.

YIANNI ASPRADAKIS

Costs will have to be trimmed

SUZANNE HADDAN

Suzanne Haddan is managing director of BFG Financial Services, an independent accounting practice

The teenage years can be expensive ones for the parents and, as a single parent with three of them, Kayley is finding her cash flow being stretched to the limit.

Her financial goals of buying cars for herself and the children, plus funding a couple more school trips, will cost about $36,000 over the next four or five years. Given there is no spare cash flow available, the focus for funding the expenditure moves to reducing costs and expenses.

One of the biggest costs is the home loan. Kayley is paying about 5.37% interest a year and to reduce the cost the home loan needs to be reviewed and a lower interest rate secured. To gain the lowest rate, the home loan will be of the basic variety with few, or no, bells and whistles such as an offset account. A reduction in the interest rate of 0.7%pa will result in a saving of $2660pa. Kayley should continue her current repayments of $1700 a month and this will give her around $13,300 over five years to assist with meeting her goals for school trips and cars.

Kayley should also consider fixing the interest rate for some or all of the loan. While we do not know what will happen to rates, fixing will protect Kayley should they increase over the next couple of years.

When the planned expenditures for cars and trips arise, the funds required would need to be redrawn from the mortgage. While this is disappointing given Kayley's goal to reduce her mortgage balance, the pain will be lessened by having a lower interest rate.

The children will become financially independent (well, that's the hope we all have) and this will allow Kayley to power into repaying her home loan.

As the school fee expense reduces, this money should be redirected to home loan repayments. This would mean an additional $1200 a month in four or so years. Repaying the existing amount of $1700 a month and adding the schools fees of $1200 a month would mean that the loan would take about a further 16½ years to fully repay.

Ideally Kayley should try to salary sacrifice into superannuation to build her wealth. Even as little as $50 a week could increase her balance by $44,000 (today's dollars) by retirement at age 65. By increasing the investment risk of her super from, say, a conservative to a growth option, the balance at 65 may be over $100,000 higher (today's dollars).

Breadwinner needs cover

ROY AGRANAT

Roy Agranat has 32 years' experience assisting people with their insurance needs and is a director of Fairbridge Financial Services, which specialises in personal and business insurance and corporate superannuation.

Ultimately as the breadwinner, one way or another Kayley does need to seriously consider income protection. She should check whether cover is offered and paid for by her employer. All income protection policies have a waiting period, or a time that must elapse from claim date before a benefit is paid. The benefit period is the period or age until which the insurer would pay the monthly benefit if you were permanently disabled – for example, for five years or until age 70. The longer the waiting period and shorter the benefit period, the lower the cost of cover.

There are a few scenarios for Kayley's consideration:

1. Take out a personal policy with a waiting period that suits her needs and budget and a benefit period of at least to age 65 or 70.

2. If the employer provides income protection with a waiting period of 90 days and a benefit period to age 65, there is no need to take out any personal cover. Check if there is a right to continue this cover if you were to move to a new employer. Obtain policy details to understand terms and conditions.

3. If the employer provides income protection with only a two-year benefit period, which is common on corporate policies held through super, then take an additional personal income protection policy with a two-year waiting period and a benefit period to age 65 or 70. If you leave the employer, the cover may cancel unless you have an option to continue it. Look for a personal policy with an option to reduce the waiting period from two years without medical underwriting.

If Kayley funds the income protection personally, obtain what is known as an "agreed" benefit contract, as this locks in the benefit amount at claim stage if permanently disabled, even if income has dropped. The premium will be higher.

The premium for the income protection funded by Kayley personally would be tax deductible. The majority of benefits paid from an income protection policy, irrespective of whether held in super or not, will be taxed as personal income.

In the event of death or total and permanent disability, Kayley would want the mortgage repaid, a capital fund for a guardian to receive a net monthly income of about $4000 for 10 years to support the children, along with an education fund, as well as funds to assist with the overseas trips and a first car for each child. She needs around $265,000 more insurance than she currently has.

Check if these insurances are offered either as part of an employer plan either outside super or as part of the employer default super plan. The cost of the cover via these sources could be lower (not always) and in some cases the employer may even subsidise the cost. Also, these covers may be offered up to a certain level with no medical questions asked.

A second option is for Kayley to fund this insurance with a personal policy from her super account. This has the benefit of still paying the premiums from super, which can free cash flow. Consider salary sacrifice to cover the cost of the premiums so as to not deplete the super balance and to get the benefit of using pre-tax dollars.

At present, trauma cover is where most lump-sum claims arise as people now survive more illnesses that would previously have led to an early death. As a result, this cover can be quite costly and cannot be funded from super, nor is it tax deductible. The benefit if paid is a tax-free lump sum. While expensive, it is important to have a component of trauma insurance as the cost of illness can be financially draining on a family. The level of trauma cover generally comes down to what the budget can afford.

Kayley's mother spends $70 a month, and has done so for the past two years, on a funeral policy which currently has a benefit of $5787. A quick calculation suggests that by the age of 90 Kayley's mother (currently 80) will have spent $13,500 (as premiums increase) on a policy that will pay out $9430.