

Budget and savings

Saving is about putting money aside to utilise in the future

When putting together a budget it is important to be realistic about what you can afford to save and what you can cut back on.

It is unwise to set up such a strict regime that you are left with no pleasures in life. If you are too harsh on yourself, it is unlikely you will continue to save.

A good rule of thumb is to try to save 10% of your net income, but if that is not viable based on your current circumstances, attempting to save something is better than nothing.

A good way to save is if you set yourself a goal, which creates an incentive because you now have something to aim for. You may wish to start with a small goal, like a holiday. If you succeed, then aim for something bigger such as a car or house.

Where to start

Simple changes to your lifestyle can make a difference to how much extra money you will have at the end of a week. Some ideas include:

- ▶ Making your lunch each day before work. People can spend up to \$10 or more per day on lunch (which can add up to more than \$200 per month)
- ▶ Share the cost of petrol by car pooling with work colleagues. Perhaps work out a roster that changes each week so you can share the wear and tear on all your vehicles
- ▶ Cut down on takeaway foods and buy fresh food rather than pre-prepared foods, which are often more costly and less nutritional
- ▶ Instead of purchasing 'brand names', look at some generic brands as an alternative. They are often cheaper but not necessarily an inferior product
- ▶ When you do your grocery shopping, it is wise to not shop when you are hungry as you tend to purchase things that you would not usually buy. Also restrict your shopping to a weekly rather than daily visit as once again, you may be tempted to buy products you don't need
- ▶ Stop smoking. The cost of cigarettes could be over \$10 per day or more which totals \$70 per week (or over \$3,600 a year). Not only will this improve your health, you will also save money and be eligible for a lower health insurance premium as you will be treated as a non-smoker
- ▶ Rather than purchasing newspapers and magazines from a newsagent, subscribe to them as they are usually cheaper and you can get them home delivered
- ▶ In addition, don't always buy books brand new. Consider borrowing them from a library or buying them second hand.

There are other savings you can make that will not alter your lifestyle, that may help to save you money. Things to consider include:

- ▶ Are you receiving the best possible deal on your car, health, home and contents insurance? Look at alternatives when each of these become payable to see if you can get a lower premium
- ▶ there may be alternatives to your mobile phone and internet service provider that are better suited to your needs
- ▶ if you have a mortgage, is it still suited to your needs and is it still competitive compared to others on the market? You may be paying a higher interest rate for features that you do not require and it may be wise to re-finance your loan with another provider
- ▶ Consider whether your bank account meets your needs. What are the bank charges you are paying and do you qualify for a waiver of any fees?
- ▶ What is the interest rate like on your credit card and what are the interest free days? There may be something available on the market that is more suitable to your needs.

How to make your savings work best for you?

Once you have worked out how much you can save, you need to work out how you will invest these savings. You may wish to arrange for an amount to be deducted directly from your salary and paid into a savings account. This way you are less likely to notice that it has been taken out and won't be tempted to spend it before you deposit it into a bank account. Also, if you get a pay rise, why not elect to put all of this directly into a bank account. You will usually not miss the extra money because you never had it in the first place.

Compound interest

The driving force behind successful savings is compound interest. That is, earning interest upon interest.

Let's say you invested \$1,000 at 10% per year. At the end of the first year, you would receive interest of \$100. If you reinvest this interest, at the end of the second year you would earn interest on \$1,100 being \$110. Your total value would now be \$1,210. Therefore, each year you are earning interest on your original capital and your accumulated returns. The longer you hold the investment, the greater the impact on your balance.

Where should I save my money?

There are many different options available but you need to establish what type of product suits your needs, i.e. low fees, high interest, good service or ready access to your funds.

For instance, if you had \$5,000 in a regular bank account, it may earn as little as \$50 per year in interest (that is 1% pa). However, if the money was invested in a cash management account with an interest rate of 5% pa, the annual return would be \$250. It is a lot quicker to save when your investment is attracting higher returns due to the effects of compound interest. It is also important to consider the frequency of the interest paid on your savings. Generally, the more often it is paid the better it is, due to the effects of compound interest. but you need to be sure that you are getting the best interest rate. Often, the overall return may be less than if interest is paid less frequently. For example, an interest rate of 4.95% pa paid quarterly is better than 5.0% paid annually due to the compounding of the interest in each quarter.

Types of accounts

Basic bank account – This account generally has no bank fees if you do not exceed the withdrawal guidelines. This account usually has no cheque facility and pays little or no interest.

Transaction account – This account allows you to use a cheque book, so it is useful for day to day banking. These accounts, however, may have service fees when you exceed the number of free withdrawals per month. Sometimes these fees may be waived for pensioners, students or those who have a mortgage with the bank.

Savings account – This account aims to encourage savings and as a result, may offer extra features, such as a bonus interest rate if you make no withdrawals, or simply a higher rate of interest than a regular transaction account. The interest rate may also be tiered, increasing as the balance of the account escalates.

Cash management account – This account offers many features, however comes at a premium of higher fees. The advantage of these accounts is they tend to pay higher interest rates, generally a set rate of interest based on the deposit amount.

Cash management trust – This is a pooled investment where your funds are put together with others to invest in a variety of short term money securities. It is necessary to apply for a prospectus if you would like to put money in a cash management trust and there is usually a minimum amount required to open an account. They generally offer cheque book facilities and have a minimum withdrawal limit with penalties for smaller amounts. The interest on a cash management trust is usually calculated on a daily basis.

Alternatives to banks

Credit unions and building societies are usually more community orientated and tend to charge lower fees than the banks, often with a higher number of free transactions. Some independent mortgage providers, in order to compete and be more customer-focused, offer more financial products than home loans. Therefore, it is important to do some research and to shop around to ensure you are satisfied with your investment

How can I save on bank fees?

Most bank accounts have some sort of fee however, there are ways to minimise the costs you may incur:

1. Reduce withdrawal fees by limiting the number of withdrawals you make on your account. Don't draw out small amounts every day, try withdrawing a larger amount once a week. If you pay for goods via EFTPOS, ask the retailer if you can withdraw extra cash as part of the same transaction.
2. Set up direct debits to pay for your bills. This is a convenient way to organise your finances and save on cheque fees as these are treated as electronic withdrawals.
3. Combine your separate savings and transaction accounts into one as this will save on fees and charges.
4. Banking over the internet generally attracts lower and often no fees or charges.

Depositing excess cash into a bank account or a cash management account are viable options but there are other avenues for investing surplus cash, such as:

Other options for saving

Superannuation is one of the Government's preferred means of saving for retirement and offers valuable tax advantages over other forms of investment including:

- ▶ Contributions made to superannuation may attract a tax deduction or tax rebate
- ▶ Earnings are subject to tax at a maximum rate of 15%
- ▶ Benefits taken after age 60 are tax free.

The important considerations with superannuation are the preservation rules attached to the contributions and the earnings. Any super contributions made after 1 July 1999 and any accumulated returns must be preserved in your account until a condition of release has been satisfied. The preservation age on retirement is 55 years (if you were born prior to 1 July 1960), increasing to age 60 (if you were born after 30 June 1964).

Contributions may be made into super as pre-tax payments (via salary sacrifice contributions) or after-tax contributions (such as a lump sum contribution, regular payment or spouse contribution).

Managed funds allow investors to pool their money with an investment manager who has extensive research facilities and experience. They provide a combination of income (including realised capital gains) and the potential for capital growth over the medium to longer term. While there is no guaranteed income return, the potential for capital growth is necessary to ensure the real value of the capital is maintained and not eroded by inflation over time.

Gearing is borrowing money to invest and potentially accelerates the wealth creation process, allowing the investor to make a larger investment than they would otherwise be able to. The borrowed money can be invested a number of ways including direct shares, property and managed funds.

Negative gearing occurs when the interest payable on borrowed funds exceeds the net income received from the investment. The investor must have a surplus income over and above their day-to-day living expenses to meet this shortfall. Gearing can be an effective strategy if the after-tax return of the geared investment exceeds the after-tax costs of funding the investment.

For further information on superannuation, managed funds and gearing, please refer to the relevant fact sheets.

Need further advice?

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