# Investing for the long haul

NOEL WHITTAKER

Medibank is a powerful brand, and there's no reason that won't continue.

MEDIBANK is the hottest topic in town right now – and everywhere I go, people ask if it's a good buy. Yes, I do think it's a good buy, but it's obvious that most Aussies are looking at it as a bit of a punt. After all, we are right in the middle of the racing season and everybody's after a sure thing.

Unfortunately, far too many prospective investors tend to shy away from shares because they see them as risky, and suitable only for a quick gamble. Time and time again I hear, "would never touch shares again – bought some years ago and lost my money".

No other asset class has the unique benefits of shares, but you need to decide whether you are a trader or an investor. Traders look for a quick deal, and take their money and run if the price goes up – investors take the slow, steady route and look for something that should give increasing returns over the long haul.

Medibank is in the long-haul category.

The Medibank prospectus comprehensively describes two principles that have been ignored by most commentators to date. These are the Risk Equalisation Trust and Community Rating – two mechanisms that together effectively redistribute the risk of health insurance underwriting equally across the whole health insurance industry.

When you take these into account, it is clear that Medibank is more of a health insurance claims administrator than an insurer. This makes it a much less risky play.

The success of Medibank will turn on its ability to process claims efficiently and economically, while maintaining its market share, and continuing to attract new business.

It is a powerful brand and there is no reason to suggest it will not continue to do well.

One of the chief executive's key performance measures for his own remuneration is to achieve a specified cost-to-income-ratio target. Expect to see a brutal cost-cutting program soon after listing.

There's a degree of uncertainty because would-be investors do not know how many shares they will get, or even the price they are going to pay.

The float has been way oversubscribed, so nobody is going to get what they applied for, but expect the issue price to be about $2.

Anybody obtaining Medibank shares at this price should expect to receive a total of 10¢ a share in fully franked dividends over the first 12 months. This is equivalent to a 5 per cent yield, which is way better than money in the bank.

It's astonishing that the Australian franking system is one of the best in the world, yet 90 per cent of Australians have no idea how it works.

To put it simply, you get a credit for tax paid by the company – this reduces the tax on the dividend that is paid to shareholders. You can even apply for a refund of this credit in cash if you don't have a tax liability.

For a self-managed super fund in pension mode, a 5 per cent fully franked yield is equivalent to an after-tax return of 7.14 per cent.

For a taxpayer on $100,000 a year, the effective tax on a fully franked dividend of $5000 would be just $558.

I am disclosing that I have applied for shares in Medibank, and will be holding whatever I am allocated for the long term.

My wish for all who become shareholders is that it will turn out to be a good buy, and above all introduce novice investors to the benefits of investing in the best asset class of all.


**SOUND INVESTMENT:** Medibank is a good investment because it is an administrator. *Picture: Glenn Hunt*

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**Noel Whittaker is the author of *Making Money Made Simple* and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. Email: noelwhit@gmail.com.**

**Q** If I am unemployed when I reach my preservation age, will I be able to access my super?

**A** This depends upon your age and your intention to work. If you are 55-60, you would need to make a statement that you don't intend to be gainfully employed for more than 10 hours within every 30 days at any time in the future. If you ceased working after 60, you have met a condition of release – and can withdraw your entire super balance tax free.

**Q** I would like to help my grandson locate a First Home Savings account but have had no luck with the banks I have contacted. Where could I find a list of banks offering this?

**A** Unfortunately they were abolished in the May 2014 budget due to a lack of interest from first homeowners.

# Check SMSF law before you pick up a hammer this summer

By **MONICA RULE**

MANY self-managed superannuation funds invest in residential property.

With finer weather on the way, a lot of people start to think about renovating these properties – especially if a property is not producing much income.

But the law is quite strict on what you can and cannot do with properties held in SMSFs.

Whether you can renovate a property held by your SMSF depends on whether the property was purchased by your SMSF outright with money accumulated in the SMSF, or whether it was purchased using money borrowed.

**Borrowings:** If the SMSF's property was purchased using borrowed money and the borrowing remains outstanding, then you are restricted from using the borrowed funds to renovate, and thereby improve, the property.

You can only use the borrowed fund to make repairs to the property.

The difference between a "repair" and an "improvement" is that a repair includes work to restore the efficiency of function of the property without changing its character.

It merely replaces or corrects a part of the property that is already there and has become worn out or dilapidated through ordinary wear and tear, or is damaged accidentally or by natural causes.

An improvement, on the other hand, is work that provides a greater efficiency of function in the property and usually involves bringing the property into a more valuable or desirable form, state or condition.

A property would be considered improved if the state or function of the property is significantly altered for the better, through substantial alterations, or the addition of further substantial features to the property.

Now, you can use money already accumulated in your SMSF to improve a property purchased by your SMSF via borrowings, as long as the improvement does not result in the property becoming a different type of asset.

**Accumulated funds:** If the SMSF's property was purchased using money accumulated in the SMSF, there are no restrictions in renovating the property.

You could even demolish the property and build a new property or properties on the land owned by your SMSF.

However, what you do need to be careful of is that firstly, your SMSF's investment strategy allows for such actions; and, secondly, you don't do the work yourself unless you are licensed and qualified.

If you are in the building and renovation business, then it is also important that any materials used in the renovation are purchased by your SMSF directly from third parties and not from you directly.

Just remember, if your SMSF has a loan on the property and is using borrowed money to fix it, you are limited to making repairs.

If your SMSF has a loan on the property but is using its own money for the renovations, you can renovate a property to improve it as long as you don't change its character.

**Monica Rule was at the Australian Taxation Office for 28 years and is a specialist SMSF adviser.**