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INTEREST RATES, FINANCIAL MARKETS AND THE ECONOMY

Our Economy: What to Expect?

The Reserve Bank of Australia (RBA) lifted the Official Cash Rate by 25 basis points to 6.50% for the month of August.

This is partly due to inflationary data which surprised the broader money market for the second quarter in succession – and we mean really surprised the market! For example, the figures evidenced a 0.9% increase in prices for the 3 months ending June 2007. The March 2007 figure was closer to 0.5%. Seasonally adjusted, the latest figure equates to an annualised rate of 3.6%, which is significantly higher than the RBA's target inflationary range of 2-3% per annum.

QUOTE

"Most people give up just when they're about to achieve success."

- Ross Perot

Wanting to Buy

MCP Group seeks opportunities to purchase from, or partner with, financial intermediaries that are seeking to sell a finance broking business or trailing loan book.

Please contact Bill Humphries or David McCleery for a confidential discussion.

Conceptually, it had to happen sooner or later – prices just had to rise. Some of the reasons outlined throughout the media include elevated petrol prices, higher accommodation expenses, labour tightness, wage growth and the recent increase in consumable costs due to the drought.

Internationally, the American economy is seemingly about to enter a phase of consolidation. There is cause for concern in the USA following structural problems within their housing sector, which is due to the recent ease of finance within their mortgage market post 9/11 (sub-prime mortgages). Sub prime mortgages are loans made to borrowers with impaired credit histories. The debt has been packaged up and sold to investors, including mutual funds. Given the rate of de-



Drought: One factor to cause inflation was the lack of rain, which increased the cost of consumables.

Market Statistics

Official Cash Rate: **6.50%**
U.S. Fed. Funds: **5.25%**
90-Day Bill Rate: **6.95%**
5 Year Bond Rate: **6.175%**
\$AUD (US cents): **80.74**
All Ordinaries (Aus): **5,638.9**

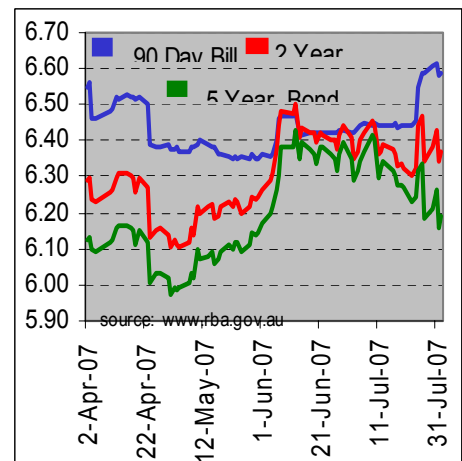
As at 16 August 2007

faults on sub prime mortgages it is very difficult to value the debt. This has led to significant losses for investors. In turn, weaker US profit forecasts have prevailed, which is partly due to increased mortgage defaults and heightened consumer credit levels.

But what has this got to do with us, the Australian economy?

The Australian share market has always had a high correlation with the US share market (up to 80%). For example, the All Ordinaries had fallen by 80 points on 24 July 2007, down from 6,400 (approx) in the first 30 minutes of trading following the large dip in the Dow of 260 points. A further 60

Money Market



Rate Rise: Money Market Rates increased sharply following the release of inflationary data.

points was then shed as the market absorbed news regarding higher inflation and prospective interest rates. Then again, to exacerbate worsening market conditions, the Dow fell by 450 points on 26 July 2007, which triggered a 160 point decline in the All Ordinaries index within minutes of opening.

The Australian and American share markets may be choppy in the short to medium term. The rate rise will hopefully produce its desired effects by slowing our economy, promoting a longer lasting period of economic sustainability.

However the recent correction in share markets should not concern long term investors as the fundamentals in the Australian economy remain strong and the world is no longer reliant on the US as the sole engine of economic growth.

QUESTIONS AND ANSWERS

The MCP Group team will answer a selection of our readers' queries in each edition of our monthly newsletter. To submit your query contact our Group by phone on (03) 9620 2001 or by email: enquiries@mcpgroup.com.au.

FINANCIAL PLANNING

HOW MUCH DOES IT COST TO PURCHASE SHARES?

The only costs involved with buying and selling shares is brokerage, with an additional 10% applied for GST provisions.

The amount of brokerage applied depends on the level of service you receive. For instance, orders made through an online account can incur as little as \$20 in brokerage per transaction. Full service brokers who research and recommend shares can charge upwards of \$100 per transaction.

Some financial services providers charge a flat fee for trades up to a certain value, then a percentage of the share transaction thereafter.

Costs such as stamp duty and non-brokerage GST do not apply.



JOINT TENANCY VERSUS TENANTS IN COMMON

Joint Tenancy is, traditionally, the most common form of home ownership amongst families. In this scenario each owner has an equal right to the possession of the property. If one member dies, their ownership is transferred to the other party. One member's share may not be sold without the consent of the other owner.

The term "Joint Tenancy" refers to an individual's right for possession over the whole property. Each individual's share may not be included in a Will and may not be sold as a separate asset. However, Joint Tenancy may be severed in certain circumstances such as divorce, which may result in a Tenants in Common ownership arrangement.



Tenants in Common: Tenants in common refers to the mutual ownership of a property which can be transferred or sold without the consent of the other owner(s).

Tenants in Common is a term that refers to the shared ownership of a property that can be sold or treated as an individual financial asset. Each owner of the property under a Tenants in Common structure can sell their portion of the property without the consent of the other owner(s). Tenants in Common ownership doesn't have to mean that each of the owners holds an equal share in the property. The estate may, in some circumstances, be divided into unequal proportions, relative to the amount of funds contributed towards the purchase of the property.

Joint tenancy is the more prevalent form of home ownership in Australia. However, with changing social trends including De Facto relationships, Tenants in Common may become a more popular form of home ownership. Another contributing factor may be the decreasing affordability of property in general (see finance article).

All parties to a Tenants in Common property ownership arrangement are advised to speak to an independent lawyer/solicitor as there are legal, as well as financial ramifications for failed ownership arrangements.



SELF MANAGED SUPER FUNDS - AN OVERVIEW

With the importance of superannuation becoming evermore present throughout the wider Australian community, Self-Managed Superannuation Funds (SMSF's) have been an increasingly popular investment structure for some future retirees. SMSF's operate much like any other Superannuation Fund, as it's primary goal is to provide funds for the members' retirement.

WHAT ARE THE REQUIREMENTS OF ESTABLISHING A SMSF?

There are a number of requirements that must be satisfied under a SMSF holding structure as follows:

- Have less than five members;
- Each of the members must be a director/Trustee of the Fund;
- No member of the Fund must be a non-relative employee of other Fund members; and
- No member of the Fund is allowed to receive remuneration for their services as a Trustee.

Members of SMSF's are almost always close business associates or family related.

WHAT ARE THE ADVANTAGES OF ESTABLISHING A SMSF?

There are many benefits of establishing a SMSF. Most commonly, these consist of the following:

1. The ability to select your own investments

When operating a SMSF you are in charge of selecting your investments and your exposure to risk. This means that you have greater control and are able to vary your Fund's investment composition as you see fit. You are able to create an investment portfolio that best suits the needs of all members, while enjoying the tax concessions available to traditional Super Funds.



Look after your Nest Egg: Trustees can select their own investment mix, meaning that they have greater control over their Super.

2. Flexibility including the ability of the Fund to purchase commercial property.

A SMSF can follow you as you change jobs and roles, and you can also elect to have the Funds drawn in numerous ways when you retire, including an allocated or complying pension.

One of the biggest advantages for small business owners is the ability of the SMSF to purchase commercial property from a member of the Fund. The property can then be leased back to the related party, assuming that a market value is paid.

REQUIREMENT	TIMING
Create the Fund	Once upon Establishment
Seek advice on the appropriateness of the Fund	Initially and if/when Required
Establish a Company (Optional)	Once upon Establishment
Administer	Ongoing
Audit	Annual
Manage Investments	Ongoing
Value Properties	Every three years minimum
Financial Advice	Ongoing if/when Required
Strategic Advice	Ongoing if/when Required

SMSF Requirements: Trustees are obliged to perform a number of jobs/duties. These can be onerous, and include keeping minutes and a defined investment strategy/plan.

DISADVANTAGES / RULES

There is a large focus on compliance for SMSF's under the Superannuation Industry Supervision (SIS) Act.

The following must always be adhered to under SIS regulation:

- You must save only for your retirement (sole purpose test);
- Maintenance of precise records of meetings and investment philosophies;
- Disallowing loans to relatives or borrowing money to increase the effectiveness of your Fund's investments (i.e. gearing);
- In-house assets (such as antiques etc) must not exceed 5% of total Fund assets;
- Buy and sell assets at their true market value;
- Do not take money out early;
- Meet lodgment requirements and regularly report to members; and
- Complete and lodge a GST activity statement.

Strict rules exist to ensure that the Fund's assets are protected to the best of your ability.

What if I break the above requirements?

Keeping up with the rules and regulations can often be a difficult process. Trustees may be prone to breaking certain rules without realising. For example, the Fund's assets cannot be used for personal purposes in most circumstances. To put this into perspective, the Fund's investment property cannot be used as the Trustee's holiday house, unless they rent it at market value from the Fund to an independent third party.

Some of the penalties for serious breaches of SIS Act legislation may include the freezing of a Fund's assets, the suspension of a Trustee's duties, the Fund may be declared non-complying which has severe taxation ramifications or the Fund can be fined by the ATO.

Even though a Trustee cannot pass on their duties to a third party, they are able to seek the legal and financial counsel of qualified professionals. This may aid a Trustee to establish a system to properly comply with government legislation.

IS A SMSF FOR EVERYONE?

Running a SMSF is an expensive affair, not only in terms of the actual financial cost but also due to the persistent requirement for the Trustees' time. It is estimated that the annual cost of a SMSF lies within the range of 2-5%, depending on the level of outside financial advice that is sought. It is generally advisable for the Fund to have assets in the order of \$300,000 plus to be a financially viable Fund option.

CONCLUSION

SMSF do have their place in the Australian Superannuation industry. Whilst they have substantial perks they are costly to run, both financially and time wise. A standard Fund can have a Management Expense Ratio as low as 1%. Therefore, we would highly recommend speaking with a certified professional before committing to such a structure.



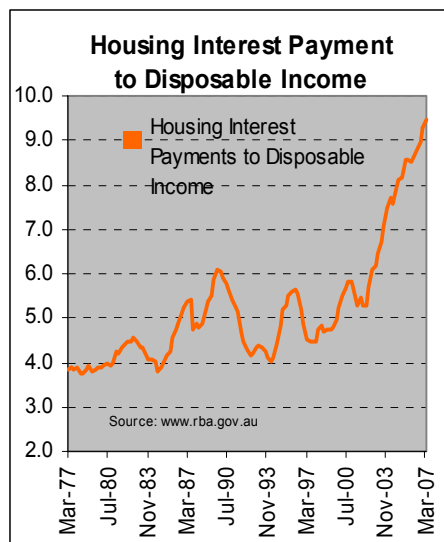
HOUSING AFFORDABILITY - FOCUS ON WHAT CAN BE CONTROLLED

There has been much conjecture around the current housing affordability problems in political and economic circles, including "mortgage stress" for existing owners.

Suggested relief strategies generally reside around generating increasing supply or removing some of the entry costs through grants or duty reductions. Compounding the issue, the buoyant economic times means a strong property market for those looking to enter or upgrade their homes.

The common theme around these discussions is that supply and demand issues are generally beyond the control or influence of a home owner. So, the only effective strategy is to determine what steps can be taken to enhance your own position.

Housing Interest Payments to Disposable Income



On the Rise: Interest Payments to Disposable income has risen sharply in the 2000's.

Working with people from a range of generations, including baby boomers, they recount stories from earlier times when the relative mortgage stress was comparable. Granted, borrowing guidelines and credit availability have become more liberated and this has led less financially literate people into

difficulty.

So what is different in the current times? A central theme may be our "have it now" society where some people are putting cars, holidays and other consumables ahead of the home purchase. The earlier generations didn't have massive credit card and other consumer debt to co-exist with their mortgage.

The supply side issue still needs attention and remedial action; however, financial literacy should be formally built into our school education system to better prepare people for the financial challenges that lie ahead.

Focus on what you can control.

FINANCIER NEWS

BankWest

BankWest have a very competitive suite of products in the home lending market. Of note is their Lite Home Loan, which comes with many of the benefits of a full priced home loan.

While BankWest have a small market presence in the Eastern states, they seek to maximise their presence in what they describe as a "major challenge to the big four banks". The move will be one of the largest ever from scratch, and will create approximately 3,000 jobs across 160 branches.

Originating in 1895 as the Bank of Western Australia, BankWest has over 860,000 customers nationwide.

Macquarie Mortgages

Macquarie Mortgages, Bank of the Year according to the most recent Your Mortgage magazine survey, has announced a low rate of 7.19% for all loans which exceed \$1m. While not for all mortgage lenders, it is a significant saving to high net worth individuals who seek to consolidate their finances.

Also attractive for borrowers who seek to refinance their existing lending facilities are Macquarie's rates for sub \$1m lending, priced at 7.25%.

RAMS Home Loans

RAMS Home Loans has launched an IPO (Initial Public Offer), raising close to \$700m in the process. This is basically where a private company of

fers script/shares to the general public as a means of sourcing funds.

It will be interesting to see exactly what the lender does with the raised funds. RAMS Home Loans has always had a tendency to heavily market their organisation, both through print and television. RAMS Home Loans may decide to expand its operations or become more aggressive with their marketing strategies. This could result in lending discounts, increased advertising and even new product launches.

MONTHLY VERSUS FORTNIGHTLY OR WEEKLY LOAN REPAYMENTS

MCP Finance encourages clients to make quarter monthly repayments weekly, or half monthly repayments fortnightly on principal & interest loans, as opposed to standard monthly. If repayments are made on a weekly basis, 52 repayments per year are made. If you pay fortnightly 26 repayments are made, with 12 made when paying monthly. This seems simple, with the underlying factor being the repayment frequency.

To explain, there are two weeks to a fortnight, 4.33 weeks to a month and 2.167 fortnights to a month. By repaying monthly, it is equivalent to 24 fortnightly repayments or 48 weekly repayments per year. The extra 0.33 weeks and 0.167 fortnights per month result in a slightly higher frequency of repayment and a subsequent saving in interest.

Example- Fortnightly Repayments

Mr and Mrs Smith take out a loan and repay \$2,000 per month (or \$24,000 per annum) on a principal and interest mortgage.

They have been advised to make half monthly repayments every fortnight. For example, they will now pay \$1,000 per fortnight (or \$26,000 per annum)

The additional repayment reduces their principal component, thereby reducing future interest, which can save years off a mortgage.