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WEALTH

TUESDAY EDITION | Edited by Andrew Main

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Don't let inflation wreck retirement

TONY NEGLINE

INFLATION has dropped off the radar as a topic in recent years but you must understand its perennial threat as you plan retirement.

Part of the low recognition is because price increases have averaged a modest 2.75 per cent each year over the past 10 years. This is very low compared to the 20 years before 1993 when inflation averaged nearly 10 per cent per annum.

In some ways a low inflation rate is more dangerous because it makes us more complacent. For example, if inflation averages 10 per cent then prices will double about every seven years. But if inflation is less than 3 per cent each year then prices are doubling every 26 years and increases often go unnoticed from one year to the next.

Suppose you're aged 65 and recently retired and you have estimated that you will spend $50,000 on your living costs this year. With a modest 2.75 per cent inflation each year you'll need income of about $75,000 by age 76 so you can maintain your lifestyle.

The mistake that some people make is that they ignore inflation and assume that $50,000 each year over their retirement years is all they need to budget for. If this were the case then their retirement assets would need to generate $1.5 million in income over a 30-year retirement period. (Given improvements in health and occupations, living into our 90s isn't out of the question for most of us.) But what impact does inflation cause? If it averages 2.75 per cent each year then you actually need to generate about $2.3m in income over 30 years to maintain your standard of living. If inflation averaged 10 per cent each year then you'd need income of $8.2m to preserve your lifestyle throughout a 30-year period.

How do investors yet to retire plan for inflation? The simplest way is to use investments that pay income that increases at least as quickly as your preferred measure of inflation. Once that income has been earned it can be invested into the same or similar investments that earn inflation-linked income. This process is then repeated until your assets generate the inflation-linked income you need to support your retirement years.

Investors who are already retired need to follow a similar pattern. They need to invest in assets that generate income that increases at the rate of inflation.

What should your measure of inflation be? A recent article in the Reserve Bank's March 2014 Bulletin says that the official Consumer Price Index overstates the real increase in the cost of living. It says that the official CPI figures measure inflation in the prices of household goods and services and this might differ for cost of living increases. It details three important reasons why this might occur.

Firstly it says that consumers often reduce the impact of price increases by purchasing less expensive items.

The official CPI measure doesn't capture these changed spending habits, nor does it capture consumers shopping around for the best price. The RBA calls these issues substitution bias and estimates that they overstate the official inflation numbers by between 0.25 and 0.5 per cent each year.

It next looks at an issue called incomplete quality adjustment. The quality of goods and services typically improves over time which increases living standards. If goods become cheaper and quality improves then the cost of living falls. It can be quite difficult to measure these improvements in the official CPI data. The RBA estimates this overstates the government's inflation numbers compared to the actual cost of living by up to 0.5 per cent each year.

The last item that causes problems in the CPI numbers is the cost of owner-occupied dwellings. The changes in established dwellings aren't included in the inflation numbers. This means the cost of living is overstated when mortgage interest rates are falling and understated it when they're increasing. A good target for superannuation investors is to find investments that pay income which increases each year by at least the official inflation rate less about 1 per cent.

Tony Negline is author of The Essential SMSF Guide 2013/14.

Sun will rise on uranium

The future is bright, even if prices will not bounce back soon

BARRY FITZGERALD

Alliance workers drill at the Four Mile uranium site in South Australia

Alliance resources (AGS)

IT is not an ideal to be a uranium producer. In fact, it has not been ideal since March 11, 2011, when a large earthquake triggered a 15m tsunami that caused Japan's Fukushima nuclear power plant to melt down.

The tsunami-triggered meltdown took uranium prices down with it, and they are yet to recover. Pre-tsunami, uranium was trading at more than $US70 a pound.

Last week the spot price for the radioactive material was looking friendless at $US33.90 a pound. But with nuclear power still covering more than 11 per cent of the world's electricity demand (more than 20 per cent in OECD countries, according to the World Nuclear Association), the shortfall between supply and demand — currently met by drawdowns on reprocessed weapons-grade material and stockpiles — means uranium will again have its day in the sun.

The new and growing imperative behind the broad agreement that long-term average for uranium is going to be somewhere north of $US60 a pound is the building of new nuclear capacity in China.

China has a real problem with pollution, which sort of comes with its annual burning of 3.5 billion tonnes of coal in support of its urbanisation and industrialisation drive. To put that in context, and to make that point that the environmental attacks on the Australian coal industry are missing the main target, Australia produces about 420 million tonnes of the black stuff, which is mostly exported.

There have been plenty of mumblings out of Beijing that improving air quality is right up there with all of its long-term plans. Apart from anything else, China's choking air quality has become an international embarrassment. Nuclear power is part of the solution, thanks to its super-low life cycle carbon emissions, which almost put it on par with wind and hydro-electric power.

And that is why, as mentioned earlier, the long-term uranium price assumption is a multiple of the current spot price.

Prices are not expected to pop any time soon, but sometime in the next three to five years is not an unreasonable expectation.

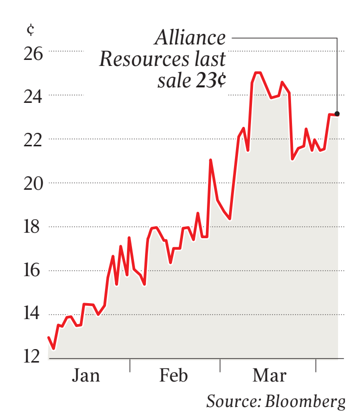
It is against that backdrop that Alliance Resources, owned 25.8 per cent by Ian Gandel's Abbotsleigh, is nicely positioned.

It is a 25 per cent partner in Australia's newest uranium mine — the Four Mile project in South Australia, owned 75 per cent and managed by a subsidiary of California's General Atomics, Heathgate.

The operation is of the in-situ leach type and when it hits its straps, it will rank as the world's 15th biggest uranium mine of any description.

First production is due this month, subject to final regulatory approval of Heathgate's monitoring plans for the project.

Shares in Alliance have been dragged higher in recent months in anticipation of all that, moving from 13c a share at the start of the year to 23c yesterday, giving it a market capitalisation of $78m.



Four Mile is no earnings bonanza, not initially at least. Total costs have been put at $40.13 a pound against what Heathgate reckons will be a $49.36 a pound sales price on forecast sales of 1.5m pounds in the period up to December 21 this year.

Positive cash flow is forecast in the first half of 2015, which is about when the first signs of a rebound in uranium prices should be taking hold.

Given the slow start to earnings from Four Mile, it has to be assumed that there have been other factors behind Alliance's 77 per cent price appreciation so far this year.

And there is. First up is the misleading and deceptive legal action by Alliance against Heathgate.

Alliance is seeking damages and the restitution of the 75 per cent of Four Mile now held by Heathgate, with a five-week trial due to kick off on June 30.

Needless to say, a win by Alliance would be transformational.

But punting on the outcome of court cases is not a recommended investment strategy.

More certainty exists about the potential for a game-changing increase in resources at Four Mile, now all the more interesting with the start to production.

The Four Mile resource currently stands at 71 million pounds of uranium.

That is globally significant in itself.

But back in February Alliance itself announced a "conceptual" exploration target for 41-78 million pounds of uranium in an area to the northeast of Four Mile.

There is again disagreement between the joint venture partners on whether the exploration cost of proving up that sort of potential should be categorised as a development cost — under which Alliance would pay its share — or as an exploration cost which Heathgate needs to cover.

Either way, the latest high-grade exploration results from Four Mile northeast have continued to point to the broader Four Mile area in outback South Australia being one of the "Australia's great uranium provinces".

IMX Resources (IXR)

The corporate restructure announced last week by IMX Resources (ASX: IXR) was all very interesting in that it was the sort of belt-tightening and refocusing sort of stuff that grumpy shareholders are increasingly demanding.

The move of the corporate office from Perth to Adelaide makes obvious sense given IMX's main go remains its 51 per cent-owned Cairn Hill iron ore operation in South Australia.

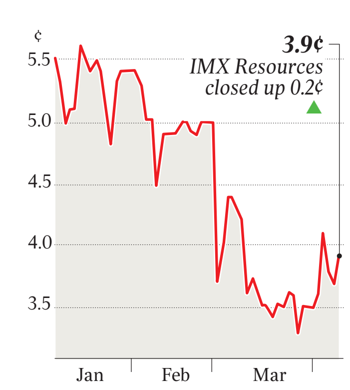
The Cairn Hill interest and other iron ore growth options in South Australia pretty much cover IMX's current share price of 3.9c for a market cap of $15.5m. And there is a better-than-average chance that new managing director Gary Sutherland, the ex-chief executive of Flinders Mines, can make the South Australia package all the more meaningful.

But today's interest is in IMX's leverage to big-time nickel potential in Tanzania thanks to its joint venture with Chinese-controlled but Australian-managed MMG at the Ntaka Hill sulphide nickel project.

Stage one of the farm-in by MMG involves expenditure of $10m by September this year, with a potential $60m commitment over five years for MMG to earn a 60 per cent interest.

The stage one commitment alone says that MMG reckons that Ntaka Hill has world-class potential, and there have been references to it targeting at least 400,000 tonnes of contained nickel at a grade of better than 1.5 per cent nickel. The word is that stage one of the MMG-funded drilling program kicks off next month, employing five rigs. Results should flow thick and fast.

Given IMX's current market cap is covered by the iron ore back in South Australia, the nickel hunt in Tanzania could well be worth watching.



IVF baby with growth potential

FLOAT WATCH

Reproductive Health Science

ASX•CODE: RHS
SHARES•ON•OFFER: 15 million
LISTING•PRICE: $0.20
MARKET CAPITALISATION: $10m
LISTING•DATE: April 24

TIM MORRIS

AUSTRALIA has a strong maternal instinct for assisted reproductive technology such as IVF (in vitro fertilisation). In 1973, Melbourne's Monash University recorded the first IVF human pregnancy and seven years later successfully produced the world's third birth from the science.

It is estimated that 1.7 million IVF cycles occur globally every year. Improved accessibility and rising average maternal ages are expected to see the market grow by 10 per cent per annum.

Domestically, the support of Medicare rebates has seen treatment numbers increase about threefold since 2000, accounting for 3 per cent of births. As the world's first "test tube baby" approaches her 36th birthday, the coming listing of Reproductive Health Science (RHS) aims to support a new generation of IVF technology.

We're attracted to the market's growth potential and benefits the kit may deliver

The Australian biotechnology company is focused on genetic testing. Its controls intellectual property surrounding a single cell chromosome analysis technique which originated at the University of Adelaide. A screening product has been initially conceived for the IVF market. By identifying high-risk embryos prior to implant, this "IVF kit" is designed to improve success rates.

Currently, 71 per cent of embryo transfers do not result in clinical pregnancy and RHS's target age bracket constitutes 50 per cent of IVF candidates. The company's entry to the ASX is taking place via a reverse merger with AO Energy. Listing proceeds are scheduled to nurture asset development towards a third trimester, with the company's IVF kit being launched this year. It will compete with existing genetic screening products that have attracted 3 per cent of the IVF market.

RHS offers speculative exposure to further penetration of these technologies. We are attracted to the market's growth potential and the benefits which its IVF kit could deliver. While the product launch offers a near-term growth catalyst, competitive challenges appear significant.

Tim Morris is an analyst at wise-owl.com.

Homework required if you're to avoid getting your fingers burnt on super buys

MONICA RULE

SELF-MANAGED superannuation funds may end up paying extra stamp duty, capital gains tax and be penalised by the Australian Taxation Office if borrowing transactions are not structured exactly in accordance with the law.

The superannuation law referred to as limited recourse borrowing arrangements allows an SMSF to borrow money to buy assets. The asset must be a single acquirable asset and must be held by a separate holding trust while the loan remains outstanding. The money borrowed can be used for repairs and maintenance but cannot be use to improve the asset. Once the loan is fully repaid the asset must be transferred from the holding trustee to the SMSF trustee.

The main areas where SMSF trustees are making mistakes are on the timing of the contract, the purchaser details on the contract, paying the deposit from their own bank account, and incorrect wording on legal documents.

Timing of the contract: Stamp duty rules differ from state to state and therefore it is important that transactions are executed in a proper manner. In NSW, Tasmania and the ACT, the contract must be signed and dated before the holding trust deed, otherwise trustees pay stamp duty on the holding trust deed as a "declaring of trust" as well as on the contract.

If the property is in South Australia, Queensland or the Northern Territory, the holding trust deed must be signed and dated before the contract. In Western Australia and Victoria, I believe you can do it in any order. However, I recommend SMSF trustees seek legal advice on this issue.

Purchaser details on the contract: The wording on the contract differs from state to state. In WA, the word "for" must be used between the holding trustee and SMSF trustee names. In NSW, Victoria, Tasmania, ACT, South Australia and Queensland, the purchaser should be the name of the holding trustee only and there should not be any other wording such as "as trustee for the holding trust" or "as trustee for the SMSF". In the NT, the wording needs to be specific; in this case: "Holding Trustee Pty Ltd as trustee for Name of Holding Trust as bare trustee for SMSF Trustee Pty Ltd as trustee for Name of SMSF". Again, seek legal advice on the correct wording on documents.

Paying the deposit: All money, including the deposit on the property, must be paid from the SMSF's bank account. This is because the SMSF trustee needs to be able to show that all money for the purchase of the single acquirable asset came from the SMSF to be eligible for concessional stamp duty. An SMSF may end up paying more stamp duty if the deposit money comes from another source.

Wording on documentation: Errors have been made by SMSFs purchasing house-and-land packages. It is most important that the single acquirable asset is identified upfront as a single-title vacant block of land along with the construction of a house on that land before settlement occurs. It is also important that the limited recourse borrowing arrangements state that the single acquirable asset is at all times a complete house-and-land package; security for the loan is at all times over the land and completed house; and it allows drawdowns for the deposits, progress payments and settlement. Incorrect wording could result in the house and land purchased being viewed by the ATO as two separate assets and so would contravene the law.

Drawing up a limited recourse borrowing arrangement is a very specialised process and requires specific wording. It is best that SMSF trustees seek an experienced mortgage broker and a lawyer who know how to draft personalised documentation. I recommend that SMSF trustees do not trust financial institutions to provide all the documentation on a loan such as this as they will be interested only in protecting their interests and may not provide the necessary documentation and specific wording to meet the requirements of the superannuation law.

If the structure does not strictly comply with the superannuation law, then the only options that may be available to SMSF trustees to unwind the transaction is to fully repay the loan or remove the asset from the SMSF. The ATO may also consider removing the compliance status of the SMSF as well as disqualify trustees. Getting LRBA structures wrong can be costly.

Monica Rule worked for the ATO for 28 years and is the author of the book The Self-Managed Super Handbook — Superannuation Law for Self-Managed Superannuation Funds in plain English. www.monicarule.com.au

Aged-care residents on notice as government beds down push for greater contributions

PAUL DWYER
CARE SERVICES

THERE'S a big change looming in aged care. From July 1 people going into residential care will be asked to make a greater contribution to the cost of their accommodation.

Entry into permanent residential care or respite must be pre-empted by an assessment by an aged-care assessment services team. Currently there is no time restriction on a high-care assessment, but low level has a 12 months' expiration. From July 1, there will be one assessment only, with no expiration.

An accommodation cost will be applied to all new residents with the means to contribute to their accommodation and care.

There are 189,000 beds in residential care; about 32 per cent of all entrants lack the means to contribute to their accommodation and will be fully supported by the federal government. Unless there is proven financial hardship, these residents will pay 85 per cent of their basic aged pension ($45.63 a day) as a daily bed fee for their total contribution. For all other ingoing residents, they will pay the daily bed fee, plus their accommodation costs.

Residents will have a choice to pay a lump sum known as a refundable accommodation deposit, a periodical payment known as a daily accommodation payment, or a combination of both. Each facility must advertise their room costs on the government website (My Aged Care) in both RAD and DAP format, plus their own website and elsewhere. The amounts advertised are the maximum allowed and can be negotiated if applicable. If a facility wishes to charge a RAD of more than $550,000 (DAP $99.30 per day), it must seek approval from the Aged Care Pricing Commissioner.

Currently residents may be asked to pay an income-tested fee (up to $26,400 a year), or an extra service fee for upgraded accommodation or services. The income-tested fee will be replaced by a means-tested fee (see below). Facilities with a current "extra services" licence will continue to charge accordingly. For other sites, they will be allowed to charge a "menu" for additional services, such as a glass of wine, newspaper or Foxtel in the room.

Residents will have up to 28 days from entry to advise how they will pay. At present residents and their families must advise their payment decisions at the time of signing the agreement. While providers have shown resistance to the idea of not knowing the payment commitment, there is some compulsion for the decision period, as 60 per cent of residents entering care are discharged from hospital and many only have four to seven days to make an accommodation selection.

The current income-tested fee will be replaced by a means-tested fee. Assets will include any lump sum payment (RAD) made to the facility. Currently a lump sum is a non-assessable asset and this policy was designed by Labor to avoid higher payments to facilities arranged to increase pension benefits. The means-tested fee will be a 12-step calculation, including both income and assets.

A lifetime cap of $60,000 will apply to any means-tested payments and a yearly cap of $25,000 will also apply. From a strong asset position, a resident may have to pay $118.48 a day for the first 211 days of years one and two, and followed by 84 days in year three. Residents will then have made all of their payments.

The maximum amount payable also applies to services received while independently living at home (Home Care Program). A maximum yearly fee of $5000 for a part-pensioner and $10,000 for a fully self-funded retiree for services within their home are included in a lifetime cap of $60,000. The current Accommodation Bond lump sum can have a monthly amount deducted by an aged-care provider for up to five years. From July 1, the retention bond can no longer be deducted from a RAD.

Paul Dwyer is a Victorian credit adviser specialising in seniors' credit and aged care.