WEALTH

WEEKEND EDITION | Edited by Andrew Main

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'SIGNING DOCUMENTS AFTER THE EVENT CAN CREATE SERIOUS PROBLEMS'

TONY NEGLINE

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PUBLISHED ON TUESDAYS

TIM BOREHAM
CRITERION

Franchisor pepped up by coffee kick

Retail Food Group (RFG) $2.98

THE coffee and snack food franchisor has been a market fave, with uninterrupted annual earnings growth of 30 per cent over the past seven years.

But the Brisbane-based mob has a structural impediment: two-thirds of its outlets are in shopping centres and for reasons made clear by Myer's Bernie Brookes and Gerry Harvey, the passing trade ain't what it was.

To ameliorate this, RFG this month finalised the $4.3 million purchase of the NZ-based The Coffee Guy Group, which operates 55 mobile vans as well as hole-in-the-wall and drive-through caffeine joints.

Earlier this year, RFG also bought Pizza Capers and Crust Pizza for a combined $71m.

RFG's other franchises include Donut King, Michel's Patisserie, Brumby's Bakeries and Esquires.

Cafes are famed for being recession-proof, but there are signs of malaise.

"Average weekly sales growth has slowed in recent years to below 2 per cent across all systems, dragged down by falling shopping-centre traffic," JPMorgan says.

Unfazed, RFG chief Tony Alford told yesterday's AGM that first-half profit was likely to be 7.5 per cent better than the previous $15m. Because of factors including the acquisitions, the second half should be "much stronger". Alford says while RFG has a "veritable arsenal of drivers" to sustain profits, next year will be all about consolidation.

There are dangers, but management has shown it knows how to run franchises. **Long-term buy**.

Norfolk Group (NFK) 52c

FOR a mob that has received takeover approaches and is up for auction, the electrical maintenance contractor is trading with the notable absence of a takeover premium. The reputational guilt by association with rival Hastie Group perhaps?

Norfolk on Tuesday said that given the board had received several non-binding and conditional approaches, a "strategic process" would start after the full-year (March balance date) results were known.

"The board continues to believe that the company is too small to remain listed as an entity at its current or recent market capitalisation," Norfolk said.

Potential listed buyers include Monadelphous, United Group and Transfield.

Norfolk shares are trading on an earnings multiple of around seven times and not much above net tangible asset backing of 44c. Criterion cautions against Hastie decisions, but Norfolk's cash-rich balance sheet bears little resemblance to its poor cousin, which collapsed in May owing $500m.

Norfolk has a good chance of being knocked off at a decent premium to its $78m market cap. **Spec buy**.

Australian Infrastructure Fund (AIX) $3.14

INVESTORS who held the stapled security for the simple pleasure of owning airport assets now have to decide whether to hang in for a series of final distributions, or sell and deploy their cash elsewhere.

AIX on Monday confirmed the $2 billion sale of its assets — predominantly stakes in Perth, Melbourne and regional Queensland airports — to the Future Fund. Holders will receive between $3.245 and $3.285 per security, after a 5.5c half-year distribution is paid in February. The payments are by way of a $2.95-2.98 payment in late April and then a payment of 24-25c a share (plus a franking credit of 2-3c a share) between June and next December.

Based on Monday's $3.14-a-share closing price, UBS estimates that hanging in there would yield anywhere from 7 per cent to 11 per cent excluding franking, depending on variables such as the timing of the second payment.

We reckon investors should **sell** now and invest in an alternative such as bank shares or bank hybrids. Or given they were attracted to airport exposures, why not switch to **Sydney Airport (SYD, $3.48)**, a much cleaner vehicle since its Macquarie days?
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***The Weekend Australian* accepts no responsibility for stock recommendations. Readers should contact a licensed financial adviser. The author does not hold shares in the stocks mentioned.**

Short-changed by dash for cash

Bank deposits are safe, but the return is far from spectacular

TONY KAYE

AUSTRALIAN financial institutions have never been as cashed up as they are now, and that's thanks to the tsunami of private savings that continues to flood into their burgeoning coffers.

The cash wave is getting bigger and bigger. According to official Reserve Bank statistics, the total level of deposits held with Australian banks was $1.74 trillion at the end of September, a rise of more than $400 billion since September 2008. Added to that is roughly another $60bn in deposits held in credit union and building society accounts.

The bulk of current deposits are with the banks.

The RBA stats show about $219bn in current deposits at September 30, another $543bn in term deposits, and about $453bn in "other deposits".

Five years ago, the numbers were significantly lower at $187bn, $331bn and $329bn, respectively.

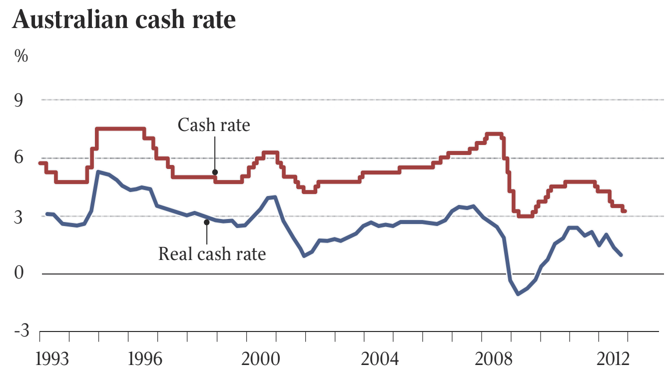
The money flow into the banks and others has been incessant, and over the course of this year has been averaging about $12bn a month, equating to about $140bn since the start of this year up to the end of September.

The cause of this cash tsunami? In a nutshell, the volatility on equities markets, and financial markets generally, has created a climate of fear. Cash is being redeemed from managed equity funds and piled straight into personal bank accounts.

It seems that, for many Australians, money in the bank is the safe and easy option helped of course by the federal government's $250,000 deposit guarantee. But, unfortunately, it's certainly not a great option when it comes to earning an investment return. In fact, the money pouring into banks and other financial institutions is earning lower and lower returns.

The volatility of equity markets has created a climate of fear
AFP

Australian cash rate



* Calculated using average of weighted median and trimmed mean inflation *Source: ABS, RBA*

Interest rates have fallen steadily of late, and the prospect of another cut to the 3.25 per cent official cash rate on Tuesday is still very high. The official cash rate has been cut by 1.5 per cent since November last year.

Back in 2009, investors could get quite an attractive 7 per cent return from a three-year bank term deposit. A year ago, that rate had dropped to an average 5.6 per cent. Right now, don't expect to do much better than the average three-year bank term deposit rate of 4.45 per cent.

But this isn't deterring investors. As term deposit rates have been falling, the amount of money flooding into them has risen steadily over the same time. In December 2009, when investors could grab that 7 per cent pre-tax return, there was $368.4bn held in bank term deposits. Now investors are earning about 30 per cent less on their term deposit funds, yet the total amount in bank deposits has jumped to more than $540bn.

For those with funds in an online savings account, the average yield is just 3.3 per cent (slightly above the 3.25 per cent official cash rate). And those with funds in at-call cash management accounts with a balance below $10,000 can only expect an average yield of 1.95 per cent.

Many investors appear to be willing to forsake yield in the knowledge that their money will be relatively untouchable in their financial institution of choice even though they will need to pay tax on their interest earnings and probably bank fees along the way.

And factoring in the effects of inflation, which the RBA has forecast will reach 3.25 per cent by June next year, those earning even the highest bank deposit rates at the moment are barely breaking even. The lesson? When it comes to yield, cash is definitely not king of the investment hill right now. Better returns can definitely be had from other investment classes, albeit the higher level of risk in areas such as the sharemarket.

A number of blue-chip listed Australian companies are paying fully franked dividend yields of between 6 per cent and 7 per cent (equating to pre-tax returns more than 9 per cent). For those with a higher-risk appetite, and a longer-term investment horizon, this may be a good alternative to earning low returns in the bank.

Tony Kaye is editor of Eureka Report

Self-managed super should borrow with great care

MONICA RULE

LAST week, Acting Tax Commissioner Brian Quigley expressed his concerns over SMSF trustees entering into borrowing arrangements without meeting the strict superannuation law requirements. He also warned property spruikers not to recommend dodgy loan structures to trustees for property.

It's a complex issue with immense scope for mishap, even for well-informed people with good intentions, so it's worth going into depth about the required mechanism, the Limited Recourse Borrowing Arrangement, and how it must be structured.

An LRBA is an arrangement where an SMSF borrows money to buy an asset (e.g. a property). Limited recourse means the lender is offering limited recourse terms. If for some reason the SMSF is unable to repay the loan, the lender can only take the asset over which the borrowing took place. It cannot take any other assets of the SMSF for the outstanding loan. The asset is held in a "holding trust" while the loan remains outstanding. Once the loan is repaid, the asset is transferred from the holding trust to the SMSF.

To enter into an LRBA, you must do the following things.

Your SMSF trust deed must allow for borrowings as well as grant security, and for the asset to be held by a holding trust. You must include LRBA-type of investments in your SMSF's investment strategy. You need to determine who is to be the holding trustee and establish a holding trust. The holding trust structure is also known as a "bare trust" or "custodian trust". You can use an individual trustee or a corporate trustee for the holding trust, but it cannot be the same trustee as the SMSF. Speak to a lawyer to draft the "Property Trust Deed" or a "Declaration of Custody Trust". This document states who the holding trustee is and their role.

On buying an asset the holding trustee acts as the legal owner of the property. The holding trustee's name must appear on the purchase document. The purchase contract is between the seller and the holding trustee.

When you complete the loan arrangement with the lender, the loan must be between the lender and the SMSF trustee.

It is the SMSF trustee's name that must appear on the loan documents as the SMSF trustee is the borrower.

You must ensure that all money used to buy the property comes from your SMSF's bank account. This includes any deposit paid. While the loan is outstanding, the holding trustee holds legal title to the property while the SMSF trustee has the beneficial interest in the property. The only function of the holding trustee is to hold the legal title to the property, grant the mortgage to the lender, and enter into leases. All rental income is paid directly to the SMSF's bank account. Expenses for the property are also paid out of the SMSF's bank account.

The SMSF makes loan repayments and, after paying off the loan, the legal ownership of the property is transferred from the holding trust to the SMSF.

It may sound straightforward, but borrowing strategies are complex and many SMSF trustees make costly mistakes. A common mistake is SMSF trustees paying the deposit on the property from their personal finances and recovering the money from the SMSF.

This can have stamp-duty consequences when the property is eventually transferred from the holding trust to the SMSF.

If the holding trustee is incorrectly recorded as the borrower this will create the same problem when the property is transferred.

Trustees must ensure that the holding trust deed is stamped to ensure that the transfer of the property from the holding trustee to the SMSF trustee attracts only nominal stamp duty.

Finally, the holding trustee can perform no other active duties and only acts at the direction of the SMSF trustee.

Otherwise the holding trust may become a GST entity and be required to prepare and lodge tax returns.

The Tax Office has issued a ruling, SMSFR 2012/1, that details all the key concepts. Trustees of SMSFs should read this before entering into any LRBA.

Next week I will explain the other requirements of an LRBA once an asset has been acquired. There are laws in relation to whether the borrowed money can be used to repair, maintain, improve or replace the asset.

Monica Rule is the author of The Self-Managed Super Handbook – Superannuation Law for Self-Managed Superannuation Funds in plain English.
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PRODUCT WATCH

BetaShares Australian Top 20 Equity Yield Maximiser Fund

WHAT IT DOES: The BetaShares Australian Top 20 Equity Yield Maximiser Fund is a managed fund that trades on the ASX and is designed to maximise income from a portfolio of 20 blue-chip Australian shares. The fund, which trades under the ASX code YMAX, holds a portfolio of the 20 largest ASX-listed securities (as represented in the S&P/ASX 20 Index). How it differs is that it sells call options to increase its income, which inevitably gives away upside share price potential of the portfolio. In addition, the fund aims to provide lower overall volatility than the underlying share portfolio. Recent research by the ASX and University of Sydney showed funds employing this strategy can add meaningful performance to equity investment returns with reduced volatility over time in most market conditions.
WHAT IT COSTS: The annual management fee is 0.59 per cent. Investors pay normal brokerage to buy or sell the fund on the ASX.
WHAT WE LIKE: Investors can obtain exposure to blue-chip stocks while accessing greater quarterly income than the share portfolio alone.
WHAT WE DISLIKE: While the fund should provide greater income, you also sell some of the upside share price potential, so it will underperform in a strong bull market.
LAST WORD: It provides an opportunity for retail investors to hold equities and maximise income in a declining interest rate environment.

THE COACH

Question: My wife and I are retired and hold substantial investments in a large Queensland superannuation fund. During the global financial crisis, we shifted from the balanced option to the diversified bonds option. We understood that the return from bonds should generally increase as the cash rate decreases. However, that does not appear to be holding true at the moment. Should we simply hang on and tough it out? Having been bitten once, we don't wish to return to equities, despite the long-term evidence of their value. I don't have a lifetime in front of me to ride out the peaks and troughs of the stockmarket.

ANSWER: There are a number of steps you should take to reduce the likelihood of making a bad call. Clearly understand what your appetite for risk is. By determining your risk profile, you will have an understanding of what asset classes you should be invested in for the long term. Your super fund may have a profile tool on its website to assist you in this process. You should aim to be invested in accordance with your long-term risk profile. Most retirees look to have about 40 per cent of their assets invested defensively. Having shares or volatile assets in your portfolio is important to provide growth in the long term. It is critical to construct a portfolio to ensure you are not forced to sell these assets to provide for your income needs at a loss during a downturn.

Identify the income you require to draw from your allocated pensions over the next two years and hold this amount in cash and term deposits within the allocated pension. Draw your income payments from these funds. When markets improve, top up the cash account from growth assets.

Bond funds generally invest in a range of government and corporate bonds. The bond manager will actively trade the portfolio to reduce capital volatility and income volatility. You are correct that if interest rates fall the capital value of bonds should rise. But since the GFC there has been no certainty of this. When interest rates start rising at some stage in the future, the reverse will also be true.

From time to time you may wish to reduce exposure to growth assets if markets are overvalued, but if you fully divest out of growth assets you run the risk of missing the market getting back in.

ANDREW HEAVEN

ONLINE Visit the wealth section at www.theaustralian.com.au to send your questions, which will be answered by Andrew Heaven, an AMP financial planner at WealthPartners Financial Solutions.
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