Divorced Mums' Survival Guide

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Divorce can be a devastating experience but when combined with the increased financial pressures it can often be too much to bear. Hasty decisions about assets are often made during the post-settlement period of turmoil which can lead to undesirable investment outcomes for both parties.

Of course, divorced Mums face a unique set of circumstances than divorced Dads which is why this article has been written specifically for divorced Mums and the challenges they face (to read the Divorced Dads survival guide click here).

There are a significant number of strategies you can use to continue to provide for your children in the best possible way. The strategies I cover in the following pages are widely applicable, but ideally target divorced Mums who:

- Are left with 50-65% of the assets, dominated by the family home.
- Have main custody of their children and receive child maintenances.
- Receive Centrelink Family Benefit payments.
- Usually forgo the superannuation in the asset split.
- Encumbered with high costs of living independently.

Let's look at a common scenario and some of the mistakes that a 'typical Mum' makes:

> *Sadly, a marriage ends. The Mum receives 65% of the asset base which normally includes the family home (say $500,000) and the mortgage (say $200,000).The father typically receives a cash settlement.*
>
> *The Mum usually receives tax-free child maintenance (from the Dad) and mostly tax-free Centrelink benefits along with part-time work (in some cases) to live on and support the mortgage payments that came with the home.*
>
> *But the Mum looks at the $200,000 mortgage she has inherited and decides to sell and buy a cheaper home for $350,000.*
>
> *In the process she has just lost $50,000 in stamp duties, agents selling fees, advertising, moving costs, connection costs, etc, so she has decreased the mortgage by only $100,000 and now has a lower value asset that increases at a proportionally slower rate.*
>
> *She has 'usually' forgone the superannuation (in settlement) or has a token amount of say $10,000 in an account that is being rapidly eroded by fees. Invariably this amount is 'out of sight, out of mind'.*

You might be surprised but the above example is a very common outcome. Any divorce lawyer who doesn't instruct his client to seek separate financial advice before accepting a settlement and to have a plan for post-settlement recovery should be racked with the guilt of a significant omission in service.

How to move on

The most productive and empowering approach you can take at this point is to start the process of recovering is to 'move on' financially by picking up the pieces that remain and make a new start.

Remember that you're not alone and there are many avenues for support and guidance. Make an appointment to see someone like myself, get some direction and get going again.

Three 'suggested' roads to recovery in this article (there are many others).

1. Keep the family home (or look to buying a home) with the bulk of the settlement.

2. Look at tax effective investing (shares, rental property etc) when you return to full time work.

3. Review your superannuation position and take it seriously. Don't add to it beyond the 9% compulsory until you reach the age of 50+ in most cases.

Irrespective of the above, we would also consider a raft of other tax-effective investing strategies regardless of your age or circumstances which I may return to in the future.

Don't sell the house

When marriages break down for whatever reason and there are children involved, it is usually, but not always, the case that the Dad moves out and the Mum retains the family home.

Consider the example from the introduction:

> *The Mum looks at the $200,000 mortgage she has inherited and decides to sell and buy a cheaper home for $350,000 – in the process she has just lost $50,000 in stamp duties, agents selling fees, advertising, moving costs, connection costs, etc, so she has decreased the mortgage by only $100,000 and now has a lower value asset that increases at a proportionally slower rate.*

Even worse examples include instances of Mum selling the family home and placing the sale proceeds in the bank. Here's what wrong here:

- Mum loses an asset that likely would have grown in value, importantly in *untaxed* dollars.

- The money received from the sale sits in a bank earning interest which then *is taxed.*

- The sale proceeds in effect reduce pensions, child maintenance and other benefit entitlements which were *untaxed*.

- And to top it all off, you are now paying rent.

Mostly it's all very, very bad.

I am not saying in all cases the right strategy is to hold the home but in most it is the best way forward. Either way you *will* need an advisor who understands all of the above – use this article as the basis for getting advice specific to your situation.

Tax usually isn't a problem for the Mum. Most of their 'income', including child maintenance (and, in some cases, spouse maintenance), part-time employment, (mostly) untaxed government benefits and other concessional rebates free the Mum of any significant tax obligation – let's keep it that way.

If you can't afford to hold onto the family home (or acquire one – equally as important) then there are two strategies we can look at to assist. One is moving from capital and interest mortgage repayments to paying interest only.

Why would you do that? Simple – rent is dead money and you don't have any claim on the appreciating value of someone else's property. Why not pay a similar or lesser amount to enjoy both the security of owning your own home as well as the capital appreciation over time?

For example: If you have a $200,000 mortgage at 7.00%, you need only pay less than $270 per week in interest, which is *much* cheaper than rent!

The second strategy is based on the notion that it is better in the short term to watch the loan go up and win in the long term on tax free capital growth.

If, for example, when we have a $400,000 mortgage (on a $600,000 home) at 7% requiring approximately $538 per week in payments and we can only afford $450...

Remember from earlier that it costs upwards of $50,000 to sell and buy again at these levels. Let's assume a 5% growth rate (conservative) of $30,000 per annum *compounding* and equivalent rent of $400. It's not hard to do the numbers, is it? To save $138 per week you are losing $30,000 in tax–free, over time compounding asset appreciation, crazy!

At this point you also need to review your other credit facilities and consolidate expensive debt (credit cards, leases, etc) which are all paid off in *post-tax* money and refuse to extend it. Draw the line in the sand, make the change.

If there is no home, then look to buying one as soon as possible with the proceeds of the settlement. Post GFC credit is a lot harder to achieve however there are still ways that require a lateral approach (for example negotiate to keep 'the ex' on the loan if you have kept home) look to family or friends to help get you re-started.

The fact is when we get to thinking about it in most cases there is a lateral way in some cases there just is not, challenge me on it anytime, we love to help.

Investing – Can you afford it?

If you are under 50 and have returned to work full time then you are probably ready to consider a raft of different investment options, if not then the reality is that the children are taking up much of your time and effort. In most cases, and where income and equity allows, you should consider investing tax-effectively into another property or shares or any one of a number of other asset classes.

Let's look at a few examples to illustrate the points.

Example:

Buy another home using the equity that has built up in your family home and rent it out.

By doing this you avail yourself of the capital growth of the property market over time. Please note though, that any capital gain here will, unfortunately, be taxed upon sale, so ... don't sell! This is perfectly fine, because you will use that (unrealised) capital gain to leverage off into your next opportunity, whatever that may be.

Alternatively, consider this approach via one of the superannuation investment strategies (described next) and avoid all tax on the sale in retirement. Very powerful stuff!

Here's how it works:

$400,000 House/Unit loan

$28,000 Interest payable at 7%

$2,500 Rates, repairs, body corporate, etc

($19,500) Rent received

$11,000 Cash flow loss

$1,500 Non cash - Chattel depreciation

$7,500 Non cash - Building depreciation at 2.5%

$20,000 Tax loss

$6300 Tax refund at 31.5%

$4700 Cash flow loss

*A reminder: in this example we have used a tax rate of 31.5%. (The tax saving rises to $9,300 for a tax payer on the 2012 top tax bracket – to a very low $1700 cash flow loss)

Not a bad scenario is it? Minor cash flow losses at worst and if you consider a conservative capital growth rate of 5%, this equates to $20,000 per annum compounding on your $400,000 property. Over time you are going ahead, rents will increase, debts will be slowly repaid and the gap between $20,000 growth and net expenses grows and so does your ability to invest again.

Where to from here? Buy another property as your equity grows over time, diversify into higher yielding shares (my preference) or buy a property with your superannuation funds. It is all very achievable. The main outtake is 'Do something, don't do nothing'.

Words of warning: Always allow for a margin of error in your strategy. If interest rates move to higher levels, so too will your loan repayments and you need to be prepared for that. As a rule of thumb, allow for 2- 3% above current rates and for periods of vacancy, major repairs etc.

Always remember that the passage of time will inflate the property's value. At the age of 45 you have a probable twenty years left in the work force – plenty of time to reap the rewards of this approach.

Superannuation for the Mums 50+

Before we lose you at this point you must know that the super tax concessions are among the most powerful on offer.

Tax-effective investment doesn't get any better than making pre-tax contributions to superannuation. Super contributions are taxed at a low 15%. Compare this to the 31.5% tax rate most taxpayers face, meaning that for every $100 you 'salary sacrifice' into superannuation, you have an immediate saving of $16.50* in tax.

*A reminder: in this example we have used a tax rate of 31.5%. The tax saving rises to $31.50 for a tax payer on the 2012 top tax bracket.

Simply by putting money into superannuation you have made a 16.5% return on your pre-tax money (or just made 3+ years of term deposit interest on it) or a 31.5% return on your pre tax money if you're a top taxpayer (you can figure out how many years of term deposit interest that one is) so don't discount using SAFE super for post divorce recovery.

Example:

Assume you pay tax at the 31.5% tax rate and receive a $10,000 bonus. You would ordinarily lose $3,150 in tax. Alternatively, if you declare to have your bonuses paid directly into superannuation, you

lose only $1,500 in tax. That's a big difference of $1,650 that you will keep. The 'catch', of course, is that you cannot get to this money until your old enough to be retired (55-60 depending on your age).

With superannuation, though, the tax-effective savings don't stop at the contributions level as earnings derived from superannuation funds are taxed at just 10%-15%. After you have retired, it gets even better, as the earnings attract an unbelievable tax rate of zero!

Further, the tax paid on superannuation payouts after the age of sixty (and retired) is again zero!

Earnings, too, in superannuation aren't counted as income for child maintenance, something further for you to consider (if appropriate) and discuss with your advisor.

A general rule with contributions to superannuation is that before making additional salary sacrifice payments to superannuation, repay all your non-deductible loans (such as home loans, credit cards, etc) and other expenses prior to the age of fifty. Once beyond the glorious fifty – consolidate and hold debt and it's all super, in nearly all cases.

We see a lot of resistance from people considering the idea of contributing more to superannuation. This is because many people don't like managed superannuation funds (usually due to fee structures, poor performance in some cases, and the fees paid to financial planners). For these people, running a self-managed superannuation fund (SMSF) is often the right answer.

Example:

Sometimes it can be very difficult to show the tax benefits to someone who is resistant to superannuation to having their $200,000+ in the XYZ Managed Fund. In these cases, it is much easier to show the tax savings with an alternative: investing the $200,000+ in their own superannuation fund (SMSF), which then buys a small factory (for example) and then rents it back to either the investor's business or someone else's.

As of September 2007, borrowing funds inside your self-managed super is now a reality through the prudent use of easily constructed instalment warrants. An instalment warrant is a form of derivative, and I am well placed to advise on the benefits of using them in SMSFs. These are both something I am particularly passionate about - so passionate, in fact, that my doctoral thesis was about SMSF and levels of measurement for safe leveraged investment.

Example:

Put $200,000 into their own SMSF, which then borrows a further $200,000 through an instalment trust structure and buys a residential unit (cannot rent that one to yourself or to an associate) cash flow positive and your 9% super payroll contributions further help pay down the loan fast.

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There are a significant number of strategies covered here that will substantially enhance the financial recovery of Mums post-settlement (and there are plenty more where they came from). Mums need to

remember that looking after her financial health is fundamental to her overall well-being and her ability to provide for her children as best she can.

It is all very achievable. Here's a summary of what you need to do:

1. Get advice first, and get it quickly (prior to settlement).

2. Try to keep or buy a home – simple enough!

3. Invest, when kids are less demanding and you're in full time work.

4. Maximise the super power of superannuation post age 50:

   a. Immediate tax-effective return on your contributions.

   b. Concessional (low) tax rates on the earnings.

   c. Tax free status at age sixty (and retired).

   d. The ability to borrow through instalment warrants (enabling your SMSF to buy property).

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