

# BRAMWELL BROWN LTD

## INVESTMENT ADVISERS – BROKERS

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### **Bramwell Brown Limited – Newsletter – August 2015**

#### **Adviser Fraud**

Yet another financial adviser has been found guilty of defrauding investors. An Auckland mortgage broker and insurance adviser has been sentenced to six years in prison for stealing more than \$3 million of clients' money. There have been a raft of new laws governing financial advisers since the Global Financial Crisis, however I doubt dishonesty will ever be eliminated completely. What steps can you take to reduce the risk of a trusted adviser taking your money?

The easiest way for an adviser to steal client funds is if investors give that adviser discretion over their money. Fraudster, David Ross is a good example – investors simply handed over their money and trusted Ross to make wise investments. Instead he used investors' funds to supplement his lavish lifestyle while sending investors bogus investment reports. It is estimated Ross lost in excess of \$115 million of clients' money over a twelve year period. Many victims lost their entire life savings.

Any investment made through Bramwell Brown Limited is registered in the client's own name. Shares, debentures, bonds, bank deposits, KiwiSaver accounts and Kiwi Bonds are all held by the individual investor. Any security you buy should be traceable by it having a certificate issued, appearing on a registry statement, or a simple letter acknowledging your holding. In some cases overseas shares might be held by a nominee rather than in your own name in order to reduce the costs associated with buying them. I don't think you can completely eliminate the possibility of dishonesty in your dealings with money; however I think you can minimise the potential by ensuring your investments are registered in your own name. You have to trust your financial adviser to be doing what you have asked, but I would warn against giving an adviser complete discretion over your funds.

Bramwell Brown has intermediary agreements with various members of the New Zealand, Australian and overseas stock exchanges, and it's these brokers that will invoice you when orders for securities are placed. This should give some security to investors because your adviser (me) is one step removed from the financial side of the transaction. Yes, at times we forward client funds to various brokers through our Trust Account and in this instance you are relying on my honesty to do as requested. However as long as those securities are registered in your own name you will be able to check that nothing untoward has occurred.

## Reverse Equity Mortgages

Last month I briefly discussed home equity loans as a means of accessing funds for retirees. For whatever reason these products seem to have a bad reputation, yet the theory behind them is sound. For those with a debt free home but little in the way of investments a reverse equity mortgage could be a good means of accessing funds in retirement. With the growing need for solutions to the problem of lower incomes this type of product will possibly move into the mainstream. However any advantages need to be weighed carefully against the cost of finance and the risk of the unknown. The possibility of having no equity left in your home when you die is very real and must be considered.

Heartland Bank (Seniors Finance) and ASB (HomePlus) are the main providers of home equity loans in New Zealand. Both have similar offerings where you borrow against your home without having to make any repayments until your home is sold. Interest compounds each month and is added to the value of your loan. There are restrictions on how much you can borrow, however the mechanics of compound interest means loan balances can grow significantly over time. Here are some features of the Heartland Bank Seniors Finance offering:

- Borrowers must be aged 65 years or over
- Lifetime Occupancy Guarantee – your home will remain the place you live in for as long as you choose
- No Negative Equity Guarantee – the amount required to repay your loan will never exceed the net sale proceeds of the property
- Loan Repayment Guarantee – there is no requirement to make any loan repayment until the end of your loan
- Minimum loan - \$10,000
- Maximum loan - \$500,000
- Minimum house value (Wairarapa) - \$250,000

The amount you are able to borrow is based on your age. The older you are the more you are able to borrow (as a percentage of the value of your home). The formula to determine how much you can borrow as a percentage of your home's value is based on your age minus 45.

| Age of Borrower                     | 65  | 70  | 75  | 80  | 85  |
|-------------------------------------|-----|-----|-----|-----|-----|
| Maximum % of Home's Value Available | 20% | 25% | 30% | 35% | 40% |

If your home was worth \$500,000 and you were aged 65 you would be able to borrow \$100,000. If you were 85 you would be able to borrow \$200,000.

One of the most important points to be aware of is the ability of compound interest to increase the amount you owe over time. Interest is charged at approximately 1.5% to 2% above the major banks floating mortgage lending rates and compounds monthly. Heartland’s current interest rate is 7.85%. Here is a table showing the effect of compound interest on various principal sums and loan terms. The interest rate used is 8%.

| <b>Interest Rate<br/>8%</b> | <b>1 Year</b> | <b>5 Years</b> | <b>10 Years</b> | <b>15 Years</b> | <b>20 Years</b> |
|-----------------------------|---------------|----------------|-----------------|-----------------|-----------------|
| <b>50,000</b>               | 54,150        | 74,492         | 110,982         | 165,346         | 246,340         |
| <b>100,000</b>              | 108,300       | 148,985        | 221,964         | 330,692         | 492,680         |
| <b>150,000</b>              | 162,450       | 223,477        | 332,946         | 496,038         | 739,020         |

Look at the 20 years column – you can see the effect of compound interest. After 20 years you owe nearly five times what you borrowed initially. You may look at those figures and think the bank is ripping you off. Yes, 8% is a relatively high rate of interest in the current environment, but ask yourself this – would you lend someone \$100,000 for twenty years without expecting any repayments? If so what rate of return would you expect for taking that risk?

If we assume a 65 year old borrowed \$100,000 their home must have been worth at least \$500,000 at the time. After 20 years they owe \$493,000. However we can probably assume houses have risen in value over that same period. If we assume house price inflation of 2% per annum their home is now worth approximately \$743,000. So they still have \$250,000 equity left in their home. Heartland also offers an option where you can protect a percentage of the eventual net sale proceeds of your home (up to 50%). When your loan is repaid you or your estate is guaranteed to receive your chosen equity protection percentage. The amount you are able to borrow is reduced accordingly. For example if you want to protect 50% of the equity in your home only 50% of the property value is used for calculating the initial lending entitlement.

The important thing is that you understand the implications of taking out a loan for a lengthy period of time without making repayments. Seek advice – talk to your family, and speak to an independent financial adviser. Explore other options that may be cheaper than taking out a reverse mortgage:

- Downsizing – can you release equity by moving to a smaller home?
- Other investments – can you sell assets that are generating lower returns?
- Bank loan – could you borrow money and make regular repayments?
- Family – do you have family that can lend money or take a stake in your home?

## Official Cash Rate

The Reserve Bank has again lowered the Official Cash Rate. It is now down to 3.00% and is predicted to drop further before the end of the year. Banks continue to reduce their term deposit rates.

|                  | <b>1 Year</b> | <b>2 Years</b> | <b>3 Years</b> | <b>4 Years</b> | <b>5 Years</b> |
|------------------|---------------|----------------|----------------|----------------|----------------|
| <b>ANZ</b>       | 3.85%         | 4.05%          | 4.10%          | 4.15%          | 4.20%          |
| <b>ASB</b>       | 3.70%         | 3.90%          | 3.95%          | 4.00%          | 4.05%          |
| <b>BNZ</b>       | 3.85%         | 4.05%          | 4.10%          | 4.15%          | 4.20%          |
| <b>Heartland</b> | 3.95%         | 4.10%          | 4.20%          | 4.25%          | 4.35%          |
| <b>Kiwibank</b>  | 3.75%         | 3.75%          | 3.80%          | 3.85%          | 3.90%          |
| <b>Rabobank</b>  | 3.84%         | 3.94%          | 4.09%          | 4.18%          | 4.28%          |
| <b>UDC</b>       | 3.85%         | 3.95%          | 3.95%          | 4.00%          | 4.10%          |
| <b>Westpac</b>   | 3.75%         | 3.75%          | 3.75%          | 3.80%          | 3.85%          |

## Secondary Market Bonds

Here is a selection of secondary market bonds with their current yields.

| <b>Company</b>             | <b>Coupon</b> | <b>Maturity Date</b> | <b>Yield</b> | <b>Price/\$100</b> |
|----------------------------|---------------|----------------------|--------------|--------------------|
| Trustpower                 | 7.10%         | December 2017        | 4.15%        | 106.64             |
| Fletcher Building          | 7.15%         | March 2018           | 4.05%        | 107.64             |
| Z Energy Limited           | 7.25%         | August 2018          | 4.80%        | 107.58             |
| ANZ Bank                   | 6.25%         | March 2019           | 3.58%        | 108.98             |
| Contact Energy             | 5.80%         | May 2019             | 4.00%        | 106.30             |
| Z Energy                   | 6.50%         | November 2019        | 5.00%        | 106.15             |
| Infratil                   | 6.75%         | November 2019        | 4.80%        | 107.52             |
| Warehouse                  | 5.30%         | June 2020            | 4.45%        | 103.68             |
| Goodman Property Trust     | 6.20%         | December 2020        | 4.15%        | 109.78             |
| Sky TV                     | 6.25%         | March 2021           | 4.50%        | 108.71             |
| Wellington Airport         | 6.25%         | May 2021             | 4.43%        | 109.20             |
| Kiwi Income Property Trust | 6.15%         | August 2021          | 5.45%        | 103.57             |
| Trustpower                 | 5.63%         | December 2021        | 4.40%        | 106.80             |
| Goodman Property Trust     | 5.00%         | June 2022            | 4.40%        | 103.53             |
| Infratil                   | 6.85%         | June 2022            | 5.00%        | 110.70             |
| Kiwi Bank                  | 6.61%         | July 2024            | 4.95%        | 105.90             |
| Mighty River Power         | 6.90%         | July 2044            | 4.75%        | 107.69             |

**DISCLOSURE STATEMENT AVAILABLE ON REQUEST AND FREE OF CHARGE**