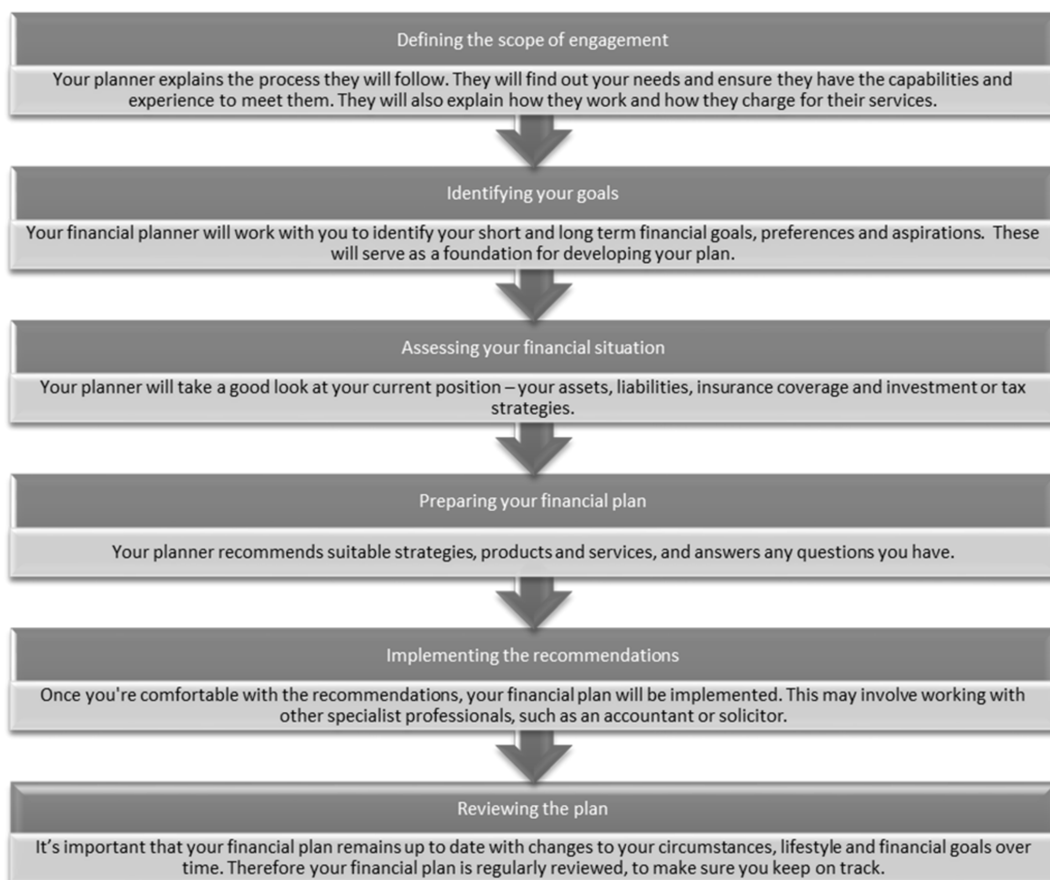
# Financial Planning Basics

## What is Financial Planning?

Financial planning involves working with a professional to navigate through the complexities of investment, taxation and changing rules and regulations. By working together you can navigate a pathway to reach your specific goals, preferences and aspirations.

Financial planning can help you through all stages of your life. The financial planning process involves the following six steps:




To gain the most value out of the financial planning process there are three fundamental issues that are important for you to consider and understand. These key components are discussed below.

## Goal Setting

The starting point for any plan is to set your personal goals. Financial goals are likely to be different for each person and need to reflect your specific preferences, aspirations and needs. Your goals may vary from short-term goals (less than one year) like buying a car, paying off your debt or going on a holiday, medium term goals (1-3 years) such as saving for your children's' education or long-term goals (5 years or more) like saving for a comfortable retirement and leaving behind a legacy.

Your goals will be more real and achievable if you can apply the following attributes:

- Specific: Make them specific to you and your family.
- Measurable: Ensure there is a measurement in place to determine whether the goals have been met.
- Achievable: The goals need to be achievable so while you may set a stretched target which requires you to be diligent don't set the target too high.
- Realistic: Your goals can be an aspiration but must still be grounded.
- Time-targeted: You need to set time targets to achieve your goals.

Once you have determined where you are heading, you can work with your financial planner to develop the pathway to achieving your goals.

## Budgeting

To put you on the path to building your wealth you need to start saving money. This may mean working out how to find more money. The best way to do this is to set yourself a budget.

Setting a budget is important for everyone no matter your age or how much money you have. It is especially important for people who are struggling to meet their goals or who keep building up debt.

A budget is not about just cutting expenses. It is about finding a good balance between your income and your expenses and deciding what is important to you so that you have money left over to save. A budget is not a fixed forever plan. You can continue to make adjustments over time until you reach a comfortable outcome and have a good strategy in place that will meet your goals.

There are two sides to a budget:

- Your income – includes income from all sources such as salary, interest, rental income and dividends, but only include your regular income and make sure you use after-tax income or allow for tax payable in your expenses.
- Your expenses – includes mortgage repayments, bills and general living expenses.

**Tip**

Go through the following documents to check you have captured all of your income and expenses:

- Bank account statements
- Credit card statements
- Pay slips (for both income and deductions)
- Cheque book details
- Expense receipts
- Bills and insurance certificates

You could also consider keeping a diary to record all your expenses – and don't forget all the little ones as this is where you can often make some significant savings.

Setting a budget is a simple step but sticking to the budget can be harder.

Below are ten tips for setting a good budget:

1. Make it realistic or you will never stick to it
2. Budget an amount for fun, leisure and personal expenses so you can avoid impulse buying
3. Save your pay rises, bonuses, special payments or tax refund
4. Look for small savings – for example, take your lunch to work, or use internet banking to reduce bank fees.
5. Pay by cash or EFTPOS to avoid credit card fees (and also avoid accumulating debt)
6. Reduce fees and charges – combine bank accounts to reduce fees
7. Put your change into a savings jar at the end of every day
8. Shop around and compare prices on insurance policies. Look for companies that offer discounts for multiple policies
9. Use lay-by options instead of debt and credit cards
10. Update your budget each year

## Understanding Debt

When used properly, debt can be an effective tool that may help you to achieve your financial goals. Debt can be used to purchase a range of items before you have saved the full purchase price.

It is important to understand the difference between 'good' debt and 'bad' debt. Debt can help you buy the family home, purchase a car or consumer goods and also enable you to purchase investment assets such as shares, managed funds or a rental property.

Where debt is used to acquire investments such as shares or property, this is known as gearing. This is often referred to as 'good' debt because it gives you the potential to claim a tax deduction for borrowing expenses and assets that will hopefully appreciate in value over time.

Borrowing to invest (gearing) simply allows you to use a combination of your own money and borrowed funds to accelerate wealth over the long-term. However it is a higher risk strategy that magnifies both the gains and losses from your portfolio. The higher the proportion of borrowed funds compared to your equity, the greater the associated risks. Options to gear into investments include margin lending, home equity loans or geared managed funds that borrow internally.

'Bad' debt is non-deductible debt like borrowings for consumer goods such as cars and holidays. Even though a loan for the family home is non-deductible, it should not necessarily be viewed as 'bad' debt because the value of the home has the ability to grow over time. But looking at strategies to pay off this debt as quickly as possible will increase your wealth.

In any case, paying off non-deductible debt before deductible debt will usually be the most appropriate course of action for many people.

The cost of borrowing can be high so you need to be disciplined and consider strategies to reduce the total interest cost, reduce the term of the loan and improve your cash flows.

Some of these strategies may include:

- Making loan repayments more often
- Making additional payments
- Repaying non-deductible debt first
- Combining loans into one account with a lower interest rate