Info Sheet

Income Protection

Have you recently taken on a mortage? If so, now is the time to review your income protection insurance.

As financial advisers we often have the privilege of celebrating with client's the purchase of their first home. It is the reward for long term budgeting, high investment into one's career and occasionally the financial assistance of family.

In the words of Scott Pape (*Barefoot Investor*):

"*The pride, and peace of mind, of owning your own home is one of life's big achievements*".

At the same time reaching the goal of homeownership comes with a price tag. Housing affordability is a key challenge of our time.

Let's briefly look at the difference in wealth between baby boomers at 25 to Generation Y (born 1981 – 1994) at the same time.

- In 1984, the average income was at $19,000 in contrast to $80,000 average today. However, residential property was cheaper costing just $64,000 on average. Compared to the $1,000,000 median house price in Sydney today.

- In 1996, the median house price was 6 times average annual earnings and today it sits around 13 times annual earnings.

Source: McCrindle Institute "Does Generation Y have it easier than the Baby Boomers?" 14th April 2016.

What these statistics mean for many first home buyers is that although they are the proud owner of a home, they are also the owner of significant debt and mortgage repayments. In Sydney a typical mortgage on a medium priced home, requires 2.04 average full-time salaries to "comfortably service" according to the Housing Industry Association.

Your ability to work and earn income is the key to debt repayment.

When it comes to servicing principal and interest repayments on your mortgage, your ability to keep working and generate income is the key to avoiding loan default. Although loss of income for a time can be planned e.g. taking time off work for the birth of a child, often the loss of income is totally unplanned and it is vital to have the right contingency plans in place. This is where personal insurance comes into its own. Developing a budget and learning to stick to it is one of the foundations of wealth creation.

Let's take the story of Ben as an example:

Ben is aged 35, a successful IT consultant and primary income earner of his family. However due to an unforeseen event, resulting in post-traumatic stress he ends up with severe depression. Under the supervision of a psychologist he is deemed unfit for work and after 3 months his sick leave is exhausted. On top of his mental health plan, he now adds the weight of principal and interest repayments equating to $3,000 per month. This situation is all too common. Fortunately, Ben proceeded with an income protection policy covering $6,000 per month and he has successfully been on claim for 2 years. With adequate cover he can continue to make loan repayments and provide a modest living for his family.

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Did you know?

Of the working population, **one in six men** and **one in four women** are expected to suffer a disability from the age of 35-65 that causes a loss of six months or more from work.

We all like to believe the philosophy "It wouldn't happen to me". However, the statistics demonstrate the importance of making sure adequate protection is in place.

Plan A is to stay fit, well and healthy performing the daily duties of your occupation. Plan B is the peace of mind and added protection that personal insurance provides.

So how does income protection work?

You can protect up to 75% of your gross income, should you be unable to work due to accident, illness or disability. This is referred to as the monthly benefit amount. Income protection benefits are payable dependent upon the waiting period and benefit period selected.

Waiting period – This is how long you are prepared to wait for your monthly benefits to be paid. This period should take into consideration your annual leave, sick leave and emergency cash available. Often waiting periods are between 30 and 90 days. Remember the longer the waiting period, the more affordable the premium.

Benefit period – The maximum period of time you will be paid should you be on claim and unable to work. Ideally the benefit period should cover you till your retirement age, protecting your earnings capacity for the length of your career.

The cost of insurance is calculated upon your age, gender, occupation, income, smoking status and income protection features selected. There is significant financial benefit in you establishing your income protection policy while you are young and healthy. Especially if your policy is structured with level premiums.

What policy is right for me?

With a variety of policies available in the marketplace, it is always important to compare 'apples with apples'. There is wide discrepancy in the definitions across policies. We believe that a comprehensive, fully underwritten insurance policy should be the starting point, offered by a reputable insurer with a strong history of paying claims.

Other key features for you to consider are as follows:

#1. Make sure your policy is agreed value.

Income Protection should be based upon your current earnings with financial evidence provided at time of application. This will guarantee your sums insured and remove the risk of your monthly benefit being revised downwards should your income level fall prior to claim.

#2. Consider level premiums.

Often insurance policies contain stepped premiums that increase with age. However, by locking in level premiums when you are younger it helps keep insurance cover affordable over the long term.

#3. Increasing claims benefit.

The cost of living is never static and when on claim it is vital your monthly sums insured increase with inflation on an annual basis.

#4. Protect your superannuation contributions.

If you are unable to work, you will no longer receive compulsory superannuation contributions from your employer. A superannuation savings option means that contributions are made into super on your behalf while you are not working, keeping your long term retirement savings on track.

If you would like to chat further about your income protection needs, don't hesitate to contact our office.

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