A good starting place in the search for more income

Reuben Zelwer

Things have never been better for borrowers. The Reserve Bank has set official interest rates at a historical low of 1 per cent, so home-loan rates in the low 3s are commonplace. But the flip side to low rates is that it is more challenging than ever for investors to obtain reasonable returns from low-risk investments. Here's a list of some good places to start.

Term deposits

The best you can hope for is to try to keep pace with inflation, with interest rates on offer of about 2 per cent. Even this might come with conditions attached, such as making regular deposits and no withdrawals.

You might be able to get a honeymoon rate for the first six months but, after that, the rate will likely halve – or worse. To get a better rate, you could always keep switching to other bank accounts for their sweetheart deals, provided you don't mind the extra paperwork. At least term deposits are secure, with deposits of up to $250,000 government guaranteed.

Mortgage funds

If you can't beat the banks, why not become one?

Investing in mortgage funds cut out the banks by allowing you to invest in a pool of loans which are directly loaned to borrowers.

It is not unusual to earn interest rates of 5 per cent or higher.

However, mortgage funds come with different levels of risk, so you need to be careful.

To be conservative, stick with a fund which holds first mortgages with a loan-to-valuation ratio of no greater than 65 per cent.

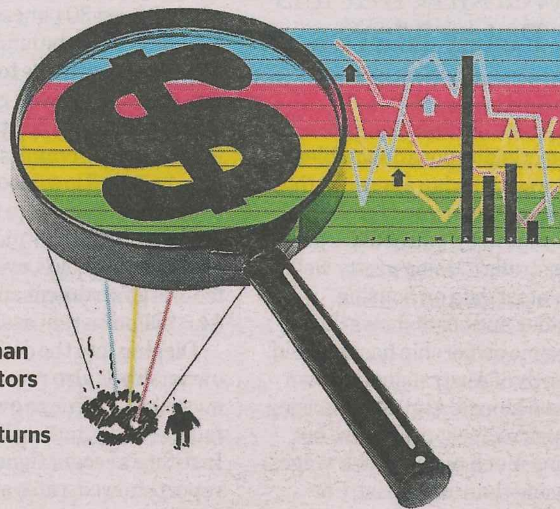
If you are bolder, you can get higher rates from funds which lend for property development and on second mortgages.

Listed fixed interest (hybrids)

Many companies, especially banks, raise money for their operations by issuing hybrid investments on the Australian Securities Exchange.

As their name suggests, hybrids have characteristics of both share and fixed-interest investments.

These come in many variations, with different terms and tax benefits, but have overall provided a good source of income for investors with lower volatility than shares.



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Shares

The average yield on the Australian share market is about 4 per cent. Franking credits, which either reduce your tax or give you a tax refund, depending on your circumstances, add up to another 1.3 per cent.

The sum of the two (5.3 per cent) is termed the "gross yield," which is useful as a comparison to some of the other options described above. And if you focus on bank stocks, the gross yield may be closer to 7.5 per cent.

Of course, companies can always reduce their dividends and there is a higher risk of this right now, as the economy slows and Australian companies are already paying out a high percentage of their profits as dividends.

Property

Leaving residential property aside, some good options for income seekers may include ASX-listed property trusts (A-REITS), or direct property funds whose underlying assets may include office, retail and industrial property.

They can provide access to assets that may be otherwise out of reach for individual investors, such as large-scale commercial properties that can provide income yields of more than 5 per cent.

As A-REITS are listed on the stock market, the value of your investment can vary daily, whereas the value of investment in direct property funds will only change as properties are re-valued, bought or sold.

As with all investments, it is critical to look under the hood and ensure you are comfortable with the risk you are taking on.

And, of course, always ensure that your portfolio is well diversified.

Good luck in your search.

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