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Your money, your future.

Financial Planning Newsletter

FINANCIAL SNAPSHOT

Mortgage versus super – a common dilemma

Conventional wisdom used to dictate Australians were better paying off their home loans, and then, once debt-free turning their attention to building up their super. But with interest rates ramping up over the past two years, and uncertainty as to when they are likely to reduce, what's the right strategy in the current market?

It's one of the most common questions financial advisers get. Are clients better off putting extra money into superannuation or the mortgage? Which strategy will leave them better off over time? In the super versus mortgage debate, no two people will get the same answer – but there are some rules of thumb you can follow to work out what's right for you.

One thing to consider is the interest rate on your home loan, in comparison to the rate of return on your super fund. As banks ramped up interest rates following the RBA hikes over the past two years, you may find that the gap between home loan interest rates and the returns you get in your super fund has potentially shrunk in comparison.

Super is also built on compounding interest. A dollar invested in super today may significantly grow over time. Keep in mind that the return you receive from your super fund in the current market may be different to returns you receive in the future. Markets go up and down and without a crystal ball, it's impossible to accurately predict how much money you'll make on your investment.

Each dollar going into the mortgage is from 'after-tax' dollars, whereas contributions into super can be made in 'pre-tax' dollars. For the majority of Australians, saving into super will reduce their overall tax bill – remembering that pre-tax contributions are capped at $30,000 from 1 July 2024 and taxed at 15% by the government (30% if you earn over $250,000) when they enter the fund.

So, with all that in mind, how does it stack up against paying off your home loan? There are a couple of things you need to weigh up.

Consider the size of your loan and how long you have left to pay it off

A dollar saved into your mortgage right at the beginning of a 30-year loan will have a much greater impact than a dollar saved right at the end.

The interest on a home loan is calculated daily

The more you pay off early, the less interest you pay over time. In a higher interest rate environment many homeowners, particularly those who bought a home some time ago on a variable rate, will now be paying much more each month for their home loan.

Offset or redraw facility

If you have an offset or redraw facility attached to your mortgage you can also access extra savings at call if you need them. This is different to super where you can't touch your earnings until preservation age or certain conditions of release are met.

Don't discount the 'emotional' aspect here as well. Many individuals may prefer paying off their home sooner rather than later and welcome the peace of mind that comes with clearing this debt. Only then will they feel comfortable in adding to their super.

Before making a decision, it's also important to weigh up your stage in life, particularly your age and your appetite for risk.

Whatever strategy you choose you'll need to regularly review your options if you're making regular voluntary super contributions or extra mortgage repayments. As bank interest rates move and markets fluctuate, the strategy you choose today may be different from the one that is right for you in the future.

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Case study where investing in super may be the best strategy

Barry is 55, single and earns $90,000 pa. He currently has a mortgage of $200,000, which he wants to pay off before he retires in 10 years' time at age 65. His current mortgage is as follows:

Mortgage	$200,000
Interest rate	6.80% pa
Term of home loan remaining	20 years
Monthly repayment (post tax)	$1,526.68 per month

Barry has spare net income and is considering whether to:

- make additional / extra repayments to his home mortgage (in post-tax dollars) to repay his mortgage in 10 years, or
- invest the pre-tax equivalent into superannuation as salary sacrifice and use the super proceeds at retirement to pay off the mortgage.

Assuming the loan interest rate remains the same for the 10-year period, Barry will need to pay an extra $775 per month post tax to clear the mortgage at age 65.

Alternatively, Barry can invest the pre-tax equivalent of $775 per month as a salary sacrifice contribution into super. As he earns $90,000 pa, his marginal tax rate is 34.5% (including the 2% Medicare levy), so the pre-tax equivalent is $1,183 per month. This equals to $14,196 pa, and after allowing for the 15% contributions tax, he'll have 85% of the contribution or $12,067 working for his super in a tax concessional environment.

To work out how much he'll have in super in 10 years, we're using the following super assumptions:

- The salary sacrifice contributions, when added to his employer SG contributions, remain within the $27,500 pa concessional cap.
- His super is invested in 70% growth/30% defensive assets, returning a gross return of 3.30% pa income (50% franked) and 2.81% pa growth.
- A representative fee of 0.50% pa of assets has been used.

If these assumptions remain the same over the 10-year period, Barry will have an extra $161,216 in super. His outstanding mortgage at that time is $132,662, and after he repays this balance from his super (tax free as he is over 60), he

will be $28,554 in front. Of course, the outcome may be different if there are changes in interest rates and super returns in that period.

Case study where investing in super may be the best strategy

40 year old Duy and 37 year old Emma are a young professional couple who have recently purchased their first apartment.

They're both on a marginal tax rate of 39% (including the 2% Medicare levy), and they have the capacity to direct an extra $1,000 per month into their mortgage, or alternatively, use the pre-tax equivalent to make salary sacrifice contributions to super.

Given their marginal tax rates, it would make sense mathematically to build up their super.

However, they're planning to have their first child within the next five years, and Emma will only return to work part-time. They will need savings to cover this period, as well as assist with private school fees.

Given their need to access some savings for this event, it would be preferable to direct the extra savings towards their mortgage, and redraw it as required, rather than place it into super where access is restricted to at least age 60.

Get in touch

We can help you decide between mortgage repayments and super contributions based on your individual circumstances, life stages, and risk tolerance. Contact us to find the best option for you.

How mindfulness can improve the way we work

Social psychologist and Harvard University Professor Ellen Langer says increased mindfulness can deliver measurable benefits.

It's fair to say the pandemic has changed the Australian workplace. Flexibility has become the new norm, with many of us working from home at least some of the week, despite the ongoing conversation about getting back to the office.

And while it's great to enjoy a work/life balance that our parents and grandparents could only have dreamed of, it does come with pressures of its own.

As we juggle the demands of work and family life – not to mention cost of living pressures – it's more important than ever to take a step back and be mindful about how we live and work.

Mindfulness is often described as simply another form of meditation. But it's much more than that. Mindfulness is the simple art of noticing new things. Paying attention. Never assuming.

Social psychologist and Harvard University Professor Ellen Langer has been studying mindfulness for more than 40 years.

Professor Langer says mindfulness is an active state of mind characterised by being:

- situated in the present
- sensitive to context and perspective
- guided (but not rigidly ruled) by rules and routine
- more engaged.

Her research shows increased mindfulness translates to measurable benefits for our psychological wellbeing, physical health and productivity[1].

When 1+1 can equal 3

It's all too easy to slip into mindlessness—the opposite of mindfulness. Mindlessness is grounded in accepting absolute truths.

Professor Langer says, "When you're asked a question to which you think you know the answer, there's probably another way to look at it."

Does 1+1 always equal 2? In a rigid theoretical mathematical context, yes. In the real world, with all the real world's variables, not necessarily.

By being mindful, and uncertain, you question everything. And this can lead to meaningful change.

Professor Langer says, "Rather than the illusion of stability, exploit the power in uncertainty."

With only subtle shifts in our thinking and expectations, we can begin to change the ingrained behaviour that saps health, competence, optimism and vitality from our lives.

Try again. Fail again. Fail better

The fear of making mistakes can be a roadblock to change. And failure in one thing can result in success in another. Professor Langer cites a famous example of a company turning a failed glue that didn't stick properly into the hugely successful concept of the post-it note.

Mindful optimism can be a more productive mindset than defensive pessimism, where you hope for the best but expect the worst. The alternative is to make a plan, and then get on with living.

Mindfulness can have some startling benefits. Many of Professor Langer's studies focus on how changing mental perceptions can lead to improved physical outcomes.

Her famous Counterclockwise study showed the mind and body are more attuned than we might think. The researchers changed the external environment for a group of elderly men and turned the clock back 20 years. The participants didn't simply emerge with a more youthful mindset, they rolled back the years in terms of their physical capabilities and even their appearance.

5 ways to create a more mindful workplace

Mindfulness doesn't only deliver personal benefits. It can also lead to better business outcomes. In a study of salespeople, participants who were encouraged to deviate from a set script and think about what they were doing ended up selling more magazines.

And mindfulness is contagious. In a collaborative workplace, there can be a knock-on effect. When you see someone else exhibiting mindful characteristics, you tend to increase your own mindfulness.

Here are a few tips from Professor Langer to create a more mindful workplace.

1. Accept you don't always know the answer
2. See accidents or mistakes as possibilities
3. Recognise everyone has something useful to contribute
4. Encourage more from the people around you
5. Exploit the power of uncertainty.

A workplace dominated by fixed mindsets can lead to problems as people become afraid a lack of knowledge will be discovered.

A workplace dominated by flexible mindsets can free people up to make meaningful change as they accept they don't necessarily have the best way of doing everything.

"Lack of expertise is what keeps us interested in what we're doing, and by extension, keeps us interesting to other people", Professor Langer says.

"If we increase our mindfulness, we increase our effectiveness, health and wellbeing."

The challenges and conflicting priorities for Australians under 40

Australians under 40 often grapple with housing affordability, ongoing mortgage repayments, family planning, and career progression.

However, these are also exciting times, marked by milestones such as buying your first home, having children and career advancements.

What's often missing are the conversations with ageing parents on the planning of wealth distribution.

With around $3.5 trillion expected to be transferred from those aged 60+ over the next 20 years – almost the size of our current super system – AMP's recent research (with under 40s Australians) has uncovered some interesting dynamics within families - including a lack of communication between the generations on wealth matters.

Not relying on the 'Bank of mum and dad'

The findings also reflect a clear desire of under 40s to secure their own financial independence, not relying on the 'bank of mum and dad', despite concerns that increasing housing unaffordability will impact their own wealth in retirement.

- 4 in 5 under 40 haven't asked their parents for any financial support
- 3 in 5 under 40 haven't spoken to their parents about wealth transferral
- Only 1 in 5 are relying on financial assistance and inheritance from their parents for their future financial security

Despite these statistics, half of those under 40s that were surveyed, believe they will need to financially support their parents, as they age.

In the current economic environment, intergenerational wealth discussions within families need to become a priority, as those under 40 reflected a general lack of confidence in achieving financial security and independence, despite their desire to do so.

- 3 in 5 under 40 believe their generation has it harder financially than their parents did, increasing to 7 in 10 for those under 29
- 4 in 5 under 40 who currently don't own a property believe it will be out of reach
- 4 in 5 under 40 believe that not owning a property will be detrimental to their long-term wealth and retirement

When you consider the above findings with the knowledge that many Australian retirees are fearful their savings won't last – a fear which prevents spending and impacts their quality of life, potentially hindering open discussions with their children – it becomes even more important that effective communication and financial planning is implemented for the benefit of all generations.

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How financial advice can help

Financial advice is important, not just for pre and post retirees, it can equally help the under 40s develop successful wealth creation and protection strategies by looking at a client's whole situation including the intergenerational wealth challenges within their extended families and devising tailored solutions for their unique circumstances.

An adviser can help younger clients engage with their maturing parents and understand the implications of different decisions with regard to intergenerational wealth transfer, including options involving financially dependent loved ones.

Contact us to see how we can help develop a wealth creation strategy to suit your goals and plans.

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