Super or the mortgage?

Many people wait until their home loan is paid off before investing more in super. However, if you are currently making more than the minimum home loan repayments, you may be better off when you retire if you make additional super contributions instead.

Why super?

There are two key reasons why topping up your super could be a better option.

The first is that home loan repayments are usually made with after-tax money. Alternatively, super contributions can be made with pre-tax dollars (if you're an employee) or claimed as a tax deduction (if you're self-employed and meet other eligibility requirements). These concessions can help you use your surplus cash flow more effectively.

The other reason is the amount of concessional super contributions[1] you can make each year is far lower than it used to be. As a result, it has become much more difficult to make large tax-effective super contributions just before you retire.

To achieve the retirement lifestyle you desire, you may need to make additional super contributions earlier than you had planned. That way you can take greater advantage of the contribution cap over the remainder of your working life.

Case study

Max is 45, earns $100,000 pa, plus 9.5% Superannuation Guarantee contributions from his employer and wants to retire at 60. He owns a home worth $700,000 and owes $300,000 on his mortgage. The remaining term is 15 years and the minimum loan repayment is $2,696 per month.

He's considering the following two options:

1. Make the minimum home loan repayments and top-up his employer's super contributions so that he takes full advantage of the concessional contribution cap in each of the next 15 years. This means he won't pay off his home loan until he's 60, but he will maximise his concessional super contributions over the next 15 years.
2. Instead of topping up his super as outlined above, he would use the cash flow to make extra mortgage repayments instead. Then when he is debt-free he would top-up his employer's contributions to take full advantage of the concessional contribution cap and use any money left over to make non-concessional contributions[2]. This means he will pay off his mortgage in an estimated 8 years and 7 months but will only maximise his concessional contribution cap for 6 years and 5 months.

The table below shows the results from both options. In this scenario, it's estimated Max could retire with his mortgage still paid off and an extra $127,995 in super.

	Option 1	Option 2
Time taken to pay off loan	15 years	8 years 7 months
Years when CC cap fully utilised	15 years	6 years 5 months
Total super accumulated over 15 years[3]	$857,005	$729,010
Value added by option 1	**$127,995**	

Assumptions: Home loan interest rate is 7% pa. Total pre-tax investment return is 8.1% pa (split 3.2% income and 4.9% growth). Investment income is franked at 30%. Salary is not indexed. SG contributions are increased progressively to 12% by 2025/26 as legislated. CC cap is increased by $5,000 in 2018/19, 2022/23, 2026/27, 2030/31 and 2033/34. Earnings in super are taxed at 15%. No allowance has been made for CGT that would be payable if the investments were redeemed.

Key issues to consider

Will you need access to any of the money before you retire?

While making additional concessional contributions could help you retire with more super, it's important to consider whether you'll need access to the money before you meet certain conditions. A key benefit of making extra home loan repayments is the money can usually be accessed at any time through a redraw facility or offset account.

What's your current age and work status?

If you're 55 or older[4] and intend to keep working, you may want to use some of your super to start a Transition to Retirement pension. This could provide you with additional income that could be used to make extra super contributions.

How much investment risk is right for you?

Making additional mortgage repayments is considered a low risk financial strategy and provides savings through lower interest costs. It may be more appropriate for you. But if you're prepared to take a moderate degree of investment risk, making additional concessional contributions could be worthwhile.

The bottom line

This super contribution strategy may be an effective way to boost retirement savings, but it won't suit everyone and the results will depend on your circumstances, including your age, risk profile and when you'll need access to your funds.

To find out more, contact Rick Maggi on 9382 8885.

1. Concessional contributions are all employer contributions (including Superannuation Guarantee and salary sacrifice), personal contributions claimed as a tax deduction and certain other amounts. Currently, the cap on concessional contributions is $35,000 per financial year if you were aged 49 or over on 30 June in the previous financial year, otherwise it's $30,000 per financial year.
2. Non-concessional contributions include contributions made from your after-tax pay or savings into your own or spouse's super account and certain other amounts.
3. These figures ignore Max's existing super balance.
4. The minimum age at which a Transition to Retirement Pension can be started may be higher than 55, depending on your date of birth.

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