

**STORY  
SUSAN HELY**

Along with paying off the family home, super has been a cornerstone of retirement planning. But governments keep changing the rules, so it's increasingly important to have an alternative nest egg.

Money asked the experts for savings strategies for four age groups: the 30s, 40s, 50s and 60s.



# Build wealth outside super

**A**ustralians have always worried about the government changing the rules for retirement savings but lately their anxiety has grown more intense. In fact, it is the No. 1 concern for retirees and pre-retirees, reports a survey of 1200 superannuants by State Street Global Advisors and Rice Warner. It found 63% of informed investors and 58% of high-net-worth investors are worried about potential government changes to super.

That isn't surprising, given the recent moves by the federal government to cut back on eligibility for the age pension, and 326,000 people will receive a reduced part-pension or none at all. And it has doubled the super tax rate for high-income earners. This is on top of raising the pension age to 67 and the preservation age to 60, depending on your date of birth. Health benefits have been reduced for many seniors as the government tightened the eligibility for the Commonwealth seniors health card.

There are certainly more changes to come, says Pauline Vamos, the chief executive of the Association of Superannuation Funds of Australia. She says super rules will be adjusted so that it has to do more "heavy lifting". Most likely there will be a tax on high balances in super and mandated income streams with limits on lump sums.

The Labor Party has flagged that, if it wins government, anyone earning more than \$75,000 a year from their super fund will pay 15% tax. This

income roughly equates to the dividends from a \$1.5 million super balance. Also Labor will reduce the high-income threshold that attracts a 30% tax rate from the current \$300,000 a year to \$250,000.

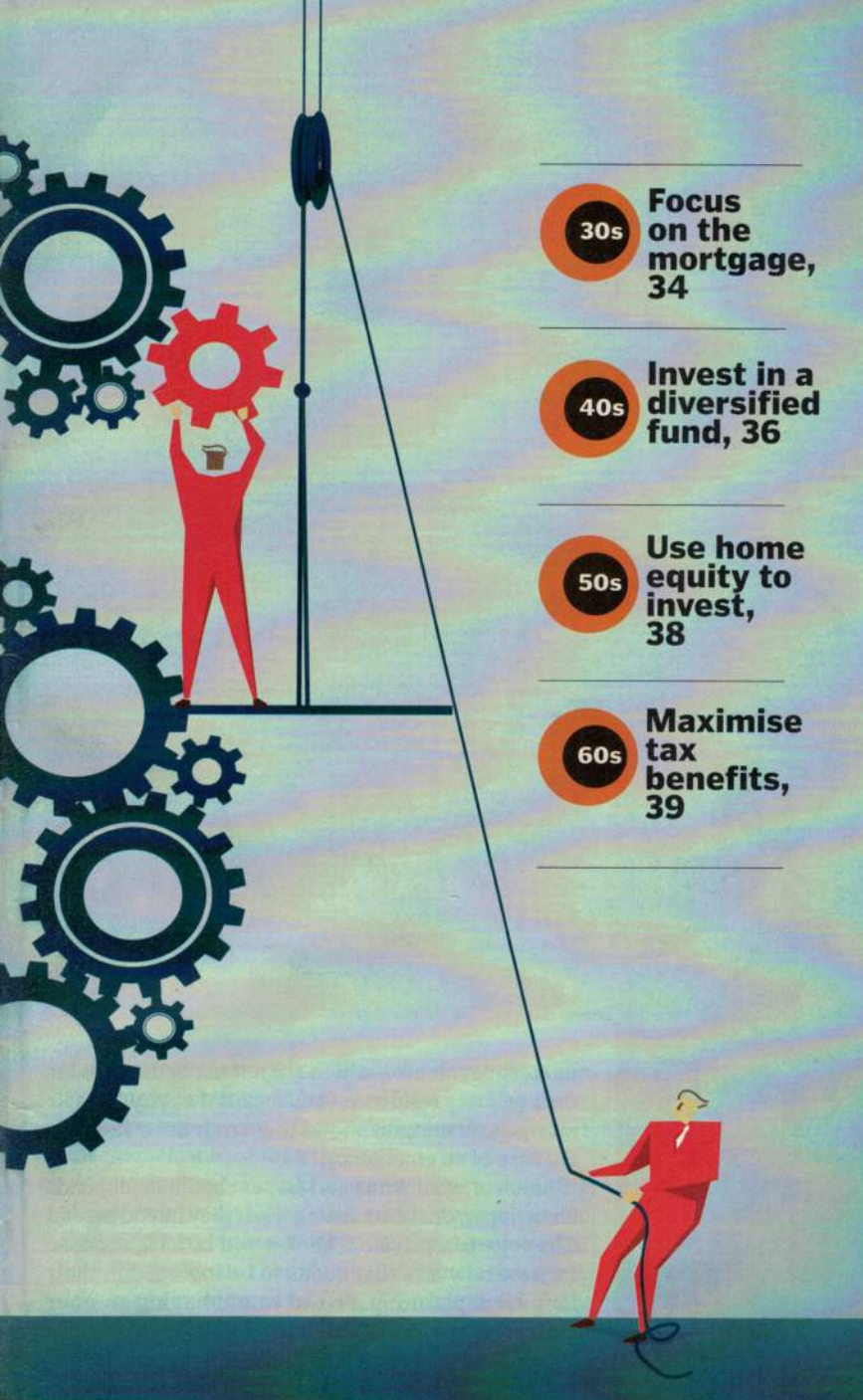
## Greater choice and control

Almost every week a report recommends changes to the super system that will affect people's retirement budgets. Vamos says the changes shouldn't be about short-term political needs.

Super has been one of two assets that Australians have focused on throughout their working lives. The other is the family home, because once the mortgage is paid off you can live rent free in old age.

With all this uncertainty, there is no better time to broaden your approach to build wealth outside super. Financial planners have been advising investors to do this for some time. One of the main





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benefits is that you can access it when you need it – not when the government dictates. As well as minimising the legislative risk, it can help fund the unexpected, such as an early redundancy or illness that keeps you out of the workforce or at a lower level of earning before you reach your preservation age or qualify for an age pension.

And you may not want to keep working until 65 or 70. Money outside super gives you more choices and more control over when you retire. While Australians are living longer, they are not necessarily working longer. The Australian Bureau of Statistics reports the average retirement age for men is 63 and for women 60. It is important to have savings so that you can afford to retire from a job that is bad for your health or wellbeing.

A downside is that holding your investments outside super can mean you pay more tax than you

would if you held them in super. If you own shares, cash, term deposits or positively geared property, you are taxed at your marginal rate, which can be up to 47c (plus the Medicare levy). In an era of low interest rates, your gains can be wiped out by tax and inflation.

There are tax-effective investment strategies for building wealth outside super that include borrowing, holding assets in the lower-income earner's name and timing the selling of assets to minimise capital gains.

“When it comes to building wealth, you need to think about what you are building wealth for,” says Vamos. Besides super, Australians typically save to pay for holidays or school fees.

### **Benefit of an early start**

While recognising that super is the most tax-efficient and consistent vehicle for building a retirement nest egg, *Money* has asked four experienced independent financial planners for tips on boosting long-term wealth for four age groups: Claire Mackay, from Quantum Financial, explains the challenges and strategies for 30-year-olds; Lynda Cross, from Mercer Financial Advice, gives advice for 40-year-olds; Joanna McCreery, director of Majella Wealth Advisers, looks at strategies for 50-year-olds; and Chris Hogan, from HLB Mann Judd, covers what people in their 60s can do.

Certainly, the earlier you begin the more you benefit from the power of compound interest. Borrowing to invest can help accelerate your wealth if you invest well for the long term, says McCreery. “Interest on the loan also helps reduce taxable income,” she says.

You don't need to buy property; you can invest a small amount in a portfolio of shares. Target shares with high franking credits on their dividends and then hold them for the longer term so you aren't hit with capital gains tax from frequent trading.

If you don't borrow, McCreery recommends investing in the lower-income earner's name. If possible, sell when you are retired or semi-retired so that you pay less capital gains tax.

There are plenty of factors to consider with all these investments. Cross says family trusts, for example, have benefits such as paying small amounts of income to children tax free, but for younger couples with fewer assets the cost of setting up and running them can outweigh the tax benefits.

With the current low interest rates, many people are putting spare money into the mortgage until they have paid off at least 50%. This can take them into their middle 40s or early 50s.

Mackay is a big fan of paying off the mortgage as soon as possible as it reduces non-deductible interest payments and the equity can be used to redraw funds needed in an emergency.

## THE 50s

**M**any people begin thinking about their wealth accumulation in earnest once they hit 50. It's often when they are earning more, the mortgage is under control and maybe they also see an end in sight to child-raising costs. Moving to a better work-life balance in the next 10 or 15 years is also often a desire.

To give yourself options in the future, 50 is a good time to plan ahead. Repaying the mortgage is an easy, low-risk way to accumulate wealth. But with interest rates low, you don't need to plough all your excess funds into the mortgage; repaying it by retirement or semi-retirement may be a fast enough schedule for many.

Salary sacrificing to super is a great way to save. With preservation age for someone who is 50 only 10 years away, the decision to increase salary sacrifice may be easier now. Super no longer seems like something you will never be able to use.

For someone like Glen earning \$100,000pa, for every \$1000 of salary he earns over \$80,000 he receives \$610 (after tax and Medicare levy) in the bank. Alternatively, he could salary sacrifice \$1000 and add \$850 after tax to super. In fact, I'd be talking to Glen about salary sacrificing as much as he is allowed to (\$35,000 less his 9.5% super guarantee contribution and any payments his employer makes to his super). If he salary sacrificed \$25,500pa, he would save a net \$6120pa in tax. Because Glen is on a higher marginal rate, it is more tax effective for him than for Narelle to salary sacrifice.

Many current 50-year-olds may find that their super balances are well under what they will need in retirement. One reason is that compulsory super was not introduced until 1992 (when they were 27) and, in the first years, the compulsory payment (the SG) was much lower, only increasing to 9% in 2002.

Today's 50-year-olds also face a challenge that recent retirees didn't, and that is the relatively low concessional contribution cap. Someone who retired five years ago was able to salary sacrifice a significant amount of their salary to super at the

## OUR COUPLE

**Fifty-year-olds Glen and Narelle earn around \$145,000 (\$45,000 and \$100,000 respectively). They have two teenage children. Their super balance is around \$200,000.**



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end of their working life. But today's concessional contribution cap for 50-year-olds is only \$35,000.

So building your super balance earlier is more important now. It's too late to leave it until you're 60. For Glen and Narelle, the SG alone is projected to result in a combined super balance of \$1.2 million by age 67. We project that would give them a retirement income of only \$42,000pa (in today's dollars) for 30 years, assuming a 6.5%pa return.

But what if you want to move to a more flexible lifestyle before you reach your preservation age? Or what if the government increases your preservation age? Building up some assets outside super as well makes a lot of sense.

After repaying your home loan, saving a monthly amount of your after-tax income is the lowest-risk way to build up assets outside super. It's not particularly tax effective though. Unlike salary sacrifice, you are investing after-tax income. All income and capital gains will also be subject to tax. To minimise this tax, we'd recommend establishing the account in the lower-income partner's name. Investing a portion of the investment in Australian shares will also give franking credits to offset tax.

For people who are relatively risk tolerant and willing to invest for the long term, we would recommend they consider borrowing. Interest on the investment loan is tax deductible, so it's a tax-effective way to invest outside super. For people like Glen and Narelle, with plenty of home equity, the cheapest source of debt will be a home equity loan. Borrowing and investing into a diversified portfolio for the long term would be a good strategy to consider. By reinvesting the income, you continually add to your investment.

An alternative strategy for our couple is to use home equity to make a deposit on an investment property and borrow the remainder. This would most likely result in a larger loan and it is therefore a bigger financial commitment, but the value of the investment is more stable than for shares. As for shares, property investment must be made with caution and research, particularly given the recent strong increase in property prices in many places.

Some words of caution:

- If your plan is to use the equity in your investment within 10 years, investing in property (or a 100% share portfolio) may not be right for you as it's a relatively short time horizon to access the full potential growth of these investments.
- Investing in any asset is most risky if you become a forced seller. Investors need to ensure they can withstand negative events like asset price falls or, in the case of property, a period of vacancy.

For many people in their 50s – particularly those who have their mortgage under control and can contribute the maximum to super and still have the capacity to save – building up an investment outside super offers more flexibility in terms of access, so can help you achieve goals before you reach your preservation age.

## TOP TIPS

- Borrowing to invest can help accelerate wealth creation if you invest well for the long term. Interest on the loan will also reduce your taxable income.
- If you don't want a large investment loan, then consider investing in a portfolio of shares.
- If the investment is not made with borrowed funds, invest in the lower-income partner's name. Also set up a monthly savings plan so that you are adding regularly to your investment.
- To minimise taxable income, invest in shares with a buy-and-hold philosophy. Frequent buying and selling will increase your capital gains tax. Holding an asset for more than a year also attracts half the tax rate on the capital gain.
- Invest part of your portfolio in shares offering high franking credits on their dividends.
- If you are investing in shares or property, and especially if you are borrowing to invest, make sure you plan to, and are able to, invest for the long term (10-plus years).
- Invest gradually into sharemarkets to minimise the chance you are doing so at the wrong time.
- Investing in property involves high transaction costs and, if you borrow most of the cost of the property, it will probably involve you losing money on the investment for a long time (rent and maintenance costs are likely to be less than the interest costs). To ensure the investment is worth making, you need to be confident in the potential for the property's price to rise in the long term.
- Make sure you won't be forced to sell when share or property prices are down. This means making sure you have the financial capacity and the risk appetite to remain invested during the tough times.
- If possible, plan to sell when you are retired or semi-retired so that you pay a lower rate of capital gains tax.