

Deductible super contributions vs mortgage

If you have spare cash you may be wondering how best to use it. Those with a mortgage often prefer to use surplus cash to pay down their mortgage. With rising interest rates and greater economic uncertainty this can be a wise choice.

However, can contributing spare cash to super give you a better outcome? Both strategies have advantages and disadvantages, but the right choice depends on your personal situation. Let's take a closer look at the options.

Option 1: Pay down your mortgage

Putting extra money towards your mortgage helps reduce non-deductible debt, that is, debt carrying interest that isn't tax-deductible. This strategy can be particularly appealing if you value certainty or plan to free up cash flow soon. Key advantages include:

- **Guaranteed savings:** every extra dollar paid directly reduces your interest costs. For example, on a 5% loan, an additional \$10,000 payment saves you \$500 a year. This is essentially a risk-free 5% return.
- **Increased equity:** reducing your loan balance builds equity in your property, which can improve your financial flexibility if you need to borrow against it or decide to sell.
- **Improved cash flow and peace of mind:** with a smaller loan, your minimum repayments shrink, giving you more breathing room and financial security.

The downside is that unlike super contributions, there are no immediate tax benefits. Over the long term, investment returns from a well-diversified super portfolio often exceed typical mortgage interest rates.

Option 2: Contribute to super

Concessional super contributions, like salary sacrifice or personal deductible contributions, boost retirement savings and cut personal tax. They're especially appealing for people near retirement. Super may be partly or fully accessible after 60 at which time withdrawals are generally tax free and can be used to repay loans whilst also having enjoyed a tax break on contributions. Key advantages include:

- **Tax benefits:** contributions are taxed at 15% in super (or 30% for some high-income earners), often below your marginal rate.
- **Long-term growth:** super investments in growth assets, plus a concessional tax rate of 15% on asset income in super, can significantly grow your retirement savings.

The downside is that funds are locked away until you reach age 60 and meet a condition of release, such as retiring, so they are generally unavailable for emergencies. Market movements may also affect your super balance along the way.

Case study

Charles has \$10,000 (after tax) of surplus cash flow each year. He is considering using this surplus cash flow to pay down his mortgage on a holiday home or making a personal deductible contribution to super. He is 55, plans to fully retire at 60 and is in the 39% tax bracket (including Medicare Levy). His mortgage is incurring interest at 6.2%.

Option 1 – pay down mortgage

If Charles makes an additional \$10,000 one-off mortgage repayment each year for the next five years, he will have about \$56,600 less debt than he would otherwise have. That figure includes the interest he no longer has to pay because the loan balance is lower.

Option 2 – make concessional contribution to super

If Charles can forgo \$10,000 of after-tax cash flow, he can potentially make a personal deductible contribution of approximately \$16,390 and be in the same after-tax cash flow position. As he is paying 39% tax, a \$16,390 deductible super contribution will reduce his tax by \$6,390 meaning his cash flow only reduces by \$10,000 per annum.

Let's assume a net super contribution of \$13,930 (\$16,390 less 15% contributions tax) invested each year into super for the next five years, and a net return of 6.2%. That is the same rate as his mortgage, which keeps the comparison conservative. In this case Charles will have about \$78,800 more in super than he would otherwise have. After five years Charles is aged 60 and if he is also retired, he is free to withdraw any amount of super, tax-free, to pay down remaining debt.

Charles has two things to get right. The \$16,390 counts towards his concessional contributions cap, together with any employer contributions, so he needs to check he has room before he contributes. He also has to give his fund a valid notice of intent to claim a deduction, and receive the fund's acknowledgement, before he lodges his tax return. Miss that step and the deduction is lost.

The verdict

There is no one-size-fits-all answer. Paying down your mortgage offers security and peace of mind. Making extra concessional super contributions can deliver powerful tax benefits and long-term growth in retirement savings.

Whether you're focused on financial flexibility now or building wealth for later, speak to your adviser to help you make the most of your money.