Wealth

Planning for retirement when you're still in debt

If you find yourself carrying debt in the lead-up to retirement, don't panic. Instead, focus on prioritising.

As they move towards retirement, most people assume their financial focus will be on building wealth. But what happens if you first – or worse, simultaneously – have to focus on reducing debt?

Unfortunately, a lot of people face this dilemma, says Ayshe Agaoglu, Financial Adviser at Australian Unity, who points out that the proportion of home owners aged 55 to 64 with a mortgage has more than tripled, from 14% in 1990 to 47% in 2015. This situation isn't ideal. "Ideally, you would enter retirement debt-free, including the home mortgage," says Ayshe.

Debt is a setback, so start retirement planning early

Whether your debt comes in the form of a home loan, personal loan or credit card, it can be a sponge that soaks up your super savings later down the track.

"It's not a good idea to start retirement having to use at least part of your super to fully pay off your debts or reduce your debt, or having to direct part of your super pensions to repayments," says Ayshe.

"If people are using some of their super savings to discharge debt at retirement, this inevitably means that their retirement income will be less than they thought – which usually means that they end up relying more on the Age Pension than they had planned."

People finding themselves poised to take too much debt into retirement often have to consider remaining in the workforce for longer than they had intended, or downsizing to a less expensive home.

"There is a range of reasons why retirees take debt into retirement. In my experience, the most common denominator in most cases has been the lack of planning for the future," says Ayshe.

"A lot of us get caught up in the day-to-day, and don't set aside the time to plan for retirement properly – so we wake up one day with the prospect of facing either a voluntary or an involuntary retirement."

The need for budgeting (hint: it never goes away)

So how do you ensure you're not taking debt into retirement? It comes back to that old standby – the budget.

Like most things, it's best to start the planning process as early as possible, explains Ayshe. "Preparing a budget 10 to 15 years ahead of retirement means you can really

understand your complete financial picture, as well as understanding any areas you might have to fine-tune. Doing this will pay huge rewards as you approach retirement."

To do this effectively, he says, the very first step is to draw up a budget of your income and expenses. "The size of the debt will then determine the kind of choices you may have. Your options may range from drastically changing your spending habits to working longer or perhaps even dipping into your super savings upon retirement to clear any debts," says Ayshe.

"Of course, this will have broader and significant effects on the lifestyle you could afford in retirement. It's best to discuss the different scenarios thoroughly with your adviser at the earliest possible time, and choose the most viable path forward."

Getting rid of debt

Once you're ready to begin paying down your debts, Ayshe suggests categorising them into "good" debt and "bad" debt.

As a rule of thumb, bad debt doesn't allow you to claim a tax deduction or doesn't generate an income – for example, credit cards or personal loans. Good debt, on the other hand, is used to create wealth – for example, borrowing for investment purposes. In order to prioritise, you could simply list all your debts from the highest interest paid to the lowest.

Once you've done this, Ayshe suggests that you decide how much of your income surplus you can commit to paying down the debt – with a focus on bad debt – as quickly as possible. Then you can move on to your good debt, such as your mortgage, and start to pay this down rapidly too.

"Other simple tips might be to increase your repayment frequency, increase your repayment amount and/or pay your salary into the loan through a redraw facility. This may lower the interest paid, allowing you to pay off the principal more quickly," says Ayshe.

Another option may be to consolidate all your various debts into one. By doing so, you can roll high-interest debts (such as credit cards) into loans with lower interest

rates, such as your home loan or, in some cases, personal loans – which again saves you interest.

Take advantage of super tax breaks and growth assets

An alternative – or more likely, a complementary approach – to paying down debt in preparation for retirement is to focus on building your super, says Ayshe.

"Depending on your situation, you can uses strategies such as making a government co-contribution, making a spouse contribution, consolidating super if you're in a couple (which reduces the running costs of your superannuation), salary sacrificing for tax purposes, and/or making a concessional or non-concessional contribution," says Ayshe. These can all be tax-effective options that give your super a quick injection of wealth.

People also have the opportunity to accelerate their wealth creation – or rebuild the capital that has been used to clear debt – by using a higher exposure to growth assets. "It's an option available to people with a higher risk appetite, but from experience, most pre- and post-retirees tend to be more conservative in nature," says Ayshe.

"Most retirees will have some of their retirement savings in growth assets; how much is allocated to growth assets will also determine the sort of a return we can aim for. How much they need will be guided by their individual situation."

Not everyone can manage to clear all their debt from the books before they retire, but there are strategies you can put in place to get rid of the debt as soon as possible. It's just a case of prioritising your finances to make the situation work for you.

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