Good income is necessary, but not sufficient to create wealth

The perspective

Household mortgage & personal debts are pivotal to an average family's financial issues & stress. Typically, families in the early stages of their working lives tend to indulge in a lifestyle that makes them over-commit to personal debts often in an unstructured way, assuming they'll be able to catch up financially later. In reality, rarely one can catch up until it's too late!

Even families with good incomes, average mortgage & other personal debts find themselves cash-tight and are unable to get ahead financially often due to unplanned personal spending & multiple loan commitments. This is why conventional wisdom holds that a good income is necessary, but not sufficient to make one wealthy.

Families with an average mortgage generally start with making minimum repayments as required by banks, spend the rest for lifestyle & other debt repayments and live on. This seems quite normal until you ponder where this ends & how to get ahead financially sooner.

On the other hand, credits are easy to obtain when you have a job with good income. Financial products are designed by financial institutions & intermediaries to sell, bundle & make profit. Due to competition among product providers, average families often end up in making poor unplanned financial decisions.

Consequently, households find it difficult to get ahead financially due to the combined effect of lack of solid financial vision, unplanned often emotional debt commitments & no financial guidance. Eventually they become ill-prepared when it's time to retire leaving them no choice but deferring retirement or retire with a compromised lifestyle.

The analysis

A family with an average initial mortgage balance of $500,000 making minimum repayments for a 25-year loan term would pay a total circa $500,000 interest to bank. To earn these repayments the family would pay another $500,000 in tax to ATO. That is, the family must earn $3 pre-tax to reduce $1 mortgage in the above situation.

If the family above is now 35, after 25-30 years they would find themselves at the verge of retirement when their mortgage is just paid off. They would then realise that they actually haven't saved enough and there's little or no time to create just enough wealth for retirement.

For a mortgage, banks calculate interest every day and charge the interest monthly. Therefore, should a family maintain cash saving elsewhere or start a savings plan leaving mortgage outstanding may prove a wasted opportunity in the context of reducing mortgage sooner. The concept of 'offset' facility bundled with a mortgage product does not really do the job as it gives a debt-stricken family the wrong signal of being cash-rich and may encourage spending.

A strategy commonly observed to be popular among bankers or mortgage brokers is to influence households split their mortgages with different fixed loan terms. This strategy is like planning to become a mortgage paralysed and is more likely to work in favour of the lenders or brokers.

The proposition

The aim of the financial institutions and intermediaries is to maximise profits by selling their products, not necessarily assisting & guiding consumers for their overall financial wellbeing.

Consumers need financial education & guidance in identifying their financial vision, planning to pay off mortgage & personal debts sooner as a matter of priority to get ahead financially & create adequate wealth to support their cherished lifestyle and retirement before time runs out.

Value of advice

Financial planners with relevant qualifications & expertise are better positioned to assist families achieve their major financial goals of paying off mortgage and other debts sooner, enjoy a stress-free lifestyle and become a self-funded retiree at a later stage.

At Next G Wealth Pty Ltd we provide our clients with customised financial planning services. We guide our clients through the process of understanding their cash flow & budget and provide a step-by-step, dynamic and forward-looking analysis of their mortgage & debt situations to identify a suitable solution. The crux of our design is to eliminate mortgage & personal debts in the shortest possible time.

With appropriate planning it is possible to pay off mortgage & personal debts within half the original loan term. This sets in motion the process of wealth creation sooner without having to wait until the mortgage is gone. In the investment context, time in the market not timing the market is important.

We assist & guide our clients uncover their financial aspirations before developing a tailor-made ‘roadmap’ with realistic wealth & retirement projections. We then update the dynamic ‘financial plan’ moving forward to incorporate any changes in their circumstances. During the ongoing review process clients naturally get engaged in giving their financial vision a reality.

A couple in their 40s with average incomes can become self-funded retirees with a combined retirement assets of $3M plus.

With a properly constructed ‘roadmap to wealth’ clients can foresee how they can make a difference to their financial wellbeing. A ‘financial plan’ can be a powerful tool to keep a family on track in achieving their financial freedom & peace of mind. After all, honest and informed advice adds value.

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