In for a long, exciting haul

NOEL WHITTAKER

Forego instant gratification in favour of the thrill of accruing real wealth.

JANUARY has gone, and all those New Year's resolutions to lose weight and get your finances in order may have gone with it. You're probably berating yourself with statements like "I've got no willpower", or "this happens every year".

Take heart – the sad truth is that the human body is not wired for long-term planning. Our ancestors were hunters and gatherers who lived by the rule of fight or flight. Their dominant thoughts were purely about survival.

As a result, we instinctively prefer an action with a fast pay-off to one with a long-term result. The scientific name for it is hyperbolic discounting – it causes people to make choices that can lead to short-term pleasure, but long-term disaster.

Credit card usage is an obvious example. Who cares about paying interest at 20 per cent on their credit card balance, living beyond their means, or getting into financial strife when they can simply swipe their credit card and get a retail fix.

Research from John Hopkins University reveals that only 10 per cent of coronary bypass patients make the necessary changes to their lifestyle to prevent further attacks. The remaining 90 per cent still opt for the short-term pleasures of unhealthy food and no exercise.

To make it more difficult, long-term progress by its nature is slow and erratic, and is often discouraging. Imagine you got excited about investing $500 a month into a managed fund that matched the All Ordinaries Index. If the market had a great year and produced 12 per cent compound you would have $6341 at year's end. The profit would be just $341. However, if the market had a bad year and went backwards by 5 per cent, your portfolio would be worth $5864. The difference is minimal.

This is the point where most people give up and move on to something else with the lure of a quick high return. However, if you kept investing that $500 a month for 35 years, and the investment averaged 9 per annum, the portfolio would grow to $1.4 million.

It works the same when you are paying off a mortgage. If you owed $300,000 on your home at 5.5 per cent with monthly repayments of $1703, the term would be 30 years and total interest payable would be $314,000.

Suppose you learned about the effect of compound interest and decided to slash your home loan to 20 years by raising your payments to $2064 a month, which would save more than $119,000 in interest. It's an exciting prospect, but after five long years at the higher payments, you would still owe $253,000, and may start to feel the result isn't worth the effort. But hang in there for another 20 years and it would be paid off. In contrast, leaving the payments at $1703 would have you still owing $157,000 in 20 years' time.

This leads us to a fundamental success principle, which is applicable in every aspect of your life – focus on the process and not the outcome. Because success comes slowly, you will almost certainly get discouraged and probably give up if you keep thinking about the outcome. It's like planting a seedling and then digging it up every year to see if it's growing. The secret is to get excited about the process, in the certain knowledge that the right process, if followed through, will almost always lead to the outcome you are looking for.

DOLLARS AND SENSE: If you water your money tree lightly and consistently, it will flourish into something large.

Q I am 27 and considering when to buy a house. My taxable income is $95,000, and I have a $6000 personal loan plus $10,000 on a credit card. Can you suggest the best way to reduce my debt, and whether I'm better off saving for a deposit or continuing to rent and investing excess income elsewhere?

A Your first goal should be to get your finances in order because on the information provided you have a negative net worth and are spending more than you are earning. The beginning of a new financial year is a great time to do this so I suggest you start by doing a simple budget which will enable you to analyse your expenses to see where savings can be made. Once you have rearranged your spending to produce a surplus, you should direct that entire surplus to paying off your personal debts. Once they are under control you can re-examine your options.

Q We have purchased a block of land and hope to build our dream home in the future, but still have a mortgage on our family home. We borrowed the entire purchase price of $350,000 with an interest-only loan. Is the interest paid on this loan tax deductible?

A For the interest on a loan to be tax deductible, the purpose of that loan must be to buy income-producing property. Based on the information supplied you do not qualify.

Noel Whittaker is the author of *Making Money Made Simple*, and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before

Lessen the stress of paying for their education

By **JOHN COLLETT**

AS every parent of school-aged children knows, the costs of education can mount up.

The most expensive schools in Sydney and Melbourne charge more than $30,000 for year 12.

The latest Australian Scholarships Group Planning for Education Index estimates that the cost of a private education in Sydney is $541,275, or more than $1 million for two children.

Melbourne is not far behind, with the costs of a private education in the Victorian capital estimated at $508,088.

Sydney is also the most expensive city for public education, with a total cost of $71,406. Melbourne, again, is not far behind, at $69,349.

But wherever you are, educating your children will cost money.

Reality check

Financial planners say parents need to think hard about what type of education would benefit their child most and then look at the numbers to see what they can afford.

Regardless of which education system they choose, parents need to start planning financially for education from the time their child is born.

No single answer

For all but the wealthiest parents, there will be no one solution. It will be a combination of specific savings and finding the money from cash flow.

Accumulated savings are most needed during the last two or three years of school, when expenses are at their highest. That is usually when there are two or three children at high school at the same time.

The earlier the savings plan is started, the better. Not only is there more time to save, but parents can also afford to take on more investment risk, such as with shares, in the knowledge that they have the time to recover from market downturns.

With an investment time frame of at least 10 years, parents will see the money grow more than if it is in a lower-returning investment, such as a term deposit, by the time it is needed for school expenses.

Ways to save

A couple of savings plans are dedicated to education and training costs. The oldest is Australian Scholarships Group. The non-profit organisation has its basic Education Fund that is designed to help with secondary and post-secondary costs. The Supplementary Education Program helps meet the costs of private primary, secondary and tertiary education costs. The Future Education Program can be started before the child is born.

ASG also has a range of educational resources intended to support parents and their children.

The Lifeplan Education Investment Fund from Lifeplan Funds Management, which is owned by Australian Unity, gives access to 16 investment options. Specially designed education savings plans receive tax breaks if they qualify under the scholarships provision of the Tax Act, which Lifeplan and Australian Scholarships Group do.

Managed funds

Investing directly, rather than through education savings plans, gives parents total flexibility on how much money is contributed and how the money in the fund is spent.

That, of course, requires the parents not to spend the money on anything other than their children's education.

Parents who are both on high incomes and want to invest directly rather than through a plan could consider investment bonds. For those with at least 10 years to invest, many planners recommend investment bonds.

Mortgage strategies

For parents with a mortgage, the experts agree that saving through a mortgage offset account is one of the best ways to save.

Most lenders have offset accounts that can be attached to their mortgages.

YOUR ACTION PLAN

Start early: Think hard about the schooling for your children and whether it is affordable.

Review the best ways to save: Whether through a special education savings plan, managed investments or direct investments, such as shares.

Get on with it: There's more time to save and more investment risk can be taken to maximise returns.

Use redraw: Consider putting some money into a mortgage redraw account. That way, the mortgage is being paid off, but the money can be withdrawn as a last resort.