MONEY

VALUE OF PERSONAL LOANS DRAWN DOWN IN YEAR TO THE END OF MARCH

€3bn

INCREASE OF 15.3%

INCREASE IN POINT OF SALE MOBILE WALLET PAYMENTS IN YEAR TO JUNE

23.9%

MONTHLY VALUE EXCEEDS €2BN

SOURCE: BPFI, CENTRAL BANK OF IRELAND

POLYGRAM PRODUCTION/ALAMY

What dreams may come when paying off your mortgage

Clearing your home loan can feel truly liberating after years of careful budgeting, but managing your newfound wealth can be a minefield, warns *Kieran O'Daly*

Finally paying off your mortgage is one of life's great milestones. It can feel like crossing the finish line after a gruelling test of patience and endurance. While it is certainly a cause for celebration, it is also an ideal opportunity to take stock as you begin a new chapter in your financial life.

"For someone paying €1,500 a month, becoming mortgage-free is the equivalent of receiving an additional €18,000 a year in disposable income, which is quite a significant sum," Nick Charalambous of Alpha Wealth says.

"The temptation is to see that money as additional spending power and just fritter it away, but it's actually one of the biggest opportunities you'll ever have to improve your long-term financial position. What you do with it will depend on your age, financial circumstances and family situation, but there are many options worth considering. There are also plenty of potential pitfalls to avoid."

EMERGENCY BUFFER

The initial inclination for most people after years of hard graft is to let the excess cash burn a hole in their pocket.

"That's understandable," Ralph Benson of Moneycube says. "It's important to celebrate the end of what has been a very long journey. It's a significant milestone that deserves to be marked before moving on and putting the money to good use by shoring up any weak spots in your finances."

Among the options Benson recommends is to pay down any other debts as soon as possible. "Your mortgage is the cheapest debt you'll probably ever have," he adds. "Anything else is expensive by comparison and should be cleared immediately."

Once you have cleared any high interest debts, it is then a good idea to use the financial discipline you have established through years of monthly payments to build or boost your emergency fund. Financial experts agree that having three ot six months of living expenses in a high-yield and easily accessible savings account is critical for dealing with any unexpected curveballs life might throw your way, such as home repairs, illness or even loss of employment.

Becoming mortgage-free may put you in seventh heaven, like Robin William in What Dreams May Come

LOOK TO THE FUTURE

"It's also important to look even further ahead than just the emergency fund period at this juncture," Hugh Lambert of Integral Financial Planning says.

"What extraordinary expenses will you need to cover over the next three to five years? This could include education, home extension, car replacement or even a wedding. With your mortgage paid off, it's a good opportunity to put money aside now to cover these short-term expenses before they arrive."

The next step should be to maximise your pension pot. Many homeowners manage to pay off their mortgage in their late forties to mid-fifties. This is often when earnings are at their highest, which makes it an excellent opportunity to redirect any excess cash into retirement planning, particularly since pension tax relief limits increase with age, rising from 15 per cent of earnings in your thirties to as much as 40 per cent from the age of 60 onwards.

Another option is to increase your insurance cover. Many people carry decreasing-term life cover linked directly to their mortgage, which means it no longer suits their needs once the mortgage has been paid off and should be replaced with something more appropriate. Reviewing other protection insurance policies such as income protection and critical illness cover and topping up where necessary is also a good idea.

Investing the excess cash in an exchange-traded fund basket or index-linked fund is a good way of increasing wealth, particularly if you have a window of ten years or more to offset any short-term losses. With cash being transferred to the investment account on a regular basis, it also helps in maintaining a saving mindset.

Many global equity-based funds have averaged annual returns of 10 per cent-plus over the past five years. Depending on your appetite for risk, you could switch into more stable funds as you approach retirement age, thereby protecting any gains made while the money that you once paid to the bank stays working for you.

> **Your mortgage is the cheapest debt you'll probably ever have**

SAFE AS HOUSES

Many people opt to use the excess cash to make home improvements. While this is generally a good idea, it is important not to spend vast sums on works that neither enhance the quality of your life nor increases the value of your home. This is particularly relevant for anyone who may be considering trading down at some stage in the future.

"People also need to think about the effect climate change will have on their living conditions and take action to future-proof their homes where possible," Lambert says.

"There has been huge focus on insulation and heat-loss prevention over the past few years but given the rising temperatures we are now experiencing, it will be important to be able to cool living spaces as well. We've had daily temperatures in excess of 20C for more than four weeks running this summer, and it looks like it's only going to get worse."

Another home-related consideration after paying off your initial mortgage is whether you might need to take out another one at some stage if you plan on moving or downsizing. "What's your plan in this regard over the next five to ten years?" Benson asks.

"Do you have an exit plan and a timetable, and do you need to start saving to ensure that you can afford it? Remember, it may not be that easy to get another mortgage as you grow older, so you need to plan ahead."

The end of a mortgage cycle can also be an ideal opportunity to offer some financial help to the next generation through tax-efficient succession planning, or even covering things such as education costs or a house deposit. The small gift exemption allows each parent to give €3,000 a year to a child or grandchild tax-free, meaning a couple can pass on €6,000 annually between them. Starting early generally provides more options than waiting until later in life. Another option is to take out a section 72 insurance policy to offset any inheritance tax liability for your heirs.

THINGS TO AVOID

After years of budgeting around a mortgage repayment, it is understandable to want to enjoy the extra money. "A newer car, more holidays or home improvements may all be well deserved, but the danger is when the mortgage payment is quietly replaced with permanent increases in day-to-day spending," Charalambous says. "Before committing to higher monthly costs, ask what you want that money to achieve over the next 10 to 20 years, since lifestyle inflation is surprisingly difficult to reverse.

"Make sure your surplus cash is working as hard as you did to earn it. If you want easy access, a competitive deposit account, such as those offered by some of the online banks, can offer a much better return than a standard current account. If your time horizon is longer, investing through a diversified portfolio may be more appropriate."

Lambert agrees. "Beware of lifestyle creep," he adds. "Don't just waste the money. Put at least 50 per cent of the excess cash into something – whether it means investing in stocks and shares, or making additional payments into your pension pot."

"Paying off your mortgage isn't the end of your financial journey, it's the beginning of a new one," Charalambous stresses. "The financial habits that helped you clear that mortgage in the first place can now be redirected towards building wealth, strengthening your retirement options and creating greater financial security."

Question of money

My wife and I purchased an apartment in trust for our son in 2014 when he was 46. Its value then was €150,000 and he has lived in it since. We are thinking of transferring the property, now worth €275,000, into our son's name. What is the best way to do this? Will it expose us or our son to any tax liabilities?

KN, address withheld

One of the primary tax benefits of using a trust in Ireland is its potential to defer capital acquisitions tax (CAT). Once distributions are made from the trust to the beneficiaries, though, CAT may arise. So, your son could face a CAT bill when the apartment is transferred from the trust to him. However, in this regard, there are a couple of tax reliefs.

First, under current thresholds, your son can inherit or be given €400,000 tax-free from his parents over his lifetime. Any surplus is taxable at 33 per cent. Because the value of the apartment is below the threshold, your son may be able to inherit it CAT-free, as long as the total value of any gifts and inheritances from you both over his lifetime does not exceed €400,000.

Second, under the small gift exemption, you can give up to €3,000 a year, per person, to any individual without it affecting their lifetime CAT threshold. In practical terms, this means you both can each gift €3,000 annually to your son, for €6,000 a year in total, tax-free. These gifts do not need to be reported to Revenue as long as they fall within the exemption limits.

If your son is likely to receive more than €400,000 in inheritances and gifts from you both, a section 72 life insurance policy could help him pay any inheritance tax liability when you die. As long as the proceeds of a section 72 life insurance policy are used to repay an inheritance tax bill, those proceeds will be tax-free. Note that if the section 72 policy proceeds exceed the inheritance tax bill, the surplus will be liable to inheritance tax. A section 73 savings plan, which is designed to help accumulate funds to pay CAT on lifetime gifts, is another option you could consider.

As well as CAT, some taxes that could be triggered by this transaction include stamp duty and discretionary trust tax, depending on the type of trust. An income tax or capital gains tax liability could also arise on income or gains in the trust.

As you can see, trust and estate planning is a complex matter. It would be important to consult a qualified tax adviser to understand the specific tax implications of the transaction you are considering.

In addition, a financial planner could help you to explore any potential strategies to reduce any tax bills that might arise.

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Eoghan Gavigan

Don't rely on a state pension with these demographic trends

Financial planners are encouraged to frame a client's retirement planning without factoring in the state pension. While it can seem like a harsh assumption, it makes for a more robust financial plan. An alternative is to factor in the pension but use a rate for pension income growth below that used for future inflation.

That's a defensible assumption for a client who is past middle age, but I wouldn't favour leaning on the state pension for a younger person who has 30 or more years to wait.

The contributory state pension, which was introduced in 1961, is unlikely to survive in its present form until its 100th birthday. The increase in life expectancies since its introduction and changing demographics mean that its future is uncertain. As the birthrate – and ratio of workers to pensioners – continues to fall, exacerbating the funding issue, and as automatic enrolment ramps up, it's difficult to see the state pension continuing to be funded to the extent it is now.

Will it be reduced? Unlikely, at least in nominal terms. Will it become a means-tested benefit? Hopefully not. Will future increases match inflation? Doubtful – which would mean that its value would reduce in real terms. The replacement fertility rate in Ireland is estimated to be 2.1 children per woman. According to the Central Statistics Office, fertility rates in Ireland in the Sixties and Seventies were always above 3.2 but today come in at circa 1.5.

> **Fewer births today means fewer woman of childbearing age**

But we are only in the ha'penny place. Spare a thought for South Korea, which has the lowest fertility rate in the world at 0.8. It is a remarkably low figure and a serious concern for its government on three fronts: economic contraction; maintaining a full-strength army to ward off the threat from North Korea; and future pension funding.

A low fertility rate can cause a momentum effect, as fewer births today means fewer women of childbearing age tomorrow, which affects any recovery in the rate.

Ireland's demographic changes are partly offset by inward migration. On a recent holiday to South Korea, I noticed that migration isn't much of a feature there. The only place I encountered non-Koreans was in tourism hotspots such as the demilitarised zone and the shopping district in Myeong-dong. Another thing I didn't see very much of was children.

South Korea is culturally very different to Ireland. It's almost a given that men get first preference for jobs, so women are forced to choose between career and family – and the cost of housing and education often means that these two things are, to some extent, mutually exclusive.

This binary choice between career and family has caused something of a cultural backlash from young Korean women. Our tour guide told me that she and her friends want to be Dinks (double income, no kids). The economic realities of raising a family are a big ask, so the ratio of working people to pensioners is likely to reduce further over time.

Much like Ireland needs to make changes to make our state pension sustainable, so does South Korea. The state pension age is already being raised from 60, and will reach 65 by 2033.

The other obvious solution is to increase the fertility rate, and South Korea has thrown the proverbial house at this. The parents of children born since 2024 can expect to receive 29.6 million won (€18,000) over the first eight years of the child's life. While the dial has been moved just a little in the right direction, it is still far short of where it needs to be.

One might wonder whether the Irish housing crisis, which shows little sign of abating, could cause a similar crisis to develop here. Living with parents for longer, delaying relationships and having children later are all plainly evident in Ireland, and all put pressure on the fertility rate.

While a number of schemes have been introduced to alleviate the housing crisis, the effect can't been seen on the ground yet. If it isn't sorted soon, then it has the potential to cause a death spiral of South Korean proportions.

It might be the case that we have to throw the house (or houses) at this, too, before it's too late.

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