

Retirement strategies: Planning for a life of leisure

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Retirement can have some negative connotations. People may associate it with getting old, loss of purpose, boredom and aged care, so is it any wonder people put off thinking about retirement, especially if they are feeling fit, healthy and are enjoying life? But this is a big mistake.



Retirement expectations

Many pre-retirees have high expectations about their retirement lifestyle. They may plan to keep active, do some travelling, take up intellectual pursuits and attain new skills.

Whether they want some or all of these to be a part of their life in retirement, effective planning is the only way they'll be able to achieve their wishes. It's a common misconception that retirement planning should only be done in the period immediately before someone is about to retire. In reality, at least five to 10 years before clients retire is the time to critically assess whether they can afford the retirement lifestyle they envisage. Without some preparation, it is unlikely that their lifestyle expectations will be fulfilled.

With retirees these days needing to fund at least 20 years of retirement on average and potentially much more, the challenge is how to do it. Reliance on the age pension could mean retirement is a less than enjoyable experience for those who want to maintain a certain standard of living.

Before working out how much is needed to fund retirement, clients need to set goals and determine how they want to spend their time in retirement. Without these goals, it is difficult to estimate how much income will be required. A retirement income goal of 60 per cent of pre-retirement income is a common benchmark.

There are many calculators available that estimate the amount of capital required for a desired income level in retirement. Table 1 provides a rough estimate of the lump sum required to generate various income levels over several retirement periods.

For many people, the bulk of the income they require in retirement will be generated by the savings they have been able to accumulate during their working lives.

Considerations in retirement planning

Factors to consider in preparing for the future include:

- superannuation;
- income streams – pre- and post-retirement;
- insurance, including income protection;
- Centrelink entitlements; and
- estate planning.



Superannuation



With concessional tax rates, superannuation is one of the most attractive retirement savings vehicles available. Investment earnings within a super fund are currently taxed at a maximum rate of 15 per cent. This contrasts with taxation at marginal tax rates of up to 46.5 per cent on many other investments. Additionally, access to money saved in super is generally restricted until retirement, when it can be used to purchase a concessional tax income stream.

Salary sacrifice

One of the most tax efficient ways to invest in super is through salary sacrifice. These contributions are taxed at a maximum rate of 15 per cent (instead of an individual's marginal tax rate). On the top marginal tax rate, salary sacrifice can mean the difference between investing up to 85 per cent of salary (after contributions tax of 15 per cent) compared to 53.5 per cent if investing after-tax salary (46.5 per cent marginal tax rate).

Co-contribution

Low to medium income employees and self-employed individuals who make after-tax investments into super may be eligible to have their contributions matched by the Government, with \$1 co-contributed for each dollar up to a maximum of \$1,000 (2009-10). The annual addition of these contributions can make a substantial difference to retirement savings over a long period of time.

Spouse contribution

In the case of couples, it can be tax-effective to accumulate superannuation in both names. If an individual's spouse does not have much super or is unable to contribute to super, spouse contributions can equalise the super between an individual and their spouse and allow a spouse to access insurance. The contributor may also be eligible for a tax offset.

Income streams

For many people, the answer to replacing lost salary in retirement lies in the form of income streams and, in particular, superannuation allocated pensions (and, less so, lifetime annuities).

Transition to retirement

For some, the idea of ceasing full-time work abruptly can be quite daunting. This is why a gradual transition to retirement can be a good strategy. It allows people to cut back on their working hours while maintaining their income or accelerating their superannuation savings.

Allocated pensions

Allocated pensions are a flexible, tax-effective way to provide income in retirement. Investment earnings are tax-free and pension payments, while taxable under the age of 60, may have a tax-free portion and a tax offset may be available. A range of investment options can be selected.

Lifetime annuities

Lifetime annuities provide a guaranteed income that can be adjusted for inflation and may revert to a spouse upon death. This type of income stream is immune to the loss of capital experienced by account-based pensions in the recent markdown and can address longevity risk. While they haven't been a popular option, it is possible that they could be made more attractive to retirees following the Henry Review into retirement income streams.

It is important to have diversified sources of income in retirement. A combination of an allocated pension in early retirement and a lifetime annuity to supplement the age pension in later retirement may be one option.

Insurance

Generally, people prefer not to think about possible ill health. But the financial consequences that follow can be significant. The loss of income close to retirement can severely erode savings plans. Long-term disability, and even death, can be even more devastating to families and long-term goals. Being prepared for the financial impact by having adequate life, total and permanent disability, trauma and income protection insurance in place can reduce the impact and ease recovery.

Of course, as people approach retirement, their need for insurance changes and therefore insurance requirements should be reviewed regularly.

Centrelink entitlements

People relying solely on the age pension to fund their retirement are in for a rather frugal lifestyle. With the maximum single pension about \$17,500 per annum, there won't be much left over to pursue the good life.

Retirees with inadequate retirement savings may be able to supplement their income with the Centrelink age pension and gain the benefits of concession cards.



Estate planning

An important and often overlooked aspect in retirement planning is estate planning. Ensuring assets accumulated over a lifetime go to clients' intended beneficiaries is the main purpose of a good estate plan.

Alternatives

If individuals want a better lifestyle in retirement than that which can be provided by superannuation and the age pension alone, they may decide to:

- choose to save more throughout their working lives;
- stay in the workforce longer and retire later;
- accept a lower income level in retirement;
- sell their home and downsize (this allows access to the capital in the house if a less expensive home is purchased);
- sell their home and rent;
- take on a reverse mortgage; or
- borrow from their family.

Save more

By sacrificing a few of life's luxuries now, people can save more. Even if people can't afford to increase their savings by much, a small but regular savings strategy can have a significant effect on their retirement nest egg.

Work longer

Working longer may not be an option for everybody. According to the latest report from the National Centre for Social and Economic Modelling, the proportion of people with good health drops from around 90 per cent for those aged 25 to 34 to about 75 per cent for those aged 55 to 64. But the need to work longer is a reality for many prospective retirees, as a result of the recent downturn in investment markets.

Lower retirement income

Accepting a lower income in retirement will help money last longer, but at the cost to lifestyle.

Sell home and downsize



This allows access to the capital in the house if a less expensive home is purchased. However, a downsizing strategy may not be the magic solution to a retirement-savings shortfall. The reality is that many clients choose to move to smaller, newer and expensive properties in more desirable areas near the city and coast. Relocation costs could potentially erode a sizeable portion of the released capital. This means downsizers may not have as much left over to live on as they had hoped.

However, many people have a sentimental attachment to the family home and do not find this a desirable option.

Sell and rent

Selling the family home to free up capital and then renting a property for the remainder of their lifetime may provide a financial advantage, but it may not appeal to many clients. To lose the security of a 'roof over their head' would be unnerving to many.

Reverse mortgage

While reverse mortgages can be useful for older people to access the equity in their homes, the products do have significant risks. For example, compounding interest may accelerate the debt. Also, interest rates are generally higher than average home loan rates. A reverse mortgage may be appropriate for clients who are asset rich/income poor, need extra income for health/lifestyle, do not want to sell the home and/or have limited financial resources.

Planning today for the desired tomorrow

For many, retirement will be a rewarding phase of life with many options and opportunities. Being financially prepared is essential. Careful planning is essential to determine the optimal time for retirement and to ensure the client has sufficient financial resources.

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Source: Money Management