Keep pension goals on track

NOEL WHITTAKER

Long-term projections of the money needed for retirement are pointless.

"DO you really need a million dollars to retire?" It's the question that has been dominating the media all week. But it's a pretty silly question when you think about it, because there are a multitude of factors that determine how much anybody would need to retire comfortably. These include the state of your health, the extent of travel you are planning, and how often the children are likely to put their hands out for help.

You'll also need to take inflation into account. Suppose you are 50 now, and have decided you will need $50,000 a year in today's dollars to live on if you decide to retire at age 65. If inflation was 2 per cent that would equate to $67,400 a year, but if inflation increased to 4 per cent that figure would leap to $91,000 a year.

For a person aged 65 who thinks they will live until age 90, the rough rule of thumb for working out how much you will need to accumulate is approximately 15 times your expected expenditure. Therefore, based on the figures above, the target could well be between $1 million and $1.4 million.

Of course, if inflation is running at 4 per cent, you should be able to achieve a much better return on your portfolio, which would make achieving the target somewhat easier.

In short, long-term projections of the amount needed for retirement are pointless. What you need to do is decide when you want to retire, how much you think you will need, and then meet with your adviser at least once a year to find out if you are on track to meet these goals; and if not what strategies need to be put in place to get you back on track.

It's also important to take into account what legacies it's reasonable to assume may come your way.

Even though a bequeathed asset may be years away, it's still worth considering when planning how much you need to invest now.

A key factor in the amount you will need to accumulate is the rate of return you can achieve on your portfolio. I am still receiving a stream of emails about the forthcoming pension changes from retirees who have nearly $1 million in assets, entirely held in cash, because they are scared to diversify in case another global financial crisis happens.

They could well end up paying a very high price for this if rates continue to fall further, which is highly likely; and in 2017, when they lose the part pension they're getting now.

The following example illustrates the importance of a diversified portfolio that is producing a good rate of return.

A person aged 50 now who had $350,000 in super, and wanted to retire at 65 with an income of $50,000 in today's dollars, would be on track to achieve that with no further contributions if their portfolio produced 8 per annum. However, if the best they could do was 5 per cent per annum, they would need to make additional contributions of $18,000 a year to achieve their goal.

But what about the age pension? Yes, at current levels most retirees will be eligible for a substantial pension, but it would be a brave person to base their retirement plans on the assumption that today's generous age pension will last forever.

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It's not hard to envisage a situation a few years down the track when the government of the day will start to ask why any retiree with, say, a few hundred thousand in financial assets, should be eligible for help from the government.

Q I have recently sold my first property and have $250,000, which will be the deposit for my next property. I am planning to buy again in about one year's time – what would be the best strategy for investing this money?

A For a timeframe as short as one year, you cannot afford entry or exit costs or the possibility of your money dropping in value because of market falls. Stick with the high interest online accounts offered by the major banks.

Q In a previous column I noted an inquiry from a woman – both she and her fiance had a principal investment. She said that his was a principal residence, because "it was tax-free as it was under the six-year rule". I gathered, maybe in error, that she meant the rent he was receiving was tax-free, rather than any capital gains tax (CGT) applicable if he sold it. I do understand the six-year "rule" but did not realise that the rental you received was tax-free! Have I misinterpreted her wording or is the rent really tax-free?

A The six-year rule refers only to CGT. It allows a person to be absent from their principal residence and maintain the CGT exemption, provided they do not claim any other property as their residence in that time. If a property becomes tenanted, the rents are assessable income and outgoings such as interest and rates are allowable deductions.

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 making any financial decisions. Email: noelwhit@gmail.com.

Should you reduce the mortgage or top up super?

By **ALEX BERLEE**

The two most common financial goals for most Australians are to own their own home and to build a decent nest egg for retirement. And they're often tackled in this order with the priority being to pay off the mortgage first, then focus on saving for retirement later. But is this the best approach?

In many cases, it can pay to think through your options.

When asking the question, "my super or my mortgage", reducing the mortgage has a lot going for it. First of all – it feels good!

We like the idea of getting out of debt and paying extra to clear the mortgage shows meaningful, guaranteed results that you can see online or on your monthly statements.

These extra payments are easily accessed through redraw or offset facilities, unlike super for those under preservation age. Also in favour of the mortgage is the ability to use your home as security for further borrowing – reducing your home loan frees up equity for gearing into another property or into shares or managed funds, using affordable mortgage finance.

Countering this, there are a number of factors in favour of a stronger or earlier focus on super. At the moment, mortgage rates are at historic lows, so the returns on extra mortgage payments are quite low, especially compared with longer-term returns from balanced or growth-based super portfolios. Investing in superannuation carries a clear tax advantage for many workers.

With before-tax super contributions broadly taxed at 15 per cent, compared with wages at up to 49 per cent, salary sacrifice means you have more of your money working for you.

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Consider someone earning $100,000 a year, and looking to direct $500 a month into extra mortgage repayments. Their alternative is a salary sacrifice of $820 a month, the difference being income tax. After super contribution tax of 15 per cent, this still leaves $697 a month accruing in super.

Assuming a mortgage interest at 5 per cent on average, and super returns at 7 per cent net of tax on average, after 10 years the difference is $77,641 reduced off the mortgage, or $120,640 added to super. Obviously a lot of factors come into play, including people's attitude to debt, but that's a big difference.

Starting early means you have more time for compounding to do its thing, and people who can start contributing more to their super at an earlier age could consider a more aggressive investment strategy for their super – generally increasing the long-term returns.

For some people, it can make sense to hedge their bets by starting a modest level of salary sacrifice along with a smaller level of extra repayments.

This can be effective for people who have already made good progress on their mortgage and have built a decent safety net of accessible funds, but who aren't ready to fully commit to super. With super contribution limits being much reduced, compared with those available just a decade ago, many empty-nesters can be left wishing they'd started their super earlier.

Just when the kids have left home and the house is paid off, they can afford to add some good amounts to super, but can be caught by the caps. For many people another thing to consider is if the mortgage might be cleared by downsizing their home at some point.

When thinking super or mortgage, it makes sense to weigh up both options in terms of risk, liquidity, return and tax efficiency to work out the right strategy or combination of strategies for your unique situation.

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