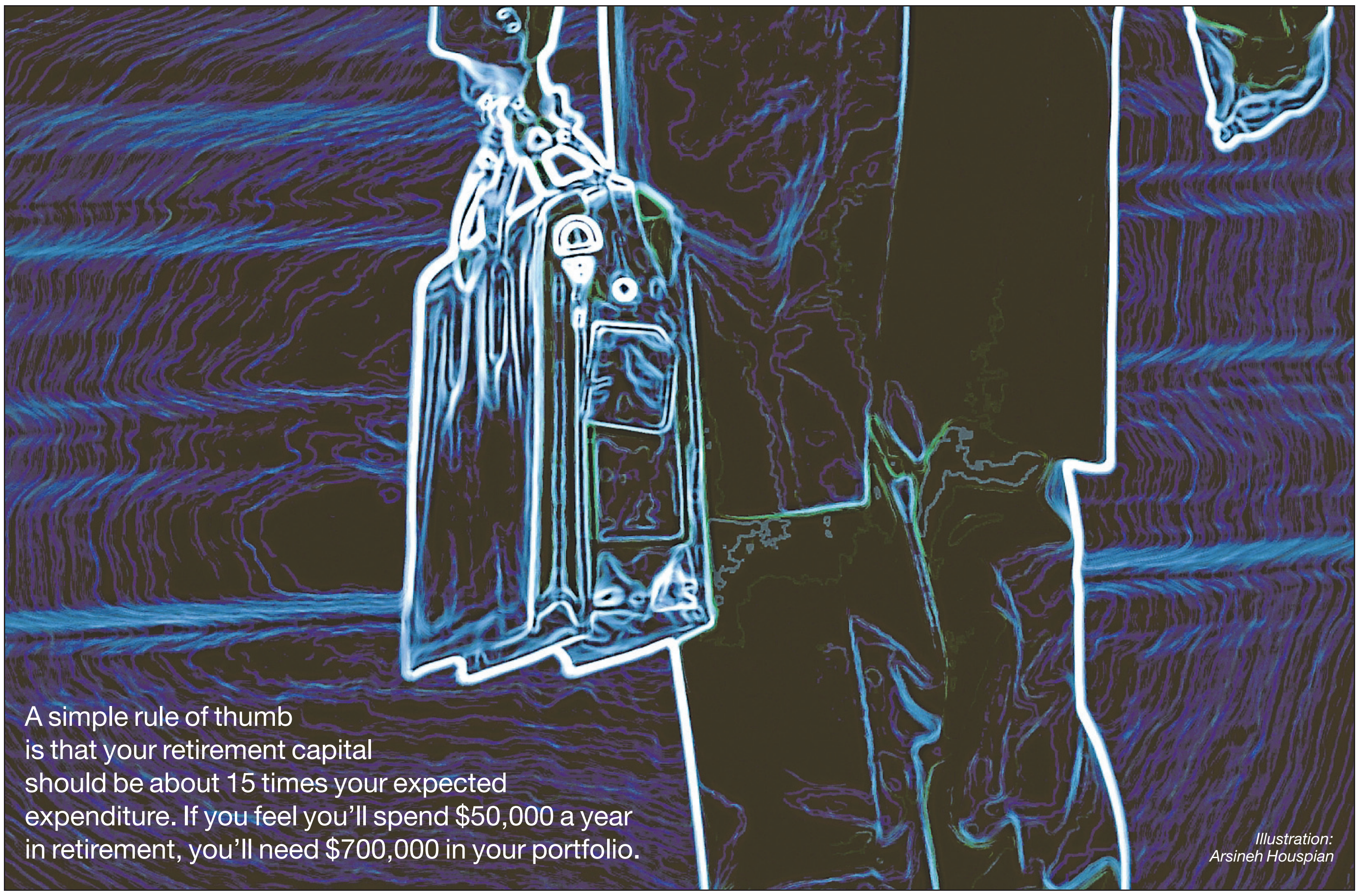
Can you afford to retire?

NOEL WHITTAKER

It's important to plan early to ensure a comfortable retirement.



A simple rule of thumb is that your retirement capital should be about 15 times your expected expenditure. If you feel you'll spend $50,000 a year in retirement, you'll need $700,000 in your portfolio.

Illustration: Arsineh Houspian

NEW research by Mercer reveals many Australians are in for a shock when they retire, as there may well be a significant gap between their expectations and reality.

Given other recent research by Mercer that shows one in three male public servants are expected to live to more than 90 years of age, it is clear that more and more Australians are facing the challenge of making their money last as long as they do.

The solution is to start as young as possible and set some specific goals, such as exactly when you want to retire and how much you'll spend when you do.

A simple rule of thumb is that your retirement capital should be around 15 times your expected expenditure.

For example, if you feel you will spend $50,000 a year in retirement, you will need $700,000 in your portfolio.

This is based on the assumption that the earning rate is 8 per cent, drawings are indexed at 3 per cent, you retire at age 65 and all capital is expended by age 91.

This may seem a huge amount of money, but don't despair – the first step in solving a problem is to define it.

For starters, our generous social security system will be there as a back-up. A couple of pensionable age who retired now with $150,000 in financial assets should qualify for around $33,000 a year in age pension.

If their expenditure goal in retirement was $50,000 a year, the additional amount needed drops to $17,000 a year when the age pension is taken into account.

Using the 15 times rule, this means they need only $255,000 in super to get them through.

These numbers may work for people who are approaching pensionable age now, but it's a different story for those who are younger – it's a certainty that the government will not have the money to maintain the present generous pension system as the number of retirees grows.

Let's think about a hypothetical family to show how planning for retirement can work.

As an example, Bob is 50 and earns $90,000 a year, his partner does not work but could find a job if necessary.

Their main assets are a home worth $700,000 which still has a mortgage of $150,000 and his work superannuation currently worth $200,000.

If inflation is 3 per cent per annum, they will need $82,500 a year when he is 65.

Applying the 15 times rule, he will need to accumulate superannuation of $1.24 million by the time he turns 65.

That sounds a vast sum, but we are talking 15 years into the future.

If his income rises by 4 per cent per annum and his super earns 8 per cent per annum, there should be $894,000 in super by the time he is 65. They will be $346,000 short of their target and unlikely to qualify for any government assistance.

The problem could be solved by Bob working longer, or encouraging his partner to get a part-time job, or by simply voluntarily increasing super contributions by starting a salary sacrifice program.

One option is to salary sacrifice $1168 a month.

After deduction of the 15 per cent contributions tax, this should give the extra $346,000 needed if his fund earns 8 per cent.

Of course investing is more of an art than a science and many things could happen to change the outcome.

On the downside, Bob could lose his job or suffer a major illness – on the plus side, he may qualify for a hefty pay rise, his partner may get a job, or one of their parents may pass away and leave them a substantial legacy from the sale of the family home.

Individual circumstances change, continually which is why ongoing advice is vital.

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 financial decisions. Email noelwhit@gmail.com.

Q It is my understanding from your columns, and from advice given by the Australian Taxation Office and my super fund, that tax-free, lump sum withdrawals (up to a certain limit) can be taken from a super fund by people over 55 but under 60. I was made redundant in late 2012, aged 55, and made several withdrawals totalling $135,000, supposedly free of tax. When I lodged my 2013 tax return, I had to declare these withdrawals as income. I then had to pay tax on the money and also refund monies received as Family Tax Benefits. I realise I paid no tax on the lump sum withdrawals, but having to declare them as income results in the same outcome – I pay tax on the amount. What is the reasoning for this system?

A Unfortunately that is the law. A person aged between 55 and 60 can withdraw up to $185,000 tax-free, but the amount withdrawn is added to taxable income and then tax eliminated by the use of a rebate. As you pointed out, it can affect Family Tax Benefits.

Q I am retired and I turn 60 later this year. I would like to withdraw the entire balance of $1 million out of my super before any laws change. I fear that those over 60 who hold money in super will be forced to take an annuity or pension and become self-funded retirees, and will no longer be able to make tax-free lump sum withdrawals. Once I have withdrawn the funds, can I reinvest some or most of it back into super without paying any tax on the contribution, and continue to enjoy the low tax environment on earnings? Would I be limited to a contributions cap, and would it all be treated as an undeducted contribution?

A As you are retired, you can withdraw the money when you wish and after your 60th birthday, it can be withdrawn tax-free. You could then recontribute it as an undeducted contribution, subject to the limits. If you are concerned about the laws changing, I wonder why you wish to withdraw from the system and then re-enter it?

Showing your spending doesn't mean showing your wealth

By **SCOTT PHILLIPS**

SO you want to be rich? Or at least have a comfortable retirement? With little in the way of real financial education in our schools, where do you start?

You might look at those around you who've "made it". The big house, flashy car and kids in private school are a couple of the most common indicators. Overseas trips, golf club memberships and plenty of jewellery are other markers.

If you can afford those things, you must be rich, goes the common wisdom, and so we look to those people for advice, or try to mirror the path they followed. And that's almost certainly a big mistake.

Show it . . . and blow it: James Packer, Lachlan Murdoch, Andrew "Twiggy" Forrest and Gina Rinehart may each have more money than God, and if you had their bank balances, you really could have the houses, cars, boats and planes of the rich and famous. They're not who I'm talking about.

I'm talking about your neighbour driving the Mercedes, your cousin who's off to the Maldives (again) and your friend who sends their kids to the best school in town – and hang the expense. Trying to follow suit is likely to cost you a large chunk of your retirement – just as it'll hurt theirs. You see, your seemingly "rich" neighbours may actually be less well off than you are – and the unassuming family down the street might have a seven-figure fortune.

Live below your means: If you want to be financially independent, the first and most important consideration is to simply spend less than you earn. As Charles Dickens' Wilkins Micawber said: "Annual income £20, annual expenditure £19, 19s and 6d, result happiness. Annual income £20, annual expenditure £20 0s and 6d, result misery." But they don't call saving "delayed gratification" for nothing. You can spend now and have nothing later, or you can save now and achieve the financial independence that will elude those whose credit cards are burning a hole in their pockets.

Follow the lead of the successful: The millionaires in your street or suburb are probably driving unassuming family cars – and they probably bought them used. They don't bother trying to impress other people by buying expensive things. They budget. And they stick to it. Millionaires focus on building their wealth, not spending it. As my colleague Morgan Housel wrote: "Financial wealth isn't what you see. It's what you don't see." Wealth comes from the cars, holidays and clothes you didn't buy.

Foolish takeaway: You won't hear that from the bloke in the BMW, or the couple who have just returned from a skiing trip in Europe, of course. Their version of wealth is showy consumption. I have nothing against those who want to blow their cash on such things – just make sure you don't confuse high levels of spending with high levels of wealth.

You probably won't notice the millionaires next door, but they'll be the ones who own their house, car, and have a significant share portfolio. If you want to be rich, that's the example to follow.

Scott Phillips is a Motley Fool investment adviser. The Motley Fool's purpose is to educate, amuse and enrich investors. This article contains general investment advice only (under AFSL 400691).