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## **Case Study - Retirement**

John 67 and Ann 65 in August this year.

Retirement income is presently met via a monthly drawing (\$6,500) from John's Account Based Income Stream which he commenced recently with \$375,000 super money with Q Super.

The annual pension of \$78,000 represents an effective drawdown rate of more than 20% which is accelerating the rate of depletion of John's superannuation.

They are trying to sell house in Inner Brisbane.

This will help them to fulfil their objective of relocating to Melbourne, but will also provide them with the capacity to 'unlock' some of the equity in your home to enhance your ability to generate retirement income.

We estimate the new capital available for investment once the house in Melbourne is purchased will be \$1 million.

Other assumptions used in calculations in this document include:

- Estimated required income in retirement of \$80,000 per annum;
- Ann has an existing super accumulation account totalling \$275,000;
- They are both retired, although John could possibly return to work to enable him to contribute to superannuation during 2009/2010;
- We have assumed a return of 7% per annum for both superannuation and non superannuation investment strategies, and
- We have assumed inflation of 3% per annum applies.

## **Strategy Options Considered:**

The three main strategies we discussed during our meeting included the following:

1. Using superannuation;
2. Purchasing a property in Sydney; and
3. Non superannuation investment.

## **Making Super Contributions**

As we know those aged over 60 will, under current legislation, receive all income from superannuation 'Account Based Income Streams' (ABIS) tax free.

To implement such a strategy would involve each of you making a one off non concessional contribution into superannuation, then combining the contribution with existing superannuation and commencing new account based income streams each. Contribution caps and contribution eligibility issue would underpin the strategy.

Our projections are based on the assumption John could return to paid employment sufficiently long enough to be eligible to contribute (40 hours paid employment during a single 30 day period) while Ann is eligible to contribute up to \$450,000 prior to turning 65 in August 2009 without the need to satisfy any work tests.

Combining his existing ABIS capital and the new contribution provides John with more than \$525,000 in lump sum superannuation benefits while Ann's one off \$450,000 contribution, when added to her existing superannuation provides more than \$675,000 in total superannuation benefits.

Both amounts then rolled over to commence separate ABIS accounts produce a minimum tax free income of \$60,000 per annum combined.

The remaining \$400,000 would be invested in a portfolio of diversified assets with a balanced emphasis on income and capital growth. A average 5% pa yield from this capital provides an additional \$20,000 per annum income, which when combined with the ABIS income, achieves your retirement income objectives.

### **Pros**

Tax effective;

Monthly income receipts from superannuation pensions;

Liquidity and flexibility;

Capacity to boost income; and

No CGT consequences for superannuation investment.

### **Cons**

Contribution caps limit capacity to 'top up' superannuation;

John would be required to return to paid employment to be able to contribute; and

Potential tax issues to estate when super is paid to a non dependent.

## **Buying Sydney Unit**

The property they were interested in acquiring is located in Sydney and includes a retail space (estimated rent \$80,000 per annum gross) and a small studio apartment which could be rented out for \$12,500 on a part time basis, allowing you to also use the apartment during the year as well.

The property is priced at a minimum of \$1.6 million and as such some borrowings would be required to fund the purchase. Retirement income would then include a combination of superannuation ABIS income (existing) and rent (less loan interest costs, land taxes, and maintenance fees). Based on the projections, the strategy would not generate the required income, and with much of the capital tied up in property, you will need to consider either a reduction in income expectations or fund the shortfall with additional borrowings.

Rising interest rates would impact on cashflow, as could the loss of tenants, renovation / maintenance costs, or changes to legislation.

The strategy has little flexibility and is likely better suited to investors not reliant on the investment to provide income, and those looking for capital growth potential over the long term.

### **Pros**

Potential for capital growth over the long term;

Tax deductions associated with on-going maintenance and borrowing costs to reduce taxable income;

A 'holiday house' in Sydney which can be apportioned for personal use; and

Weekly, fortnightly, or monthly rent receipts.

### **Cons**

The need to borrow money to finance;

Interest rate risk;

Limited capacity to boost income in the event of rising personal costs;

Risk associated with vacancy;

The need to fund on-going maintenance costs; and

An estimated cashflow SHORTFALL, which is difficult to overcome given the illiquidity.

CGT if sold?

| [Tax on income?](#)

## **No Super Contributions, Invest Funds in Ordinary Portfolio**

This strategy assumes the opportunity to contribute to superannuation is not available. The \$1 million in net sale proceeds is invested in a diversified portfolio of assets with an emphasis on tax effective income and long term capital growth potential.

In our projections we have assumed an average return of 7% per annum (4% income and 3% capital growth). The strategy also assumes John's ABIS is retained and that Ann's superannuation is rolled over to commence an ABIS as well. The required income level is achieved through a combination of income earned and capital gains redeemed.

### **Pros**

Flexibility to nominate more income as required; can do this with ABP if over 60?

Capital growth potential depending on asset allocation selected;

Limited tax to pay on income earned;

### **Cons**

Required income is generated by a combination of income and capital growth which may lead to additional CGT payments;

Income received can vary with returns on underlying investments or interest rate movements'

No estate tax benefits; and

## **Summary:**

Retirees must engage a strategy that provides liquidity, the generation of the required income, and the capacity to adjust the strategy at short notice, and with minimal cost in the event of changes to personal objectives, circumstances or legislation.

The more tax effective the strategy, the lower the required gross return to meet the income objectives, and the lower the level of investment risk needed to be undertaken.

In light of these points, superannuation and non superannuation portfolios best meet your objectives and circumstances, although the superannuation option does have both time, and contribution limitations. Major long term tax benefits though.

## **Other Points for Consideration:**

### Centrelink Age Pension

Based on the information provided, John is eligible for at least a partial Centrelink Age Pension benefit, at least until the house is sold and the net proceeds added to the retirement income portfolio. This is because the principal place of residence is exempt from assessment under the Centrelink income and asset tests.

Optimising any Centrelink entitlements for our clients is a feature of our strategic financial planning services and we would be happy to assist you in this area. In the meantime you can elect to contact Centrelink directly to discuss your options.

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