Getting the

How do you pick the 'right' time to leave full-time work? Start with the answer, advises independent financial planner *Richard Sheargold*.

People aged between 50 and 65 (generally pre-retirement years) are facing some of the most difficult questions in their financial life cycle. Deciding on how much personal wealth will be needed in retirement, and thus a realistic date to retire, can be a very daunting task.

We should try to unravel the complexity of this by starting with the *answer*. By that I mean, let's look at a dollar amount needed to live on in retirement. As a general rule of thumb, my clients can usually live on 75 per cent of their take-home pay for the first eight to 10 years of retirement. This equates to approximately $35,000 to $50,000 per annum for an average Australian household, if you are living in a mortgage-free situation. If this is too simplistic, then do a budget on the potential monthly outgoings in retirement.

If I am seeing people for the first time, I ask them to prepare a budget for the present and one for their retirement (see the worksheet on page 62 of the Special Report in this issue of ***Your Life***). I suggest that they should be mindful of eliminating any employment expenses (such as transport, buying lunch etc.) but also mindful that they may incur other costs (such as those involved in a hobby, travel, grandchildren *or even golf*). If my potential clients come prepared with a budget, then they have answered the question before they even ask it!

Let me reiterate that the first thing one loses when retiring is the ability to provide a wage or salary. This loss of income obviously needs to be replaced with some other form of income stream, whether that be self-funded (superannuation and/or other investments) or through the Age Pension, or a combination of both. So if I have some idea of how much people would like to spend each year in their retirement, I can work backwards to calculate the lump sum or 'pot of gold' that is needed to supply this. Obviously, the earlier you start contributing to this pot, the more achievable it will become.

By the end of the first interview, I should have a good understanding of the client's goals and objectives, which translates to knowing an agreed budget (couple or single), years to retirement, preferred age at retirement and, most importantly, the amount of money invested in superannuation or other investment vehicles. I can now calculate how big we need that 'pot of gold' to be. It is not a difficult calculation, especially when I can cheat and use a financial calculator.

The good news about the pot of gold is that, more often than not, the number that I think my clients need to work towards is more than achievable. This is because the value of compound interest, inflation and contributions to superannuation can make a 10-year superannuation portfolio nudge close to seven figures. So there is no need for people to get nervous. Further, I prefer to consider achieving savings goals in increments. Rather than looking purely at the very long term, why not bite off manageable chunks in one-year or three-year plans?

It is also important to remember that saving for your retirement is not an exact

timing right

science. I may be able to calculate the magic number, but during that savings period you are likely to be at the mercy of investment market fluctuations (both property and shares), changing legislation and changing personal circumstances. What we need to understand also is that:

- budgets are rarely adhered to
- people rarely have a uniform lifestyle throughout the duration of their retirement.

The second point is important as it is unusual to see a client at age 80 spend more than a client at age 65. That is, people generally spend far more in the early stages of retirement than in the later stages, resulting in an evening-out of the income required.

Meet Joe and Sarah

At this point it helps to consider an example of clients who are seeking retirement planning assistance and typically do not know what to expect. They are unsure about how much they need in retirement, whether it is too late to start saving, if they can ever take a holiday and so on.

Joe and Sarah (both aged 50) are a typical Aussie couple lucky enough to have a mortgage-free family home, $200,000 in superannuation and a combined salary of $76,000. They spend most of their wages on daily expenses but have $20,000 in the bank for a rainy day. They agree that they would like to retire no later than age 62 but are unsure if they will have the money to do so.

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When they phone to make an appointment, I ask them to think about their goals and objectives before the consultation. I also ask them to complete a budget on what they spend now and what will change in retirement.

Let's work through the numbers. We'll start by assuming that they would like to spend $45,000 per year in retirement for the first 10 years and then drop to $35,000 per year after that. Now, if they retire at 62, then statistically they have 20 to 23 years of retirement ahead of them. By using my financial calculator (or *Microsoft Excel*) I can calculate that they will need more than $732,000 in retirement assets to pay them their desired income for the 20 years (for Joe and Sarah's example, I am assuming this will involve superannuation only).

Now, this $732,000 is a big number considering they currently only have $200,000 in superannuation. However, they have 12 years to achieve this target and, by investing the superannuation in a balanced portfolio of shares, property securities, cash and fixed interest, they could achieve an eight per cent per annum return after fees and taxes. In addition, because they are still working, they are able to take advantage of the salary sacrifice rules and contribute enough to help them achieve their desired goals and objectives. In this instance, I believe they should make a yearly contribution of $15,000 pre-tax into superannuation (made up of the current nine per cent contributed by their employers and additional salary sacrifice). If they do so, (once again using my trusty financial calculator) they should have a balance of well over

$740,000 at retirement and therefore achieve their retirement income goal.

In this example, I have used an inflation rate of three per cent. In addition, as both Joe and Sarah will be over the age of 60 when they retire, they will not have to include their allocated pension income payments in their tax return (should they lodge one). The income will be assessed for the Centrelink Age Pension, however, but at a reduced rate.

To create an income stream from this retirement 'pot of gold' that is superannuation, we need to roll the proceeds into an allocated pension in retirement (or before retirement, if Joe and Sarah want to take advantage of transition to retirement [TTR] arrangements[1]). Once we have established the allocated pension they can then receive an income stream.

So, within a two-hour meeting I am able to help Joe and Sarah calculate the magic number and confirm a clear and defined goal, as well as establish a method to achieve that goal. The number looks very large, but if we break it down into three-year intervals it becomes far more realistic and emotionally achievable.

One thing I am very wary of, though, when I discuss the salary sacrifice strategy with clients, is that I do not want them to 'rob Peter to pay Paul'. In other words, I would

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not like to recommend a strategy of salary sacrifice to achieve more money in retirement if it meant really doing it tough in a pre-retirement life stage. If the money would have been otherwise spent on non-essentials, then by all means save it for retirement. If it means seriously cutting into your current lifestyle, think very hard about the merit of such a strategy. Remember, we want to keep a float of money in the bank for that rainy day. If you contribute too much to superannuation you may be left short before retirement.

It is also very important that, if you seek advice, you continue a long-term relationship with your licensed financial adviser. Each year he or she can guide you as to whether you are on track to achieve your retirement goals. Such yearly reviews are important given the changing nature of legislation, economic conditions and your personal circumstances. The Australian Securities & Investments Commission (ASIC) suggests that, as a minimum, financial advisers need to see each and every client at least annually. If you have some form of investment recommended by a financial adviser, make sure you are getting an annual service. Remember, you are probably paying for it – so why not use it?

In the example above, Joe and Sarah were able to achieve their goals by planning early. If you haven't been lucky enough to get in early, or your financial circumstances have restricted you from salary sacrificing into superannuation, then the Age Pension is always there as a (very thin) safety net, even if this only means a part-pension to supplement your allocated pension income stream. There are also programs such as the Pension Bonus Scheme to help you build your retirement pot of gold, although they may require you to work a little longer than you would have wished.[2]

The best news is that it is never too late to seek advice and, in most cases, you will benefit from good strategic financial knowledge. Whatever you have in superannuation or investment assets, the methodology works the same. Start with the answer and work back to the question. YL

1. See ***Your Life*** Spring 2007 for information on TTR.
2. See ***Your Life*** Autumn 2008 for further information about the Pension Bonus Scheme.

Disclaimer: *Whilst we make every effort to provide up-to-date information that is accurate, this information must not be relied upon without first seeking the appropriate professional advice. Any scenario provided is for illustrative purposes only. Without knowledge of your needs, goals and objectives we could not provide appropriate advice. Therefore this advice is of a general nature only and should under no circumstances be relied upon to suit your particular situation. Bluegum Financial Services Pty Ltd, trading as Stonebridge Wealth Solutions.*

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The **Australian Taxation Office** (ATO) offers comprehensive information about Transition to Retirement measures.
Ph 13 10 20
Web **www.ato.gov.au/super**

Detailed information about the Pension Bonus Scheme, including a downloadable brochure, is available from Centrelink.
Ph 13 23 00
Web **www.centrelink.gov.au**

Income and Expenditure			
	You	**Your Partner**	
Salary/Wages	$	$	
Other Taxable Income	$	$	
Tax Free Income	$	$	
Centrelink/DVA Income	$	$	
Pensions	$	$	
Employer Termination Payment	$	$	
* Other	$	$	
Reportable Fringe Benefits	$	$	
TOTAL	**$**	**$**	
Annual Expenditure			
Personal/Family Expenses	$	$	
Housing	$	$	
Transport	$	$	
Insurance			
General	$	$	
Tax Deductible Expenditure	$	$	
TOTAL	**$**	**$**	

Assets and Liabilities			
Value of Assets (non-income earning)	**You**	**Your Partner**	**Joint Ownership**
Family Home	$	$	$
Contents	$	$	$
Motor Vehicle/s	$	$	$
Other	$	$	$
TOTAL	**$**	**$**	**$**
Value of Investments	**You**	**Your Partner**	**Joint Ownership**
Investment Property	$	$	$
Superannuation Funds	$	$	$
Annuities or Pensions	$	$	$
Term Deposit(s)	$	$	$
Shares	$	$	$
Managed Investments	$	$	$
Cash	$	$	$
TOTAL	**$**	**$**	**$**
Value of Liabilities	**You**	**Your Partner**	**Joint Ownership**
Home Loan Balance	$	$	$
Investment Loan Balance	$	$	$
Personal Loan Balance	$	$	$
Combined Credit Card Balance(s)	$	$	$
Other	$	$	$
TOTAL	**$**	**$**	**$**