DO YOU NEED **$1 MILLION** TO **RETIRE?**

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GAPfinancial

A GAP Financial White Paper
RETIREMENT PLANNING SERIES

Welcome

Welcome to the GAP Financial Retirement Planning Series.

My decision to deliver a series of whitepapers on retirement planning eventuated from two core beliefs.

First, educating future and existing retirees on retirement planning provides the awareness needed to ask the right questions and make the right decisions on something as important as funding their retirement.

Second, great advice makes a difference and has an enormous role in helping people secure retirement adequacy.

And these beliefs have been formed because we have seen great advice work.

We are very much a part of our valued client's retirement journey and their experience of a comfortable retirement.

This series is the culmination of many years of work and the experience and knowledge we have gained in developing retirement plans for our valued clients.

A common theme in this series is that while the value of your retirement nest egg is important, and will most certainly help you secure a comfortable retirement, what you do with this money is equally important. And that's where advice and education comes into play.

Bad investment decisions, poor planning and being unaware of the rules could easily compromise your income in retirement.

One of the important roles I have is to ensure my clients make the right decisions about retirement.

I hope the Retirement Planning Series provides you with the guidance you need to make the right decisions about your retirement.

Happy retirement!

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Introduction

Recently there has been commentary suggesting retirees will need $1 million in superannuation to retire comfortably.

The Association of Superannuation Funds Australia (ASFA), which publishes comprehensive data on this topic annually, state a couple will need $640,000 and singles $540,000 in their Super to retire comfortably (September 2015).

It is important to note from the outset that we are referring to today's dollars when discussing retirement lump sums.

At GAP Financial we have clients with under $300,000 in Superannuation enjoying a comfortable retirement.

So which number is it? How much do you actually need to retire comfortably?

Well like most questions of this nature, it depends.

Personally, I believe the $1 million figure is overly simplistic. There are a number of other factors which influence how much retirees need including when one retires, how long they plan to work, how much they spend, how they invest their nest egg, their family situation, what their objectives are, and the list goes on.

The reality is very few Australians will retire with this sort of money. So the $1 million assertion does little to help the majority of aspirant retirees apart from raising anxiety levels unnecessarily.

The aim of this paper is to shed light on how much one needs to retire with a bit more science, and in doing so help aspirant retirees feel more confident about their financial future.

How much will a retiree spend each year?

It's a simple and familiar concept - how much you need to live on each year will depend on the sort of retirement lifestyle you want.

Clearly there is a positive relationship between the amount of superannuation you need to retire and how much you plan to spend each year. But our spending habits vary which makes it difficult to lock in a firm number.

But for the purpose of this paper I will use the benchmarks provided quarterly by ASFA.

> **ASFA states in its September 2015 quarterly report that couples aged 65 today will need $58,915 a year and singles $42,962 a year for a comfortable retirement.**

According to ASFA a comfortable retirement includes things like annual domestic holidays, a reasonable car, private health insurance, good clothes and enjoying bottled wine.

For a modest retirement annual needs are less with singles needing $23,695 and couples $34,090 a year.

How much you need to live comfortably in retirement will depend on the spending choices you make, how you manage and control your budget and ensuring you don't waste money on things which do not necessarily bring you happiness.

Average annual retirement needs
(AFSA, 2015)

COUPLES
$58,915

SINGLES
$42,962

There may not be a direct correlation between the high cost of regularly dining out, helping the kids too often and driving a fuel guzzler and your level of happiness or comfort. Yet these things alone could easily contribute an additional $5,000 or $10,000 to your annual budget.

Another important consideration is that most retirees will be more active, and therefore likely to spend more, in the first half of their retirement than in the second half. In our experience factoring this in can reduce the initial lump sums required at retirement.

The Australian Superannuation Landscape

These days' retirees face the reality they are likely to live longer than those before them, and they fall short of ASFA benchmarks of required super savings noted above.

Today in Australia, nearly 575,000 people rely mainly on their superannuation savings to fund their retirement income, while 1.8 million people rely on the Age Pension (Colonial First State, November 2015).

According to Australian Super the average retirement payout (determined by the average savings for those aged 60-64) was $112,600 for women and $198,000 for men – a long way off the $1 million mark. In fact a long way off the ASFA benchmarks.

Australia as a whole has a retirement savings gap of $1 trillion (Rice Warner Actuaries, 'Longevity Savings Gap', Sep 2012).

And over 68% of Australian's over 40 do not have a specific level of saving or income they are aiming for in retirement (Investment Trends November 2011, Retirement Income Report).

If we look at life expectancy many of us can expect to live a quarter of our lives in retirement.

A male currently aged 65 can expect to live a further 19 years and female a further 22 years (MLC Analysis, June 2012).

In fact, there is a one-in-three chance that one will live to 95, and a one-in-ten chance that one will live to 100 (ABS, 2013).

It is therefore possible to have a retirement spanning 30 years or more. But despite this and low levels of retirement savings Australians in the main need to do more to address these important issues.

Age Pension and Super – A hybrid income strategy

One thing often overlooked in the retirement lump sum debate is that most retirees will receive a part or full age pension at some stage during their retirement, and ignores the huge impact the age pension has in supplementing retirement income needs and reducing the pressure on retirement lump sums.

> **A vast majority of retirees and my clients have a hybrid income strategy in place with income being sourced from both the Age Pension and Retirement pensions such as an allocated pension.**

Without this – all other things being equal – you may well need a number closer to the $1 million being talked about.

To put this in perspective the Australian Institute of Trustees has calculated that the full Age Pension is worth at least $390,000 for a single person and $590,000 for a couple during retirement.

The age pension system in Australia is designed to be a retirement safety net. Even if at the start of your retirement you receive a part-aged pension or do not qualify for a pension at all, you can't assume this will be the case throughout your retirement. It is likely that later in your retired life – as your savings and investments reduce in value and fall below the age pension thresholds - you will receive a full or part age pension.

In August 2015 the Money Saver HQ reported that Chief Executive Officer of the Australian Institute of Superannuation Trustees Tom Garcia said the core problem with the claim Australians need $1 million in Super was that industry commentators failed to consider the important role the age pension plays in boosting their retirement income levels.

The financial analysis in this paper assumes the use of the age pension when possible as a source of retirement income.

Busting the million dollar myth

GAP Financial has undertaken its own analysis to shed some light on how much you need to retiree.

The financial analysis below summarises the longevity of retirement nest eggs across nine scenarios for a retired Couple and Single.

These scenarios are formulated on three lump sum amounts and three spending scenarios.

The analysis assumes a retirement age of 65, eligibility for the aged pension, an annual investment return of 7.1% and use of an account-based pension structure to fund pension payments.

Our analysis reveals a couple with $500,000 in Pension assets will be able to generate a retirement income of $60,000 (slightly above the ASFA benchmark of $58,915) indexed for inflation for 26 years (Age 91).

A single retiree with $400,000 in Pension assets and annual living expenses of $40,000 (slightly below the ASFA benchmark of $42,692) can expect their money to last 28 years.

Years money will last - Couple

Pension Amount	Living Expenses $40,000	Living Expenses $60,000	Living Expenses $70,000
$700,000	More than 38 years	34 Years (Age 99)	23 Years (Age 88)
$500,000	More than 38 years	26 Years (Age 91)	17 Years (Age 82)
$300,000	More than 38 years	14 Years (Age 79)	9 Years (Age 74)

Assumes an average annual return on investment of 7.1% and inflation rate of 3%

Years money will last - Single

Pension Amount	Living Expenses $40,000	Living Expenses $60,000	Living Expenses $70,000
$600,000	More than 38 years	23 Years (Age 88)	16 Years (Age 81)
$400,000	28 Years (Age 93)	16 Years (Age 81)	11 Years (Age 76)
$250,000	19 Years (Age 84)	10 Years (Age 75)	7 Years (Age 71)

Assumes an average annual return on investment of 7.1% and inflation rate of 3%

Retirement savings do not last as long for single retirees due to the lower age pension entitlements applying to singles.

These numbers above are within range of the ASFA lump sum benchmarks which indicate that couples require $640,000 and singles $545,000 in savings to have a comfortable retirement (September 2015).

They also illustrate the relevance of retirement budgets, importance of investment returns and the role the age pension has in funding retirement income needs.

Investing for Retirement Adequacy

Our analysis hinges on one very important assumption – that you invest your retirement savings and achieve a long term average return of 7.1%. Incidentally ASFA assumes a return of 7% in their calculations.

As I mention in my whitepaper, "The Three Investment Risks You Can't Ignore in Retirement", it is highly unlikely a bank deposit will average 7% longer term, so the implication is clear - in order for these amounts to be sufficient retirees will need a market-based investment.

The Superfunds magazine (September 2015 issue) published average superannuation fund returns as far as 50 years to 30 June 2015. The 20 and 25 year return was 7.5% and 7.9 % respectively. So with the right investment strategy this sort of return is achievable.

> **The traditional route of cashing in a lump sum and investing in a bank deposit will not fund a comfortable retirement as doing so will expose your retirement to your worst enemy – inflation.**

The long term average return on cash in the last 10 years of 4.7% has barely kept up with inflation at 2.8% (RBA Calculator).

Investing in retirement to achieve an adequate rate of return to ensure retirement adequacy is fundamental. In other words for most retirees not investing is not an option.

It follows that one of the biggest risks to the longevity of your retirement assets is a bad investment strategy.

Even you have the magical million, a bad investment strategy may cause you to lose a majority of your investment or at minimum jeopardise a comfortable retirement.

But investment returns should not be pursued at all cost and with disregard to the risks of losing your capital.

These are the things you need to be aware of.

1. Don't put all of your eggs in one basket

Diversifying your investment across asset classes reduces risk of loss and will help smooth out investment returns in the event one asset class underperforms in a given period.

2. Don't put all of eggs with one manager

But investing through one fund manager or a limited group of fund managers will expose investors to fund manager risk – essentially the risk of poor investment performance from one manager dragging down the investment performance of the overall portfolio.

3. Markets are volatile

The one thing we cannot avoid even with these things in check is market volatility - the ever present roller coaster ride of share prices and market indices.

Growth assets such as Australian Shares, International Shares and Property needed to generate long term returns are more 'volatile' than defensive assets such as Bank Bills, Government Bonds and Cash.

With this in mind a retirement investment strategy should have an appropriate mix of both defensive and growth assets to ensure that two important requirements are met.

First, the investment strategy must be consistent with an investor's appetite for risk and market volatility; a more conservative investor will lean towards more defensive assets. Second, that market volatility does not severely diminish your investment as you draw down to fund your retirement income needs.

Closing the GAP

If after reading this paper you feel you are on track to a comfortable retirement then well done! But if you think you may be behind schedule there is no need to despair.

> **A small change in your retirement planning strategy in the lead up to retirement can make a substantial difference to the longevity of your retirement nest egg and the quality of your retirement. And if you don't have time to build your super then the focus should be making the most of what you have.**

Below are some insights of the things you can do in both situations.

Leading up to retirement

Increasing your super contributions – even by a little - will make a difference

Think about increasing your superannuation by salary-sacrificing. This can be achieved by asking your employer to pay a portion of your salary into your superannuation fund before-tax. While the fund will have to pay a 15% contribution tax on the amounts contributed you will save the income tax (at marginal rates) you would have paid on receiving the amounts as salary.

For example One Path calculates that salary sacrificing just $5,000 a year could see you have an extra $196,625 in Superannuation after 20 years (OnePath October 2014).

Once you turn 55, you might want to consider a Transition to Retirement strategy. This involves drawing a pension from your super while you're still working and salary sacrificing a larger slice of your income. You'll pay a tax rate of just 15% on your contributions and boost your retirement savings inside super at the same time.

Already retired

If you are already retired and have assets helping you fund your income needs then you should consider fine-tuning your current strategy. Some of the things you can do include:

Review your investment strategy

A review of your existing investment, assuming you're invested, could reveal that your existing strategy may not suit your needs. It may not be sufficiently diversified or may not have the right mix of growth (shares, property) and defensive assets (government bonds, fixed interest).

Simplify your banking structure and manage to a budget

This applies to everyone not just retirees. If you have a complicated banking account structure with multiple bank accounts and credit cards it would be difficult to monitor your spending. By setting a budget and monitoring your expenses from one or two 'spending hubs' it will make it easier for you to manage your expenses and ensure you are not exceeding your budget, which is not easy to do at the best of times.

Part-time work doing something you enjoy

Retirement does not necessarily mean you have to stop work completely! I have clients who are retired and earning $15,000 or $20,000 a year in important jobs such as driving school buses, gardening, working in a hardware store and house minding. And it may not impact on your age pension as Centrelink do not assess the first $6,500 of salary and wage earnings (if you are assessed under the income test). This reduces the reliance on your lump sum for your retirement income, not to mention the enormous mental and physical health benefits.

Conclusion

The analysis in this paper reveals the ASFA numbers as being more realistic. And if the ASFA benchmarks are a stretch for you then a blend of good financial advice, forward-planning and good common sense will go a long way in ensuring you have a happy retirement.

I am sure you have heard the famous quote. Those who fail to plan, plan to fail!

At GAP Financial we believe that what you do in retirement and with your retirement savings is just as important as the size of your savings.

I can assure you that retirees with the magical million can easily transition into an uncomfortable retirement without a good financial plan and a sound investment strategy.

Most retirees would have spent the better part of the last 40 years building up their superannuation. It follows that investing some money and time in the form of a retirement plan makes sense.

Recent developments in retirement products and retirement advice strategies offer retirees who seek advice an enormous opportunity to ensure retirement adequacy and have the retirement they deserve.

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