

focus

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Welcome to the Spring edition of Focus.

Many retirees have achieved the great Australian dream of owning their own homes. While they have benefited on paper from the sharp rise in property values, after tapping into their retirement nest egg over a number of years they come to the realisation that their money is running out. It's a common dilemma and now some financial institutions are allowing retirees to borrow against their house. In this issue we explore the pros and cons of reverse mortgages.

We also look at the benefits of salary sacrificing to maximise your income in retirement, including a transition to retirement strategy to boost your superannuation.

We also report the findings of a recent survey of Australians aged under 40, which shows a high percentage of women do not contribute extra dollars into their super and acknowledge they have inadequate savings for retirement.

If you would like more information of any of the topics in this newsletter, please contact us.

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Reversing the retirement cash drain

It's an unfortunate reality that a high percentage of older Australian retirees do not have enough funds at hand to see them all the way through their retirement years.

Having accumulated superannuation throughout your working life, the hope is that there will be enough of an income stream post retirement to give you the sort of comfortable lifestyle you were planning on without having to go without.

Yet, having perhaps retired at age 65 with what they believed was a suitable retirement nest egg from their accumulated superannuation, many Australians are finding that 10 or 15 years down the retirement track their money pool is quickly evaporating as they try to maintain their pre retirement lifestyle.

Those that are home owners have benefited from the sharp rise in property values around the country, but despite being asset rich on paper they are poor from a cash flow perspective.

Financial institutions go into reverse

Recognising this dilemma, as average life expectancies continue to rise, an increasing number of financial institutions are offering retirees with their own home a way out from their immediate cashflow problems by lending funds that are funded via equity in their property.

Marketed as 'reverse mortgages' or home equity release loans, retirees can draw down on their home equity by taking a lump sum, a series of regular payments similar to a pension, or a combination of the two. Taking a lump sum, for instance, enables the borrower to fund a renovation plan on their home, a holiday or a new car.

Words of Wisdom

A minute's success pays the failure of years.

Robert Browning
(1812-1889)

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Reversing the retirement cash drain (cont.)

The main difference between a reverse mortgage and a standard home loan is that, with a home loan, the loan balance is reduced over time and the borrower's equity will increase. With a reverse mortgage, no regular repayments are required, and interest charges are accrued on top of the loan and capitalised, increasing the size of the loan over time.

The loan, together with accrued interest, is repaid when the house is sold or the owners die. Some lenders require repayment when the borrower moves out of the property.

A retirement blessing or last resort?

There are mixed views on the merits of reverse mortgages, with most financial experts agreeing they should only be used as a last resort to supplement retirement income from pensions.

Those needing to take them may consider that even though they are withdrawing equity, the borrowed amount is being offset by the ongoing appreciation of their asset. This is correct to a degree, although rising interest rates and stagnating or falling asset prices prove that owners cannot always expect a positive return.

A general concern is the risk that as debt accumulates, because no repayments are being made, the borrower could end up owing more than the value of the home if they are not disciplined or are forced to tap into their equity relatively early in retirement and live to a very old age. Another scenario is if interest rates rise and the value of the property actually drops over time, to an extent that the borrower ends up owing more than the value of their property.

Tip

Guard against owing more than a property's value by using a reverse mortgage that offers a 'no negative equity guarantee'.

The maximum amount that can be borrowed (as a percentage of the value of the property) is substantially lower than a traditional mortgage and is determined by the age of the homeowner at the time the loan is initiated.

The older the homeowner, the more money may be borrowed, with most institutions lending up to a maximum of about 40-50 per cent for older people.

Understanding the consequences is vital

People receiving the age pension may be interested in reverse mortgages to increase income, but it is important to understand whether social security entitlements or their ability to afford aged care accommodation will be affected.

It's important to do your homework first. For example, most products come with a 'no negative equity guarantee', meaning that the value of the loan cannot exceed the value of the home. However, these can be waived if the home is not well maintained or building insurance isn't paid up.

For more information, go to the Australian Securities and Investments Commission website at www.asic.gov.au/fido and click on the Retirement income link under Products. Then click on the reverse mortgages link on the page.

If you are considering taking out a reverse mortgage, it's important that you do get advice from a qualified financial planner.



Making the salary sacrifice

We often talk about the retirement savings gap, and the need for most Australians to direct more of their income into superannuation so they can live a comfortable lifestyle once out of the workforce.

There's no doubt that a big savings gap exists, but by using salary sacrifice strategies from your work income and starting the process early, there are huge benefits that can be achieved, even by workers on average incomes.

Salary sacrifice is simply the term for using your pre-tax salary income to make voluntary contributions into superannuation in addition to superannuation guarantee payments made by your employer.

In effect, you are sacrificing some of your salary, but it may be a sacrifice well worth making.

Getting the salary benefits

If you have a high marginal tax rate – the highest being 46.5 per cent – the benefits of salary sacrificing can be substantial. As well as only having to pay 15 per cent tax on the amount sacrificed, instead of your marginal tax rate, directing the right amount into super may also:

- entitle you to certain tax offsets such as the Mature Age Worker's Tax Offset or the Low Income Earner offset
- make you eligible to receive a government co-contribution for any personal superannuation contributions you make
- reduce any impact on social security benefits you may receive

The Federal Government's announcement of another reduction in marginal tax rates in the last budget means some individuals will have less tax to save by salary sacrificing. On the other hand, because you have less tax to pay, you also have more net income available and can probably afford to salary sacrifice more into super.

Working out your net income requirements is really the first step in calculating how much gross income you can afford to salary sacrifice into superannuation.

Let's take an example of someone earning a \$100,000 gross salary (net of superannuation guarantee contributions) who requires a net income of \$60,000 per annum.

The following table highlights how a salary sacrifice strategy can be used to achieve this under the old tax rates and the new. The numbers show that it's possible to salary sacrifice more in the new tax regime, end up with the same income, and substantially increase your superannuation savings.

Salary sacrifice pay-off

	Pre 1 July 2006 tax rates	2006-07 tax rates
Salary package	\$109,000	\$109,000
Super guarantee	\$9,000	\$9,000
Salary sacrifice	\$14,500	\$18,200
Assessable	\$85,500	\$81,800
Tax	\$24,210	\$20,570
Medicare Levy	\$1,283	\$1,227
Net income	\$60,008	\$60,003
Net increase in super	\$19,975	\$23,120

As the table shows, the net increase in super is \$3,145 per annum despite no drop in income.

Fact box

A low income or unemployed person with very low super may not be able to fund premiums for insurance in their super (since the premium is funded from the super balance). Where that person has a high income earning spouse, contribution splitting may enable them to fund insurance in super by the high-income earning spouse splitting their contributions to the person.

Avoiding the super rush

For people approaching 60 in particular, salary sacrificing a large amount of income often becomes a necessity to ensure there are more concessional dollars being directed into superannuation savings that will be used as a pension income stream post retirement.

Rather than waiting until the last minute, and having to live on a low budget by putting more income into super, starting earlier and salary sacrificing into super earlier will result in a higher level of retirement income without dramatically affecting your income now and without having to live on a shoestring later.

We'd be happy to discuss your salary sacrificing options with you in more detail. Please contact us to make an appointment so we can get you on the right path to retirement.

Women Face Super Savings Shortfall

The ideology of saving more towards our retirement is now well entrenched, with recent Government measures aimed at helping all of us build a bigger pool of capital that can drawn down upon once we stop working.

Yet, a national poll of under 40s released in July found a high percentage of women acknowledge their savings towards retirement are insufficient and unlikely to give them an adequate level of retirement income.

Commissioned by Finsia, which was formed from the merger of the Securities Institute of Australia and the Australasian Institute of Banking and Finance, the survey showed 69% of women do not contribute extra income into their super and 52% concede their super savings won't allow them to reach an adequate level of income in retirement.

The women surveyed said they more likely to consider that they would work in some paid capacity in retirement (57%), and 63% of women expected to be not employed for a period before retirement but did not know how they would contribute to their retirement savings during this period (only 15% nominated their spouse as a fall-back plan).

Recognising the need for planning

The survey, involving 600 Australians aged 25-44, found that women were significantly more likely to consider retirement planning important (at 84% compared to men at 80%), and were less likely to consider they would be a fully self-funded retiree.

They were also more likely to consider they would be a combination of self-funded retiree and a government pensioner (43% compared to men at 39%).

A good way to save

At the same time, another survey commissioned by Finsia found that by adding an extra 3% contribution to the compulsory 9% superannuation guarantee levy would significantly improve individual retirement savings

For participating contributors on average income, this represents a 33 per cent boost to their final retirement benefit.

The survey found that Australia's under-40s overwhelmingly support increasing the compulsory superannuation rate of 9% and would welcome compulsory employee contributions of 3-5 % on top of the 9%.

The women surveyed expressed a high preference for superannuation and agreed that "superannuation is a good way to make me save" (at 82%).

The same percentage agreed that compulsory superannuation was forced savings and barely noticed the deductions.

Overall, the women surveyed believe they would need less dollars in retirement than men, with women significantly more likely to consider they'll need less than \$500 a week (at 67% compared to men at 59%), while men were significantly more likely to consider would need more than \$500 a week (at 40%, compared to women at 28%).



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