



## Transition to retirement

The nature of retirement is changing and so are the rules. If you want to reduce your working hours or pay less tax without sacrificing your income, 'transition to retirement' could be the answer.

Longer life expectancies mean many Australians are spending more time in retirement than ever before<sup>1</sup> – increasing the burden on our social security system and the importance of accumulating superannuation (super).

As a consequence, the Government is encouraging us to remain in the workforce beyond the traditional retirement age. A recent incentive is the option to access your super before you fully retire, through a transition to retirement pension.

You can access a transition to retirement pension of between 4-10 per cent of your account balance if you've reached preservation age (currently 55) and you are still working.

### A better lifestyle on the same income

Transition to retirement provisions allow you to supplement your income by drawing a regular

pension payment from your super fund. There are two principal ways you can benefit:

- convert to part-time work without decreasing your income, and spend more time doing the things you want to do; or
- continue to work full-time but reduce your tax by taking a pension and salary sacrificing more of your income into super (or your spouse's super).

Should you continue working past 65, you also benefit from ongoing employer contributions to super which ultimately increases the value of your retirement nest egg.

### Tax treatment

If you are under 60, part of your pension payments will be taxed, but you may receive a 15 per cent tax offset on the taxable component. Once you have reached age 60, all pension payments are tax-free including lump sums.

Your financial adviser can help you structure your pension to legally minimise your tax.

### How does the Transition to Retirement strategy work in practice?

#### Case study

Ted, who is 57, has a salary of \$80,000 per annum (plus 9% superannuation). He wishes to continue to receive his current net income but maximise the effectiveness of his super. He currently has \$400,000 in super and decides to commence a transition to retirement pension of \$30,000 p.a.

As the table below illustrates, Ted has not changed his cash income at all, but has saved over \$4,000 in tax each year which stays in his superannuation account. If he retires after turning age 60, all benefits including the tax saving are tax free.

#### Note about salary sacrificing

Although salary sacrificing into superannuation is a great strategy for increasing your retirement savings, not all employers offer this feature to their employees. Also under these arrangements your

	Without strategy <sup>#</sup>	With strategy <sup>#</sup>
Gross salary	\$80,000	\$42,000
9% super contributions	\$7,200	\$7,200
Salary sacrifice into super	–	\$38,000
Super pension drawn	–	\$30,000
Tax paid plus Medicare Levy (less offsets)	\$20,300	\$12,280
Net cash	\$59,700	\$59,720
Superannuation asset <sup>#</sup>	\$430,962	\$435,207
Increase in super due to strategy	–	\$4,245

<sup>1</sup> [http://www.aihw.gov.au/mortality/data/life\\_expectancy.cfm](http://www.aihw.gov.au/mortality/data/life_expectancy.cfm)

<sup>#</sup> Earnings are 6% p.a in a superannuation account (net 15% tax) and 6.5% a pension account (nil tax). Salary sacrifice and 9% superannuation contributions are taxed at 15% in super. Earnings and super contributions are credited monthly.

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# Subprime crisis – what's it all about?

Stories about the US subprime crisis are still dominating the news. But what's it all about and why does it impact us?

The literal definition of 'subprime' is 'below optimum'. In other words, it's a catchy label given to a large number of loans which shouldn't have been granted. Under normal circumstances, these customers' poor credit history would have made them blatantly ineligible for a mortgage.

Low interest rates and a booming US property market, however, saw many banks and other lenders in America relax their criteria and approve a slew of subprime mortgages.

Not surprisingly, over time many of these loans proved difficult (if not impossible) to service.

Things reached critical mass mid 2007, when many subprime customers' low interest rate ('honeymoon') periods came to an end. What's more, construction of new houses outpaced housing demand and, as a result, prices began to fall. Many borrowers found that not only were they unable to repay their loan, their houses were now worth less than what they owed the bank.

As large numbers of subprime borrowers defaulted, lenders were forced to sell houses in an already distressed market. As a result, outstanding debts could not always be recovered and several large US banks reported substantial losses.

## But what has this got to do with us in Australia?

The level of exposure to the subprime loan market i.e. low doc loans, in Australia is not as significant as in the US. Locally we have stricter criteria and lending practices especially for this type of loan. However, when the large US banks reported losses, this led to a weakness in bank shares across the globe.

What's more, the losses weren't limited to US retail banks. Investment banks had repackaged subprime mortgages and sold them on to investors worldwide. A common way to raise funds for home loans is 'loan securitisation', which is a bundling of a large number of loans to form a new type of investment vehicle.

When loan defaults began in the US, these repackaged mortgages fell in value and investors lost money. Many investors were able to return these subprime-backed securities to the investment banks, causing further damage to the lenders' bottom line.

Listed companies with large revenue exposure to the US and high debt levels saw their share price drop. And as investors got nervous, this further fed share market volatility.

## What's to come?

The impact of the US sub prime market crash isn't over just yet. It's generally accepted that the worst subprime loans were the 2006

vintage whose honeymoon rates will end throughout this year.

But while the potential US recession centres on problems in the subprime lending market, it is also impacted by the US' large budget deficit, and slowing economic growth, fuelling fears of a global slowdown.

## So what can we expect in the coming months?

The biggest issue facing world markets is the US recession debate. Will the US enter a recession or will they manage to avoid it by, for example, aggressively cutting interest rates?

If it does enter a recession, the next question is whether emerging markets can take up the slack in the global economy.

Over the last eight years or so, emerging markets (such as China, India, Russia and Brazil) economies' have grown at a more rapid rate than the developed world. Interestingly, most world savings in recent years have come from emerging markets, while developed countries (such as the US) have been running budget deficits.

As a result, many economists are debating that if the US economy does enter a recession, the world may not follow. However, this economic decoupling debacle does not mean a market decoupling. Because of globalisation and the sheer volume of US corporate operations worldwide, a downturn in US share market will at some point affect the rest of the world.

On a positive note, domestic economic fundamentals are considered sound, corporate earnings are at record highs and we have the lowest unemployment rate in decades. So, while short-term market volatility is to be anticipated over the next 6 to 12 months, the long-term outlook is positive.

## Financial peace of mind

The best approach to weather out the storm is sticking to your long-term strategy. Your financial adviser has the expertise to develop a personalised financial plan which, through diversification and analysis of your objectives, can continue to work towards your long-term goals.

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'salary' decreases and this could have a flow on effect to other employment benefits you receive – e.g. compulsory super contributions may be determined using actual (reduced) salary and can also take into account salary sacrifice contributions.

### Seek professional advice

Transition to retirement provisions can mean reducing your working

commitments and pressures without necessarily reducing your standard of living. There are, however, various levels of complexity and the strategy is not suited to all investors.

Only a financial adviser can help you determine the best approach for you. Ensure your retirement planning is on track by seeking professional advice.

# Why talk about super for women?

Women make up around half of the paid labour force, yet they typically retire with 50 per cent less superannuation (super) than men.<sup>1</sup> Despite introducing compulsory contributions 15 years ago, the Australian Government estimates one third of the aged population will still be reliant on a Government-provided aged pension in 40 years, and the majority of those recipients will be women.<sup>2</sup>

While women are increasingly financially independent – whether they marry or not – lower super contributions place their independence at risk in retirement.

## Issues that affect women's super savings

### Compulsory super is not enough

For many women, the compulsory super contribution of 9 per cent is not enough. It's based on the needs of someone working full-time throughout their adult life, but on average, women spend up to 20 years out of the workforce or working part-time due to being the primary carer.<sup>3</sup>

### Women often work in lower paid industries

Women tend to have less discretionary income due to lower incomes in female-dominated industries (e.g. teaching, nursing). The increasing number of women running small businesses – often to manage the demands of work and family – are particularly at risk as they may not have compulsory super at all.

### The 'I'll worry about it later' attitude

Super is sometimes so difficult to understand that we choose to ignore it. A low level of financial literacy around super for both men and women, and a tendency to think about other more immediate forms of investment like buying a property or shares, all contribute to this relaxed attitude towards super.

### Historical issues

Australia's ageing population is an enormous issue given compulsory contributions to super only began in 1992, so older women typically have less super. The problem is perpetuated because younger women are likely to be called upon as unpaid carers for their parents.

### Women live longer than men

A longer life expectancy for women of about five years means women spend more time in retirement<sup>4</sup> therefore they actually need *more* super than men to remain independent and live comfortably.

### Things to think about

Here are some super strategies that will help you fund your retirement lifestyle, regardless of your age – and men can benefit from these strategies too:

- First, do your sums. Think about what you want in retirement, including travel or other big-budget plans as well as living expenses. The amount of paid work you do, or hope to do in the future also needs to be taken into account in determining your super strategy.
- Talk to your partner about your super strategy, particularly if one of you does less paid work or is on a lower income. Your financial adviser can suggest tax-effective strategies you may both benefit from, such as having the higher

income earner make super contributions into a spouse account.

- In the unfortunate situation of divorce, remember to consider superannuation when arranging financial settlement. After the family home, super is often the second largest asset your family has.<sup>5</sup> There are tax implications for splitting or transferring super so consulting a financial adviser at this time is highly recommended to ensure a beneficial outcome.
- If you are single, or a single parent, you will need to take extra precautions for your retirement income. There are a range of tax incentives as well as the Government's Co-contribution scheme that can help you increase your super savings. Your financial adviser can explain these strategies to you and recommend the best approach taking into account your individual situation.
- Small business operators, as well as those on low incomes, need to take additional responsibility for super contributions. Even if you're self-employed, you still need to make contributions towards your retirement – this is more tax-effective now through the Government's 'Simpler Super' changes for the self-employed.
- If your discretionary income is low, look for other means to top-up your super. Consider investing a windfall such as an inheritance or tax return if and when you can. Over time, the compound interest will be beneficial.

Super is a complex beast. However, there is an increasing amount of financial literacy information and educational material available to help you. The most valuable thing you can do is take an active interest in your super so you're able to harness its benefits. Ask your financial adviser for more information on applicable super savings strategies for you. Alternatively, consider visiting the Government's financial literacy web site [www.understandingmoney.gov.au](http://www.understandingmoney.gov.au).

1 Australian Government Office for Women 2006 refer <http://www.superannuation.asn.au/Media-Release-12-June-2007/default.aspx> and <http://www.aph.gov.au/house/committee/efpa/super/subs/sub073.pdf>

2 Australian Government Department of Family and Community Services 2005 refer [http://ofw.facs.gov.au/downloads/pdfs/FaCS\\_HoR\\_submission.pdf](http://ofw.facs.gov.au/downloads/pdfs/FaCS_HoR_submission.pdf)

3 Investment and Financial Services Association refer p2 [http://www.ifsa.com.au/documents/Fact%20Sheet\\_keep%20your%20edge\\_women.pdf](http://www.ifsa.com.au/documents/Fact%20Sheet_keep%20your%20edge_women.pdf)

4 Australian Government Australian Institute of Health & Welfare 2007 refer: [http://www.aihw.gov.au/mortality/data/life\\_expectancy.cfm](http://www.aihw.gov.au/mortality/data/life_expectancy.cfm)

5 Investment and Financial Services Association Limited 2004 refer: [http://www.ifsa.com.au/documents/Fact%20Sheet\\_keep%20your%20edge\\_women.pdf](http://www.ifsa.com.au/documents/Fact%20Sheet_keep%20your%20edge_women.pdf)

# Realising the dream

Twenty years ago, it was a common strategy to save a 20 per cent deposit and then look for a home to buy. Employing this same strategy today excludes people from the real estate market and introduces a game of catch up, in an attempt to save money faster than the real estate market increases in value.

Home ownership is moving beyond the reach of many Australians, with figures revealing the proportion of people who own their home outright has slumped by almost 20 per cent in the past 10 years.

A report released by the Australian Bureau of Statistics (ABS) shows that in 2005-06, just over a third (34 per cent) of homes were owned outright by their occupants – down from 42 per cent in 1994-95. Over the same time, the proportion of homes owned with a mortgage increased from 30 per cent to 35 per cent.

While most people aged 65 years or more now own their home outright, only about one in two Baby Boomers (aged 55-64) can make that claim.

The ABS report partly puts the decline in outright ownership down to an increase in the number of people extending their mortgages to fund other projects.

In 2005-06, there were more people in private dwellings (up 13 per cent) than in 1994-95, but the average household size decreased by 7 per cent.

The report found that the proportion of gross household income required to meet housing costs increased from 12 per cent to 14 per cent.

Sydney had the highest housing costs in Australia – for private renters, Sydney's costs averaged \$294 per week, followed by Canberra (\$280) and Darwin (\$259). For owners with a mortgage, Sydney's housing costs averaged \$443 per week, followed by Canberra (\$343) and Brisbane (\$338).

The median value of owner occupied dwellings rose from \$186,000 to \$350,000 – up 88 per cent between 1994-95 and 2005-06.

## First home buyers

The report found that first home buyers with a mortgage were generally young, couple families with two incomes.

First home buyers with a mortgage had an average household income of \$1,544 per week in 2005-06, 18 per cent higher than the average for all households.

One in four (25 per cent) first home buyers with a mortgage purchased medium and high density housing in 2005-06, up from 15 per cent in 1995-96.

Young people aged between 20 and 30 (generally referred to as Generation Y), are being squeezed out of the property market by a combination of their own spending patterns, lower incomes and the financial strength of baby boomers according to a Roy Morgan research report, State of the Nation.

The report found that those under 30 owe an average of \$202,000 compared with the average of people between 30 and 44 years of \$179,000.

Interestingly the report also found that incomes for those under 30 have increased at a slower rate than for the rest of the population and that only 13 per cent of this group have a home loan, compared with 17 per cent of the previous generation when they were that age.

Baby boomers are helping to keep property prices high by continuing to buy well past middle age while increasing the level of equity in their houses to 72 per cent from 66 per cent 10 years ago.

There are many strategies available to help you save and budget in order to be able to afford your home or an investment property sooner. Ask your financial adviser about some strategies today.



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