How much super will be enough?

Working out how big a pot you need hinges on the answers to five queries, says *David Andrew*

If you do a Google search for "how much is enough in retirement?" you will get almost 85 million results.

So if you've been wondering how much is enough for your retirement, you're not alone.

The answer will depend on your circumstances and expectations.

In attempting to answer this question, we need to understand the five big questions for retirement.

1. How much are you hoping to spend in retirement?
2. How much can you save?
3. How much investment risk do you want to take?
4. When are you planning to retire?
5. How much do you want to leave behind?

For many years, finance researchers have suggested drawing down 4 per cent of your portfolio a year is a safe withdrawal rate.

If a retiree invested in a balanced portfolio of 50 per cent shares and 50 per cent bonds, and drew down 4 per cent of their portfolio each year, they could reasonably expect their assets to last 30 years, or so the argument went. Using the 4 per cent rule, a retirement income of $50,000 a year would require capital at retirement of $1.250 million and there would be an expectation the money would last your entire lifetime.

The Association of Superannuation Funds of Australia publishes a standard benchmark for singles and couples to live modestly and comfortably in retirement.

Currently ASFA suggests a couple would need $34,226 to live modestly and $59,236 to live comfortably, although if your retirement plans extend to things like regular international travel, helping children and regular vehicle upgrades, then clearly you will need more.

In Australia we enjoy a generous social security system in the form of the age pension.

Just how long the system will remain generous, is another matter.

For those retiring in the next five to 10 years, there is a reasonable chance the retirement pension system will remain viable, but the state of our national finances does raise questions about the sustainability of the system.

Under the current rules, a retired couple with over $1 million in assets can still receive a part-pension, although the eligibility rules become tougher from January 1, 2017 when the assets test for a homeowner couple will reduce to $823,000.

To illustrate how generous the system is, let's take the example of John and Ruth, who own their family home and have $350,000 in superannuation and savings. Let's say they draw $14,000 from an account-based pension each year, their age pension payment would see them achieve a retirement income of over $45,000 each year.

So let's consider the how much question for 50-year-olds planning for their retirement some time after 2030.

The much-maligned 2014 Federal Budget papers outlined the Government's funding problem in highlighting the rapid increase in the proportion of the Australian population aged over 65.

This growth in the over 65s points to tougher eligibility requirements for age pension benefits, meaning today's 50-year-olds are likely to be retiring at closer to 70, and may not enjoy the benefits retirees do today.

While it's good to know the pension is there as a backup, many Australians are not planning on using it, simply because they have an expectation of a higher income in retirement, and are prepared to save enough to achieve this result. This group is broadly referred to as the self-funded retirees.

For this group, how much you will need mainly depends on how much and for how long you will be drawing on your investment pool — the earlier you retire, the larger your capital base needs to be, while continued work, even on a part-time basis, will stretch out your drawdown.

For self-funded retirees, the prospect of running out of money is usually the biggest concern. Managing your capital to minimise the possibility of errors, and ensuring your wealth is not eroded by inflation, become the two most important areas to consider.

Superannuation will probably be the ideal structure for you because the tax benefits are considerable and will stretch your wealth further.

When we invest for retirement we are making decisions that need to pass the test of time.

A retiree aged 65 is likely to live for 20 years and perhaps as long as 30, so they will need a long-term investment plan.

The only problem is investment markets can be uncertain. This is where the amount you draw down from your portfolio each year will help you deal with market uncertainty.

Let's say you invest half your portfolio in a diversified portfolio of global and Australian shares, and the balance in cash and fixed interest investments. Significant market events like the 1987 stock market crash and the global financial crisis can have a big impact on your retirement, so the possibility of an event like this needs to be factored in.

This is where the idea of a drawdown rate is important.

Let's say you want a retirement income of $75,000 each year.

An annual drawdown. of 3.5 per cent is considered safe, which means your portfolio would need to be just over $2 million, but you will be able to withstand most economic downturns and market shocks during your lifetime.

A safe drawdown means you will sleep well at night, but you will need a bigger portfolio to provide the safety you need.

A moderate portfolio drawdown of 4.5 per cent each year means you need less capital to fund your $75,000 annual lifestyle, but you may be more susceptible to an economic downturn or market shock.

A higher drawdown again of 5.5 per cent each year would suggest you may need even less capital to fund your lifestyle, but your portfolio and your lifestyle will be far more susceptible to a market downturn.

Finding the right level of investment risk and the right level of drawdown will depend on your risk tolerance and the concern you may have about running short of funds during your lifetime.

The final factor we can't ignore is we do tend to need less money as we get older. Past the age of 80, we tend to travel less and spend less on lifestyle expenditure.

Spending more in the early years while we're healthier and physically active makes sense so it's a matter of finding the balance between spending for today and ensuring there's enough for tomorrow.

David Andrew is managing director of Capital Partners

David Andrew

UNDER THE CURRENT RULES, A RETIRED COUPLE WITH OVER $1 MILLION IN ASSETS CAN STILL RECEIVE A PART-PENSION, ALTHOUGH THE ELIGIBILITY RULES BECOME TOUGHER FROM JANUARY 1, 2017.

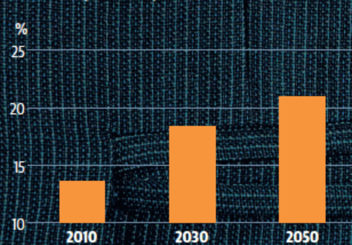
POCKET CHANGE

ASFA RETIREMENT STANDARD

	Annual living costs	Weekly living costs
Couple - modest	$34,226	$656
Couple - comfortable	$59,236	$1136
Single - modest	$23,797	$456
Single - comfortable	$43,184	$828

AGEING AUSSIES

People aged 55 and over as a proportion of Australians (2010-2050)



AGE PENSION ASSETS-TEST FREE AREA

	Homeowner		Non-homeowner	
	Until June 2016	Jan 2017	Until Jun 2016	Jan 2017
Single	$205,500	$250,000	$354,500	$450,000
Couple	$291,500	$375,000	$440,500	$575,000

CAPITAL NEEDED

Retirement Income	Safe 3.50%	Moderate 4.50%	High 5.50%
$50,000	$1,428,571	$1,111,111	$909,091
$75,000	$2,142,857	$1,666,667	$1,363,636
$100,000	$2,857,143	$2,222,222	$1,818,182
$125,000	$3,571,429	$2,777,778	$2,272,727
$150,000	$4,285,714	$3,333,333	$2,727,273

Acronym soup easier with a healthy serving of RAM

According to the last set of figures from the Australian Government actuary, a man turning 65 this year and wanting to retire has a statistical life expectancy of about 18.5 years and a woman nearly 22.

For those people who are currently saving and investing for their retirement, these statistics present a very real challenge because they are directly linked to knowing how much they will need to enjoy a financially secure retirement.

The problem in determining how much is enough begins with the answer; it depends.

It is with the above in mind many people might find it very helpful to have some principles and easy-to-understand mathematical measures to use as a guide in accumulating and later dispersing funds for their retirement.

When considering a superannuation fund retirement portfolio most people have no problem understanding that it is likely to last longer if the rate of withdrawal is lower.

However, there are other aspects of a retirement portfolio that may not be quite so easy to understand.

High on the list of those considerations is the issue of portfolio design: How have different portfolios behaved in the past? So let's think about this a bit more.

THE RETIREMENT ACCOUNT MULTIPLE

First among the key principles in the mathematics of retirement portfolios is the retirement account multiple.

RAM is simply the size of the superannuation account balance at retirement as a multiple of the retiree-to-be's final year of salary.

Let's look at Tony who has a final year salary of $100,000 and a superannuation account balance of $700,000. Tony has a RAM of 7.

This is a critical number to know because once we know the RAM, calculating Tony's income replacement ratio is straightforward: RAM x withdrawal rate = income replacement ratio.

If Tony multiplies his RAM number by an initial withdrawal rate of 5 per cent per annum it produces the following equation: 7 x 5 = 35 per cent income replacement.

In other words, if Tony withdraws 5 per cent of the $700,000, which is $35,000; $35,000 is 35 per cent of his final year's salary of $100,000.

In the above example it is clear to see that Tony's income replacement in retirement (as a percentage of the final year's salary) is simply a mathematical relationship between his RAM and the chosen withdrawal rate percentage.

Next comes the really tricky part: how best to invest Tony's superannuation so that he does not run out of money. If financial security in retirement for Tony is defined as having his superannuation fund survive (not run out of money) for at least 18.5 years, there can be no doubt that in today's low-interest rate environment his portfolio will have to include growth-orientated investments such as shares and property.

Let's say that Tony has selected an income replacement ratio of 50 per cent for his retirement.

Because Tony has a RAM of 7, he will need to implement an initial withdrawal rate of 7 per cent per annum to create a 49 per cent income replacement ratio (7 x 7 per cent = 49 per cent income replacement ratio).

What is equally important to understand is that if Tony had a RAM of 10, he would only need a 5 per cent withdrawal rate to produce the 50 per cent income replacement ratio he desired.

This in turn means that his superannuation retirement portfolio can afford to have a lower level of growth-orientated investments.

In the above example you can see the luxury of using a lower withdrawal rate is created by having a big RAM.

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