AFR WEEKEND

SmartInvestor

Everything you need to know about your money

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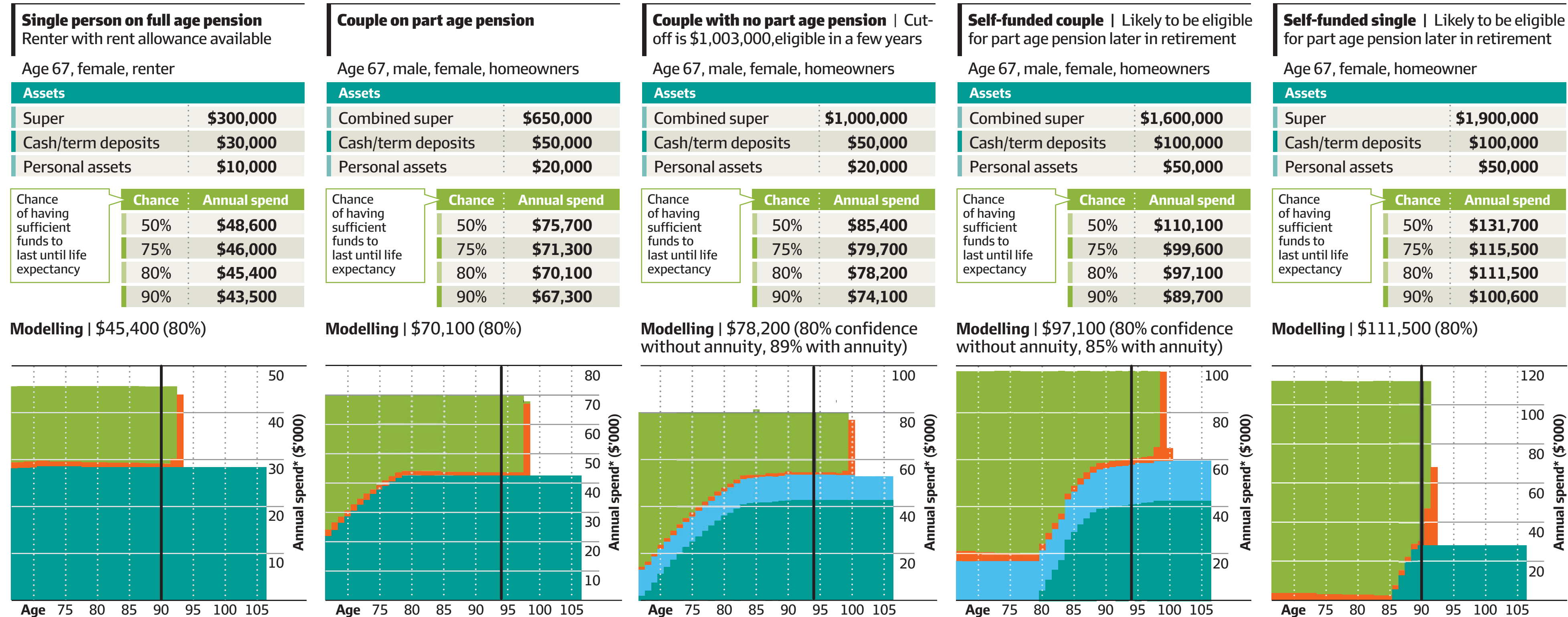
Edited by Debra Cleveland: dcleveland@afr.com

Five scenarios

How much you can afford to spend a year in retirement

Age pension | Annuity | Other income | Account-based pension | — Life expectancy



Single person on full age pension
Renter with rent allowance available
Age 67, female, renter

Assets	
Super	$300,000
Cash/term deposits	$30,000
Personal assets	$10,000

Chance of having sufficient funds to last until life expectancy	Annual spend
50%	$48,600
75%	$46,000
80%	$45,400
90%	$43,500

Modelling | $45,400 (80%)

Couple on part age pension
Age 67, male, female, homeowners

Assets	
Combined super	$650,000
Cash/term deposits	$50,000
Personal assets	$20,000

Chance of having sufficient funds to last until life expectancy	Annual spend
50%	$75,700
75%	$71,300
80%	$70,100
90%	$67,300

Modelling | $70,100 (80%)

Couple with no part age pension | Cut-off is $1,003,000, eligible in a few years
Age 67, male, female, homeowners

Assets	
Combined super	$1,000,000
Cash/term deposits	$50,000
Personal assets	$20,000

Chance of having sufficient funds to last until life expectancy	Annual spend
50%	$85,400
75%	$79,700
80%	$78,200
90%	$74,100

Modelling | $78,200 (80% confidence without annuity, 89% with annuity)

Self-funded couple | Likely to be eligible for part age pension later in retirement
Age 67, male, female, homeowners

Assets	
Combined super	$1,600,000
Cash/term deposits	$100,000
Personal assets	$50,000

Chance of having sufficient funds to last until life expectancy	Annual spend
50%	$110,100
75%	$99,600
80%	$97,100
90%	$89,700

Modelling | $97,100 (80% confidence without annuity, 85% with annuity)

Self-funded single | Likely to be eligible for part age pension later in retirement
Age 67, female, homeowner

Assets	
Super	$1,900,000
Cash/term deposits	$100,000
Personal assets	$50,000

Chance of having sufficient funds to last until life expectancy	Annual spend
50%	$131,700
75%	$115,500
80%	$111,500
90%	$100,600

Modelling | $111,500 (80%)

*Indexed for CPI

SOURCE: CHALLENGER

HOW TO NOT OUTLIVE YOUR SUPER

Retirement Work out which of these five retiree types you are to guide your spending after you stop working, says **Joanna Mather**.

Longevity risk – or the prospect that you will live longer than you anticipate and therefore run out of retirement savings – keeps many people up at night.

Take actuary David Orford, the managing director of annuities business Optimum Pensions, whose mother died of a heart attack at 72. Her father also died of a heart attack at 72. Orford, 62, has had a heart bypass operation and takes cholesterol medication and reckons it is possible he will live longer than his father who died at 93.

Then again, 47 per cent of people die before they reach life expectancy, and he could get hit by a bus tomorrow.

"People often say variability of investment returns is the biggest risk post-retirement, but I think it's 100 per cent longevity risk," Orford says. "That's apart from losing your spouse, which has no effect on women but results in reduction of life expectancy for men."

The point is not to be flippant about Orford's mortality but to acknowledge that life expectancy projections are just that – best guesses. As such, the biggest financial question many people face is how to budget for an enjoyable retirement while minimising the risk of outliving their savings.

The retirement income of most Australians comes from the government-funded means-tested age pension, an account-based pension (an amount withdrawn regularly from superannuation), or a combination of both.

How much to spend

Even before they get to longevity risk, many retirees struggle with working out how much to spend.

"Clients ask three things," says David Reed, who runs Sydney-based The Retirement Advice Centre. "'When can I retire?' 'How much can I spend each week?' 'How long is it going to last?' And the thing that answers all of those questions is their withdrawal rate."

There are some free guides. The federal government's Moneysmart website offers a retirement income calculator, as do many superannuation funds.

The Association of Superannuation Funds of Australia developed a "retirement standard" in 2014 and updates it regularly to track changes in cost of living.

The current ASFA standard for a "comfortable" lifestyle is $71,723 income a year for couples and $46,620 for singles. The lump sum required for a "comfortable" lifestyle for a couple is $690,000 and $595,000 for a single. A "comfortable" lifestyle includes the occasional restaurant meal, an annual domestic trip and an international trip once every seven years.

The annual income guide for a "modest" lifestyle is $50,981.27 for couples and $32,417.48 for singles. The lump sum required for a "modest" lifestyle is $100,000 for both a couple and a single.

"There tends to be a level of conservatism built into the way many people spend their money in retirement," says Jonathan Scholes, who specialises in wealth management at financial advisory and accounting business Findex. "As financial planners, we are often talking to clients about taking that holiday or buying that new car rather than necessarily saving for when they are 95."

"In many instances, our clients are sacrificing their own personal standard of living to leave more to the children and their beneficiaries. But we still do have individuals who spend more money than perhaps their capital allows."

For a fee, financial planners will use life expectancy data, actuarial insights and computer modelling to devise suggestions for how much clients can confidently spend each year.

With that in mind, *Smart Investor* asked Challenger's head of technical services, Andrew Lowe, to model five typical retiree types to see how much they might be able to

ILLUSTRATION: SIMON LETCH

draw from their savings each year without running out of money before they hit life expectancy.

The five retiree scenarios are: age pensioner; part age pensioner couple; self-funded couple soon to become part age pensioners; self-funded couple; and self-funded single. The modelling uses Challenger's retirement illustrator tool for financial advisers, based on assets and super balances at age 67.

Different scenarios

Each scenario is detailed on the next page, while the graphic above shows the annual sum each retiree type might be able to spend based on their superannuation, other savings, age pension eligibility and life expectancy.

The table on the next page shows the "safe spend" for balances from $200,000 to $3.8 million.

For each scenario, Lowe provides an amount at which the retiree/s can have varying levels of confidence – ranging from 50 per cent to 80 per cent – that they won't outlive their savings.

Given the federal government wants superannuation funds to ensure customers have access to financial products that guarantee lifetime income and Challenger is in the business of selling annuities, Lowe has included the purchase of a CPI-linked lifetime annuity in two of the five scenarios.

Annuities provide guaranteed income over a set period in exchange for an upfront cost – Lowe's scenarios involve using 20 per cent of super savings to buy an annuity.

All superannuation in the scenarios is assumed to be invested 50 per cent in growth assets such as shares and 50 per cent in defensive assets such as bonds.

All modelling is to life expectancy, which is the age(s) to which an average Australian of a given age can expect to survive (or at least one of the people in a couple is expected to survive), based on Australian life tables 2015-17.

"In many ways the key is confidence," Lowe says. "When retirees have the confidence that they will have money available later, they can spend more earlier in their retirement. Current behaviour, with the majority drawing only the minimum, suggests that retirees do not have that confidence to spend."

The mandated drawdown rate from super in retirement ranges from 5 per cent to 9 per cent according to age, and many people use the minimum rate as a rule of thumb for what they should spend.

For many retirees, this results in unnecessary penny-pinching, according to the federal Labor government, which has called for submissions to a Treasury review looking at how to give retirees more confidence to spend their retirement savings, either via new products or better advice.

"The problem is most retirees do not have access to the appropriate products to help them maximise their super over their lifetime," Assistant Treasurer Stephen Jones said when he launched the review in December. "In fact, 84 per cent of retirement savings are held in account-based or allocated pensions, with only 3.5 per cent

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Glenn and Annette Mitchell feel it was a mistake not to seek advice. PHOTO: PETER WALLIS

From page 29

How much you can spend without outliving super

held in annuities. Unlike account-based pensions, annuities offer the option of receiving regular payments for life, regardless of how long a person lives."

Brisbane couple Glenn and Annette Mitchell purchased an annuity when they retired in 2014. They ran a business manufacturing sheepskin seat covers for 34 years and felt capable of managing their retirement finances.

"That was a mistake," says Glenn, a father of two and grandfather of four. "We did not know the rules that governed Centrelink benefits and the impacts of investments on pension entitlements.

"The biggest issue for us was the income from our rental property investment was not sufficient to sustain our outgoing expenses throughout retirement, so we needed an alternative, assured income."

Glenn says that the annuity lifted the couple's annual income from roughly $44,000 a year to $89,000.

Some would argue the government-funded, means-tested age pension paid by Centrelink is the ultimate longevity hedge. If you run out of money, then you'll qualify.

The Treasury discussion paper says retirees tend to worry about the upfront cost of annuities, don't like the idea that large sums of money are "locked away" when health or aged care emergencies might arise, and are worried about "wasting capital" if they die at an early age.

Superannuation funds and insurance providers are working on ways to make annuities more attractive, such as allowing the withdrawal of capital in an emergency.

The government is trying to figure out ways it could make the products cheaper by taking on some of the insurance risk.

Retiree types

Age pensioner | The first retiree type is a single woman who is renting and eligible for the full age pension. She has $300,000 in super, $30,000 in cash and term deposits and $10,000 worth of personal assets (such as cars and jewellery). She has a life expectancy of 90.

Lowe's modelling shows she can draw $45,400 a year (indexed with inflation each year) with 80 per cent confidence she can maintain that level of annual spending to her life expectancy. If her retirement savings run out, she will need to rely on the age pension, currently $28,514 a year for a single ($42,998 for couples). "If she were to ask me how much she could spend in retirement, I would take her maximum rate of age pension – which is $28,500 – and combine it with [an account-based pension using] her $300,000 super to find she can buy a very confident additional level of income," Lowe says. "She can have a 50 per cent degree of confidence that she could spend $48,600 a year and a 90 per cent degree of confidence at $43,500 a year."

Part-pensioner couple | The home-owning couple in this scenario has $650,000 in combined super, $50,000 in cash and deposits and $20,000 of personal assets. Their life expectancy is 94.

If they draw a combined income of $70,100 a year, they have an 80 per cent chance of having sufficient funds to maintain that budget to age 94.

Initially, less than one-third of their income comes from the age pension and two-thirds from super and private savings. But over time the age pension increases to represent more than half of their income.

Self-funded couple soon to become part-pensioners | As homeowners with $1 million in super, this couple just misses out on qualifying for the age pension when they retire at 67, although they will become eligible in a couple of years.

They can draw a combined income of $78,200 a year with 80 per cent confidence they will not outlive their savings.

If the couple allocates 20 per cent of their retirement savings to a CPI-linked lifetime annuity (at a cost of $200,000), their confidence level rises to 89 per cent.

The annuity would guarantee lifetime income of an extra $10,500 a year.

Self-funded retiree couple | These homeowners have $1.6 million in combined super, $100,000 in cash and term deposits and $50,000 of personal assets.

They can draw a combined income of more than $97,000 a year with 80 per cent confidence that they will not outlive their savings.

If they were comfortable with a 50 per cent degree of certainty, they could dial up their annual drawdown to $110,000 a year. They are likely to become eligible for a part-pension later in life.

If they invested 20 per cent of their super savings in a lifetime annuity ($320,000), they would get more than $16,500 a year of guaranteed, CPI-linked income for as long as they live and their account-based pension would last longer.

Self-funded single | This single homeowner has $1.9 million in super, which puts her at the upper end of what is allowed in tax-free retirement phase super accounts. She is also likely to be eligible for a part age pension later in life.

With an 80 per cent level of confidence, she is unlikely to run out of money spending $111,500 a year. For the first decade or so of retirement, her income is derived from an account-based pension and other income (interest on savings) until she becomes eligible for a part age pension at 90. SI

Budget blueprint

Annual 'safe spend' amount depending on your balance

'Safe' is based on a 90% chance that the spending amount (indexed for CPI) will be sustainable to the life expectancy (LE) of 94-years-old, investing all savings in a 50% growth risk profile account-based pension. Table also illustrates the confidence the spending would be sustainable to six years beyond life expectancy.

Retirement	Safe spend*	LE + 3yrs	LE + 6yrs
$200,000	$51,100	84%	78%
$400,000	$58,700	85%	78%
$600,000	$64,700	84%	76%
$800,000	$69,300	83%	73%
$1,000,000	$73,200	82%	71%
$1,200,000	$77,700	82%	72%
$1,400,000	$82,700	82%	72%
$1,600,000	$87,800	83%	73%
$1,800,000	$93,600	83%	74%
$2,000,000	$99,700	83%	75%
$2,200,000	$106,400	83%	75%
$2,400,000	$113,000	83%	75%
$2,600,000	$119,700	84%	76%
$2,800,000	$126,600	84%	77%
$3,000,000	$133,800	84%	77%
$3,200,000	$141,100	84%	78%
$3,400,000	$148,600	84%	78%
$3,600,000	$156,400	84%	78%
$3,800,000	$164,000	84%	78%

SOURCE: CHALLENGER