Rescue your retirement

Is retirement creeping up on you and is your super account looking a little low? It's never too late to use property to supplement your income. *Kevin Eddy* explores the options

It's a well-documented fact that people in the developed world are living longer – and that the proportion of older people is increasing. The government's 2007 *Intergenerational Report* predicts that over-65s will make up a quarter of the population by 2050, and life expectancies are only projected to increase from their current averages of 79 for men and 84 for women.

When you consider that your super fund may have to cover 15 or 20 years post-retirement, the current average super fund size at retirement seems rather inadequate at $75,000. If you live for 15 years after retiring, that's just $5,000 a year – or a paltry $3,750 per year if you live for 20 years after retiring.

Bernard Kelly from retirement planning firm Retire Laughing is forthright about the state of most people's retirement funds.

"I don't think anyone has enough money in their super fund – not you, not me, and not the people who are currently in their 50s and 60s," he says. "The dream that retirement is just one big holiday does not exist – and people will soon realise that no one's got enough to live on."

Harsh talk: but does increasing longevity also create opportunities, particularly in terms of using property to supplement your super income, or funding your latter years entirely? After all, as people live longer, it's possible for them to enter the property market later and still reap the benefits of a full property cycle. That's also conditional on being able to fund those purchases, of course: banks are increasingly twitchy about lending money as borrowers get older. However, the advent of self-managed super funds (SMSFs) has opened up a new angle on property investing – one that potentially promises tax-free gains from those properties.

To help find some answers we gathered together a number of financial planners and asked them for their views on the best way to play 'catch up'.

Should you consider investing in property via an SMSF, and if so what are the restrictions on doing so? When building your portfolio, should you concentrate on positive cash flow or building capital gains – and how should this change as you get older? How can you structure this so that you make the most of what you have – and minimise the amount that goes to the tax man?

50+

Property strategy

Paul Benson, Guidance Financial Services:
The 'fiftysomething' investor is still at least 10 years away from retirement, so I would argue that growth is the focus. When you're talking about property investment for someone 50 years of age or older, SMSFs just scream out given the significant tax benefits – particularly with borrowing. If you're using an SMSF, there are two paths you could take.

One would be to take the view that the property will provide an income stream in retirement. If that is the approach, then you would aim to pay down the debt between purchase and planned retirement to maximise the free cash flow in retirement. Therefore, you would focus on using

> "The dream that retirement is one big holiday doesn't exist – no one's got enough to live on"

the rental income and employer super contributions all as inflows into the fund to pay down that debt on the basis that by the time you've got to retirement, the debt is either completely or substantially cleared and the property has positive cash flow. You can then use that cash flow to help fund your retirement.

Alternatively, an investor who is expecting significant inflows – say $50,000 to $100,000 plus per annum – into their super fund in the years ahead may aim to have multiple properties. However, one of the peculiarities of buying properties within an SMSF is that once you acquire a property, you can't then use the equity in that asset to leverage yourself into a second property as you normally would. So, you'd probably look at interest-only loans, so that you can build up enough of a cash pool within your super account in order to buy a further property. Depending on the circumstances in which you want to retire, you can do this as many times as you need to.

The end game to that is that at some point you'll want to sell off some or all of the properties, and because it's in super it'll be capital gains tax (CGT) free on sale. So you have a CGT-free sale, from which you can either liquidate the proceeds or use them to pay off the debt on a couple of other properties and live off the rent.

Bernard Kelly, Retire Laughing:
The advice that I provide to my private clients, typically people in the late stages of work without anywhere near enough funds for 20–25 years of comfortable retirement, is that virtually their only option to catch up with an inflation-protected portfolio is to become a landlord using negative gearing with an investment that will attract the ideal tenants.

In my mind, this is a young couple with children in primary school. The investment property should ideally then be a four-bedroom and ensuite family home, on its own block, in a family suburb, in a growth corridor, near to clusters of jobs, where land tax is lowest and where rents are relatively high.

You need to maximise the capital gearing – high cash flow won't pay off the mortgage – and the pricing should be just under the median price. The reasoning behind this is that you don't earn more rent proportionately for a more expensive investment, and by staying just under the median you will have the broadest possible market to exit into when the time comes to realise on your investment, if that's what you choose to do. However, I'd recommend not selling – instead, before you retire, put a line of credit against your portfolio, to give you enhanced financial flexibility. Drawings are not earned income, so are not subject to personal income tax, and as you haven't sold, there is no exposure to capital gains tax.

Structure and tax

Paul Benson:
Anyone buying an investment property is doing so to create a financial nest egg, but one assumes that those making their first investment after turning 50 are thinking more specifically about

Super timeline

50–55
Super contributions taxed at 15%, up to a limit of $50,000 (until June 2012). Most self-employed people can claim a full tax deduction for their super contributions.

55–59
CGT on assets held within super taxed at the following rates: where asset is held less than 12 months, full gain is assessed and taxed at fund tax rate of 15%. Where held for more than 12 months, one-third of the gain is ignored.

Super contributions taxed at 15% (including investment earnings) up to a limit of $50,000 (until June 2012).

Super withdrawing: first $160,000 (2010/11 financial year rate) is tax-free; the balance is taxed at 15% plus the Medicare levy – assuming you are retired and eligible to withdraw (in 'pension phase').

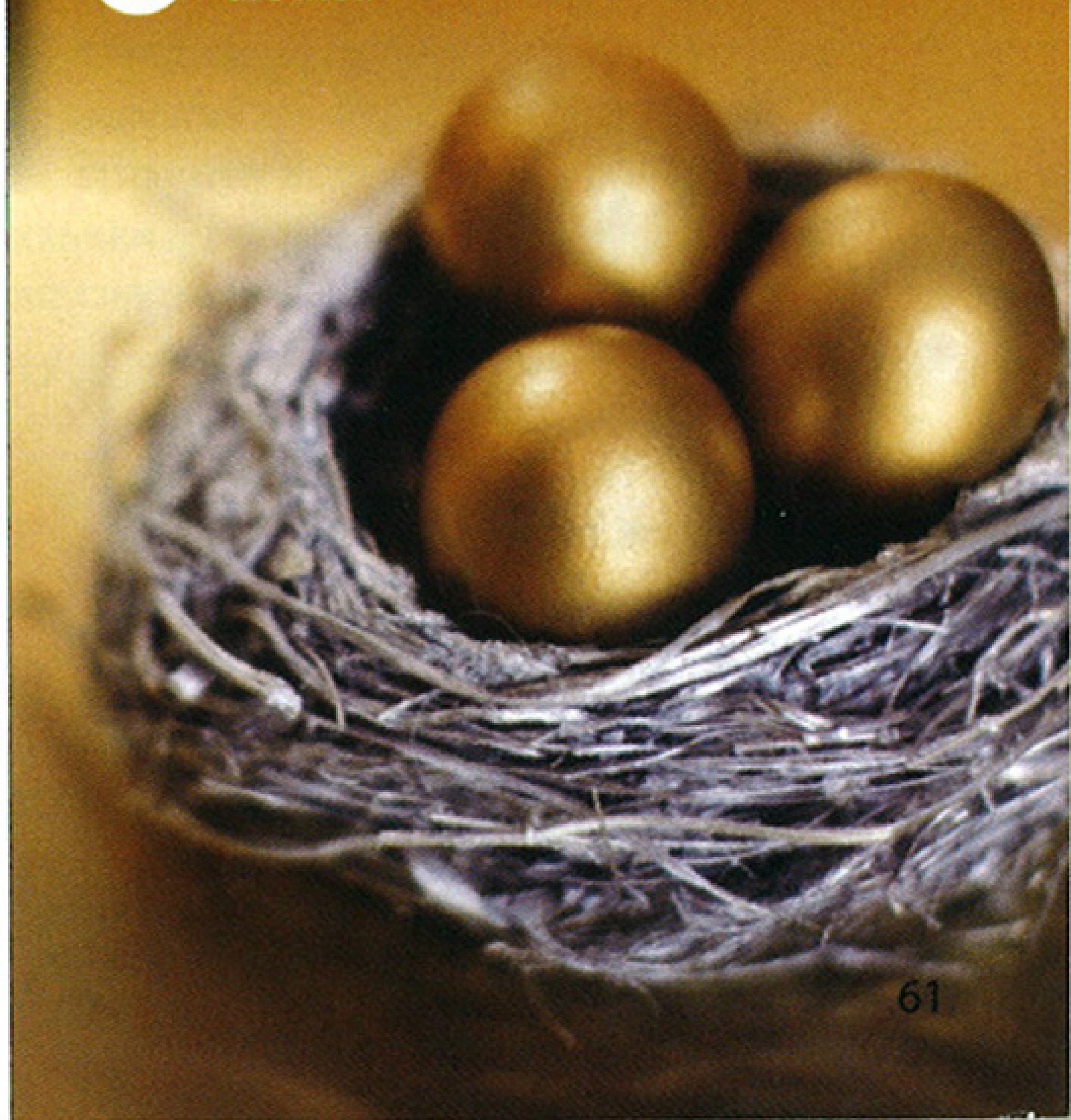
Able to enter into Transition to Retirement programs from age 55.

60+
If you are retired (in 'pension phase'), super income is tax-free. This includes investment income and income from capital gains.

If you plan to still be contributing into the fund, you will need to also have a portion of your super in 'accumulation phase'. That portion will be taxed as per the 55–59 age bracket.

65+
Eligibility for Centrelink age pension begins between ages of 65 and 67. Other elements remain as per 60+ age bracket.

75+
Contributions to super can no longer be made, except where certain conditions are met.



Transition to Retirement

Transition to Retirement is a scheme that's available within superannuation that can give you more investing power if you're buying property through an SMSF.

It's intended to facilitate people going into retirement in a phased manner – for example by reducing your working hours to two or three days a week, and allowing you to draw income out of your super (not lump sum).

However, you can combine this with salary sacrifice to maximise super accumulation. How it works is you draw income out of your super – say $20,000 a year – and you salary sacrifice the equivalent of $20,000. As salary sacrifice is taken pre-tax, this may see as much as $28,000 paid into your super. The net consequence of that is that your super builds up faster and you can then use this within an SMSF to leverage into property.

You can start doing this from age 55: while the 'pension' you are drawing from super is taxed at your normal tax rate, you are given a 15% credit on the pension as a rebate for the tax the super fund paid when it received your super contribution. After age 60, the super income is tax-free.

providing for their retirement. That of course is what the superannuation system is there for, and as mentioned above, I'd recommend an SMSF.

You need a certain amount to go into an SMSF – it's not hideously expensive, but there are some costs associated with setting up one in the first place. You wouldn't set one up for $50,000 worth of super, for example. The common minimum figure bandied around is $200,000, although where the investor is intending to borrow, less might be feasible, and I couldn't imagine doing it for less than $100,000.

Ayda Shabanzedah, Grow Consulting Group:
If you've got $150,000 to $200,000 in your super fund at the moment, setting up an SMSF would definitely be the way to go. Banks will typically lend about 72% to an SMSF, so you really need a deposit of about 30% within a super fund – and on a $400,000 property you're looking at more than $130,000. Additionally, if your employer pays the 9% super contributions into the SMSF, then you can buy positively geared properties, with the super tax benefits when you decide to retire: if you retire after 60, then you pay no capital gains tax on investment earnings.

Ken Raiss, Chan & Naylor:
If you are between 50 and 59 years old you are probably working and so borrowing may still be available. You could be at the peak of your discretionary spending life, when the home is paid off, children are off your hands and both spouses are working.

At this age you can also contribute up to $50,000 per person of concessional (eg, tax deductible) contributions into super until June 2012. After that date, your maximum concessional contributions fall to $25,000 (unless your super balance is below $500,000). At age 55 you can also enter into Transition to Retirement, which is a good way of putting extra tax into super (see box above).

What should I do?

- Build your portfolio with an emphasis on capital growth, rather than positive cash flow
- Work out your exit strategy – selling properties, paying down debt, or using a line of credit to access equity
- Consider setting up an SMSF
- Consider building up your super fund using transition to retirement

60+

Property strategy

Paul Benson:
Assuming you're investing within an SMSF, you're unlikely to be able to build a multiple-property portfolio at this stage, unless you've got sufficient funds at the outset. Therefore, your focus should be on paying down the debt, via a combination of rent, employer or self-employed contributions and salary sacrifice.

It may be that any investment is conservatively geared intentionally, so that there is positive cash flow from day one: perhaps 50% debt, 50% equity. However, that's reliant on having enough equity. If you're looking at doing this via self-managed super, you're going to need an absolute minimum of $150,000 in your super fund for even a $300,000 property.

Ayda Shabanzedah:
What you do here will depend a lot on whether you are still working. If you are working, you should follow a similar strategy as would a fiftysomething, just with more emphasis on positive gearing.

In fact, you really do need to be looking at positively gearing properties and how to reduce your capital gains liability – which is where SMSFs really do come into their own. If you don't want to or can't go into an SMSF, the alternative is to look at trust structures.

Another option at this point is downsizing: if you have a big home, it may be worth selling that, raising capital and reinvesting.

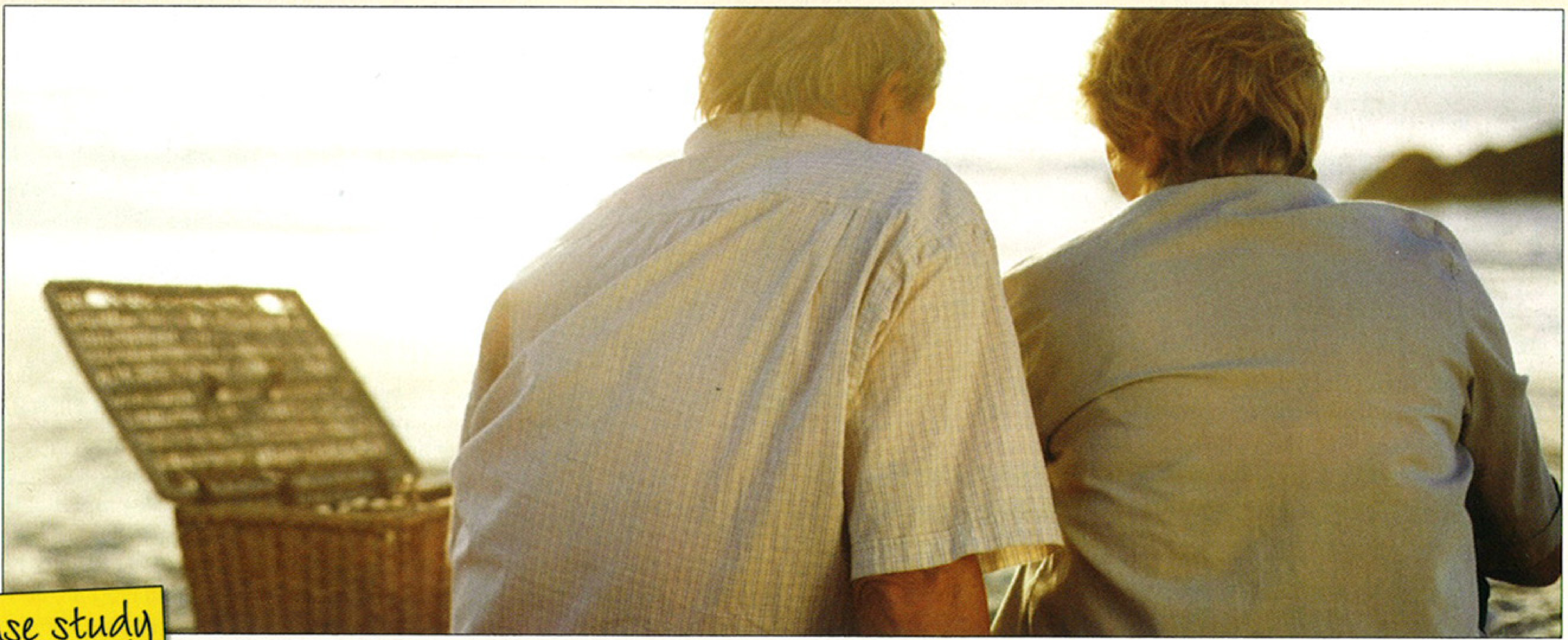
Structure and tax

Ken Raiss:
At ages 60–69 the game changes considerably. Any investments into super would be tax-free in super, and tax-free when paid to you if in pension stage. Therefore, while you are working and contributing you get tax deductions, and in pension stage tax is nil.

Some of our clients are borrowing in super to purchase property. The deposit comes from super, and the fund (which must be an SMSF) borrows. While working, any negative gearing can be made tax deductible by making extra super concessional contributions through salary sacrifice – therefore, the tax benefits are the same regardless of whether the asset is outside of super or inside. However, at age 60, any positive rent would be tax-free, as would any profit on sale if in pension stage.

Paul Benson:
Salary sacrifice can be particularly useful at this point if you're still employed: you can choose to put in more of your pre-tax income into your super, over and above the 9% your employer already pays. That will not only boost your retirement savings, but will also generate some tax savings. You could potentially use this to offset a shortfall in holding costs.

Transition to Retirement strategies also have the potential to generate some



Case study

Jayne and John's story

Jayne and John are in their mid-60s and are investing in a cash-flow positive property as part of a comprehensive financial strategy to fund their retirement

In 2008 the couple were debt-free and approaching their mid-60s. Both were working: John full-time in his business, and Jayne part-time. Both had set their retirement year as 2015, and were very conscious that they each had parents living well toward their 90s.

They jointly owned their home, which was valued at around $600,000, held some $150,000 in bank accounts and had accumulated a diversified portfolio of shares and managed funds valued in mid-2008 at around $700,000. John has, for some years, held life insurance and income protection insurance (with benefits payable to age 65) through a self-managed superannuation fund (SMSF). He also maintained a trauma policy outside superannuation. Jayne has life cover via super and they both maintain private health cover.

The GFC had significantly reduced their share investments, so they decided to diversify their assets and income in preparation for retirement. John had previously owned direct property investments, and believed that the development of a mining project near a remote country town in Queensland might see an increased demand for residential properties nearby. They knew the area well, and jointly purchased a residential block in late 2008 in a town not too far from Emerald, Queensland, for about $160,000, with a $100,000 deposit.

In 2009, the couple borrowed to build a four-bedroom, two-bathroom house, which saw the loan balance increase to $380,000. By late 2009, they had a solid tenancy in place. It was cash flow positive from the time it was initially let, and currently rents for $4,000 per month (up from $3,600 per month when first tenanted). The loan balance has also since been reduced to under $300,000.

The exit plan for this property investment is to sell it before John and Jayne turn 75, pay out any remaining loan, and direct any surplus into superannuation. To contribute, they will need to meet the 'work test' of working 40 hours in a 30-day period in the year in which the contribution is to be made.

Peter Hillis, a financial planner at One26 who worked with the couple on their strategy, says that there are benefits to selling at a certain time of year.

"If the property was sold with settlement in May or June, then each might make a non-concessional contribution in June then another in, say, August, before they turn 75," says Hillis. "John's business, when sold, may also be eligible for capital gains tax concessions, with proceeds contributed into superannuation."

John and Jayne's ongoing living expenses are presently funded primarily by drawing tax-free part pensions from their self-managed superannuation fund. The investment property surplus and Jayne's wages are applied towards reduction of the investment property loan, while John's business makes concessional contributions to their super.

They have both made non-concessional contributions of cash and shares to super in the past, and appreciate that the relevant contribution caps need to be carefully observed to avoid excess contributions tax.

Jayne and John have previous experience with property investments and already held a diversified portfolio of other investments. They understood what they were doing, took a 10-year-plus investment outlook and carefully considered the risks involved – not least the significant risk that if the mine (which has a projected 15-year life), were to not proceed, or were to close, their returns could fail.

Their foresight in regards to the location has helped, but the return on their investment is still heavily dependent on the demand for the property, which in turn depends on the mining activities near the town continuing.

Even so, it is likely that John and Jayne will earn a positive return on their property investment over the next 10 or so years, beating inflation, and with their diversified portfolio of shares, property and cash there is a good chance of their funding a long and happy retirement.

excellent tax benefits for those who are still working; however, careful planning is required here to ensure the cash inflows and outflows work (see box on p62).

In terms of tax treatment, capital gains is tax-free in regards to super from age 60.

What should I do?

- Consider your employment status and plan your strategy accordingly: if you'll still be working, go for capital growth with an eye to moving to cash flow; if not, concentrate on creating positive cash flow
- Pay down debt as much as possible
- Make sure you're making the most of tax concessions via superannuation and SMSFs (if appropriate), Transition to Retirement and salary sacrifice

65+

Property strategy

Paul Benson:
At this age, it's better to avoid negative gearing and only buy what is affordable. What you're trying to do is generate income, and if you're geared you've got to meet the loan repayments which reduces how much income you've got to live on. Essentially, we're looking for positive cash flow. It's also worth bearing in mind that a property may not be suitable as the main asset of the fund even if it is debt-free, as the income after expenses (council rates, insurance, maintenance, etc) may not be attractive compared with other options. Therefore, property may only be suitable if there is sufficient retirement savings such that the property investment is only a portion of the fund.

Ayda Shabanzedah:
This is the point where you should look to realise the income received from your assets.

You should be considering which investment properties to sell, paying off all loans and be able to leave an asset in your will to family. Bear in mind that, at this age, there is no capital gains tax for income related to super, so if you have investment properties held in super funds, profits will be tax-free. Otherwise, it depends on how you originally purchased the assets.

Structure and tax

Paul Benson:
The main thing that does become relevant is that, at some point between 65 and 67, you will become eligible for the age pension. Superannuation is relevant here because most of the income generated through your super is not counted for the income test. Therefore, from a Centrelink point of view, it's desirable to hold your assets within the super environment as you'll get a better treatment when it comes to being assessed for the age pension.

Ken Raiss:
The main tax impact in this age bracket are changes in how much and how you can contribute into super within this age bracket. After age 65, you can no longer average three years' worth of after-tax money (non-concessional contributions) which has an annual limit of $150,000.

Therefore, at age 64 or under, you could put in $450,000 in one year, being three years' average. At age 65, any concessional contributions require you to pass a work test, and you must satisfy this test before you can contribute if you are aged between 65 and 75.

However, the definition of work is 'any paid employment', and you must only work 40 hours in a 30-day period, so it is a fairly unrestrictive test.

> At age 65+ it's better to avoid negative gearing and only buy what is affordable

Contributions to super can no longer be made after age 75. There is, however, an opportunity for some to continue making the 9% super guarantee contribution if you are working under a registered award that allows your age bracket to be employed. For some, particularly in a family business environment, this may be possible.

What should I do?

- Focus on positive cash flow properties – at this point, you should be extracting or supplementing your income
- Avoid loans if at all possible
- Consider reverse mortgages

Disclaimer: No magazine article can consider your individual circumstances or personal needs in relation to investment or tax strategies. You should seek advice for your particular circumstances before embarking on any course of action