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Edition 113, 12 June 2015

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A Swiss makeover for Australian super

Geoffrey Kingston

Superannuation policy is tired. Yawns greeted the recent seven-year freeze of our compulsory contribution rate, and that's been just one sign of malaise. Switzerland is renowned not only for high-end spas and wellness clinics, but good retirement policy. It's time we signed up for a Swiss makeover.

In 1972 Switzerland came up with the useful principle of organising retirement income policy into three pillars:

1. Social safety net.
2. Compulsory occupational super. It reduces free riding on the first pillar by affluent households, helps ensure a decent proportion of wage income is replaced in retirement, and boosts national savings ahead of baby-boom retirements.
3. Incentives for voluntary contributions by people seeking comfortable self-funded retirements. More controversially, it also helps retirees to build up an estate for their children.

Since 1992 Australia too has had three pillars, but each needs re-sculpting.

Updating Australia's three pillars

Our first pillar, the age pension, goes back to 1909. It has increasingly become not just a safety net but a middle-class entitlement. Seven out of 10 retirees rely primarily on the pension. Nine out of 10 draw some pension during part of their retirement.

Since 2009 the pension for a single retiree has stood at 28% of male average earnings. That's the highest percentage since World War II, and possibly pre-war as well.

In its first budget the current Government tried to phase in reduced indexation of the pension. Indexation was to be wound back to growth in consumer prices alone, instead of the maximum of growth in wages and growth in consumer prices. The Senate blocked this measure.

The Government could return to the Senate with the relevant Swiss policy, namely, indexation at the average of growth in wages and growth in consumer prices. This would amount to a compromise whereby pensioners are generally protected in real terms but do not participate fully in the growth of community living standards.

Our second pillar is also dilapidated. At 9.5% of wages the compulsory contribution rate leaves us snookered. On the one hand it's too low to counter pervasive pension dependence. On the other hand, and to the extent employers are unable to pass the compulsory levy on to employees, it jeopardises the competitiveness of Australian workers, particularly young ones. To the extent employers are able to pass on the compulsory levy to employees, however, young workers struggle to pay down study debts and put together a deposit on a home.

Swiss policies towards the second pillar can get us out of this bind.

The lifetime compulsory contribution rate in Switzerland averages about 12% of lifetime wages. This rate would be high enough for our second pillar to make worthwhile inroads into pension dependence.

Because young workers need to pay down study debts, raise a home deposit and avoid being priced out of a job, compulsory contributions on their behalf should be cut. In Switzerland the mandatory contribution rate for workers aged between 25 and 34 is just 7% of wages, compared with 15% in the case of workers aged between 45 and 54. Compared with Australia's flat 9.5%, Switzerland's age profile for compulsory contributions is closer to what an intelligent and far-sighted household would voluntarily choose in the absence of compulsory super and the age pension.

To support the competitiveness of Australian workers, future rises in compulsory contributions should fall on employees. This would take us part-way towards the Swiss policy whereby employers are allowed to pay as little as one half of second-pillar contributions.

Employer contributions to our super are generally taxed at a flat 15%, as are fund earnings before retirement. In this way, there is no progressivity in our super taxes, apart from contribution limits and a higher tax on employer contributions on behalf of those with salaries exceeding $300,000 per annum. Wealthy families use housing investments outside super to avoid tax, access the pension and protect planned estates. This diverts savings from productive investments, and props up house prices.

In Switzerland and most other countries, by contrast, super taxes are delayed until retirement. Retirement income is taxed in line with the regular progressive rate scale. So lifetime taxation of super is effectively a progressive consumption tax. This promotes fairness and efficiency.

Then there is the worrying fact that Australian super funds have the highest exposure to growth assets within the OECD. Switzerland, by contrast, caps equity investments at 50% and real estate investments at 30%.

New type of super account

We need a new kind of super account alongside the familiar one paying lump sums after retirement. These new accounts would be reserved for lifelong income streams, again echoing Switzerland, which encourages annuitisation of second-pillar benefits. Precise specification of eligible lifelong income streams — life expectancy products versus full life annuities, minimum annual escalation rates, etc. — is of second-order importance, and is best left to another occasion.

Like existing accounts the new ones would be subject to contribution limits. Indeed, these limits would initially need to be low, to protect the budget in the short term.

The new accounts would be tax-free until retirement, at which point annuity income would face the regular rate scale. Exposure to growth assets within the new accounts, once annuitised, would be capped at 50%.

Super contributors could open either or both types of account, in this respect echoing the United States and Canada. (Good as it is, Swiss policy isn't the answer to all our problems). Over time, however, changes in contribution limits would redirect compulsory contributions into the new Swiss-style accounts. Likewise, compulsory contributions on behalf of new workers would go into the new accounts.

The old-style accounts would still be taxed upfront, largely free of asset restrictions and eligible for lump-sum withdrawals. But they would eventually be reserved largely for third-pillar retirement savings.

Geoffrey Kingston is a professor in the Department of Economics at Macquarie University. He would like to thank the Centre for International Financial Regulation (CIFR) for research support.

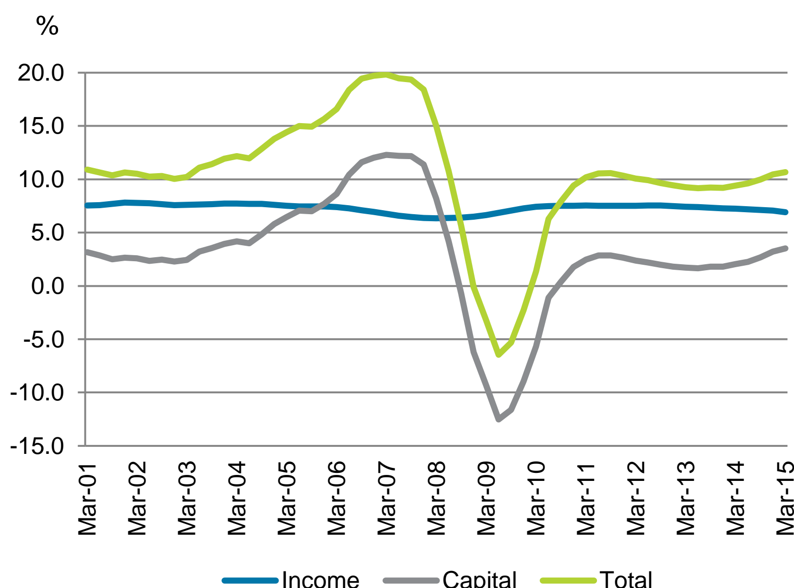
Demand for non-residential property drives returns

Adrian Harrington

Fuelled by strong investor demand, the latest PCA/IPD Australian All Property Index reveals that non-residential property has performed strongly in recent years.

Direct non-residential property has been a key beneficiary of the hunt for yield, and for good reason. The lure of high and relatively stable income is driving investors to bid up property prices. Non-residential property generated an income return of 6.9% in the past year, underpinning the total return of 10.7%, as shown in Figure 1. This is now the sixth consecutive year of positive total returns since the GFC.

Figure 1: Non-residential Property Annual Returns to 31 March 2015



Source: PCA/IPD Australian All Property Index. The PCA/IPD Australian All Property Index tracks the performance of 1,293 non-residential property assets with a combined value of $137 billion. Participants represent A-REITs, unlisted wholesale and retail property funds, syndicates and private investors.

Property returns by sector

Industrial property was the standout performer over one and three years with a total return of 12.4% for the year and 11.2% p.a. for the 3 years to 31 March 2015 (Figure 2). The relative high yield (+8.2% in the past year) and the repositioning of the sector from manufacturing to high quality distribution centres leased to 'blue-chip' tenants driven by the growth in logistics (transport and storage) is attracting significant investment into industrial property. The industrial sector is also benefiting from rising land values as the rezoning of inner city industrial land to residential gathers momentum, particularly in Sydney and Melbourne.

Figure 2: Non-residential Sector Returns, One and Three Year to March 2015

Source: PCA/IPD Australian All Property Index

The next best-performing sectors were retail centres and other property (carparks, self-storage, medical centres, etc.), both with a total return of 10.9% for the year to March 2015. The robust retail sector performance was driven by solid capital growth - the 4.1% capital return was the highest of the major property sectors.

The recent cut in interest rates to their lowest level on record, lower fuel costs and a pick-up in housing activity have contributed to an improvement in retail sales however the rate of growth remains below the historical average. As evidenced by the recent sales updates from the listed retailers, parts of the retail environment still remain challenging due to both cyclical and structural factors (on-line retailing, changing retail formats etc.). Despite this, investors continue to chase retail centres, particularly sub-regional and neighbourhood centres; the major regional centres rarely change hands given they are tightly held by Westfield, AMP, Lend Lease and QIC.

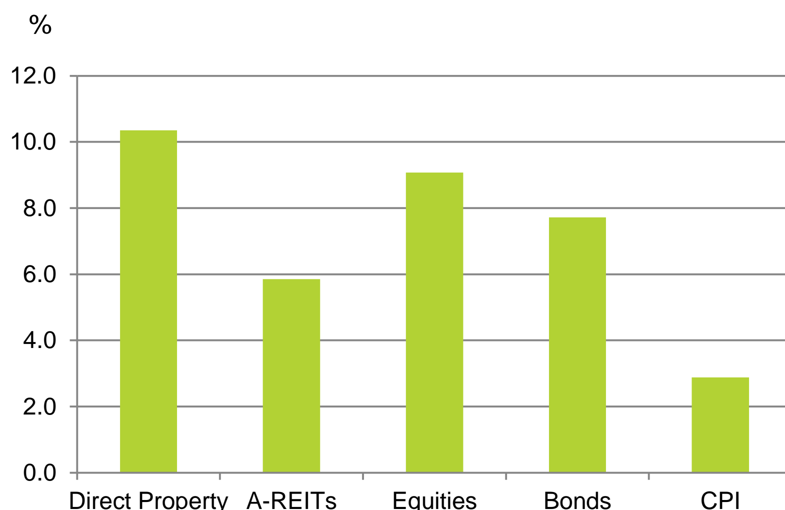
Despite the office sector returning a healthy 10.2% for the year and 9.5% p.a. over three years, there is growing divergence in the performance of the major office markets. Melbourne CBD was the best-performing office market with a total return of 13.5%, 6.6% of which came from capital growth. Next best was the Sydney CBD office market with a total return of 11.5%. Both markets are benefiting from the strong competition from investors for office assets and signs that tenant demand is improving.

At the other end of the scale, the Perth CBD and Brisbane CBD markets are being impacted by the slowdown in the mining sector. Both markets recorded declines in value over the year of 1.9% and 0.3% respectively. We expect values in both these markets to fall further in the year ahead. Weak demand and further new supply will push the vacancy rate in both markets higher – above 15.0% in Brisbane and more than 20% in Perth – putting further downward pressure on rents and values.

Property versus other asset classes

Whilst non-residential property was not immune from the GFC fallout (capital values fell 12.5% in 2009), its performance over the longer-term has been stellar, generating a total return of 10.4% p.a. over the past 15 years outperforming A-REITs (+5.9% p.a.), Australian equities (+9.1% p.a.), and bonds (+7.7% p.a.) (Figure 3). As a rule of thumb we expect non-residential property to generate a total return of 10% over a cycle with circa 7% coming from income and 3% from capital growth.

Figure 3: Non-residential Property versus Other Asset Classes, Annualised Total Return 15 Years to 31 March 2015



Source: PCA/IPD Australian All Property Index, MSCI Indices

As we approach the half way mark of 2015, we expect continued strong investor demand for non-residential property to support total returns above 10%. According to IPD, the spread between bond rates and non-residential yields is now 432 basis points, well above the long-term average 232 basis points. With 10 year bond yields not far off their historic lows, on this measure, non-residential property looks attractive.

For global investors, Australian non-residential property looks cheap relative to the 3-5% yields on offer in the gateway cities of London, New York, Tokyo and Hong Kong. A significant amount of equity has been raised to invest in property globally. One example that typifies this global phenomenon is the private equity juggernaut, Blackstone, who recently raised $US15 billion ($19.5 billion) from pension funds and endowment foundations, to invest in global real estate – some of which is earmarked for Australia. Add leverage to this, and they have a $30 billion 'war chest' to deploy.

We also have a huge wave of Asian capital, particularly from the Chinese and Singaporeans, looking for a home in Australian property. Debt market conditions are favourable, both availability and cost, and as one global investor told me on a recent trip to Hong Kong, *"Australian property may look expensive to you but to us it is not – our cost of capital is lower than your domestic capital and this is not going to change anytime soon."*

Risks to watch for

Despite interest rates being at historical lows, investors should continue to assess how various interest rate scenarios may impact the performance of property going forward. Although we expect rates to stay lower for longer, investors need to keep an eye on the long-end of the yield curve, as it is the long term bond rate (not the cash rate) that property investors use as the yardstick for comparing property 'cap' rates. Any rise in long bonds over the next two years is likely to be modest or even delayed if the Australian economy weakens further. However, the recent sell-off in bonds in response to comments made by the US Federal Reserve Chair Janet Yellen, served as a timely reminder of continuing volatility in global capital markets and one thing is assured, Australian non-residential property will not be immune from any future impending fallout.

Whilst interest rates are an important consideration in the purchase of property, they are not the only consideration. Investors need to exercise caution that acquisitions make sense on a through-the-cycle basis and capital structures (debt levels and LVR covenants) remain relevant through the cycle.

Property is a total return proposition and the current focus on yield may not entirely compensate investors for loss of capital down the track if yields blow-out. With below trend economic growth forecast in the next few years, we expect tenant demand to slowly improve across most Australian non-residential

property sectors and sub-markets. The cost of securing tenants will remain high with elevated incentive levels leading to lacklustre rental growth. When asset prices are being driven by unprecedented liquidity being injected into the financial system rather than underlying real estate market fundamentals, we find ourselves heading into uncharted territory. As a result, we are now in an environment where investors need to exercise caution.

It is imperative therefore, that investors identify and quantify the risk in their property portfolios. Factors such as the supply and demand dynamics of the market, strength of lease covenants, duration of the leases, and rent review mechanisms remain fundamental to the assessment of risk. Answers to these will be critical in the investment decision to either buy at this point in the cycle or sell assets in order to take advantage of investors who are becoming increasingly aggressive in their requirement to deploy capital.

If there is one thing that remains a priority for all investors it is having a well-diversified portfolio. Bought well, non-residential has a key role to play in a mixed-asset portfolio.

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Risk aversion in practice in large funds and SMSFs

David Bell

Risk aversion is a complex issue which I have previously discussed (see 'There's more to risk aversion than most planners realise'). Across the super fund industry, I see many intriguing case studies, and managing for these challenges is important for both large funds and SMSFs. As superannuation assets continue to grow, more people will need to decide how they think about risk aversion.

A quick refresher on risk aversion

Financial risk aversion defines our attitudes to taking financial risk. In academic literature risk preferences can take many forms, including absolute risk aversion and relative risk aversion – it is these two on which I focus in this article. Absolute risk aversion means that our risk aversion relates to a dollar amount. Relative risk aversion means that our risk aversion relates to a percentage of our portfolio. So as a portfolio grows in size, all else equal, an individual whose risk preferences take the form of absolute risk aversion would prefer to shift into a less aggressive portfolio while an individual whose risk preferences take the form of relative risk aversion would not change their investment strategy. It's an important distinction.

A 1% loss is easier to take than $1 billion

Mark Delaney is the highly regarded CIO of Australian Super, the largest super fund in Australia with in excess of $90 billion in assets. But Mark will likely have an undesired record: the first Australian super fund CIO to lose $1 billion in a day. Of course this should not reflect poorly on Mark as it is largely a function of the large assets under his management.

How do super fund CIO's, and indeed managers of any large asset pools, deal with numbers of this size? In my case I have many days where the funds I manage make or lose $50 million. Clearly the mindset needs to be one of relative performance. A 1% loss sounds more digestible than $1 billion! Relative risk aversion is probably the preferred lens through which risk is interpreted in this instance. If CIO's were focused on the absolute numbers then we are talking big numbers which will only become larger.

Let's consider the case of someone with an absolute risk aversion mindset. I once worked with a proprietary trader who consistently returned an excellent profit on a small capital base. The bank noted

his good return on capital and doubled his capital. The trader's percentage risk levels halved and he made the exact same dollar profit as before! This is a case of very strong absolute risk aversion in practice.

What if a super fund CIO had absolute risk aversion tendencies? As their fund grows they would be inclined to take the same amount of dollar risk and thus the percentage risk would drop. This could well be to the detriment of the fund's members who require growth to achieve their retirement outcomes. Is there a place for an absolute risk aversion mindset amongst super fund CIO's? I would argue not: after all super funds are managing pooled funds on behalf of many members. The risk taken on their behalf should not be influenced by the overall size of the fund. Though I do not love the fact that the industry remains so peer group focused, this represents one positive aspect. Peer grouping ensures that super funds consistently take the amount of risk that the industry deems necessary to take the lead to achieve retirement outcome goals (whether this is the right amount of risk is the big issue for another day!). Effectively peer grouping forces a relative risk aversion mindset.

So are super funds consistent in their application of a relative risk aversion mindset across all of their business? I believe there are inconsistencies. For example I met a director of a super fund recently who was talking about delegation of decision-making. The director found it hard to delegate any decisions, even on a small proportion of the overall portfolio, to the investment team because the dollar size was very large. Clearly this suggests absolute risk aversion characteristics. A mismatch of the form of risk aversion preferences across super fund executives and directors could lead to less effective decision-making and unnecessary tensions.

It is important to note the role of media, too. The media like to attract attention. If we return to our Mark Delaney example, which is more likely to attract readers: "*Australian Super loses 1% in a day!*" or "*Australian Super loses $1 billion in a day!*"? Clearly the latter – which suggests that media by necessity has an absolute mindset. As super funds grow in size the risk of adverse media increases, which in itself risks a bad reaction by super funds.

SMSFs

The issue of appropriate risk preferences is not as clear cut for SMSF trustees. The key difference is that an SMSF is most commonly established for a single or a couple. In this sense the account could be viewed as a personal or joint savings account and so elements of relative risk aversion and absolute risk aversion could both be relevant.

It could be important to maintain a percentage level of portfolio risk as the fund grows in size because this is necessary to grow the asset pool to support the desired retirement outcome. However an absolute mindset may come to the fore as the absolute size of gains or losses could be felt quite tangibly by the SMSF trustee in terms of the impact on their retirement outcome.

What if an SMSF has strong absolute risk aversion tendencies? They might reduce risk as their fund grows in size. This risks the fund not growing as much as is necessary to achieve targeted retirement outcomes. An SMSF trustee could also consider some risk scenarios. For example "I stand to lose $50,000 if CBA shares drop to $60. Perhaps I should diversify into other Australian stocks." An absolute risk aversion mindset potentially leads to more technical risk management mistakes of diversifying the portfolio into areas where the trustee may have less conviction while also not realising that the SMSF would remain heavily exposed to a drop in Australian shares.

Conclusion

Risk aversion is a complex but fascinating area where there is still much to learn. The examples highlighted demonstrate that both relative and absolute risk aversion preferences exist in industry and among SMSFs. There are risks to the effective operation of both large funds and SMSFs in not understanding their own biases. For large super funds the main risk could be inefficiency and tensions due to a mismatch of risk preferences amongst key staff. For SMSFs a strong absolute risk aversion could stop retirement goals being reached and be a catalyst for other risk management mistakes.

David Bell is Chief Investment Officer at AUSCOAL Super. He is working towards a PhD at University of New South Wales.

Changes are coming to superannuation

Graham Hand

There are few more important issues facing retirees than potential changes to superannuation policies. They affect whether it is worthwhile putting more money into super, and even whether to take money out to avoid adverse consequences. Unfortunately, when the Prime Minister contradicts the Treasurer and Assistant Treasurer, it's difficult to know what to expect and when.

Cuffelinks has no political agenda, but despite repeated comments from Tony Abbott that there would be no adverse changes to superannuation in this term or the next (if re-elected), there is no doubt such amendments are on the minds of the Treasurer and Assistant Treasurer. For example:

- Joe Hockey told the ABC's Q&A programme on 25 May 2015 that he does not say 'never ever' to anything in politics, and "*At some point, and now is not the time, and it won't be for a while, but at some point we have to look at the future of the entire retirement income system*.'' Plus when he released the Tax White Paper on 30 March 2015, he noted the Paper queried "*the appropriateness of superannuation concessions".*
- As we noted here, the Assistant Treasurer, Josh Frydenberg, told the Sustainable Retirement Incomes Forum last week: *"The Government will, of course, consider good ideas put forward as part of the Tax White Paper process and any changes recommended by that process will be taken to the Australian people at the next election."*

Change is coming. In selecting from the claims and counter-claims, those which are written down and considered in painstakingly-prepared speeches must be the most credible, rather than door stops or off-the-cuff responses in the heat of Parliament or a television programme. For these, we go to Frydenberg's speech and the content of the Tax White Paper, especially Section 4 on Savings. There is little doubt from these that a tightening on super concessions will come, at the latest by the next election. It is worth reading Frydenberg's entire speech for context. Consider the evidence:

The 'good ideas' in the Tax White Paper

The Government will, *of course,* consider good ideas in the Tax White Paper, but what are these good ideas? Here are some (the bolding is my emphasis):

"The flat rate of tax on superannuation contributions means that ***most high income people receive a larger tax concession, relative to their marginal tax rate, than low income people****. The same is true during the accumulation phase and even more so during the retirement phase when there is no tax on earnings."*

"The different rates of tax on earnings in the pre- and post-retirement phases add costs to the operation of the superannuation system. ***They also give rise to tax planning opportunities that are usually more accessible to high income earners****."*

"With Australia's ageing population, more individuals will enter the retirement phase where no tax is paid on earnings in superannuation funds. ***This will put pressure on the long-term sustainability of the superannuation tax arrangements****, particularly given other long-term budgetary pressures as the population ages, such as calls for higher spending on health and aged care, and relatively lower revenue from personal income taxes."*

"Individuals and entities willing to engage with complexity in the tax system can structure their affairs so as to minimise their tax liability. This can involve using different legal forms or structures to take advantage of opportunities presented by concessions or gaps in the structure of the law."

*"**Confidence in the tax system can be eroded when people think others are not paying their fair share of tax**. This can be due to concerns over concessions, aggressive tax avoidance or tax evasion activities."*

***"Higher-income earners tend to be more capable of taking advantage of more favourable tax treatments (like superannuation),** while those with the lowest ability to pay tend to save more in the more heavily taxed vehicles (such as bank accounts)."*

These are the pointers that suggest a response to the White Paper will include addressing concessions for high income earners.

The 'White Paper process' is not only the White Paper itself, but the responses, many of which criticise the concessions to high income earners. This question is asked in the White Paper:

"How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?"

Notable among submissions already made public is from ASFA, the Association of Superannuation Funds of Australia, the industry body representing major funds, which states:

"ASFA is recommending that a limit of $2.5 million be placed on the superannuation funds an individual can rollover to commence an income stream in retirement. Amounts above this ceiling must remain in the accumulation phase and continue to attract the nominal earnings tax of 15 per cent or be removed from superannuation. Non-concessional contributions should also be capped at $1 million over a lifetime to prevent very large balances from accruing in the future as an integrity measure to complement the $2.5 million capital cap."

Superannuation is an income system, not a savings system

There has been a distinct change in the messages around superannuation since the publication of the Financial System Inquiry Final Report, driven by David Murray's incredibly simple idea that superannuation should have an objective. And what is the most likely objective? As Murray told the same Forum last week,

"*We felt the system could only progress based on an income in retirement. Some people say it should be a retirement savings system. They're not the same thing."*

This puts everyone accumulating their millions into superannuation on notice that super is not meant to be a wealth accumulation vehicle for passing money to the next generation. Does Frydenberg support this? You bet:

"What it is really getting at is that the tax concessions provided for superannuation are intended to encourage and support an individual's retirement income – not to accumulate savings that can be passed on to future generations. Capital is supposed to be depleted over one's retirement rather than being preserved as a bequest."

Expect to hear much more of this to justify changes, encouraging retirees to spend their money rather than leave it in their will. Said Frydenberg:

"Being too conservative in how they draw on their super account balances can lead to retirees living frugally and settling for a lower living standard in retirement. It can also mean that for some, much of the money they worked hard to earn and save is left as a bequest, rather than supporting their retirement, as intended."

A new Capital Depletion rule to address longevity

At the Forum, Frydenberg came close to announcing a new policy to encourage retirement products without immediate income but which might kick in at say the age of 80 to cover longevity risk. He said:

"For example, rather than complying with a minimum withdrawal rule, could products instead be allowed to comply with a capital depletion rule … (to) better cater for longevity risk products that have more flexible payment structures, including deferral periods. We have also been consulting on ways to make it easier for people to purchase longevity insurance incrementally, which could be more attractive to some retirees compared to parting with a lump payment ... But a rule that allowed for flexibility on drawdowns so long as there is a depletion of the capital over time would be able to cater for such products."

While it would be premature of me to announce the outcome of this review today, I am hopeful that we will be able to deliver a package of changes that facilitates the emergence of new and innovative retirement income stream products."

The basic intention is to give people more confidence to spend their superannuation in the earlier years of retirement, say from the age of 65 to 80, knowing they have an income stream that then kicks in. Only time will tell if this product will be popular but clearly, annuity providers are excited by the possibility, including new entrants in the life insurance sector. Would retirees then enjoy a higher standard of living?

There's no 'never ever' in politics

When the Government responds to the Tax White Paper and the Financial System Inquiry, some of these issues may be clearer. But we'll see important changes to superannuation over the next couple of years which will be **adverse** for some people, especially those with large SMSFs. Joe Hockey was right: never rule out anything in politics.

Graham Hand is Editor of Cuffelinks and was a guest at the Committee for Sustainable Retirement Incomes Forum. This article is general information and does not provide specific advice to anyone.

Adapting to new pension asset testing

Noel Whittaker

Despite the rumours, superannuation and negative gearing were left untouched in last month's Budget. However, the government announced a change in attitude to wealthy pensioners by amending the asset test thresholds and taper rate from 1 January 2017.

By increasing the level at which the pension starts to reduce due to assets, and by steepening the taper rate itself, they managed to increase the pension for many less affluent recipients while reducing it, or even removing it, from the wealthy ones.

For a single homeowner, the base will rise from $202,000 to $250,000 and for a homeowner couple it will rise from $286,500 to $375,000. The cut-off points will be around $535,000 for single homeowners, and $810,000 for homeowner couples.

These are approximate numbers, as the changes will not take effect until 2017, and the thresholds will be increased on 1 July each year by the CPI.

This will hit retirees with substantial assets hardest. An age pensioner couple with $750,000 of assessable assets should currently be receiving $602 a fortnight pension. Under the new rules, this would drop by $430 a fortnight, or $11,180 a year. That's going to have a big impact on their budget.

Many people make the mistake of valuing non-investment assets at replacement value – they should be valued at second hand value. This would put a figure of $5,000 on most people's furniture. The new taper

figures mean that every $10,000 of assessable assets has an effect of $780 a year on the pension. Overvaluing your car and furniture by $50,000 will cost you $3900 a year in pension, whereas spending $100,000 on travel and house renovations (thus reducing your assets) will increase your pension by $7800 a year indexed for life. That's equivalent to a capital-guaranteed return of 7.8% per annum on your money.

You can also reduce your assets by gifting part of your money away, but seek advice before you do so. The Centrelink rules allow gifts of only $10,000 in a financial year with a maximum of $30,000 over five years. Using these rules a would-be pensioner could gift away $10,000 before 30 June and $10,000 just after it, and so reduce their assessable assets by $20,000.

A couple could also invest $12,000 each in funeral bonds, which are exempt under the assets test.

I was discussing the changes on radio recently and a listener pointed out that under the proposed rules, a person with $900,000 in assets would get no pension whatsoever, and if their money was in the bank earning 3%, the income generated would be just $27,000 a year. They contrasted this with the situation of a full pensioner with minimal assets, who would be getting $34,000 a year indexed.

It's a valid point, but as I said to the listener, the person with $900,000 would be taking a very high risk if they kept their money in cash. They should have a diversified portfolio, which hopefully should be giving them at least 6%.

Yes, I am well aware that many retirees are risk averse – this is why I have been urging my readers for years to get acquainted with growth assets like shares at as early an age as possible. Doing this means they won't panic and sell out when the market has one of its normal downturns.

One last piece of advice – be wary of spending unnecessary money just to get a higher pension. The fact that the government has been forced to back away from the hard decisions in the Budget is a clear indication that it may be many years before Australia's finances are restored – further cuts to welfare must be expected.

Noel Whittaker is the author of Making Money Made Simple and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. See www.noelwhittaker.com.au.

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