Hi Everyone,

In this blog I wanted to give a brief introduction to annuities and illustrate a couple of examples how they can be used to add security and certainty in long term retirement strategies.

What is an annuity?

An annuity is an investment that pays you a guaranteed income for a period of time, which can be fixed or the rest of your life. Unlike an account based pension, annuities give you certainty. You know how much income you'll get and how long it will last.

What are the benefits?

- You are paid a guaranteed income regardless of how markets perform. This provides certainty of retirement income – like a defined benefit pension
- Annuities purchased with superannuation money are tax free from age 60
- Only the income component (if any) of an annuity purchased with non-super money is taxable
- You don't pay tax on investment earnings
- Income payments can be set to increase annually at the time the annuity is purchased
- They can help to improve your age pension due to Centrelink friendly treatment
- Annuities are flexible in that you can withdrawal your money (with some exceptions), you can have indexed income or non-indexed, choice around death benefits and estate planning.

What are the downsides?

- You cannot take out partial withdrawals - It's all or nothing. However, this can be overcome by setting up multiple annuities, which does not cost extra
- You cannot choose how your money is invested
- Over the long term, an annuity may pay less than a market-linked investment
- There is no opportunity for capital growth

I have put together a couple examples below, which show how annuities can be used effectively in retirement planning.

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Case study 1:

Luke and Linda own their own home, they have $500,000 each in ABPs (total $1m). This is invested in a balanced investment portfolio (50% growth, 50% defensive). They are currently not receiving the Age Pension due to their asset value, but were receiving $6,946 p.a. just before 1 January 2017 based on the same level of assets. They would like $60,000 p.a. in retirement income and think this will be achievable given their level of assets. However, they want to see if they can **confidently** spend more. Together, we test their current strategy using our portfolio analyser tool.

Luke and Linda — retirement income probability

Certainty level	80%	90%	100%
Initial income	$60,000	$58,000	$52,500

When presented with the results, Luke and Linda are surprised and concerned that they only have an 80% chance of meeting their required income goals up until the time there is a 50% chance that one of them will be alive (based on life expectancy factors).

They are risk-averse and want to enjoy their retirement without having to worry about their current expenditure. So they ask us if there are anything they can do, which might improve their cash flow certainty in retirement.

We run our illustrator tool again but this time with a 30% allocation to a lifetime annuity and compare this result to Luke and Linda’s current retirement drawdown strategy

Luke and Linda — Lifetime annuity portfolio income

Certainty level	80%	90%	100%
Account based pension	$60,000	$58,000	$52,500
Portfolio + lifetime annuity	$65,000	$63,000	$58,000
Difference	+ $5,000	+ $5,000	+ $5,000

With a 30% allocation towards the annuity, Luke and Linda increase their probability from 81% to 97% of meeting their retirement income goals to the 50% chance that one of them will be alive. They can now maintain their $60,000 p.a. expenditure.

Case study 2: Single homeowner, part-pensioner

Marcus is a 65-year old homeowner who has a $400,000 ABP with a 50/50 risk profile. Marcus is a very confident person and believes that he will be able to spend his pre-retirement salary of $50,000 through his retirement. He has not yet processed the effects of the Age Pension taper rate changes which saw his Age Pension reduced from $15,356 p.a. just before 1 January 2017 based on the same assets level to $11,688 p.a. this represents a reduction of $3,668 p.a.

Marcus seeks a second opinion from Nest Advisory Group regarding his expenditure and balance. Together, we use the illustrator tool to test Marcus' current retirement income strategy.

Unfortunately, we discover that Marcus has a 0% chance of meeting his $50,000 p.a. income until the 50% chance that he will be alive.

Marcus — current strategy

Certainty level	80%	90%	100%
Initial income	$37,000	$36,000	$33,000

Knowing that Marcus will not be happy with this outcome, we test how a 30% ($120,000) allocation towards a lifetime annuity may assist in providing Marcus with more confidence in his retirement income strategy.

Certainty level	80%	90%	100%
Account based pension	$37,000	$36,000	$33,000
Portfolio + lifetime annuity	$39,000	$37,500	$35,000
Difference	+ $2,000	+ $1,500	+ $2,000

Marcus is now optimistic that this strategy will provide a higher income with much more certainty through his retirement.

These are just 2 examples of how annuities can be used to boost income and certainty in retirement. As always, feel free to get in touch if you would like to see how this might work for you.

Cheers,