How a farmer turned his finances around

Simplifying structures and streamlining accounts can reap substantial rewards in retirement phase.

Summary: *Changing investment styles can make a huge difference, even if you do it later in life. The below case study of a Victorian sheep farmer sheds light on the importance of superannuation in the broader scheme of personal finances.*

Key take-out: There's a lot other members could learn from this farmer, who only upped his ante in retirement, to cut annual fees by almost one-third and dramatically lift income without working any harder.

A farmer is thought to be the ultimate all-rounder, but they don't teach investing at agricultural college.

At 55 years of age, Victorian sheep farmer Damien 'Smithy' Smith put out the feelers, had a few conversations, read more than a couple of books... and a decade later, decided to sort out his finances. He's a thoughtful man, used to waiting for things to come to fruition, and certainly not one to rush.

Smithy inherited the property where he was born as well as his father's accounting and banking practices. These businesses were very successful in the 1950s, but not quite in the new millennium when we first met in 2012. At the time, Smithy had four bank accounts, one small super account, two private loans to family members, $230,000 in the bank, a handful of shares, and three parcels of land worth about $1 million.

Sounds like a lot. But Smithy was reaping very little financial reward. All of this amounted to about $1.3 million. And, inclusive of the Low-Income Tax Offset (LITO), his earnings were below the tax-free threshold of $20,542.

In October 2012, Smithy's superannuation was still in accumulation phase and the balance stood at $61,000. It was being taxed by stealth within the fund. Side note: *It's a common misconception that super is tax-free after age 60. Withdrawals from super are tax-free, but the earnings within the fund do not get tax-free status until the accumulated super benefit is transferred to pension phase.*

It was all too much. Smithy was also paying 1.51 per cent per annum in super fund administration and investment fees, over and above the tax on his super balance.

Using super to fertilise the finances

Financially, Smithy needed to start reaping more than he was sowing. For him, this meant transferring a significant portion of his assets to the superannuation environment to meet his retirement income needs.

Over the last five years, Smithy's cash and term deposits have gradually been reinvested in cost-effective investments and account-based pensions, with the added benefits of diversification to match his moderate 50 per cent growth / 50 per cent defensive asset allocation.

Receiving reasonable offers from neighbouring farms, Smithy has been selling off parcels of his family's land. The sales have taken place in stages to mitigate capital gains tax. Smithy now retains two blocks, worth around $300,000 altogether.

Never too late

Smithy was a hard-working farmer dusty on the financial front. After spending a few years scrubbing up, and weeding out his finances, he's now living more comfortably than ever before as a self-funded retiree.

It's testament to the fact it's never too late to turn things around.

Smithy now has $50,000 invested in cash and term deposits, and $410,000 invested in a non-super investment account using index funds. He also has $90,000 on private loan to a family member, and $541,000 in an account-based pension, which is now 100 per cent tax-free.

His invested assets now total approximately $1.4 million net of all taxes (including CGT to date) and net of all investment fees. These assets do not include his personal assets.

Smithy is generating a far better return across all his investments than a miserly term deposit rate of 2.3 per cent per annum, and it's still in keeping with his moderate risk profile.

His non-super investment is also achieving good growth as he does not draw any income from this. Right now, in fact, Smithy's account-based pension minimum income drawdown – approximately $27,000 per annum – is covering all his living costs.

Breaking it down

The following earnings were achieved for the 12 months to October 2017:

Account-based pension	5.90 per cent (net of investment and administration fees, tax-free)
Investment account (non-super)	5.84 per cent (net of investment and administration fees)

If measured from March 2016, when the account-based pension was reset with a further non-concessional super contribution of $180,000, the account-based pension rate of return is 7.22 per cent per annum. There's a similar longer-term per annum rate of return on the non-super investment account (since reinvested from cash and TD's in March 2016).

And there's nothing stopping this farmer from adding further non-concessional super contributions to his account-based pension, possibly over the next five years, using proceeds from sales of his remaining land. This provision is contingent on being able to satisfy the work test, which effectively allows people over 65 but under 75 to make super contributions, subject to being gainfully employed for at least 40 hours in a 30-day period per financial year.

The outcome

Remaining invested in the previous super fund with fees of 1.51 per cent per annum would have cost Smithy an annual fee of $14,360. While a necessary evil, fees are the weeds of the financial world.

By changing to a lower cost provider, Smithy's combined account-based pension and non-super investment account fees are now less than half, at 0.60 per cent per annum. That amounts to just $5,706 per annum – a big saving of $8,654 per annum.

Further, the income earned from his account-based pension is tax-free, so he essentially has no further requirement to lodge tax returns. That's based on the Senior Australians and Pensioners Tax Offset (SAPTO) cutting in at $32,279 and Non-Assessable Non-Exempt (NANE) account-based pension income. He has transferred a significant portion of his estate into the 100 per cent tax-free income and CGT-exempt account-based pension environment.

Smithy has a tax-free net income of $55,060 per annum from an account-based pension, non-super investments, and small amounts of bank interest and modest casual wages.

Evidently, he has dramatically improved his financial situation – and removed administrative burdens in the process.

As it should be for all, simplifying and streamlining accounts has been a critical step in his retirement planning. Now he has one bank account, one term deposit, one private loan, one account-based pension, and one non-super investment account.

It's an easier life, where he also outright owns his personal effects and vehicle.

Once we get our own ducks in order, then we can start to see the big picture, which is important for those at or nearing retirement. The simplified estate will also allow tax-free funds to pass to his beneficiaries without a farm assets fire sale, particularly if over the next five years, Smithy is able to sell his remaining farm land and add the proceeds to his account-based pension.

Theo Marinis

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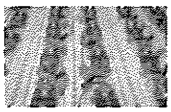

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