

With South Africa's household saving rate sitting at a scary 1.5% of GDP, only a very small percentage of people in this country will be able to afford retirement. To retire comfortably requires planning, discipline and time for your plan to be effective. In addition, there are many uncertainties over which you have little control, so a reasonable margin of safety is required.

At retirement, the pool of investments you have built up during your earning days will need to produce an income to cover your living costs; guard against the effects of inflation; be a sufficient buffer against volatility and help fund unforeseen expenses. Naturally, the more income you draw from the investment, the less time the investment will support your needs, and vice versa. In addition, if the income you draw matches your investment return the effects of inflation will result in less and less purchasing power over time. While higher returns may produce more growth, if there is more risk associated with these returns, you need to consider the effects of volatility or loss of capital.

Start saving

Building up an investment that you can use to fund retirement takes time. Starting early not only increases the amount that can be contributed, it also increases the effect that growth can have on these contributions. For an investment of R500 per month, growth accounts for 25% of the fund value after five years, 43% after 10 years, 57% after 15 years and 68% after 20 years (assumptions: 6% inflation over the period, 12% investment growth).

The Association for Savings & Investments SA (ASISA) recently drew up guidelines for living annuities, specifically showing how the income rates that are drawn from an investment affect the length of time before income rates start to fall (see **Table 1**). These can be used as a gauge in your planning process. If you retire today and draw 2.5% to 7.5% of your investment per year, your

investment could potentially sustain you in excess of 13 years before your income falls (some basic investment assumptions are detailed in the table).

But what should your investment look like in today's value?

If, for example, your current net income is R300 000 per year after tax, you would require a drawdown, pre tax, of approximately R280 000 to maintain this lifestyle (assuming a person in retirement can live off 70% of current spending, which would need to be grossed up for tax). To support this, you would need an investment of between R4m and R11m in today's value. While the range is large, the more you save, the more security and certainty you will have. Below this figure you may struggle to maintain your lifestyle.

While the table is a very rough guide it does give a target (1) to save towards and (2) that can be used to determine what monthly contributions will be needed to achieve this.

Utilise incentives that encourage retirement saving

Retirement annuities are structured to encourage saving. Contributions are excluded from personal taxable income and any interest and growth (including interest and dividends) is tax free. In addition, at retirement the tax exemptions and subsequent tax rates are favourable.

Before the end of February each year, an opportunity arises to maximise the benefits of an RA and reduce the tax payable. Fifteen percent of non-retirement funding income (see text box) can be contributed to an RA and this amount is deductible off your taxable income.

Therefore, if you have done a self assessment and believe you owe tax, contributing to an RA can reduce the amount of tax you owe, while building up your retirement investment.

Table 1 | Years before your inflation-adjusted income will start to reduce

Annual income rate selected at inception	Investment return per annum (before inflation and after all fees)				
	2.50%	5.00%	7.50%	10.00%	12.50%
2.50%	21 years	30 years	50+ years	50+ years	50+ years
5.00%	11 years	14 years	19 years	33 years	50+ years
7.50%	6 years	8 years	10 years	13 years	22 years
10.00%	4 years	5 years	6 years	7 years	9 years
12.50%	2 years	3 years	3 years	4 years	5 years
15.00%	1 year	1 year	2 years	2 years	2 years
17.50%	1 year	1 year	1 year	1 year	1 year

Source: ASISA

In the table the column on the left shows the starting income drawn from an annuity and assumes that this will be adjusted to keep up with inflation (inflation assumed to be 6%). The top row refers to the investment return that you expect from your investment. This is a nominal figure after deducting fees. The years in the table indicate how long it will take for your income, which increases with inflation, to reach 17.5% of your remaining capital amount. This is the point where your income will drop in subsequent years.

What is non-retirement funding income?

If you are self employed, or your employer does not offer a pension/provident fund, your income is considered 'non-retirement funding'. You may contribute the greater of R3 500 or 15% of your non-retirement funding taxable income to an RA tax free.

If your employer offers a pension/provident fund that you may select to invest in, your income is known as 'retirement funding income'. However, you may still earn non-retirement funding income such as a bonus or car/entertainment allowance and can contribute the greater of R1 750; R3 500 less your allowable pension fund contribution; or 15% of the non-retirement funding income tax free. Any additional payments (over the 15% limit) may be carried forward and offset against future taxable income.

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