Game plan:

How to retire within 10 years on a $52k pa passive income

Jo and Chris Worsfold are keen to get their property investment portfolio up and running, with a view to retiring in 10 years. Can they achieve their goals?

Tasmania-based Jo Worsfold and her husband Chris got in touch with *Your Investment Property* in search of some first-time investor advice. As Jo admitted when emailing us, the couple really had no idea where to start, but were keen to get their portfolio off the ground as soon as possible – if they could afford it. "My husband and I have been wanting to get into investing in real estate for some time now, but had absolutely no idea where to start. We are also unsure of whether or not we can even afford to start investing now," wrote Jo.

"We want to invest for the long-term goal of an early retirement, rather than for the short-term increased cash flow. Chris' dream is to one day be able to buy an old classic car, and my dream is to have plenty of savings tucked away so we can live day-to-day without worrying about money."

With two young children to look after (four-year-old Alicia and two-year-old Ethan), Jo does manage to squeeze in some part-time bookkeeping work to help out with the family finances, bringing in around $3,000 a year, but the couple's main source of income comes from Chris' full-time job as a diesel mechanic.

With overtime, Chris brings in around $55,000, which keeps the family balance sheet in the black. However, they find that – even with Jo's additional income – it's often difficult to save.

The players Jo and Chris Worsfold

Ages: 33 & 31
Occupations: Part-time bookkeeper & diesel mechanic
Income: $58,825
PPOR: $300,000
Equity: $261,000
Mortgage: $39,000
Super: $98,300
Savings/shares: $7,800
Dependents: Two children

The coaching team: Empower Wealth Advisory

Property advisor:
Cate Bakos
Money and wealth advisor:
Michael Pope
Finance advisor:
Cameron Morgan
Empower Wealth founder:
Ben Kingsley

The Empower Wealth team consists of highly qualified and successful professionals with years of experience and proven track records in offering specialised advice to their clients, within their qualified disciplines. Empower Wealth offers professional advisory and fulfilment services in residential property investing, mortgage broking, financial planning, money and wealth planning and wealth education.
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How they stand

Income: Net worth

Assets	Liability	Asset	Net worth
PPOR		$300,000	
Super		$98,300	
Contents		$70,000	
Vehicle		$18,000	
Shares		$2,400	
Mortgage	$39,000		
Credit card	$2,000		
Total	$41,000	$488,700	$447,700

Monthly budget

Description	Cash	Credit	Total annual amount
Food & household	$1,100		$13,200
Living & lifestyle	$1,420		$17,040
Savings & emergency	$100		$1,200
Bills		$1,302	$15,628
Fixed payments	$498		$5,980
Total	$3,118	$1,302	$53,048

Planned future expenses

Reason	Variation	Frequency	Start	End
Upgrade to camper trailer	$5,000	Once off	06/11	
Christmas visit to WA	$4,000	Once off	12/11	
Regular family holidays	$4,000	Yearly	01/15	
Disneyland holiday	$20,000	Once off	01/20	
School fees	$500	Yearly	02/12	01/19
School fees	$2,000	Yearly	02/19	01/25
School fees	$500	Yearly	02/14	01/21
School fees	$2,000	Yearly	02/21	01/27

"We're putting a little bit of Christmas money away but we're finding that, if we need the car serviced or something else crops up, we're digging into it and then we've virtually got none again," says Jo.

On the plus-side, Jo and Chris are debt-free apart from a $2,000 credit card and an admirably low home loan of $39,000. With their Westbury home being worth in the region of $300,000, their low debt level leaves them with a healthy equity base to work with.

Plus, as the children reach school age and Jo has some more time on her hands, she plans to ramp up her bookkeeping business and boost the family's income. On top of this, Chris expects his annual earnings to increase by $20,000 once he finishes his second trade apprenticeship in 2015.

"I want to build my bookkeeping business up, but I'm expecting that I'll have to wait until both the kids are at school but that's a big personal goal – to have a bigger business with a lot more clients, earning a far bigger income than I am now," says Jo.

In the meantime, however, Jo and Chris are keen to find out what their options are and kick off their property game plan as soon as possible, rather than holding off for a few more years until the kids are at school.

"I'd hate it if we waited a few years until the kids are at school and found out that we could have done something now. I don't want to have any regrets," says Jo.

"We get pretty impatient. When we want to do something, we try to figure out how we can do it straight away."

In terms of how far they'd like their property investment journey to take them, Jo estimates that a passive income of $1,000 a week would be sufficient to allow them to retire comfortably. And as for the retirement date, Chris' 40th birthday wouldn't be a bad target, although they admit that aiming to retire within a decade may be a little ambitious for now.

"Originally, a few years ago we thought that by the time my husband was 40 we'd like to retire, but I don't know how realistic that is," says Jo.

Other than being able to wave goodbye to the daily grind and live more comfortably than they do now, Jo and Chris are motivated by the quite understandable desire to spend more quality time with the children before they flee the nest – including a couple of big family trips.

"We'd like to continue to invest after retiring, but by then the kids will be in their early teens so we'd like to do a couple of big family holidays that we can all do together, like going to Disneyland," explains Jo.

The game plan

So, with an overview of their situation in hand, we approached one of our expert coaching teams to help Jo and Chris on their way to Disneyland and beyond.

Having given Jo and Chris a pile of homework to do, the Empower Wealth team put together an outline of the couple's current financial situation based on the information that Jo and Chris gave them. The team was then able to put together the family's wealth projection (see table at right), based on their current financial situation and planned future expenses (see p75).

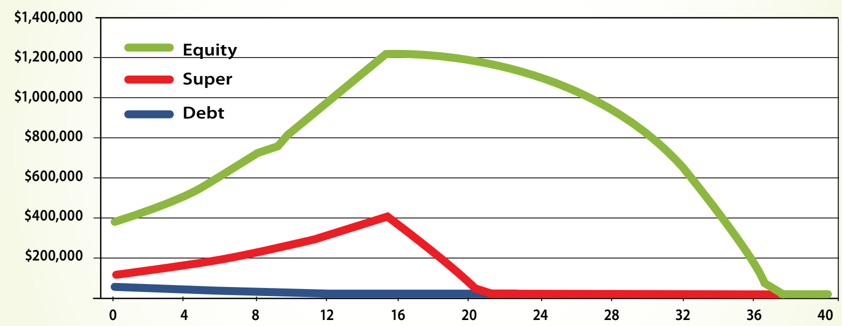
Now, as with all such forecasts, a few assumptions need to be made in order to plug all the numbers in and come up with a realistic result. The team's assumptions are as follows:

- 7% pa capital gain on their property
- 6% pa net return on superannuation
- 3% inflation for costs and wages
- 3% interest on any savings outside of offset or transactional accounts
- Jo and Chris will be able to draw against the value of their home (for example, using a reverse mortgage) to fund loan repayments and living expenses once their super funds have been exhausted
- no external financial support from government pensions, discounts or rebates
- retirement is pushed back to a more realistic 15-year target

Investment goals

- **Retire within 10 years if possible on a passive income of $52,000 pa**
- **Spend more time with the children**
- **Go on some family holidays, including a trip to Disneyland**
- **To live day-to-day without worrying about money**

Current wealth projection



Wealth projection

Assumptions out of the way, the team factor indexation into Jo and Chris' desired passive income of $52,000 and estimate that this figure will need to be $81,014 in 15 years' time.

The team then put together a wealth projection for Jo and Chris and the good news is that, if they carry on as they are, they'll be able to pay off their debt in just over 11 years. The bad news, however, is that if they then choose to retire after 15 years and start drawing from their super fund at their desired passive income level, their super nest egg will be spent just seven years later.

If they were then to draw their desired retirement income from the remaining equity they wouldn't have a cent to their names in 37 years. (See graph above.)

"The path that they're on at the moment is going to fail them," explains Empower Wealth founder Ben Kingsley. "They're going to run out of cash, so without any assistance or coaching, their current game plan will be a fail."

So how can Jo and Chris improve their situation, turn that fail into a pass, and achieve their goals?

Streamline their finances

First up, the Empower Wealth team suggests that Jo and Chris streamline their finances to use their surplus cash more effectively. This is done by paying all of their income into a mortgage offset account to help bring that $39,000 debt down as quickly as possible.

All essential spending, such as fuel and bills, will then be made using a credit card – which will be paid off using the offset account before the credit card's interest-free period expires. A separate transaction account will also be set up for living and personal spending costs, and $580 a week will be transferred into this account from the offset account.

The team predicts that freeing up this surplus cash and restructuring their finances as suggested will help Jo and Chris to pay off their home loan more quickly (in four years) and increase their super contributions, but this still won't allow them to retire on their desired income in 15 years without exhausting their super fund within 12 years of retirement.

They therefore need to throw some leverage into the equation, says Ben. In other words, borrow money to make money through property investment.

"We're assessing where all their sources of money are coming from. So in their case, that's their salary, as they've got no investment income and there's no government assistance," explains Ben. "And then the other source of cash flow will be from borrowing, so that's where we're bringing leverage and property into the equation."

Proposed cash flow position

	Annual	Monthly
Total income	$58,825	$4,902
Total expenses	$47,068	$3,922
Loan repayments & fees	$4,934	$366
Cash flow surplus/deficit	$7,364	$614

Assumes an expenses inflation rate of 3%; a salary indexation rate of 3%; a loan variable interest rate of 7.95%; and ongoing bank fees of $180 annually

Success at last

So, as well as streamlining their finances, Jo and Chris need to make some prudent property investments in order to build up enough wealth and passive income to meet their goals. The team, therefore, put together one last wealth projection which now includes the purchase of two investment properties – and this is the plan that finally sees them retiring comfortably in 15 years.

Because the purchase of investment properties involves taking on extra debt, for Jo and Chris to be able to retire in 15 years – and have a passive income that's sufficient to fund both living expenses and mortgage repayments – the Empower Wealth team predict that they'll need to bring in a rental income of $70,000 pa rather than the initial target of $52,000.

This increased passive income allows the couple to pay off their entire debt in 20 years and six months – in other words, they'd be debt-free within five-and-a-half years of retiring.

Once retired, they'll have just under $2.5m in equity thanks largely to the capital appreciation on their properties, and enough in the super pot to live on for 31 years. After their super's run out they can start dipping into their equity, which is forecast to have grown to a massive $16m in 40 years' time. Even after 40 years' worth of inflation, this will be more than enough to live on – around $4.7m in today's terms assuming 3% inflation per year. (See graph below.)

'Moving parts'

Ben admits that there are a lot of variables, or what he calls 'moving parts', that need to be assumed to make this kind of sophisticated wealth forecast. These include: Jo and Chris' rate of income growth, property purchase costs, rental yields, capital growth rates, property occupancy rates, and property management costs.

But by being conservative in these assumptions – for example, setting the capital growth for their investment properties at 8% pa and rental yield at 5% pa – Ben believes that the team has come up with an outcome that's both realistically achievable and one that meets Jo and Chris' goals.

"It took a lot of work to find the right solution cash flow-wise," he says. "But we're pretty confident that they'll end up at that position or thereabouts, which I think is a wonderful outcome."

So, with a bit of financial juggling, a couple of prudent investments and a lot of discipline, Jo and Chris can achieve their goals within 15 years. But what type of property investment should they go for and how soon can they get that portfolio on the go? Empower Wealth property advisor Cate Bakos runs us through the property selection process.

Property selection

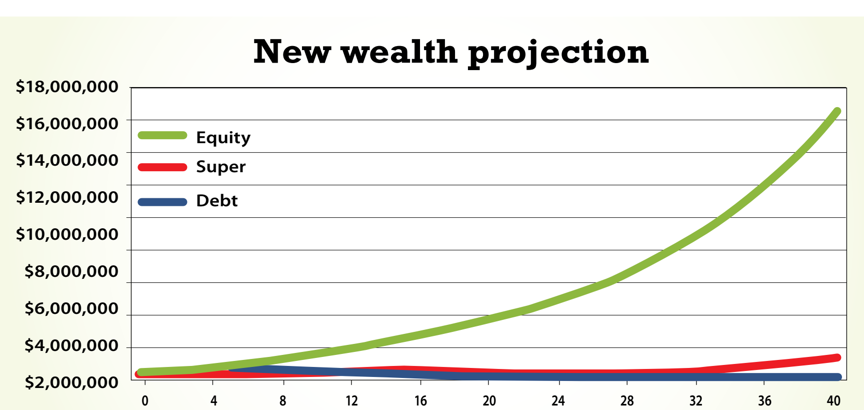
"Jo and Chris gave us a comprehensive insight into their current balance sheet, wish-list and plans for the future. We asked them to highlight some of the important elements in their future plan so that we could model the costs of their requested items, all outgoings, expense items, and their current incomes and then work out the most suitable types of investment properties and time to acquire the properties," says Cate.

Based on her conversations with Jo and Chris, Cate made the following assumptions before picking out some potential investment properties:

- Jo will take on more bookkeeping work over the next year and increase her income by $250 per month
- Jo will increase her work load even more by being able to work school hours once their youngest child starts school in 2015 (earning an additional $15,000 pa)
- Chris' income will increase a further $20,000 once he finishes his second trade apprenticeship in 2015

And when it comes to financing the purchases, the plan is to release $200,000 in equity from Jo and Chris' PPOR.

"This equity will potentially provide for two investment property purchases over a 12-month period and enable a $50,000 buffer for Jo and Chris' future as property investors," explains Cate.



Property one

Given Jo and Chris' current incomes and the assumptions stated above, Cate suggests that their first property (to be purchased immediately) meets the following criteria:

- house on full block of land
- purchase price capped at $200,000
- vacancy rate lower than 2%, and preferably 1% or less
- rental return above 5%
- moderate underlying historical capital growth potential of 8%

- property to be within walking distance (2.5km) of town centre

So, with these points in mind, Bakos suggests Ballarat East as a potential location for Jo and Chris' first investment property purchase.

"Ballarat's population currently sits at 94,000 and the major industries are diverse. In addition, the city has two universities and reasonable employment rates," says Bakos.

It's a city with plenty of industry in its own right, including manufacturing, IT, agriculture and mining, and is

> "We can't believe that it's possible to invest now, rather than a few years down the track"

the main hub for Victoria's historical goldfields region. Recent infrastructure improvements include a high-speed rail link to Melbourne (making the state capital reachable in 64 minutes on an express train), and the completion of the Western Highway between Melbourne and Ballarat (making just over an hour's drive between the two). The local airport is also planned to be upgraded within the decade.

"Most compelling, however, is the sustained population growth that the area has been experiencing," says Cate, who cites ABS figures showing that Ballarat saw an increase of 2,100 residents in the year to June 2009.

"With infrastructure upgrades, reduced commuter times and lower affordability, the township has increasing appeal to those who wish to upgrade their home and leave the capital city to move into the area," says Cate.

She sets a maximum purchase price of $200,000, which is eminently achievable considering the city's median house price of $225,000.

Given this target purchase price, Jo and Chris would need to borrow $160,000 to fund the purchase at 80% LVR, with the remaining $40,000 coming from their PPOR equity. All up, they'd need to release $50,000 in equity to cover their deposit, government charges, stamp duty and legal costs.

Property two

Assuming Jo's income increases by $250 per month as predicted, Cate suggests the following criteria for the couple's second purchase:

- purchase price within $300,000
- vacancy rate within 2%
- rental return above 5%
- moderate underlying capital growth of 9% (factored in conservatively on the wealth projection calculator at 8%)

In order to meet these specifications, she suggests that Jo and Chris take a look at East Geelong and Thomson, also in regional Victoria. Like Ballarat, Geelong has seen a population spike in recent years, with its increase in resident numbers of 4,000 beating all comers in regional Victoria in the year leading to June 2009.

"Like its regional counterpart, Ballarat, Geelong has become a popular alternative for major city inhabitants who have decided that the economic benefit of buying a home in a commuter city is a better choice for them," explains Cate.

Jo and Chris' proposed budget of $300,000 is significantly below the area's median house price of $400,000, but Cate highlights recent sales and current listings as evidence that 5%-plus yielding property is out there for $300,000.

In order to reduce their portfolio's overall risk level and keep repayments manageable, it's suggested that Jo and Chris purchase this second property at 72% LVR rather than 80%. In order to do so, they'll need to release $100,000 in equity from their PPOR, 85% of which will cover the deposit, while $15,000 will be set aside for government charges, stamp duty and legal costs.

The verdict

Jo and Chris have the capacity to start investing right away, but they're unlikely to be able to retire on their target passive income for another 15 years. This is a significant increase on their original ambitious goal of retiring within 10 years, so what do they think?

"It's going to push retiring back from 10 years to 15 years, but Chris is actually happier with that because he said he wouldn't know what to do with himself if he retired in 10 years!" explains Jo. "So it's worked out for the best.

"We're very happy, and can't believe that it's possible to invest now, rather than a few years down the track. We'll definitely be buying our first property as soon as we can get the ball rolling."

Getting the ball rolling will involve a fair bit of financial restructuring, but Jo's delighted that, with a bit of tinkering, they can improve their budget situation and get that first investment on the go.

"We've been battling to put our money together. But when we spoke to the team, they said 'this is what you do: you put all your money in this account and just take out the bits that you need to live off'. It's just made it so much easier for us."

Emboldened by her game plan, Jo's confident that they'll have that first investment property under their belts this year, bringing them that much closer to their dream retirement.

Disclaimer: The information and strategies contained in this article are for illustration purposes only and as such should not be taken as financial advice. Readers should seek advice from qualified professionals before investing

Final summary

	Current situation	After restructuring finances	With property investment
Total equity in 15 years	$1,163,590	$1,473,656	$2,428,519
Remaining equity in 40 years	-$734,540	$1,009,405	$16,528,683

Your turn...

What do you think? Do you agree with this assessment, or do you think Jo and Chris should follow a different path? Have your say at our forum at www.yipmag.com.au/forum – the best responses will be featured in a future issue.

Alternatively, if you're in need of some expert guidance and would like to take part in this regular feature, email your contact details and a brief overview of your situation to editor@yipmag.com.au.