Generating income in retirement.

Ron Goodwin, 74 year old owner of 37 rental properties accumulated over 29 years, recently earned opprobrium from the usual quarters by advising other landlords not to be "too kind" to tenants. Numbers published in the resultant furore reveal Mr Goodwin receives $14,500 rental income per week on a property portfolio which he calculates is now worth about $18 million compared to rating valuations of $13.6 million.

We don't know how much Mr Goodwin paid for his properties or when, so we are unable to calculate his capital gains but we do know he has $4.8 million in debt. At a cheap option, say interest only loans of 5.5% p.a., interest would be $5077 per week alone. Rates should take out at least another $1300 per week and we haven't even started on maintenance, insurance, property management, legal fees and the rest. My guess is that Mr Goodwin's income is around $7500 per week at best after all costs – probably much less.

On an $18m portfolio that's a cash return of 2.17% p.a. assuming costs offset tax to zero.

In Mr Goodwin's case that still leaves a hefty income of $390,000 p.a. – but his situation could hardly be considered "retirement" or normal. The work and stress levels must be enormous – even if he does employ managers. Few much younger people would want the task.

For more modest rental property owners, particularly retirees wanting to earn supplementary income, 2.17% simply isn't good enough. Yet the broad acceptance of high stress and ongoing work in exchange for such pitiful returns, shows just how deeply runs New Zealand's love affair with rental property and faith in never-ending capital gains. But those who, unlike Mr Goodwin, have acquired rental properties more recently risk stagnant capital values or even capital loss in the medium term as rising interest rates spread out from the United States and fast-tracked building programs catch up with declining demand – as is already starting in Australia.

Convincing New Zealanders that a diversified investment portfolio offers growth, greater income, better liquidity, equivalent security and less stress than rental housing is an uphill task. A Goodwin supporter when stating that "we don't trust the sharemarket" still speaks for many. But, if not entirely convincible, rental property investors should at least consider an investment portfolio instead of another property when seeking to augment a pension.

The catch is not that our capital markets can't be trusted but, just like purchasing a string of good rental properties over time, building a valuable investment portfolio takes patience, skill and some measure of hard work.

Handing over your life's savings (along with a monstrous "establishment fee") to some slick financial product salesperson for immediate deposit into his or her employer's own managed fund isn't going to do it. Such benevolence may well boost the salesperson's bonus but is unlikely to achieve the investor's financial goals over the short or even long term. Recovering your funds when you want them may not be so easy either.

In contrast, characteristics of a portfolio constructed specifically to suit an individual investor include direct ownership of investments, asset liquidity, low volatility and definitely *no* pooling of investor funds. In addition to minimising fees, direct ownership of investments offers access to valuable rights issues, special share plans, related issue offerings, transparency of returns and peace of mind through security of ownership that other avenues may not promote or, in some cases, even permit. Careful selection of special opportunities as they arise can add significant extra value to a portfolio over time. Also, listed investment vehicles should be used where possible as these hold some important advantages over unlisted funds. Only unlisted funds with outstanding bona fides and performance should be considered. Importantly, with direct ownership, full control of the portfolio lies with the investor and funds remain readily accessible if needed.

A well-constructed personalised investment portfolio can provide both income and capital growth with the proportions variable depending on the needs of the investor. Included will be both growth and income assets diversified across the many sub-asset classes of shares, bonds, property and cash with, perhaps, a small allocation to some "alternative" higher risk asset class where the investor is both knowledgeable and comfortable.

Even in today's ultra-low interest rate environment good returns are possible.

Rather than experience an income decline in real terms and relative to capital deployed, over the past four years the real owner of an actual conservative income portfolio (not a "model") has seen asset growth of 7%-8% compounding *after* fees and tax at the investor's prescribed rate, of which 5% - 6% comprised income. A more aggressive real growth oriented portfolio has compounded at 12% - 13% p.a. of which about 4% p.a. was in the form of income. These figures take full account of the sharp downturn in global equity markets seen in August and September this year.

In future, income from both portfolios is expected to continue growing as recent investments move to full contribution mode and at least some income is reinvested.

At the 2.17% rental housing return, a $25,000 supplementary income would set back the retiree $1.152 million. That's about one house or two apartments in Auckland terms. Assuming age doesn't incur discrimination against borrowing the deal could be financed with about $900,000 cash plus a $250,000 interest-only mortgage at 5.5%.

The same income could be achieved through a personalised investment portfolio of $455,000, (perhaps including one or two matured Kiwisaver accounts) and no borrowing at all.

In both cases further capital growth is expected but not guaranteed.

So a personalised investment portfolio does offer a real alternative or at the very least a worthwhile addition to rental housing as a source of income in retirement.

Oh, and by the way, you do get to spend more time in the camper van, with grandchildren, at the gun club, tramping, dancing, skiing, another OE…..you name it. For most of us in later life that beats chasing miscreant renters, building repairs, legal wrangles and mortgage worries.

Worth thinking about.

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I specialise in providing professional investment advice to those wanting to play a part in building their own investment portfolio. All ages welcome.

22 October 2015