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Pension plans ignored as investors turn to property

Personal Finance

Many Irish have no savings for retirement, others miss out on generous tax breaks

Niall Brady

PENSIONS awareness week kicks off tomorrow with the grim statistic that, despite all the publicity and generous tax breaks, almost one million people have done nothing about saving for retirement.

Only half of the workforce is covered by occupational or personal pensions, according to figures issued last week by the Central Statistics Office (CSO). But despite government efforts to tackle the pensions time-bomb, including the introduction of no-frills Personal Retirement Savings Accounts, or PRSAs, coverage has hardly budged



over the last two years.

PRSAs are already looking like an embarrassing flop, with thousands of employers openly flouting the requirement to make them available to all workers. Even where employers are complying with the law, just over 16,000 workers bother to make any contributions to PRSAs.

But the CSO numbers fail to tell the full story, ignoring the huge shift away from conventional pensions towards alternative ways of saving for retirement. According to the CSO, the proportion of self-employed people with personal pensions is actually dropping. This does not mean they are burying their heads in the sand; it simply means they have turned to property and other assets as a better investment alternative.

And who can blame them? Pension performance has been miserable in recent years, with managed funds averaging just 1% growth a year since 1999. After the investment industry has taken its cut – including brokers' commissions, entry charges and fund managers' percentages – the average pension will be down another 1.5% to 2% a year.

The result is that many pensions are stuck in the red, worth considerably less than the money paid into them in recent years.

The arguments used to justify these fees are looking increasingly threadbare, especially with new research by pension consultants Hewitt & Becketts showing that most investment managers cannot even match the performance of the indices of the stock markets where they invest (see Moneybox).

Little wonder that thousands of people are turning their backs on pensions, believing that property is a much better bet for accumulating wealth that can be used to finance retirement. Irish households are estimated to

own €30bn to €33bn worth of investment property; more than three-quarters view the investment as their pension, according to research by Gunne estate agents.

The flight to property could turn sour for thousands of buy-to-let investors who are betting that the boom will continue and that today's rock-bottom mortgage rates will last into the future. Even if property continues to build on the gains of the last decade, many buy-to-let investors simply do not own enough of it to provide a decent income in retirement according to Martin Haugh, managing director of HLD Actuarial Consultants.

"To provide an income in retirement of €20,000 a year, you would need to recover over €600,000 from your buy-to-let property after repaying any loans, taxes and expenses," he says. "This is a tall order when the typical property is a €250,000 two-bedroom flat with a 70% interest-only mortgage."

Property can look like the perfect way to kick-start your pension savings, especially if you have left it late in life to begin planning for retirement. The ability to borrow means that a relatively modest deposit of €30,000 to €40,000 can be easily leveraged to acquire a €250,000 apartment. A nest egg of this size would require years of patient saving to accumulate

using a conventional pension.

But Haugh believes this strategy could easily backfire. "If you're 45 to 50 and haven't any pension savings behind you, it's tempting to buy an apartment in Smithfield (in Dublin's north inner city) as your pension," he says. "But you wouldn't be giving yourself much time for the property to appreciate in value and, assuming you use an interest-only mortgage, it would probably have to be sold when you retire."

Haugh believes property can be a great pension asset, provided it is part of a wider investment strategy. "We seem to have a genetic predisposition to property in Ireland but, unfortunately for the average person, property is likely to be their only investment asset.

"Investments should be built up in layers, beginning with a basic pension product. Once you've got a retirement income of €10,000 to €15,000 a year in place, you can start looking at alternatives such as property."

No matter which way you work the maths, conventional pensions will always have one killer advantage: the tax breaks. For the 650,000 PAYE workers paying the top rate of income tax, this means that €100 invested in the company pension only costs them €52.

No other investment can compete with this type of incentive – even if it is used all too often as a smoke screen to bury lousy investment performance and high charges. Property diehards would still be well advised to divert some of their money into a conventional pension, if only to cash in on the tax breaks.

Many people contribute just enough to a pension to maximise the tax-free lump sum that can be taken at retirement which, for employ-

ees with 20 years' service, can amount to 150% of final salary.

This means there will probably be nothing left over to provide a regular income in retirement, but this is of no consequence to investors who have other assets and are keen to exploit one of the few ways of getting at their paychecks free of tax.

"If you have 20 years clocked up and you retire on a salary of €40,000, you can take €60,000 from your pension fund as tax-free cash," says Jim Lee, pension sales manager at Friends First. "Anecdotally we're hearing that a lot of people are using the money to help their children with deposits on houses of their own. But if you haven't provided for it by making additional voluntary contributions, taking the maximum lump sum can leave a very big hole in your pension."

"No other investment can compete with the tax breaks on pensions... even property die-hards would be advised to put some of their money into one"