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Researching retirement

In December last year, we began an initiative to help improve financial literacy in the workplace. As part of that initiative, we ran a series of workplace surveys. Of those surveyed 77% did not know how much they needed to retire, and 35% were unable to estimate what proportion of their retirement needs would be met by KiwiSaver.

These findings are consistent with our experience helping New Zealanders over the preceding two decades. In advising individuals, families and trusts, the two most frequently asked questions we receive are: How much do I need to save for retirement? And, for those in retirement; Do I have enough?

Surprisingly, there has been little formal research into either question in New Zealand. With the help of members of the Royal New Zealand Returned and Services' Association, MetlifeCare and a number of leading New Zealand financial advisory firms including NZ Funds Private Wealth, we analysed the experiences of 348 New Zealanders in retirement. The results highlight some common misconceptions and miscalculations about retirement spending and identify a number of areas where retirees' experiences may differ. Finally, the research exposes areas of change which may leave future generations vulnerable. Taken collectively the findings should help future generations be better prepared for, and therefore get more enjoyment out of, retirement.

Process

In order to analyse how New Zealand individuals and families behave in retirement we contacted retirees with an 18 question survey. The survey was web-based and confidential.

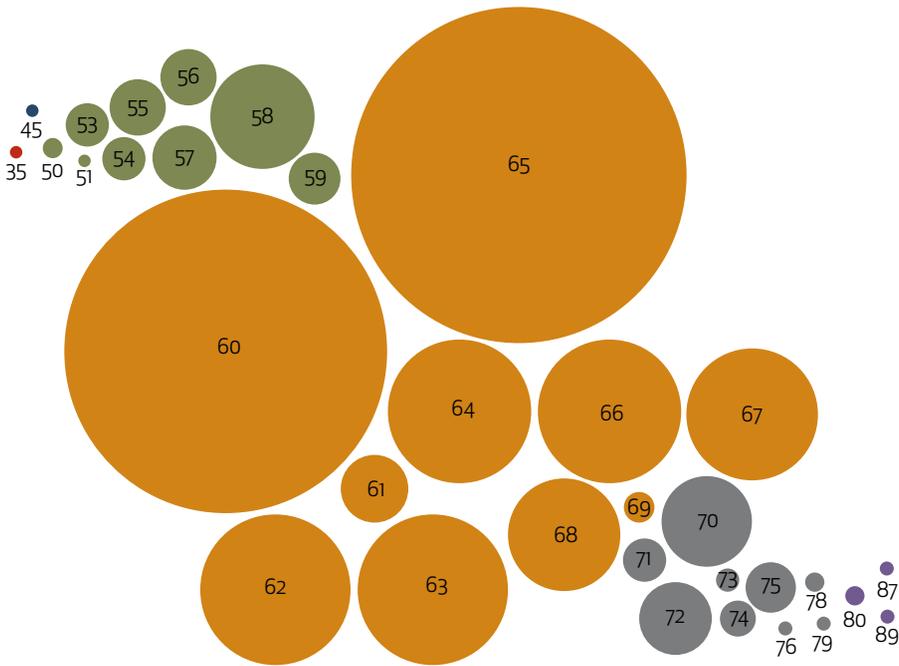
Of the respondents, 28% had been retired for less than six years; 26% for between six and 10 years; a further 28% for between 11 and 20 years; but only 17% for more than 20 years. This ensured statistically significant results across most stages of retirement, except for those with more than 20 years in retirement where the fewer number of responses make the results less reliable.



At what age do New Zealanders retire?

Legislative changes preventing age-based discrimination, increased flexibility of work place and working hours, coupled with a rising life expectancy, have all contributed to making the age at which we retire a highly personal choice. The survey recorded a wide range of retirement ages ranging from 35 in one case, to 89 in another. Despite a wide spread of retirement ages most opted to retire at either 60 or 65. Future generations are likely to retire later. At present, the average NZ Funds myWealth member is 41 years of age and wishes to retire at 64¹.

NEW ZEALAND RETIREMENT AGE



SOURCE: NZ FUNDS RETIREMENT SURVEY.

What percentage of pre-retirement household income do New Zealanders plan to retire on?

In preparing for retirement, the survey revealed that the average retiree expected to live on approximately 63% of their pre-retirement income. Specifically, 59% of retirees surveyed expected to spend 60% or less. A further 25% expected to spend approximately 70% of pre-retirement income, while only 16% contemplated spending 80% or more.

In our experience, clients find planning a reduction in expenditure for retirement easier than the reality of cutting aspects of their pre-retirement lifestyle when they enter retirement. A figure of 60 or 70% entails a 30 to 40% reduction in lifestyle, which for most is unrealistic. However, assuming the expense of paying a mortgage and raising children has ended, many New Zealanders save a significant proportion of their income in the years leading up to retirement. Contemplating a retirement income of 60 to 70% of pre-retirement income may therefore not entail as dramatic a change in actual spending as it first appears. By comparison United States based research found retirees budgeted to spend between 70 and 80% of their pre-retirement income².

Spending patterns in retirement

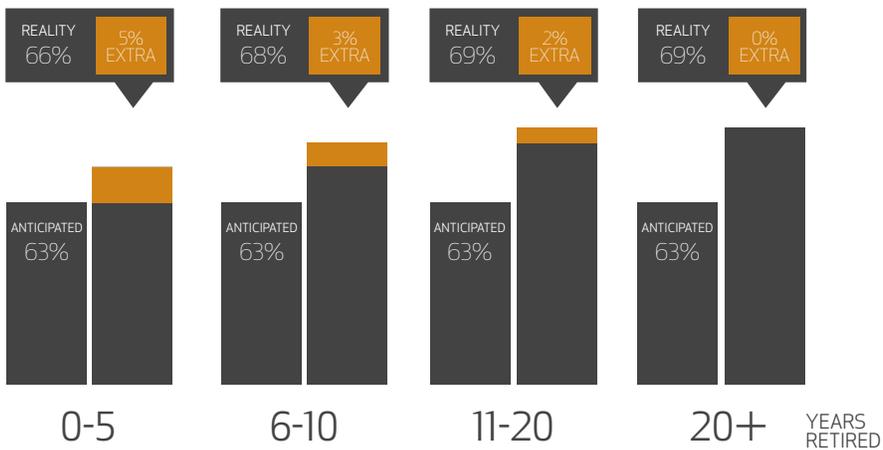
In the first five years of retirement retirees spent 5% more than anticipated, or 66% of their pre-retirement income, bringing the reality of retirement in line with NZ Funds' anecdotal experiences advising clients in retirement.

Interestingly, in the second five years the level of spending did not decline, but instead rose a further 3% taking annual spending to 68% of pre-retirement income. Some retirees find that there are a number of one-off costs associated with initial retirement such as a changes in clothing, club memberships, sporting equipment or volunteer work. Anecdotally, we had expected some of these expenses to be one-off in nature and decline over time. In the first ten years this was not the case.

In the second decade of retirement expenditure rose again, but this time by only 2% on average. This took spending in years 11 to 20 of retirement to 69% of pre-retirement income.

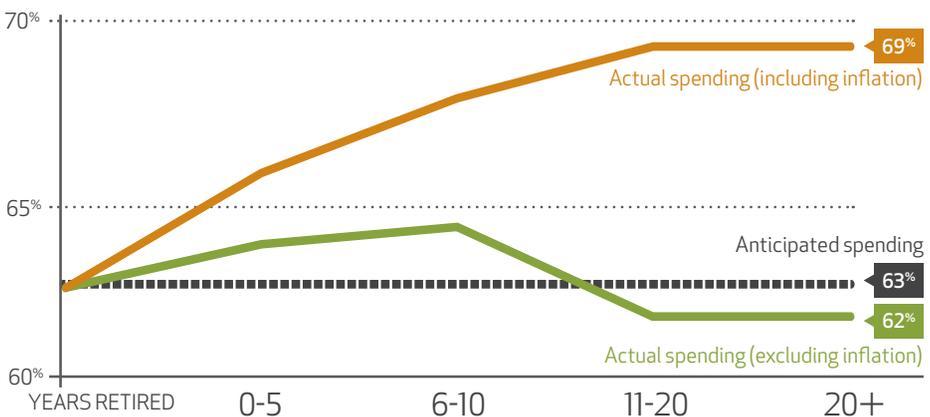
Finally, for those still enjoying retirement after more than twenty years there was no further increase in expenditure, but neither was there a decline. And unlike retirees' experience in the United States, there was no discernible hockey stick increase in overall expenditure because of health related expenses in old age.

RETIREMENT SPENDING: ANTICIPATED SPENDING VERSUS REALITY



What the research does clarify is that New Zealanders anticipated retiring on 63% of pre-retirement income, but in reality end up spending on average 68% of pre-retirement income, or a little more every five to ten years. When retirees' responses are indexed with inflation it demonstrates that the "unanticipated" additional expenditure is broadly equal to the economy's inflation rate. We compensate for this in our financial planning process by modelling clients' expenditure growing in retirement by the rate of inflation.

RETIREMENT SPENDING: ANTICIPATED SPENDING VERSUS REALITY



SOURCE: NZ FUNDS RETIREMENT SURVEY, CONSUMER PRICE INDEX, NZ FUNDS CALCULATIONS.

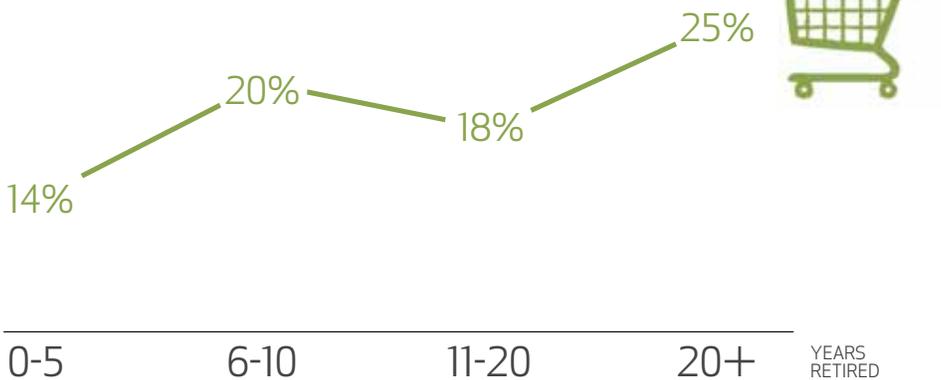
What causes over and/or underspending in retirement?

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FORGETTING TO ACCOUNT FOR INFLATION

Understanding what causes under or over spending in retirement is important, as it helps retiring New Zealanders to identify likely hot spots for overspending. In all periods the cost of living (including housing) was identified as the primary reason for spending more than planned. As retirees moved further away from their start point, the cost of living and housing became a more common reason for overspending. We attribute this to forecasting future spending in nominal terms - that is, forgetting to increase future spending by inflation.

RETIREES IDENTIFYING COST OF LIVING AND HOUSING AS REASONS FOR OVERSPENDING

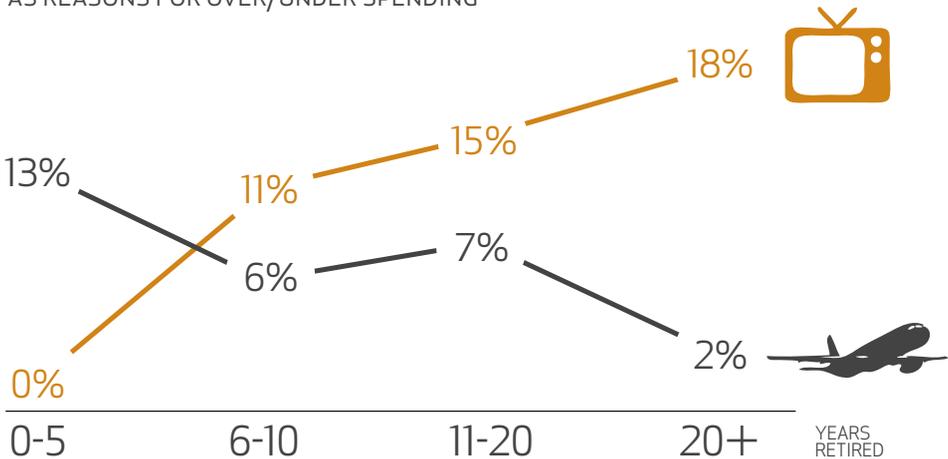


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TRAVEL AND LEISURE

As anticipated, travel and leisure feature prominently as a reason for overspending. Interestingly it was the second most commonly given reason for overspending in all periods, after a general rise in the cost of living, except after 20 years in retirement. However, countering this group were a rising number of retirees who reported less activity outside the home as a reason for spending less than anticipated. In fact in all periods, except for the first five years of retirement, most retirees who spent less than they anticipated did so because of less activity outside the home. As the number of years in retirement increased, travel and leisure became a less relevant factor overall, whereas less activity outside the home rose in prominence. Suffice to say, those retirees who anticipate a healthy, active retirement will need to incorporate that into their financial planning or they are likely to overspend.

RETIREES IDENTIFYING TRAVEL VERSUS LESS ACTIVITY OUTSIDE AS REASONS FOR OVER/UNDER SPENDING

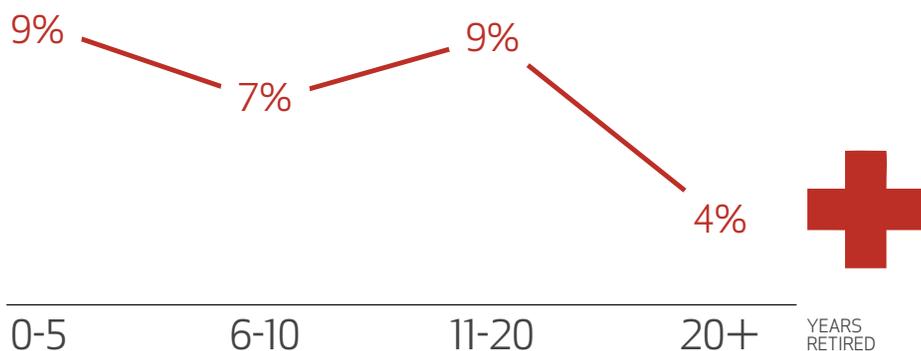


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HEALTH

Health appeared consistently as a factor in both over and under spending. Unfortunately, the results of the survey do not address whether spending less than anticipated due to health was because of poor health and a corresponding reduction in travel and leisure and other expenditure, or good health which might have resulted in lower healthcare costs than anticipated. The same uncertainty exists with retirees who identified "health" as a reason for overspending. We can however conclude that either good or bad health will be a prominent reason for over or under spending for approximately one in ten retirees.

RETIREES IDENTIFYING HEALTH AS REASON FOR OVER/UNDER SPENDING

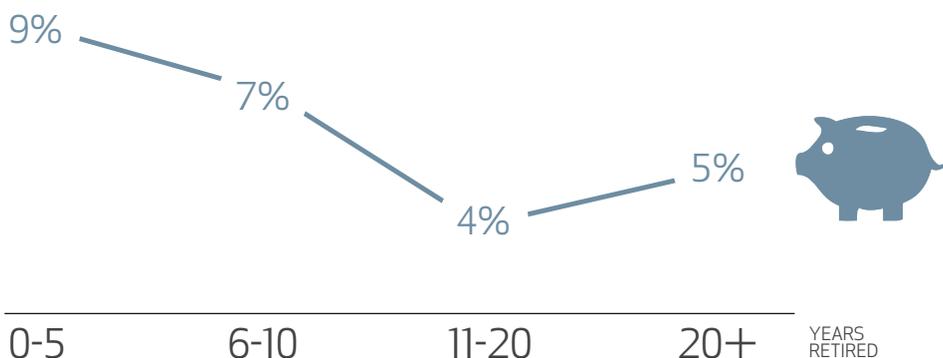


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FINANCIAL CONSTRAINTS

Similarly to health, almost one in ten retirees identified financial constraints as a significant factor affecting their retirement spending. We cannot tell how many of the responses were due to a natural inclination to be conservative versus actual financial constraints, but it is an important observation nonetheless.

RETIREES IDENTIFYING FINANCIAL CONSTRAINTS AS REASON FOR UNDERSPENDING



Are New Zealanders financially secure in retirement?

The good news is that 85% of retirees felt comfortable with their financial situation and almost half of those anticipated leaving an inheritance. Only 15% of those surveyed wished they had done more to prepare for retirement.

One factor contributing to New Zealanders' financial security in retirement has undoubtedly been NZ Super. On average NZ Super covered only 52% of retirees' expenses. This finding is consistent with research undertaken by Ashton and O'Sullivan³ which found NZ Super on its own was below a 'minimum income for healthy living'.

There was, however, some evidence to suggest that those who had retired recently (less than six years) were relying less on NZ Super, whereas it was likely to be more heavily relied on by those who had been retired for a number of years.

What might the future hold?

Over the next 50 years the ratio of New Zealanders over 65 years of age to those under 65 of age will increase from 12% to 27% as the baby boomers continue to retire and life expectancy increases.⁴ There is unlikely to be as much financial support available per person in retirement for future generations.

This is likely to affect both NZ Super and our healthcare system. We have already seen announcements from the United Kingdom, Germany, Ireland and Australia, by way of example, that they plan to systematically increase the eligibility age for financial support in retirement. NZ Funds expects New Zealand will follow suit.

COUNTRIES WITH PLANS TO RAISE THE RETIREMENT AGE



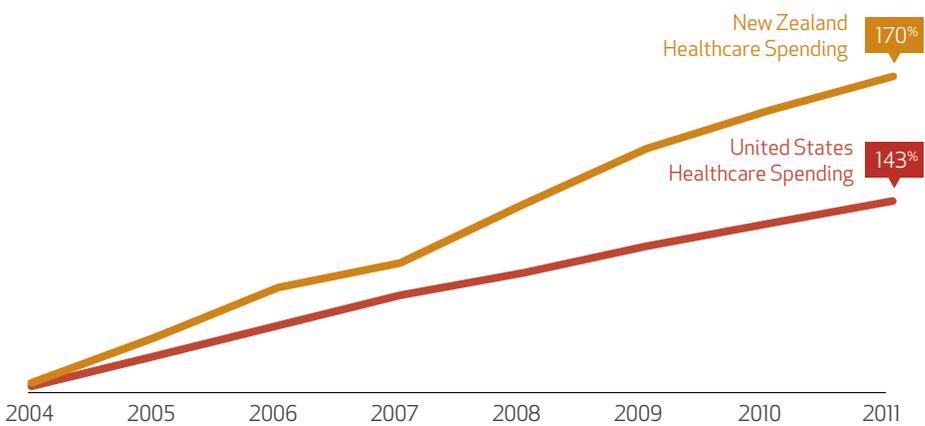
SOURCE: OECD "PENSIONS AT A GLANCE 2009" AND LATER ANNOUNCEMENTS.

* THE UNITED KINGDOM HAS ANNOUNCED THAT THIS TIMETABLE IS LIKELY TO BE ACCELERATED.

Almost half the retirees surveyed (48%) experienced an increase in expenditure due to a health related issue. For most this health issue was first encountered in their 60s and 70s. That is, after they entered retirement and when they were no longer earning. In answering how they might finance future health related expenses 56% mentioned retirement savings while 43% were happy to rely on the public system. 61% of retirees did not wish to put money aside for an unexpected health expense, while 80% either did not wish to use the equity in their home, or did not have sufficient home equity to fund an expense.

Overall the research showed that current retirees rely heavily on New Zealand's extensive and generous public healthcare system. This is undoubtedly the reason why retiring New Zealanders have not faced an upward hockey stick in expenses in their latter years of retirement. Given the pressure demographics will put on our healthcare system, future generations may wish to factor a little more into their retirement budget, for rising health insurance costs or to self insure against future healthcare costs.

GROWTH IN HEALTH SPENDING: NEW ZEALAND AND UNITED STATES



SOURCE: OECD STATEXTRACTS.

Conclusion

While the insights of those already in retirement are an important source of information for younger generations, each retiring generation, and each individual retiree, will face their own unique challenges. With the help of those New Zealanders already in retirement we are now better equipped to understand where miscalculations occur and why. We should also be able to build more reliable financial forecasts by enabling retirees to consider factors which are likely to have a meaningful impact on their financial wellbeing, such as the rising cost of living and their personal health status.

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Investment Analyst

¹ myWealth is NZ Funds' interactive software. It is an easy way for you to estimate how much you may need to save for your retirement, and it will show you how you might build your wealth through your working life. Your KiwiSaver, home, mortgage and other assets can be considered to see how they may all contribute to your future savings. To get free access to myWealth, go to <https://mywealth.nzfunds.co.nz/> or contact NZ Funds.

² Paulin, G.D. & Duly, A.L. (2002). Planning Ahead: Consumer expenditure patterns in retirement. *Monthly Labor Review* 125, 38, and Bernicke, T. (2005). Reality retirement planning: a new paradigm for an old science. *Journal of Financial Planning*, 18(6), 56-61.

³ Ashton, T. & O'Sullivan, J. (2012). A minimum income for healthy living (MIHL) – older New Zealanders. *Ageing and Society*, 32, pp 747-768. Data from this paper was presented by Toni Ashton at the Spending the Savings: Decumulation and Middle-Income Retirement Symposium on 30 November 2012. The Symposium Proceedings was compiled by Dr M. Claire Dale, Research Fellow, The Retirement Policy and Research Centre.

⁴ Statistics NZ. Scenario: medium fertility, low mortality, net migration 10,000pa.