Brent Sheather's RESEARCH

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SAVING FOR YOUR RETIREMENT – DO YOU NEED TO BE A MILLIONAIRE? Part 3

Four weeks ago this column began a three part reality checking exercise relating to the question of how much one actually needs to save for retirement. Part one rehearsed the scare tactics from the fund management sector urging individuals to live in poverty whilst working, so as to save a $1m or so which would apparently facilitate a comfortable retirement. In contrast the modelling outlined in part two suggested that a more modest sum of $350,000 would, with National Super, in all probability support a "no-frills" retirement, as defined by Massey University's Financial Education Centre. In today's third and final instalment we will estimate whether saving a sum of $350,000 is achievable for an individual earning the average wage and then we will assess the income and associated terminal sum required to fund Massey's upmarket "choices" retirement alternative.

So if we need to have $350,000 saved at retirement for this level of income the big question is will saving "just 3%" of our income be enough? To calculate this we will assume, for simplicity, a relatively conservative, constant 40% bonds/60% equities asset allocation. As regards earnings the Statistics Department advises that the average wage in NZ, as at March 2024, was $80,000 per year but as someone aged 21 is likely to be earning less than $80,000 we will again be conservative and assume $60,000 per year. On this basis, an individual starting out in KiwiSaver at age 21, will likely amass a terminal sum, in real 2024 dollars, of around $450,000. Those numbers directly contradict statements from the fund management sector outlined in Part 1. For example "unfortunately, the average Kiwi will only get 60% of their current income (including NZ Super) if they stick to the 3% contribution rate." In fact an individual who retires when earning the average wage of $80,000 per year will likely achieve a terminal sum in 2024 dollars of $450,000 enabling them to derive an annuity stream of around $23,000 pa i.e. with National super for a couple, a total after tax income about equivalent to the estimated 2024 after tax wage.

However let's be realistic: in real life, an individual might begin contributing to KiwiSaver when they start work but withdraw the lot for their first home, sometime in their 30s. If we adjust the model to assume a starting point at age 32 and use the average wage for individuals in the 30-40 age group that produces a more modest terminal sum in 2024 dollars of $370,000. Again that is enough, with National Super, to produce the $826/week needed to fund Massey's "no-frills" retirement.

Next up we will model the savings required to fund the "choices" retirement option outlined by Massey's Financial Education Centre. The Retirement Expenditure Guidelines paper detailing the difference between the "no-frills" and "choices" scenario can be found here. A worst case scenario for a "choices" retirement is a one person household in a provincial area. Massey estimates a weekly cost of $1263 so, with NZ super at $496/week, that leaves a deficit of around $770/week. To produce this level of annuity income, increasing with inflation, the model estimates that a sum of around $800,000 is required. To achieve that terminal sum an individual starting KiwiSaver at age 21 and earning the average wage of $80,000 pa, would need to save around 5% of his/her income, assuming no windfalls from parents. Alternatively, with a more aggressive asset allocation of 75% equities and a lower fee structure of 0.4% the $800,000 objective is possible at just a 3.3% per annum employee contribution level. Again that result is at variance with the dire warnings from the investment experts.

In a previous story NBR subscriber, Lefthander 13323, made the following interesting observation "A third important factor that reduces saving in NZ is the existence of a generous (relative to both average incomes and other countries) taxpayer-funded national superannuation scheme. It is rational for a large proportion of the population (lower income people) to prefer current consumption given the promise of NZ Super in retirement. There is no case to raise taxes to subsidise additional saving when we have already raised taxes to fund NZ super. To those who claim we do not save enough, I say show me who it is that is not saving enough and why that is so."

Earlier in this series we noted one KS provider's lobbying in favour of increasing KS contributions to 12% of earnings. I thought it might be interesting to see what terminal sum and annuity income this outsized savings plan might mean for an individual earning the average wage: the numbers are $1.25m and $1200 per week respectively, both in real terms. If you add National Super for a couple to that last number the individual's earnings in retirement are likely to be well above the average, after tax wage. Is that the objective of saving for retirement – earning much more than when you were working, a time when, as Dr Biggs noted in Part 1, spending decreases substantially? This reality obviously doesn't intrude on the thinking of fund managers: what's likely foremost in the mind of the finance sector is that this level of contribution represents a proverbial goldmine – I calculate that even at just 1%, management fees in real terms, over both the 44 year period contributing to KiwiSaver and the 29 years or so years in decumulation, would total around $300,000. Whilst that proposition would likely represent a comfortable working life and retirement for many members of the investment community the problems with saving 12% in Kiwisaver for NZ Individuals employed in less lucrative jobs are manifest. Most obviously it would likely prevent the individual from getting a mortgage or if he/she did, having enough to live on. So 12% is a recipe for a very austere lifestyle for most. There is also a few glaring risks implicit in an oversized emphasis on KS – firstly what if, as in Australia, NZ Super is means tested? Secondly what if Kiwisaver balances or some part thereof are compulsorily annuitized? Additionally, KiwiSavers must have all their funds with one, probably high cost, fund manager so that's another risk and absolutely at variance with how pension funds invest their money. Last but not least what if you die before retirement? A good friend of mine died recently aged 66 however he lived for today, saved nothing – travelling widely and surfing most days. One of the last things he said was words to the effect that he had had a good life and had no regrets priortising today over tomorrow. RIP Lance. That comment really highlighted the risk of "living for tomorrow". None of us knows what's around the corner and balancing the requirements of living today with the need for a comfortable retirement will depend on your personality type, how much you earn, what you intend to leave to your kids, and how wealthy your parents are.

Disclosure: Private Asset Management doesn't sell KiwiSaver, Brent Sheather isn't in KiwiSaver, however he encourages most people who are not self employed to join.

Brent Sheather is a Financial Advice Provider. A disclosure statement is available upon request. Brent Sheather may have an interest in the companies discussed.