Super Consumers Australia

Realistic spending levels and savings targets for retirement planning

WORKING PAPER: NOT FOR CITATION

Motivation for project

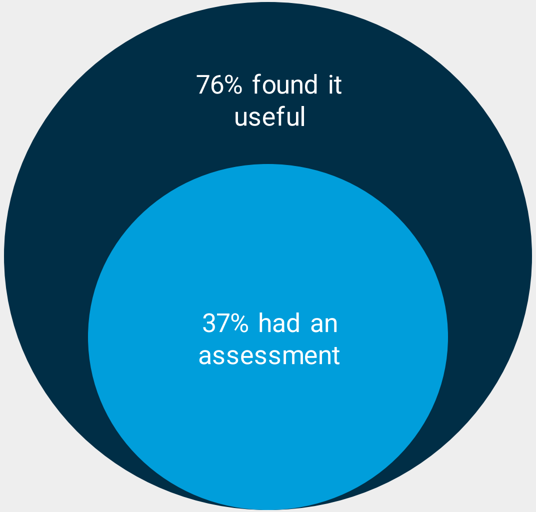
Pre-retirees want to know how much to save for retirement

- We ran a nationally representative survey of 45-80 year olds in 2021
- “How much do I need to save for retirement” was the most researched retirement planning topic among eleven presented to pre-retirees.

Top five most researched topics	Percentage
How much you need to save for retirement	**66%**
Superannuation rules and procedures	61%
Age pension eligibility	44%
Tax rules in retirement	39%
Retirement income products	29%

But most pre-retirees are not accessing financial advice

- Our survey shows most pre-retirees are not having an assessment made of how much they need to save for retirement.
- Those who do typically use a financial advisor and find the assessment valuable.



And many pre-retirees prefer to do their own research

- We identified a group of respondents that take an “engaged DIY” approach to retirement planning.
- This group are confident in their ability to make financial decisions, actively manage their finances but prefer not to rely on financial professionals

ENGAGED DIY
My financial decisions are very important and I am confident enough to do it myself

37%

ENGAGED DELEGATORS
My financial decisions are very important, and I see the value in the expertise of professionals

25%

DISENGAGED
I'm not that interested in my finances

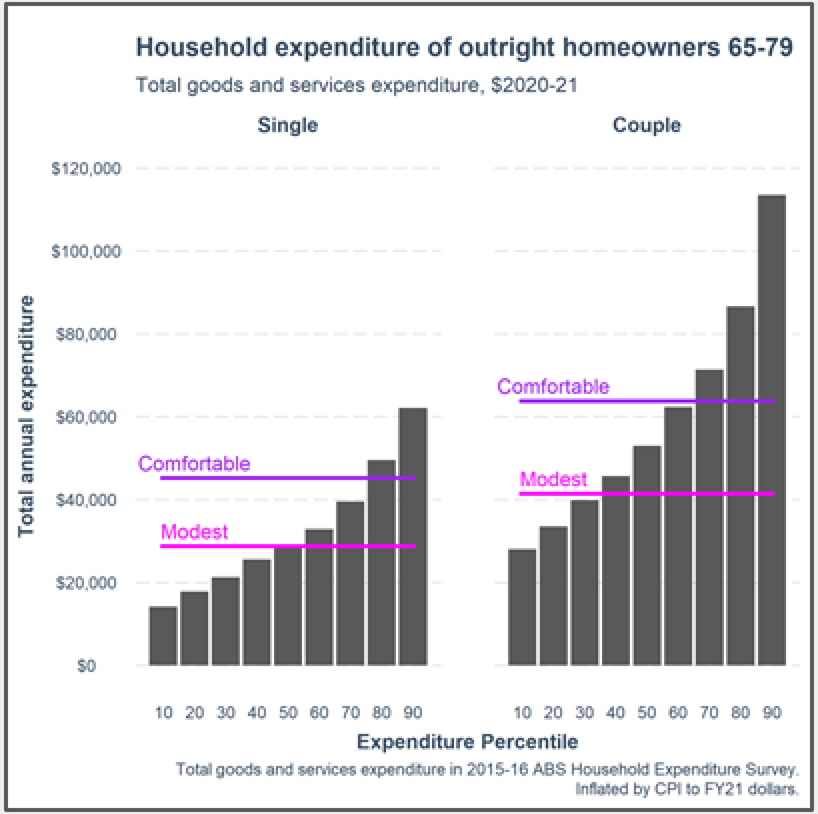
38%

The ASFA standards are widely cited, few recall using them

- The ASFA retirement standards are widely cited by super funds, ASIC MoneySmart, the media and academics.
- They produce a “modest” and “comfortable” standard for homeowners “around” 67 based on budgets designed to suit particular cohorts and tested against consumer panels.
- Our survey found 6% of 45-80 year olds recalled having used them

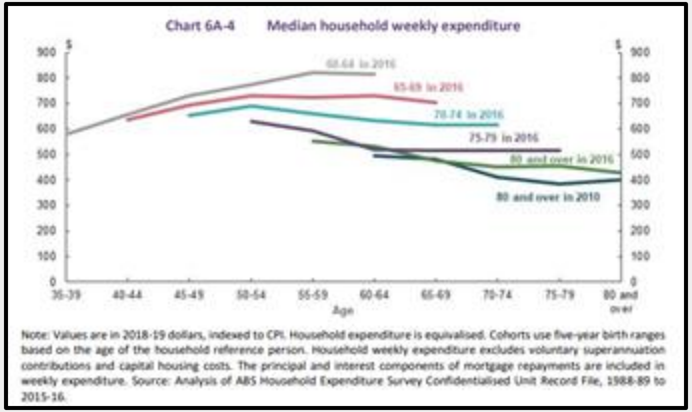
Lack of consistent targeting limits utility

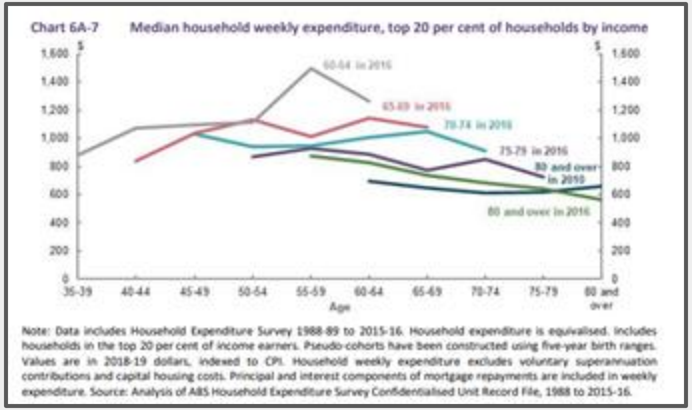
- Comfortable standard consistent with moderately high to very high expenditure (couples vs singles)
- Modest ranges from low to average expenditure (couples vs singles)
- Some important cohorts (middle income couples, low income singles) have no standard that reflects their spending.



Savings targets are inflated, sending the wrong message

- The ASFA savings targets assume your spending grows in real terms throughout retirement.
- The Retirement Income Review found spending has stayed the same or declined for recent retiree cohorts.
- The RIR found a median earner would need an SG rate of 16.5% to save enough for the comfortable standard.
- Savings targets are substantially lower when we assume fixed real spending





No appropriate standards for pre-retirees

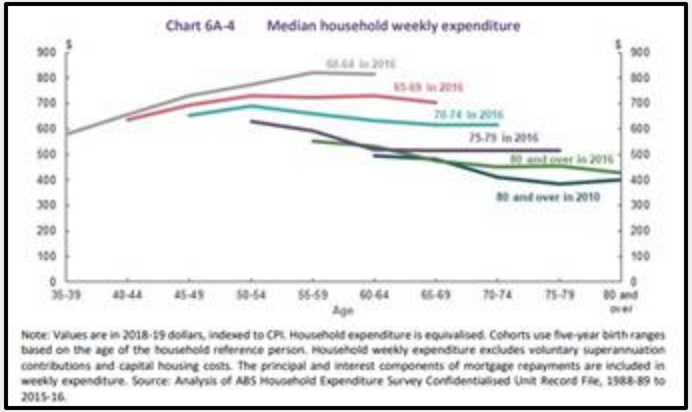
- The ASFA standards target people aged around 67
- Pre-retirees around age 57 may not retire for another ten years
- The cost of a bundle of goods and services will have risen substantially by then
- Our survey found pre-retirees are the most engaged with our draft standards
- Our qualitative research found that engaged pre-retirees tend to begin “focused planning” for retirement in their mid-50’s

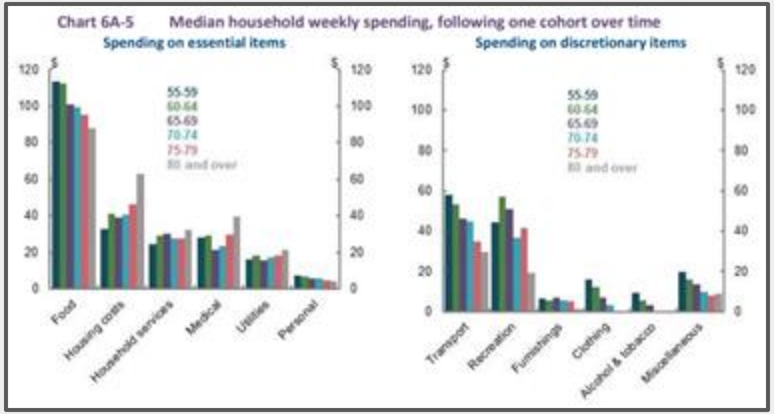
	INTEREST IN RETIREMENT STANDARDS
Total	**53%**
Pre-Retirees	62%
Retirees	31%
Male	53%
Female	53%
45-49	63%
50-54	64%
55-59	66%
60-64	54%
65-69	37%
70-74	29%
75-80	27%

Rationale for approach

Middle and high income people spend the same or less after retiring

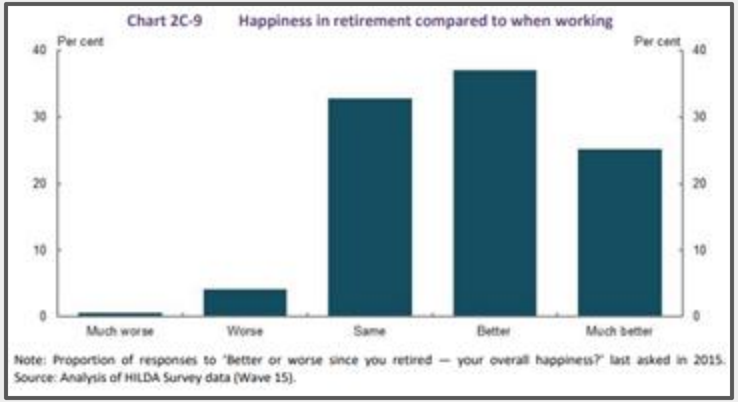
- The Retirement Income Review found spending has stayed the same or declined for recent retiree cohorts.
- They analysed middle and high income cohorts

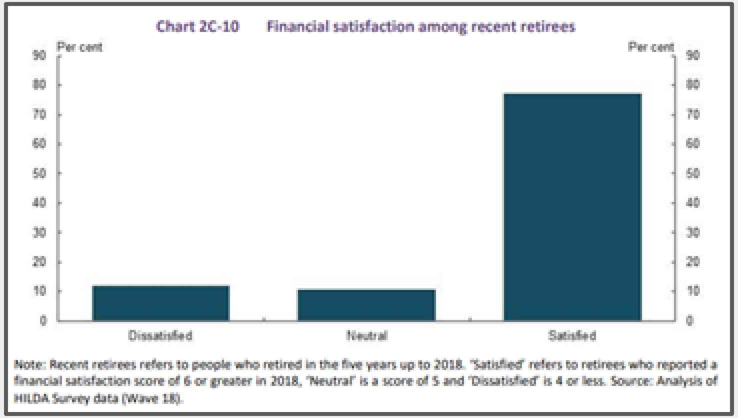




Most retirees are happier and financially satisfied

- A large majority of retirees are happier in retirement than during working life
- The vast majority of recent retirees are financially satisfied
- The main exception are renters

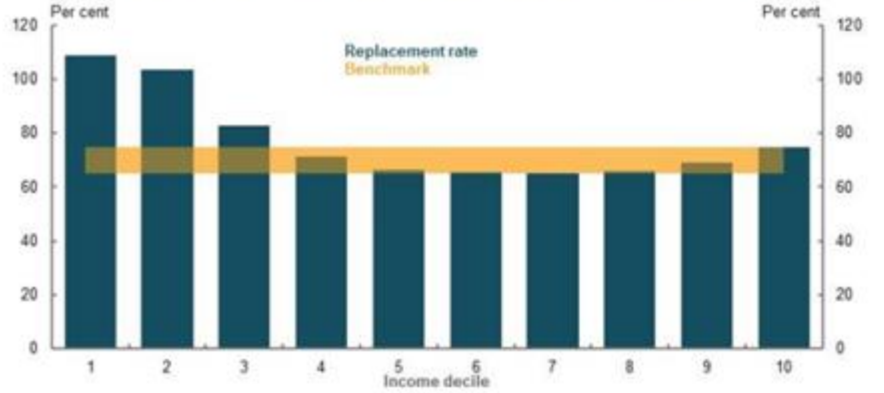




All cohorts of retirees are meeting replacement rates

- The retirement income review found all income deciles were meeting a replacement rate of 65-75% of their working life income.
- This indicates retirees are broadly smoothing consumption into retirement.

Chart 2C-8 Replacement rates for households aged 65-74 in 2017-18



Note: Uses a cohort methodology where households aged 55-64 surveyed in 2007-08 are compared with households aged 65-74 surveyed in 2017-18. This will not be the same household but is broadly indicative given the household belongs to the same age cohort. This approach may include some people who are retired but aged 55-64 and not retired aged 65-74. Incomes from 2007-08 have been inflated using wages, consistent with the review's mixed deflator methodology. The income measure is equivalised disposable household income, which includes actual drawdowns from superannuation. Source: Analysis of ABS Survey of Income and Housing Confidentialised Unit Record File, 2007-08 and 2017-18.

Home-owners have low levels of poverty and fin. stress

- ACOSS and UNSW's "Poverty in Australia" 2020 report found 10% of home-owning over 65s live in income poverty vs 13.6% of the general population.
- For homeowners, the age pension exceeds most poverty lines.
- A large majority of homeowners over 65 are not in financial stress (71%)

Consumers see value in independent retirement standards

- A majority of survey respondents see an “independent, expert superannuation consumer group” as best placed to provide savings targets
- 62% of pre-retirees in our survey expressed moderate or greater interest in our standards (66% of 55-59 year olds)

“I’ve used calculators before, but they are from super funds themselves, so you always wonder. I like that this is based on actual people,it makes it more independent”

Pre-Retiree, Female 58yr

Our approach

- We produce spending levels and savings targets for low, middle and high spending outright homeowners (75% of households over 65)
- We produce targets for pre-retirees (around age 57) and recent retirees (around age 67)
- The construction of our savings targets reflects current retiree spending patterns - we assume constant real terms expenditure through retirement
- Our savings targets incorporate uncertainty in investment returns during retirement to give people confidence to spend

Value add for consumers

- Useful benchmarks for most homeowners, regardless of income.
- Applicable to pre-retirees
- Realistic savings targets
- Provides people with confidence to spend in retirement

Methodology

How we derive the spending levels for recent retirees

1. Analyse equivalised household expenditure (excluding housing costs) of households aged 65-69 years from ABS Household Expenditure Survey 2015-16
2. Set retirement benchmarks at: 30th percentile; 50th percentile and 70th percentile of retiree spending
3. Add in typical housing costs for outright homeowners at each expenditure percentile
4. Inflate all spending forward to 2020-21 by changes in the Consumer Price Index since 2015-16

Key assumptions for recent retiree spending levels

- Age cohort reflects recent retirees -> 71% of household heads are not in the labour force
- Expenditure near the start of retirement is appropriate measure for expenditure through retirement -> conservative, given recent cohort patterns
- Inflating spending by CPI is appropriate -> When we compare the average equivalised ex-housing spending of 65-69 year olds in the 2009-10 HES to the 2015-16 HES, it increases at a similar rate to CPI.

How we derive the spending levels for pre-retirees

1. Analyse equivalised household expenditure (excluding housing costs) of households aged 55-59 years from ABS Household Expenditure Survey 2015-16
2. Set retirement benchmarks at: 30th percentile; 50th percentile and 70th percentile of retiree spending
3. Apply a factor to each benchmark expenditure equal to the observed change in household expenditure for that percentile for the cohort aged 55-59 in the 2003-04 HES and 67-71 in the 2015-16 HES.
4. Add in typical housing costs for outright homeowners at each expenditure percentile
5. Inflate all spending forward to either 2020-21 or 2030-31 (changes interpretation) by changes in the Consumer Price Index since 2015-16

Key assumptions for pre-retiree spending levels

- Factor correctly reflects life cycle decline in expenditure -> Reasonable first pass assumption as reflects change in most recent cohort. Aggregate spending changes combines preferences, cohort specific changes and external factors e.g. GFC. Scope to improve using average of several cohorts or regression approach that separates different factors.
- Inflating spending by CPI is appropriate -> When we compare the average equivalised ex-housing spending of 55-59 year olds in the 2009-10 HES to the 2015-16 HES, it increases at a similar rate to CPI.
- CPI projection is appropriate -> We use the midpoint of the RBA target band

How we derive the savings targets

- We assume the household wants to maintain spending in real terms from age 65 to age 90.
- We account for age pension eligibility
- We account for investment uncertainty using a stochastic model (bootstrap distribution using parameters based on historical returns)
- We set a level of confidence that savings will last to age 90 and run the model

Key assumptions for the savings targets

- We use 65 as the beginning of retirement based on recent survey data on average retirement age
- We use 90 as the end of retirement based on cohort estimates of life expectancy in the 2015 Intergenerational report
- We assumed CPI of 2.5%, the midpoint of the Reserve Bank of Australia's inflation target band.
- We assumed nominal wage growth of 4%, consistent with the 2021 Intergenerational report.
- We assumed the user is invested in a 60/40 growth/defensive split balanced fund in retirement
- Based on historical returns for an Australian portfolio we use a net return of 5.6% during the retirement phase and a portfolio standard deviation of 10%.
- We assumed people are in receipt of any Age Pension they were eligible for. We applied the age pension eligibility test based on an assumption of $25,000 in assets outside of super (consistent with the ASIC MoneySmart retirement calculator).

Results

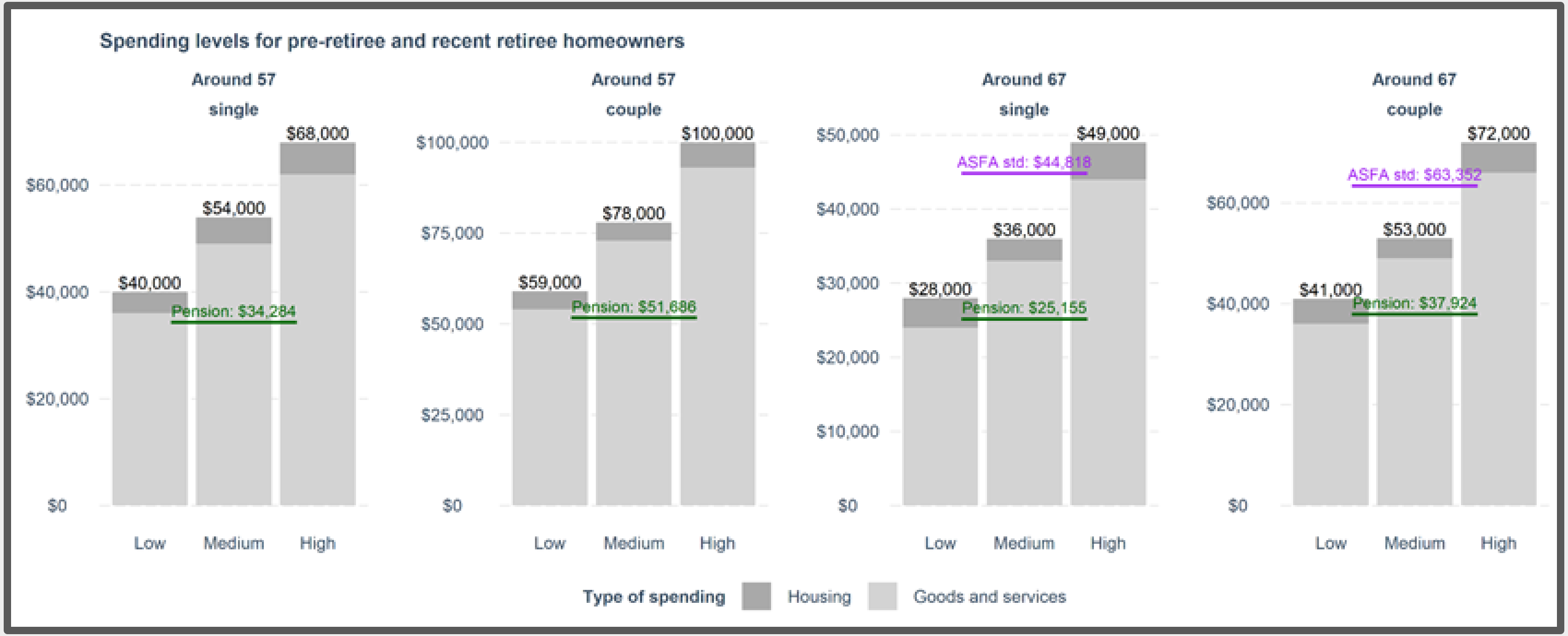
Our current spending levels and savings targets

- We provide fortnightly and annual spending levels to help consumers benchmark to their household spending
- Our savings targets provide a consumer with 90% confidence that they can spend at the level given until age 90.
- Here the “around 57” levels and targets are in 2031 dollars, we are also exploring a today’s dollars version.

Spending levels and savings targets for pre-retirees and recent retirees

			Fortnightly spending	Annual spending	Savings target
Aged around 57	**Single**	**Low**	$1,538	$40,000	$94,000
		Medium	$2,038	$53,000	$345,000
		High	$2,615	$68,000	$902,000
	Couple	**Low**	$2,269	$59,000	$132,000
		Medium	$3,000	$78,000	$469,000
		High	$3,846	$100,000	$1,230,000
Aged around 67	**Single**	**Low**	$1,077	$28,000	$70,000
		Medium	$1,385	$36,000	$231,000
		High	$1,885	$49,000	$712,000
	Couple	**Low**	$1,538	$40,000	$88,000
		Medium	$2,038	$53,000	$314,000
		High	$2,769	$72,000	$975,000

How our current spending levels compare to benchmarks



What about renters?

- Renters make up around 15% of households aged 65+
- Income poverty (41%) and financial stress (63%) are prevalent in this cohort
- Using actual expenditure to produce targets is inappropriate as even middle income renters do not spend much more than relative poverty levels and exhibit substantial financial stress.
- Aspirational targets may also be inappropriate as existing renters may not be able to afford them.

What about people who retire with a mortgage?

- Household with a mortgage make up 10% of households aged 65+
- For those that intend to pay off their mortgage with super, they can subtract the outstanding amount from their super balance
- They can then benchmark the remaining balance against the standards

Further research

Potential enhancements

- Consider custom CPI inflator for spending levels
- Consider inclusion of (aspirational) renter standards
- Produce consumer guidance based on insights from qualitative research
- Incorporate stakeholder feedback where appropriate