Extended Abstract:
REALISTIC SPENDING LEVELS AND SAVINGS TARGETS FOR RETIREMENT
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Background

One of the key observations of the recently completed Retirement Income Review was that complexity, misconceptions and low financial literacy have resulted in people not adequately planning for their retirement or making the most of their assets when in retirement.

Our research sought to better understand how consumers go about planning for retirement and the difficulties they face. Finally it attempts to displace one of these barriers by producing spending levels and an associated reliable savings target which consumers can use in planning to align their pre and post retirement standard of living.

The Review found issues with the quality of retirement phase assistance. It pointed to “major shortcomings” with one of the main retirement targets often cited in the space, the ASFA standard. Most significantly, its ‘comfortable’ standard is too high for people on middle to low incomes to achieve without substantially reducing their consumption during working life. In addition, the methodology used to produce savings targets does not accord with the evidence on retiree spending patterns and leads to overinflated targets.

Our research, based on a nationally representative survey of 45-80 year olds run in 2021 found that knowing how much to save for retirement was the most difficult aspect of planning for 26% of respondents. This was the most commonly nominated area of difficulty among a list of 11 common retirement planning activities. Only 37% of respondents had undertaken an assessment of how much they needed for retirement, of this group 76% found the assessment useful. This quantitative research indicated that consumers are finding these assessments difficult to undertake, but once they had undertaken them, they were very useful. If we could improve the quality and accessibility of these assessments then we could help consumers with a major barrier in retirement planning.

Super Consumers Australia undertook a research project to produce more realistic and therefore useful spending levels and associated savings targets for retirement. We used ABS data to produce spending levels for recent retirees (around age 67) and pre-retirees (around age 57) based on their actual expenditure. We produced spending levels for singles and couples based on whether they have low, medium or high levels of spending relative to their peers. We also commissioned a nationally representative survey and in depth interviews to understand how people plan for retirement and how they responded to and used our draft spending levels and targets.

We have taken the feedback from these research sessions and various external stakeholders to produce guidance that acts as an introduction to consumers to spur deeper consideration of their retirement savings targets. The intention is that this information will shift the narrative on saving to retirement towards more realistic targets and provide useful guidance to people on what levels of savings different levels of spending in retirement require.

Method

We produce annual expenditures for groups of recent retirees (around 67) and pre-retirees (around 57) based on weekly expenditure data from the ABS Household Expenditure Survey (HES) 2015-16. The groups are single and couple homeowners who we classify as being low, middle or high expenditure households. Those levels reflect the 30th, 50th and 70th percentiles of expenditure.

For both groups it was first necessary to inflate their expenditure from FY16 to the point at which the user is intending to retire. For the recent retiree standard, this was the present so we inflated their expenditure (both housing and ex-housing) by CPI to the end of FY21. For the pre-retirees it was ten years from now, so we inflated their expenditure by CPI to the end of FY31. We then applied an adjustment based on the observed decline in spending for 55-59 -> 67-71 year olds between the 2003-04 HES and the 2015-16 HES. This allows for a lifecycle decline in spending.

We estimated ex-housing and housing expenditure separately. The ex-housing expenditure sample was of either 65-69 year old or 55-59 year old single family households. We derived the equivalised expenditure percentiles (weighted by the survey weights) and then applied a factor of 1.5 (the ABS standard) to derive the couple expenditure. For the housing expenditure the sample consisted of 65-74 year old singles and couples that were outright homeowners or homeowners with a mortgage. We subtracting mortgage interest repayments from their housing costs and applied an equivalisation factor of 1.1 for couples housing expenditure. We derived the equivalised expenditure percentiles for housing costs and then applied the factor of 1.1 for couples. Finally we combined the ex-housing and housing expenditure to produce total fortnightly and annual household expenditures for our groups.

We produce savings targets that provide an estimate of the savings required to sustain spending at one of our low, medium and high spending levels through retirement. Below we detail the rationale for each of our major assumptions and explain the process used to produce the savings targets.

Major assumptions for savings targets:

- We use 65 as the beginning of retirement based on the Retirement Income Review analysis of recent surveys that finds the average retirement age is generally between 62-65[1] and a recent ABS survey which found the average intended retirement age is 65.5[2]
- We use 90 as the end of retirement based on cohort estimates of life expectancy from age 60 and 70 in the 2015 Intergenerational report, which indicate 90 is a conservative estimate for men and accurate for women.[3]
- 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 Treasury estimates of long-term nominal wage growth as set out in the 2021 Intergenerational report.[4]
- We assumed the user(s) were invested in a 60/40 growth/defensive split balanced fund based on Productivity Commission findings, reproduced in the Retirement Income Review.[5]
- Based on historical returns for an Australian portfolio with those weights and reasonable assumptions for fees and tax, we chose a rate of return net of tax and fees during accumulation of 5% and a net return of 5.6% during the retirement phase. We chose a portfolio standard deviation of 10%.
- We assumed people were 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).

We applied a bootstrapped model for investment returns based on the assumptions above to produce each of the savings targets, producing versions for 50%, 80%, 90% and 95%. When we ran interviews on the draft retirement standards participants tended to prefer the 90% target and were confused by the concept of confidence levels. Therefore we now present the 90% target and leave the explanation of confidence level to the text.

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[1] Retirement Income Review (2020) p. 63

[2] ABS (2020) "Retirement and Retirement Intentions, Australia, 2018-19"

[3] 2015 Intergenerational Report `Australia in 2055` (2015) p. 5

[4] 2021 Intergenerational Report `Australia over the next 40 years` (2021) p. 11

[5] Retirement Income Review (2020) p. 516

Results
We present below the draft spending levels and savings targets as of November 2021. Our intention is that people can use these figures to benchmark their expenditure to an appropriate target for the maintenance of living standards in retirement.

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