

Tax Working Group Public Submissions Information Release

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New Zealand's Savings Health Check

Introduction

New Zealand has a poor savings history and analysis of household balance sheets and savings patterns indicate that many New Zealanders may be unhappy with their retirement. Given the importance of this issue against the backdrop of an aging population and the increasing demands on public finances, we believe the government should undertake a more formal review of the savings situation in this country.



New Zealand's household savings rate is negative

While household assets and wealth have been increasing recently due to increasing house prices and surging equity markets, New Zealand's household savings rate has actually been negative over the past few years. Savings data both here and overseas include an allowance for depreciation on houses, but even after taking this out of the equation, the household savings rate in New Zealand is still very low at just under 1 per cent.¹ This compares to savings rates of about 4.6 per cent for Australia and around 5 per cent for the USA and Europe (including the effects of depreciation on housing).

Household savings rate by country

OECD data	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Australia	1.9%	8.3%	6.1%	7.4%	8.1%	6.8%	7.3%	7.5%	5.6%	4.6%	n/a
Euro Area	6.6%	6.8%	8.0%	6.5%	6.0%	5.7%	5.8%	6.0%	5.6%	5.3%	n/a
USA	3.1%	5.1%	6.4%	5.8%	6.2%	7.9%	5.2%	5.9%	6.3%	5.0%	n/a
NZ	0.1%	-1.8%	1.4%	2.4%	2.6%	0.9%	0.7%	-1.1% (e)	n/a	n/a	n/a
NZ (RBNZ data)*	-4.1%	-0.4%	-2.2%	1.2%	2.1%	2.4%	0.5%	0.1%	-1.5%	-1.3%	-2.8%

Source: OECD. <https://data.oecd.org/hha/household-savings.htm>. RBNZ data was used in the bottom row of the table because the NZ data from OECD is blank for 2015, 2016 and 2017. Found here <https://www.rbnz.govt.nz/statistics/m6>

What is a country's household savings rate? The household savings rate is equal to gross household disposable income less household final consumption expenditure and consumption of fixed capital. Essentially when a country's savings rate is negative, households in aggregate are spending more than they are earning. This means they are drawing on current savings or using debt to fund current spending.

Why does it matter? Household saving is a primary domestic source of funds to finance capital investment, which is a major driver of long-term economic growth.

¹RBNZ data on Consumption of Fixed Capital, 2017.



What's the current situation for New Zealand households?

While national measures of savings can be indicative of a problem, it is even more instructive to look at the individual situations of many households. If we compare New Zealanders to Australians – the median Australian household has over \$200,000 more wealth after we deduct their loans than the median New Zealand household.² However, after accounting for the more generous universal NZ Super pension, New Zealand households and Australian households are roughly neck-and-neck based on current savings. The real differences are coming though. This is because Australians are saving considerably more per year and investing it more effectively. Their aggregate household savings are 6 to 7 per cent higher per year and their superannuation contributions are currently 9.5 per cent versus around 6 per cent for most KiwiSaver investors.

In addition, roughly 65 per cent of Australian Superannuation is invested in growth assets compared to KiwiSaver which has only 48 per cent in growth assets.³ The situation is even more dramatic looking at KiwiSaver default funds, which have only 15 to 25 per cent invested in growth assets. New Zealand's lower savings rate and preference for more conservative assets will ultimately result in large differences at retirement – as explained later in this report.

Massey University and Westpac produce a regular survey showing how much one-person and two-person households are spending during retirement. They then group different expenditure levels into what they call a *Choices* retirement and a *No-Frills* retirement. They found a two-person Metro Household would spend roughly \$57,000 p.a. for a *Choices* lifestyle during retirement. A more detailed analysis of the Massey expenditure data shows that expenditure on “freedom” related lifestyle expenditures as opposed to “core needs” is around \$190 per week or \$9,880 per year for a two-person household. This appears to include all domestic and overseas travel, eating out and leisure activities which likely include activities such as club memberships, movies, etc.

We believe this expenditure level may be understating what a true *Choices* retirement looks like. For example, the data appears to only provide for a couple to have one modestly priced meal out per week. It also does not allow much for travel – even smaller trips within New Zealand. Adjusting for these types of expenditures, and acknowledging the shift in lifestyle expectations amongst younger generations, we would argue a true *Choices* or what we are calling a *Choices Plus* lifestyle, could require an extra \$10,000 a year in expenditure.

² Stats NZ Household Net Worth Statistics: Year ended June 2015. ABS Household Income and Wealth Distribution 2015-16.

³ Morningstar KiwiSaver Survey December Quarter 2017.



What's the current situation for New Zealand households?

The Massey report also shows that based on their Metro *Choices* lifestyle, a couple needs to save about \$486,000 (in today's dollars) to supplement the government pension. Based on our view of a comfortable retirement, this figure would have to be closer to \$630,000 if a couple were to retire today, and about \$955,000 if they were to retire 20 years from now.

Of course, those who make more income typically spend more in their retirement. Abey and Ford address this issue in their book "How Much is Enough?" which provides a range of learnings for all households as to how to balance investments with aspirations, to achieve financial security and personal well-being. Arun Abey was a founder of the very successful Ipac Securities, a holistic financial planning firm which expanded from Australia to Asia, Europe and South Africa. They provide a rule-of-thumb that assuming the mortgage is paid off, most couples need around 75% of their final year's salary to sustain a good lifestyle in retirement. They also express this rule in terms of a multiple of your final year's salary. Below we have reproduced their table from a New Zealander's perspective, averaging the results for men and women – noting that women have longer life expectancy and hence require more savings. This rule-of-thumb has a number of critical assumptions.

- First, that you are happy to consume all your liquid savings in retirement and leave your house as the only asset in your estate. We find many clients who prefer to live off the income from their savings and are uncomfortable drawing down the capital – this would of course require a substantially greater savings balance to see you through retirement.
- Second, that your investments generate a 5 per cent return after inflation. Any change in this number has a very material impact on the savings required. For example, if you invested your savings in term deposits and only received a return around the inflation rate, the lump sum you would require would be over 40 per cent higher. This reflects the impact of compounded returns over the life of your retirement and the fact that you are using your investment returns to fund a larger part of your lifestyle.
- Third, the rule is most relevant for middle income earners and assumes a zero pension. In New Zealand, the universal NZ Super pension provides for a substantial safety net for New Zealand households. We provide a revised estimate of the rule-of-thumb adjusting for the impact of NZ Super. For high income earners, who tend to save a high proportion of their income, the 75 per cent rule may be overly generous, but this will depend on their own lifestyle expectations.



What's the current situation for New Zealand households?

Abey & Ford's table adapted for New Zealand investors

Desired retirement age	Salary before you stop work	Lump sum required	Lump sum required (Assuming NZ Super is Collected from age 65)	Multiple of final salary
50	\$50,000	\$879,396	\$523,447	10
	\$100,000	\$1,758,791	\$1,402,843	14
	\$150,000	\$2,638,187	\$2,282,239	15
55	\$50,000	\$816,719	\$405,255	8
	\$100,000	\$1,633,439	\$1,221,974	12
	\$150,000	\$2,450,158	\$2,038,693	14
60	\$50,000	\$744,268	\$268,628	5
	\$100,000	\$1,488,535	\$1,012,896	10
	\$150,000	\$2,232,803	\$1,757,163	12
65	\$50,000	\$660,516	\$110,692	2
	\$100,000	\$1,321,032	\$771,208	8
	\$150,000	\$1,981,547	\$1,431,723	10
70	\$50,000	\$563,701	\$94,467	2
	\$100,000	\$1,127,403	\$658,169	7
	\$150,000	\$1,691,104	\$1,221,870	8

Table assumes life expectancy of 90.



Households may have to increase savings rate to have a comfortable retirement

The median New Zealand household currently has around \$62,000 in financial assets. Assuming retirement is 20 years away, at age 65 their Metro *Choices* lump sum target is \$688,000 and their *Choices Plus* target is \$955,000.⁴ Below we have calculated the savings contribution rate to achieve these targets assuming you consume all your savings in retirement (i.e. there is no buffer for longevity). This shows that relative to the current average KiwiSaver contribution rate of 6 per cent, the actual target contribution rate would have to be 11 per cent for a *Choices* lifestyle and 17 per cent for a *Choices Plus* lifestyle assuming you invest in a growth oriented fund with target returns of 8 per cent per annum before fees and tax. However, if you adopt a far more conservative strategy with a target return of 6 per cent per annum before fees and tax, then the annual contribution rate would need to increase to circa 17 per cent for the *Choices* Lifestyle and 26 per cent for the *Choices Plus* lifestyle.

It's important to note that we are not advocating all additional savings are invested into a person's KiwiSaver account. Because there are currently no tax benefits for additional KiwiSaver contributions above \$1,042.86 and the fact that your money is locked up until age 65, it may make more sense for a person to invest their additional savings into a professionally managed diversified PIE Investment Fund or other investment vehicle.

Required savings rate for median household – Growth Investor⁵ vs. Conservative Investor⁶

Growth Asset Allocation

Median Financial assets	Median Household Annual Salary (2017)	Desired Retirement Type	Desired Retirement Expenditure (incl. NZ Super)	Required savings rate as % of income	Required savings p.a. (\$)
\$62,000	\$86,000	<i>Choices +</i>	\$67,000	17%	\$14,620
\$62,000	\$86,000	<i>Choices</i>	\$57,000	11%	\$9,460

⁴ Stats NZ Household Net Worth Statistics: Year ended June 2015. Extrapolated to estimated 2018 figure by assuming 8% p.a. return on non-financial assets over past 3 years. Milford internal calculations were used to solve for the lump sum value needed for today's median household to fund a *Choices* and *Choices Plus* retirement upon reaching age 65.

⁵ Growth Asset Allocation assumes 8% p.a. gross investment return pre-retirement and 7% p.a. gross investment return during retirement. Fees and tax reduce gross return by 2% p.a.

⁶ Conservative Asset Allocation assumes 6% p.a. gross investment return before and during retirement. Fees and tax reduce gross return by 2% p.a.



Households may have to increase savings rate to have a comfortable retirement

Conservative Asset Allocation

Median Financial assets	Median Household Annual Salary (2017)	Desired Retirement Type	Desired Retirement Expenditure (incl. NZ Super)	Required savings rate as % of income	Required savings p.a. (\$)
\$62,000	\$86,000	<i>Choices +</i>	\$67,000	26%	\$22,360
\$62,000	\$86,000	<i>Choices</i>	\$57,000	17%	\$14,620

In addition to these target savings you need to pay off your house. This is a major annual outlay for many New Zealanders. Statistics New Zealand's 2015 data tells us that the average household with a mortgage, is paying a little over \$400 per week in mortgage repayments.⁷ Assuming an outstanding loan term of 20 years, this would imply total repayments of \$415,000 or principal outstanding of \$262,500.

⁷ Stats NZ Household Economic Survey June 2015.



So how do we fix this problem?

At a national level

At an individual level people need to be looking at how to increase their savings and ensure those savings are effectively invested.

1. Increase our savings rate

Although KiwiSaver has been a fantastic success, there is still room for improvement. Before he was Finance Minister, Grant Robertson said he'd like to see KiwiSaver contribution rates lifted from 3 per cent to 4.5 per cent (story [here](#)). The problem with this is a certain part of the population cannot afford to contribute more and hence such a policy can be a pretty blunt instrument.

The above table shows the median New Zealand household will have to save at least 11 per cent of its income to achieve a comfortable retirement. However, the average person contributing to KiwiSaver is currently only saving around 6 per cent of their salary (including employer contributions). This means they would need to roughly double their annual savings.

A more effective way to encourage people to save more to KiwiSaver than the minimum 3 per cent would be to incentivise them to do it. For example, allowing people to make tax-deductible contributions (or contributions out of pre-taxed income), capped at a certain amount each year, to their KiwiSaver account. Currently, the median New Zealander is earning about \$49,000 per year,⁸ yet anyone earning over \$35,000 has no tax incentive to contribute more than the minimum 3 per cent to KiwiSaver. Australia, the US, the UK and Canada all have stronger forms of tax incentives to encourage extra retirement savings – and all these countries have higher savings rates than New Zealand (see table on page 2).

⁸Stats NZ median weekly earnings from paid employment, June quarter 2017



So how do we fix this problem?

2. Get asset allocation right

Making matters worse, the small amount we are saving is being invested too conservatively. 81 per cent of KiwiSaver members have 10-plus years until retirement, yet only 32 per cent of KiwiSaver money is invested in growth oriented funds.⁹ This is a huge misalignment because growth funds will almost certainly outperform conservative funds over long time periods.

For example, the average KiwiSaver default fund (which is about 80 per cent invested in bonds and cash) delivered a return of 5.4 per cent per annum over the first 10 years of KiwiSaver compared to the average KiwiSaver growth fund which delivered 6.7 per cent per annum.¹⁰ And this period includes a major market downturn which typically favours conservative funds. If you extrapolate these returns forward, a 25-year-old investor would be over \$200,000 better off at retirement simply by choosing a growth fund instead of a default fund (see graph on following page). That's roughly \$10,000 more of annual retirement income each year. The better performing KiwiSaver growth funds have done even better, with the top quartile of managers delivering 8.5 per cent per annum over the first ten years of KiwiSaver.¹¹ This illustrates how getting asset allocation right will have a very significant impact on the quality of New Zealanders' retirement lifestyles.

⁹ Morningstar KiwiSaver Survey September Quarter 2017 & IRD Monthly KiwiSaver Stats.

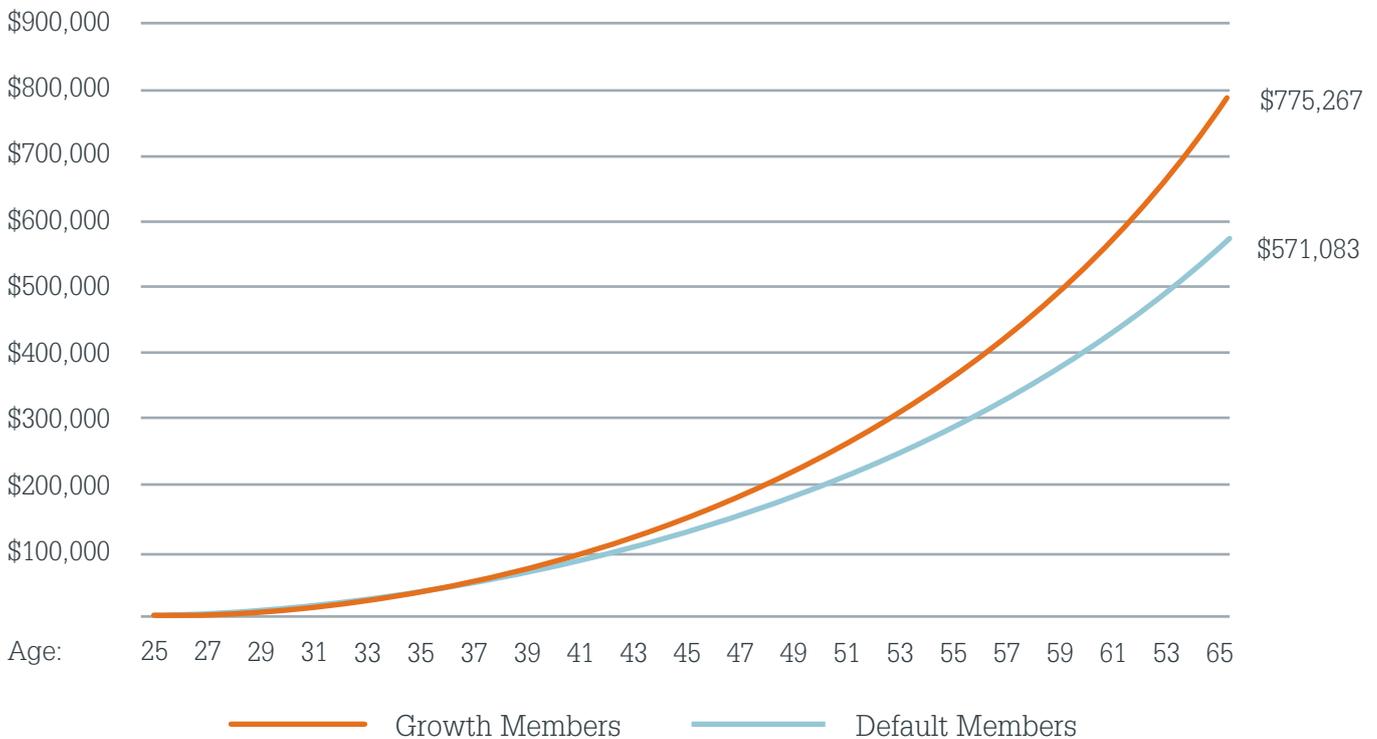
¹⁰ Morningstar KiwiSaver Survey September Quarter 2017. After fees and before tax.

¹¹ Morningstar KiwiSaver Survey September Quarter 2017. After fees and before tax.



So how do we fix this problem?

Growth (6.7%) vs. Default (5.4%) at retirement



Calculation assumptions: Starting gross salary at age 25 of \$50,000, \$0 starting KiwiSaver balance, 3% employer and employee KiwiSaver contributions, no withdrawals, no additional contributions, 2.5% p.a. salary growth, returns are after fees and before tax, lump sum not adjusted for inflation.

Comparing to Australia again, in total, their superannuation money is heavily weighted to higher returning growth assets with roughly 65 per cent invested in equities.¹² This compares to Default KiwiSaver funds which tend to allocate 15 to 25 per cent in equities. New Zealanders also tend to hold a substantially higher proportion of their non-KiwiSaver assets in cash and term deposits, thereby weighing down aggregate investment returns.

¹² ASFA Superannuation Statistics December 2017.



So how do we fix this problem?

	Bank Deposits	Managed Funds & Super	Managed Funds / Bank Deposits ratio
Australia (\$b AUD):	\$1,024	\$3,231	3.1x
New Zealand (\$b NZD):	\$164	\$221	1.3x

Sources: RBNZ - June 2017 - C22 table (household balance sheet) & T40 table (Total FUM) & T43 table (KiwiSaver) - \$152 managed funds + \$69 Superannuation. RBA - June 2017 - Table E1 (Household and Business balance sheets) & Table B18 - (Managed Funds) - \$3,231 total managed funds Including super.

Therefore, not only are Australians getting wealthier through higher savings, they are investing in a much smarter way for retirement – creating a double whammy to increase wealth creation.

At a national level

We believe the government should do a detailed study of individual savings patterns and retirement requirements. Their report should include a clear statement on the sustainability of NZ Super and the sorts of pensions that can be provided by the government over a long period of time. It is important that the public know how much Super they can rely on so they can plan accordingly. We also believe there is a strong case for savings-based tax incentives as in other higher-saving developed economies. This would encourage additional retirement savings and help reduce our negative national savings rate. Lastly, the government should consider the adoption of an aged-based approach to Default KiwiSaver fund enrolment. This would help ensure younger investors with long investment time horizons are being allocated to more growth oriented investment strategies.

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