HOLM TRUTHS

Down to earth advice for savers and investors from independent investment commentator Mary Holm

AUTUMN 2005

Moving the goalposts

One of the oft-quoted rules about setting goals is to make them realistic.

If a sports coach tells a young woman that to get into the Olympics she must trains four hours a day, she may well give up. If he says 30 minutes of daily training should get her into the top club team, she is more likely to rise to the challenge.

The same is true of retirement savings goals. If you've ever worked through a formula or calculator that shows you need to save a huge portion of your income from now until retirement, you may have turned your back on the whole topic. It's just too hard.

A more positive way of thinking is that, even if you save much less than suggested, you will clearly be better off than with no savings at all.

Another idea is to consider how working part-time in the first five or ten years of retirement can reduce your required savings at 65 – without reducing your income during retirement.

An increasing number of people are continuing to work in paid employment, at least part-time, after their 65th birthday. In fact, about a quarter of 65-69 year olds now work.

Many do if for social reasons, or because they want the challenge. But they also find that it can make a big difference financially – depending, of course, on how much they earn, and for how long.

Let's look at the situation for Jack, a single 50-year-old with no retirement savings who expects to retire at 65.

He would like an annual after-tax retirement income of $30,000, including his after-tax $13,300 of NZ Super, until age 86.

That age is about five years past the average 65-year-old male's life expectancy – just in case Jack turns out to be long-lived. If he lives on past 86, he will be content with just NZ Super.

• If he stops work completely at 65, he will need to save $274,000. He must put aside $15,100 a year until retirement.

• But if he earns just $5,000 a year for five more years after 65, his required savings at 65 drop to $250,000. That means putting aside $13,800 a year – somewhat easier.

• And if he earns $20,000 a year for ten more years after 65, the savings target is only $96,000. He would need to save only $5,300 a year – not much more than a third of the original figure. For more examples, turn the page.

(CONTINUED PAGE 2)

WHAT ABOUT COUPLES?

The examples in this article also work for couples, except that NZ Super is about $8,000 more a year, after tax. So you would get income of $38,000 a year.

Unless you are both in poor health, you are best to use the graph and table for retirement income continuing until 90.

Now let's look at Jill, who is in a similar situation, except that women tend to live longer than men. Five years past the average 65-year-old female's life expectancy takes us to 90.

That means Jill is likely to draw retirement income for longer, so she needs to save more.

Still, she too can considerably cut her required savings by planning to work part-time after 65, as shown below.

How might Jack and Jill earn the post-65 money?

In some cases, by continuing their current work part-time. Many people, though, find that effective age discrimination prevents that.

For them, retirement preparation might include gathering information or developing skills or clientele for new part-time work.

They might teach their work skills or hobby in adult courses, or mow lawns, alter clothes, bake special cakes, become a home handyman… the possibilities are endless.

Another way to create income is by using the equity in a mortgage-free home. See "Using that Equity" on the back page.

3 QUESTIONS

1. Do you want more than $30,000 a year?

If you double the total savings numbers in the graphs and the annual savings numbers in the tables, you'll get income of $46,700 a year including NZ Super. If you triple the numbers, you'll get income of $63,400 a year.

2. What if you already have some retirement savings?

If you are already halfway to the savings goal – meaning you have savings that you expect will grow to half the required level by the time you turn 65 – your additional saving will need to be half the annual savings amount each year.

If you are a quarter of the way there, you will need to save three-quarters of the amount each year.

3. How does inflation affect it all?

Our numbers assume that the return on savings before and after retirement is 2.5% a year, after fees, tax and inflation.

Your "nominal" return (before taking inflation into account) will be higher. So your actual savings and your annual income in retirement will be higher than shown here.

But your "real"(inflation-adjusted savings) and income are given here.

Confused? The main point is that you can treat all the numbers as being worth what they are worth today.

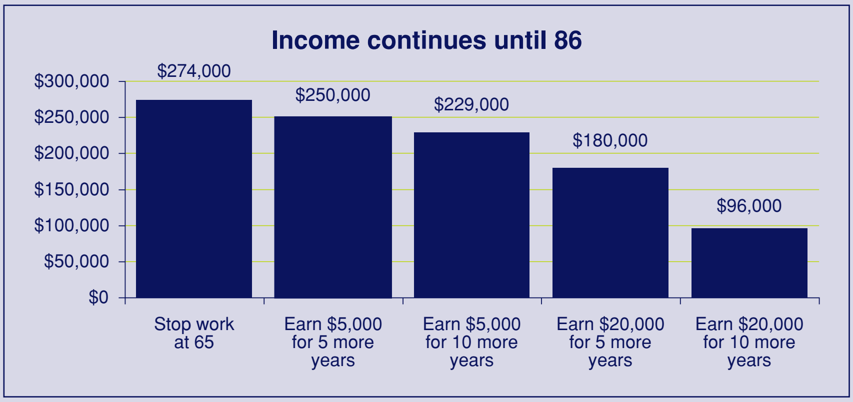
We also assume that NZ Super will grow by inflation. Currently, it grows a little faster, by the average growth in wages.

"Man is so made that he can only find relaxation from one kind of labour by taking up another."

Anatole France, 1844-1924, "The Crime of Sylvestre Bonnard"

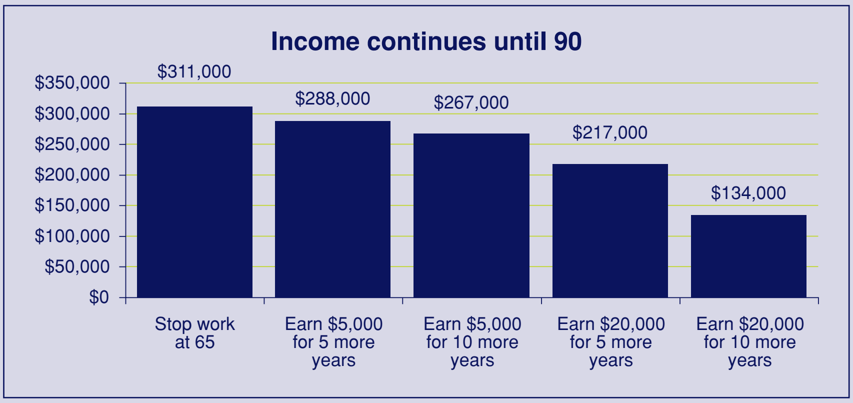
MAKING IT EASIER

Savings needed at 65 to receive income of $30,000 a year after tax, including NZ Super at single rate



Annual savings to get to goal, with $30,000 income until 86

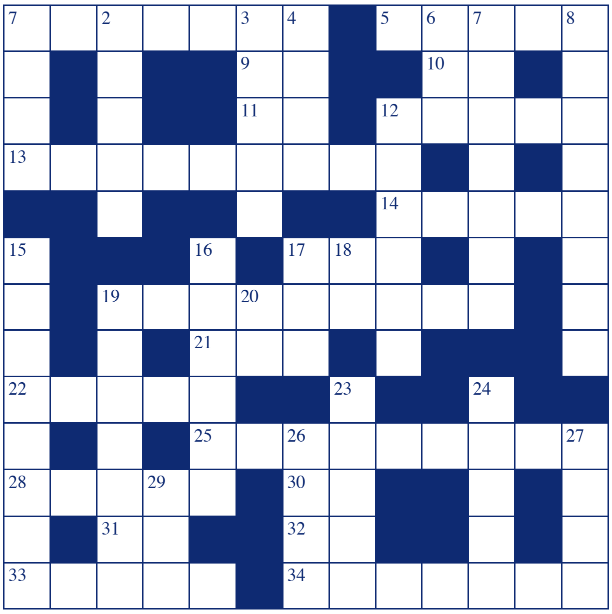
Age	Stop work at 65	Earn $5,000 for 5 years	Earn $5,000 for 10 years	Earn $20,000 for 5 years	Earn $20,000 for 10 years
30	$4,900	$4,500	$4,100	$3,200	$1,700
40	$7,900	$7,200	$6,600	$5,200	$2,800
50	$15,100	$13,800	$12,600	$9,900	$5,300
60	$51,400	$47,000	$43,100	$33,700	$18,100



Annual savings to get to goal, with $30,000 income until 90

Age	Stop work at 65	Earn $5,000 for 5 years	Earn $5,000 for 10 years	Earn $20,000 for 5 years	Earn $20,000 for 10 years
30	$5,600	$5,200	$4,800	$3,900	$2,400
40	$9,000	$8,300	$7,700	$6,300	$3,900
50	$17,200	$15,900	$14,700	$12,000	$7,400
60	$58,500	$54,100	$50,200	$40,900	$25,300

Note: The $5,000 and $20,000 earnings are after-tax.



Solution: Back page

HOLM TRUTHS CROSSWORD AUTUMN 2005

ACROSS

1. Borrowing to invest (7)
5. Artist's stand (5)
9. Motorists' club (initials) (2)
10. About (2)
11. NZ "mainland" (initials) (2)
12. Ripoffs (5)
13. European country (9)
14. Power of speech (5)
17. US investigation agency (initials) (3)
19. Difficult task (9)
21. Asian sauce or bean (3)
22. NZ forest giant (5)
25. Attempt (9)
28. Interior (5)
30. Letter in alphabet (2)
31. Printer's measure (2)
32. Boy's name (abbrev.) (2)
33. Toy bear (5)
34. Not adjusted for inflation (7)

DOWN

1. An aim (4)
2. Sharp (5)
3. Of the nose (5)
4. Profit, winnings (4)
6. Curved line (3)
7. Disease (anagram) (7)
8. One who hears (8)
12. Keeping money for later (6)
15. Vehicle for moving goods (8)
16. Not as difficult (6)
17. Move through air (3)
18. Exist (2)
19. Stirred violently (7)
20. _ _ and behold! (2)
23. A greeting (5)
24. Twelve (5)
26. Church or university leader (4)
27. Adjusted for inflation (4)
29. Finish (3)

From the Mailbox

Dear Mary:

I struggle with the notion that we simply have to own a house! What don't I understand?

Let's assume a couple has saved $150,000, and that can produce say $15,000 a year less tax.

Assume they then follow the majority and purchase a house at about $450,000, using their $150,000 and a mortgage of $300,000.

The cost of their home occupancy is:

Loss of income on their equity, say $10,000 (after 33% tax)

Interest on mortgage at 8%, $24,000

Rates, insurance, repairs and maintenance, say $4,000.

Total, $38,000.

This is apart from debt reduction.

They could probably rent the same house for, say, $18,000, so they are immediately behind by $20,000 a year.

For my money, I would prefer to invest my $150,000 and add to it at the rate of $20,000 a year, rather than watch my house value increase when, until I sold the house, that would do nothing to help my lifestyle over my 30 years of working life.

If I buy the house, I get to retire with a mortgage-free home now worth, say, $1 million. I'm asset-rich but income-poor, having to struggle on superannuation and not much more.

- **House prices may grow more slowly than shares – although not necessarily.**
- **But houses are usually geared.**
- **Consider non-financial issues.**
- **Home equity can be released.**

On the other hand, if I keep investing initially $150,000 plus the other funds, by my assessment this collectively could grow to $2 million or $3 million and produce substantial income.

Some will argue about the capital gain on the house. I would sooner have the money in my lifetime than leave the house to be sold and the beneficiaries to then do what I couldn't afford – holiday in Hawaii.

Dear Reader:

I could argue with several of your assumptions. Earning 10% on the $150,000 is rather high; renting the same house for $18,000 seems way too low, and so on.

And altering those assumptions can make a big difference to your outcome.

But that's not the main point.

Let's look at capital gains on houses. We would expect the value of a house to grow more slowly than some alternative investments, such as diversified shares or a share fund – because it's a less risky investment.

And, when you think about it, house prices can't grow much more than wages over the long term, or how could people buy them?

Yet, when I look at your expectation that the house won't much more than double – from $450,000 to $1 million – in 30 years, that seems too conservative. It's growth of only 2.7% a year.

Around 4% a year would be more realistic. The difference doesn't sound like much, but it would add about $500,000 to the house's final value.

Also, I don't think you're fully taking into account the effect of gearing – or borrowing to invest.

A house buyer has to pay interest for the privilege of gearing. But he or she enjoys the capital gain not just on the initial $150,000, but also on the borrowed $300,000.

If you follow your plan, you gain only on the $150,000 plus the $20,000 a year cost saving.

Sure, in the end that adds up to big money, but only gradually. You don't have nearly as large a sum invested over a long period, and that makes a big difference to the final tally. *(CONTINUED PAGE 4)*

(FROM THE MAILBOX, CONTINUED)

What, in fact, tends to happen is that over the long run, owning a home versus renting a home of similar quality will leave you financially roughly equal.

After all, if renting became clearly the better option, fewer people would buy houses. That would dampen down house prices to the point where renting was no longer better. That's the way market economies work.

At the moment, however, that's not true. While house prices and rents grew at roughly the same pace through the 1990s – both rising quite fast in the middle of the decade and then falling around the end of the decade – that hasn't happened in the latest house price boom.

Rents are now down relative to house prices. In the meantime, then, it may make sense to stay out of the housing market if you are not in it.

In the long run, though, there might be little in it financially. So you might as well make your decision based on non-financial factors.

If you rent, you can get kicked out of your home, and you are less free to decorate and garden in the way you want to.

On the other hand, you have less responsibility and fewer worries about maintenance, and you can move easily and cheaply.

If you own your home, it's the opposite.

I suspect many people's choice is affected more by these factors than financial ones – and that's fair enough.

Just remember, though, that by the time your income stops in retirement, it's best to have either a mortgage-free home or enough capital to rent a home for the next 20 or so years.

USING THAT EQUITY

Our correspondent points out that people who have their savings tied up in a house are often asset-rich and cash-poor.

They can be at a big disadvantage compared with people who rent their home and keep their savings in liquid assets, such as bonds and shares.

However, there are many ways you can continue to own a home but also make use of at least some of that money. They include:

- *Using a home equity release plan. Several are now on offer in New Zealand, giving you a lump sum or regular payments. In exchange, the company gets some of the proceeds when you sell your home.*

However, these schemes can be expensive. Seek independent financial advice before signing up.

- *Taking in a boarder.*
- *Converting part of your home to a self-contained flat.*
- *Subdividing your land.*
- *In some areas, taking advantage of a rates deferral programme. You pay low or no rates, and then the local council gets the money back, with interest, when you finally sell your home.*

Some of these programmes are better than others.
Again, seek independent advice.

You're welcome to send questions to From the Mailbox.
Email them to maryh@pl.net, or mail them to P.O. Box 8520, Symonds Street, Auckland. Please include your phone number. Unfortunately, Mary can't answer all questions in Holm Truths, and cannot correspond directly with readers.

Holm Truths Crossword Solution

G	E	A	R	I	N	G		E	A	S	E	L
O		C			A	A			R	E		I
A		U			S	I		S	C	A	M	S
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"The fellow that owns his own home is always just coming out of a hardware store."
Kin Hubbard, 1868-1930

WRITER AND PUBLISHER
Award-winning journalist Mary Holm writes the *Money* column for the NZ Herald and *The Investor* column in the Waikato Times, Dominion Post, Christchurch Press, Otago Daily Times and other major newspapers. She runs seminars, is the author of *Investing Made Simple* (Penguin, $27.95, at good bookstores), *Snakes and Ladders – A guide to risk for savers and investors* and *The REAL Story – Saving and investing now that inflation is under control* (both published by the Reserve Bank. They can be downloaded from www.rbnz.govt.nz. Click on publications). Mary holds a BA in economic history, MA in journalism and MBA in finance.

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