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MLC 20:20 Retirement Report

A clear view on factors influencing Australian experience

Contents

Prologue

What really shapes Australian retirement? Does the lump sum make the biggest difference? Can we anticipate what we'll spend during life after work?

NULIS Nominees (Australia) Limited (NULIS) has been examining some of the accepted wisdom about the average retirement and how much money you need. As a result, NULIS commissioned its own research from actuarial firm Milliman – and found some surprising things we want to share with Australians planning for life after work, and the advisers who help them.

Milliman reviewed the spending patterns, behavior and trends of Australian retirees over the past 20 years, using innovative analytics to develop the kind of real insights that will help our ageing population make meaningful plans for retirement with greater knowledge and confidence.

It's time for a new discussion

The **MLC 20:20 Retirement Report** is the first paper in a series of four that focuses on lifestyle spending. While there are industry standards used to determine what savings people need in retirement, we want to provoke deeper discussion on one of Australia's most pressing generational issues. That's why Milliman has used extensive research expertise to drive insight about individual needs beyond the default averages most people are aware of.

So let's get real about what matters in retirement, what it might look like and what it might cost.

Introduction

In many parts of life, averages are used to rationalise the unknown. But our experience also teaches us that averages don't always tell the whole story – there is the well-known joke about the statistician who drowned in a river because it was three feet deep, on average.

When it comes to retirement, averages are commonly used, when referring to the amount of income or superannuation that people should target. However, they don't adequately capture the diversity of lifestyles that Australians live and hope to achieve once they finally transition from decades of full-time work.

We are all different, and there is substantial variation in our lifestyle goals and objectives.

An in-depth understanding of how retirees spend their hard-earned savings and the changes that occur throughout retirement becomes more important than ever, and can provide additional insight and guidance when combined with more traditional statistics and averages for each person staring down the confusing path of retirement planning.

This white paper discusses some practical insights into how the financial behaviour of retirees can have a direct impact on the kind of retirement that people can expect, and consequently the sort of planning they will need to do in conjunction with their financial adviser for the retirement they want to have.

Four things that can make the biggest difference to your retirement
Money is just one of them

1. Your money

The average retiree has a predictable pattern of spending – it's mostly the amount that changes from person to person, which means average data isn't so average.

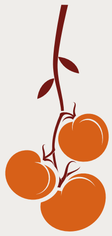
Needs vs Wants

50:50

average spend split throughout retirement.

You say 'organic tomato', I say 'tomato'

As the pace of life slows, we value spending on 'essentials' even more. Of course, one person's organic food is another's wild extravagance.



Over the course of retirement, transport expenditure decreases

55% **more**

than any other category.

2. Your body

Health is just as important as wealth when it comes to your post-work spend.

Health care's the one thing most retirees spend more on as they age

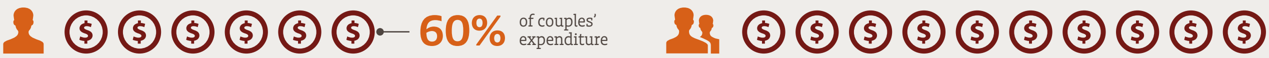
Declining health, more specialists

Health care spending tends to increase. Medicare helps but there are still out-of-pocket expenses like specialist appointments to factor in.

3. Your partner

Couples have the relative luxury of sharing resources, while singles need to ensure they cover essentials. But over time, everyone spends less on the 'extras'.

Singles spend around 60% of couples' expenditure



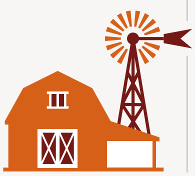
4. Your postcode

Where you live determines how you live. Expect quite a large variation in lifestyle between states and city and country – mainly due to the price of essentials, which make up more of our spend over time.

The country is cheaper – but there are trade-offs

City vs country
Spend difference per year for 80- to 84-year-olds:

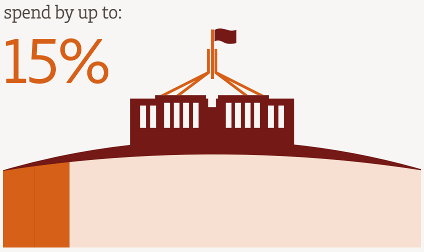
10.8%



Canberrans spend more

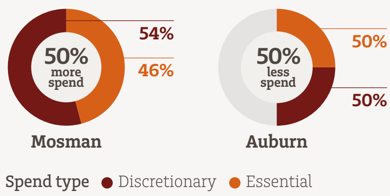
Your state affects retirement spend by up to:

15%



A tale of two suburbs

Mosmanite retirees spend 50% more than their fellow Auburnites, in pretty much the same proportions.



What we already know

There has been extensive research conducted across the globe to explore and develop retirement planning concepts, in areas such as saving and wealth creation, portfolio construction and drawdown strategies. This has led to an evolution in retirement theory, from assuming financial needs are constant in retirement, to accepting that it is difficult to plan for such a long and unknown period of time without a deep understanding of how retirees actually use their hard-earned – and saved – money after they stop working.

When it specifically comes to lifestyles and spending trajectories in retirement, we start with two major research works. The first was developed by Michael Stein, in his 1998 book *The Prosperous Retirement*[1], where he coined the popular "Go-Go, Slow-Go and No-Go" description of the three phases of retirement. These phases are characterised as follows:

- **Go-Go:** the stage which most closely resembles the working years, but with more free time. Retirees typically experience this stage, maintaining their pre-retirement interests and initiating new hobbies. These are also the years when retirees travel the most.
- **Go-Slow:** retirees begin reducing their activity levels. This may be a result of declining health or physical ability, but may also simply be the result of a larger sense of contentment and changing family dynamics. For example, retirees may choose to remain closer to home and focus on things like spending time with grandchildren.
- **No-Go:** changes to health, physical and mental, that are associated with ageing increasingly become a priority and area of focus to maintain retirement lifestyles and wellbeing. Hence, aged care and health care become the primary focus for spending over leisure activities.

What we already know

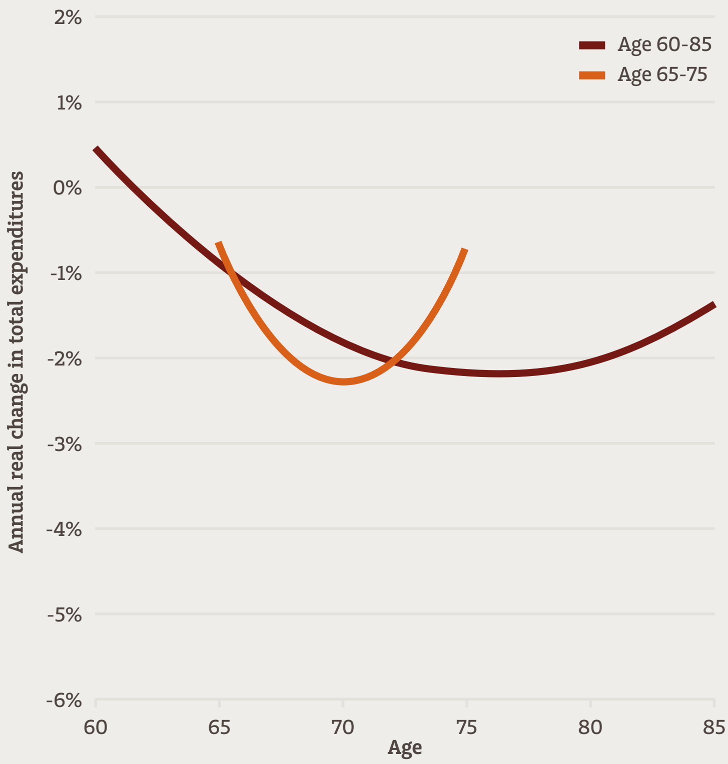
The second is a paper for the *Journal of Financial Planning* by David Blanchett at Morningstar[2], which details the decline and subsequent rise in retirement expenditure for American retirees. In his research, Blanchett demonstrated that the traditional wisdom, of spending that remains constant over time, is not actually what retirees experience. In real terms, spending declined at a rate of one percent per annum during retirement, until later in life when rising health care costs kicked in. Blanchett coined the notion of the "retirement spending smile" that describes the shape of the curve of spending for retirees. This is illustrated in the figure at right.

Blanchett's research concepts are strong examples of the evolution of retirement planning in places like the United Kingdom and the United States, and they mirror the experience of Australian retirees.

The power and insight created by observing how retirees deploy their savings, either to fulfil their lifestyle goals or respond to the natural changes that occur as they age, reinforce the intuitive understanding that there is no such thing as an average retirement.

This paper explains that while a retiree's financial needs are not constant, they are predictable. This is highlighted through the presence of a consistent trajectory of, and pattern of expenditure across, retirees; it's mostly the magnitude that changes from person to person.

Annual real change in consumption for retirees



Source: Blanchett, David. "Exploring the Retirement Consumption Puzzle". 2014. *Journal of Financial Planning*. 2014; 27 (5): 34-42.

Beyond average consumption figures

As we've highlighted in the previous section, every retiree household is different and their consumption needs vary. Delving further into some of the causes for this variation, we are able to identify four critical factors that influence retirement expenditure.

Affluence

Relative wealth is the clear and dominant factor influencing lifestyles in retirement, and is closely tied to traditional notions of retirement adequacy. How much wealth a retiree has heading into retirement enables them to have more flexibility, and they spend in line with their level of affluence at the point of retirement. However, it is important to remember that affluence does not operate as a standalone factor when determining lifestyle choices in retirement.

While earlier retirement theory has focused on observations about the whole population, or honed in on less-affluent cohorts, in this paper we focus on the patterns of the mass affluent population of retirees, given that they generally seek advice and have more opportunity for discretionary expenditure.

Location

Where a retiree lives will also influence their outgoings. Anecdotally we already understand that living in rural areas is cheaper than living in the city, and data backs this up. In addition, postcodes within cities can be a factor when considering a retiree's level of spending. But there are also broader social issues at play when determining location factors.

Health

Health is usually not considered to have the same impact on retiree lifestyles as their level of wealth. However, the data shows that once spending on health increases, all other discretionary spending tends to decrease. There is truth in the proverb: "good health is above wealth". In addition to the impact of health on spending generally, spending on health-related items also goes up, even though in Australia it is tempered by the public health care system, Medicare.

Household composition

Single-person households will generally have different financial needs, particularly with respect to the basic and essential costs of retirement, relative to those households where spending is shared among more than one person.

Solving for adequacy myths

In the past several years we have seen extensive commentary on "how much is enough". Much of this commentary homes in on a single magic number that retirees need to have saved, leading into their retirement years.

The reality is that there is no single number that Australians need to have in mind when preparing for retirement.

Not only are the most commonly stated numbers accumulation focused – with a lump sum amount rather than how that would be derived into an income during retirement – but they also do not take into account the variations in expenditure that occur as a result of the factors described in the previous section. For example, $1 million in the hands of one healthy retiree living in the country will be spent completely differently than the same amount will by an unhealthy retiree living in the city.

The chart below outlines the expenditure pattern across wealth bands and ages for current Australian retirees.

We can see that the overall national averages are skewed by the top percentiles. Put plainly, the people who spend a lot in retirement, really spend a lot. Their expenditure, when counted in overall averages, suggests that more money is "required" in retirement. But as we can see, the median – or the 50th percentile – spend is less than the average, reflecting the greater weight and impact the wealthiest retirees have on these statistics.

This chart also reinforces and corroborates the retirement theory we outlined earlier, and how overall expenditure decreases as we progress through the three phases of retirement.

Categorisation of expenditure

Essential vs discretionary expenditure

When considering the nature of retirement expenditure, it is important to understand the distinction between fundamental and essential needs (housing, clothing, food) versus needs that may be more lifestyle oriented and, consequently, discretionary in nature (e.g. travel, hobbies, other leisure activities). Intuitively, as levels of retirement wealth increase, there is a higher allocation in dollar terms to discretionary expenditure. Most extra spending we see in top retiree deciles is in discretionary spending and that contributes to overall averages being skewed.

This is driven through the simple reality that as people have more to spend, they do; and also make wider choices from a broad opportunity set about how their expenditure is allocated.

A key insight from the data is that the overall proportion of expenditure between essential and discretionary items doesn't change: it's roughly 50:50 throughout the course of retirement, across cohorts of wealth and age. But a deeper analysis also offers a number of additional insights:

- Wealthier retirees have a larger pool of savings to divide between the two types of spending, which affects their quality of lifestyle. Not only is their discretionary spending higher in absolute terms, but the level of expenditure and the quality of essential items goes up – for instance, more organic food, higher electricity usage to power larger houses, etc.
- As retirement savings dwindle over time, and as retirees age and/or their health declines, the level of expenditure on essentials remains constant, and discretionary expenditure decreases.

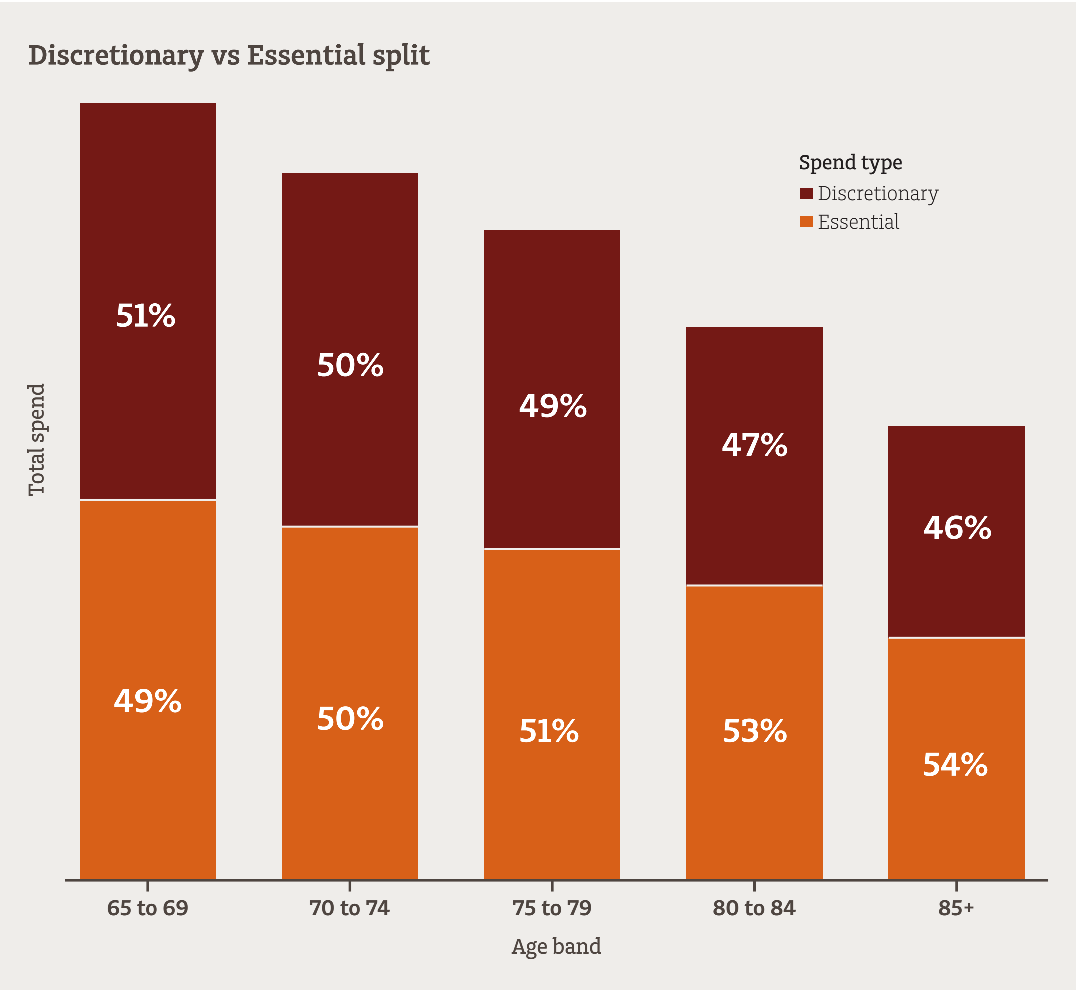
Categorisation of expenditure

For couples in the 70th percentile (top spenders), the proportion of their essential spending rises from 48 percent to 54 percent. However, their total overall expenditure is only two thirds of what it was at the beginning of retirement and, as a result, the dollar amount of discretionary spending halves.

In the later years, this decrease is a social phenomenon as much as it is a picture of how much a retiree has left to spend, particularly in the upper deciles. As we age, we value the essential items more, and as the pace of life slows down we place less emphasis on things such as hobbies and diverse activities.

As we can see, every marginal dollar available to a retiree will be allocated to essential spending first, then to discretionary spending. This makes sense to the average person; however, what's important to note is that the personal choices of every retiree will also dictate this split, over it being a simple mathematical formula to calculate adequacy, or a one-size-fits-all economic-style "basket of goods". After all, to some people organic tomatoes are an essential item, and to others they are a luxury.

For couples in the 70th percentile, the proportion of essential spending rises from 48% to 54%



Source: Milliman Retirement ESP 2019

Categorisation of expenditure

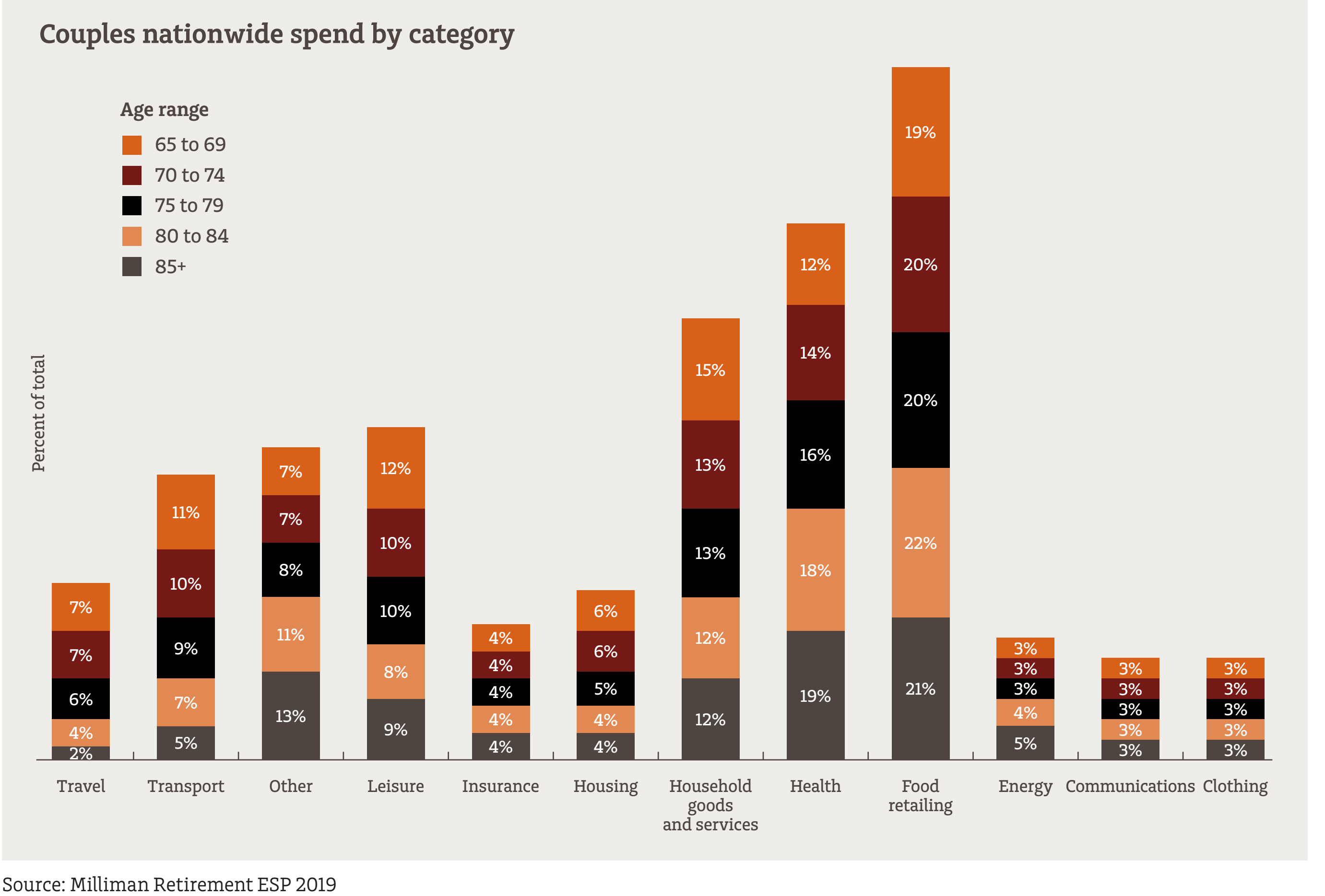
Major areas of retirement expenditure

Not only can we see that expenditure changes over time, or that affluence and ageing can affect the areas that drive the financial needs of retirees, but we are also able to drill down beyond the absolute magnitude of expenditure to understand the underlying categories and components from which these aggregate figures are comprised. Insight at the category level enables us to better understand, identify and plan lifestyles and specific goals in retirement.

The chart below illustrates how retiree couples in the 70th percentile (top spenders) allocate their money as they move through retirement.

It can be observed that some spending – the essentials – remains similar (and consequently contributes towards a higher proportion of overall expenditure over time).

Food and household goods and services are areas where spending doesn't change as much as other categories. Any sharp declines in food retailing typically happen in the areas of major supermarket spending, while other smaller places to shop, such as delis and greengrocers, remain constant. In the area of household expenditure, furniture tends to be purchased up front in the early years, and is the only noticeable decline in latter years of retirement.



Source: Milliman Retirement ESP 2019

Categorisation of expenditure

Over the course of retirement, clothing, communication and energy expenditure all remain fairly constant.

Other types of major expenditure categories show fairly obvious declines. Travel in particular, as would be expected, declines through the course of retirement. The sharpest declines occur in the areas of third-party providers such as travel agencies, accommodation and flights, which all take a major hit.

Leisure spending of all varieties show remarkable decreases, where total expenditure amounts halve. Cafes, restaurants and pubs; liquor purchases; and gambling all show significant declines over time. Spending on sports clubs, golf courses and country clubs only decrease minimally though, indicating that retirees prioritise certain leisure activities – hobbies – over eating out.

Different types of insurance, including major items of home and car insurance, all decline throughout retirement. This can be attributed to a variety of reasons, such as downsizing, moving into aged care facilities, and subsequent reduced motor vehicle usage. In line with this decreased usage, transport – noticeably anything relating to expenditure on cars – decreases equivalently, as the requirement, ability and desire for physical mobility decreases.

As we explore later in this paper, health care spending is the only major item that increases over time.

This level of expenditure analysis highlights another reason why it is important to help retirees understand where their money goes, as it's not as simple as the overall total averages would suggest. For instance, those who are not interested in travel, where their expenditure could be redirected towards other lifestyle areas, such as leisure spending. And for some people, insurance may become more important due to their individual circumstances.

Whichever way a retiree needs to direct their funds, helping them understand spending categories will subsequently help them plan their retirement spending in a more practical and relatable way.

Needs vs Wants

50:50

average spend split throughout retirement.

Location

City pace vs country living

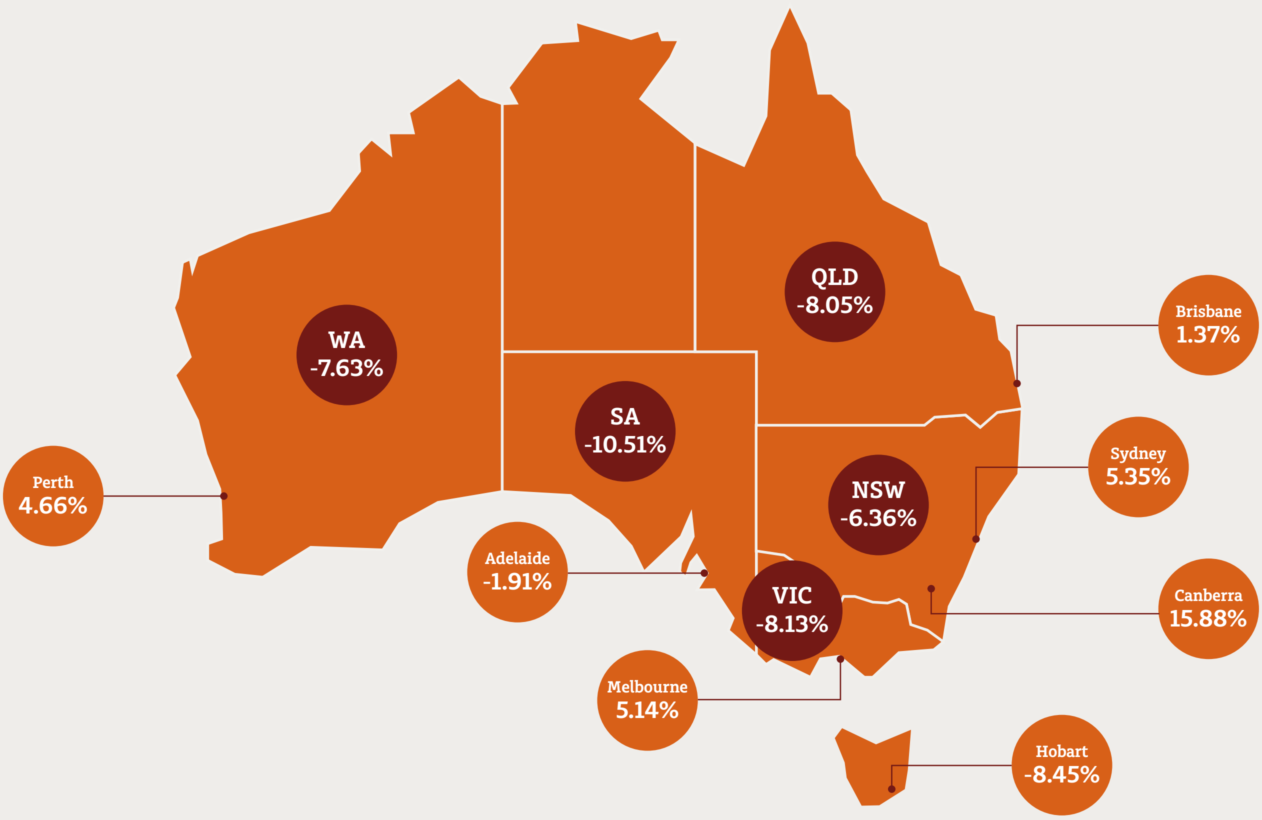
Statistics found in the Household, Income and Labour Dynamics in Australia (HILDA) survey, and retirement spending research undertaken in some of Australia's universities, all indicate that where you live determines how you live, and this is especially true in retirement.

Further to this, the data indicates that expenditure of retirees in some locations varies significantly from nationwide averages; some, like those who live in Canberra, by as much as 15 percent higher than the Australian average.

The map shows the variance between the nationwide average and each state, as well as capital city averages. We observe that retirement living in cities really is more expensive than living in rural areas. For retirees living in rural South Australia, their lifestyle will be very different from someone living in Sydney.

When the location statistics are further analysed by age, we observe a significant variance between living in the city and living in the country. By the time you are in the later years of retirement, it is almost an 11 percent difference per year.

Average state vs nationwide spend



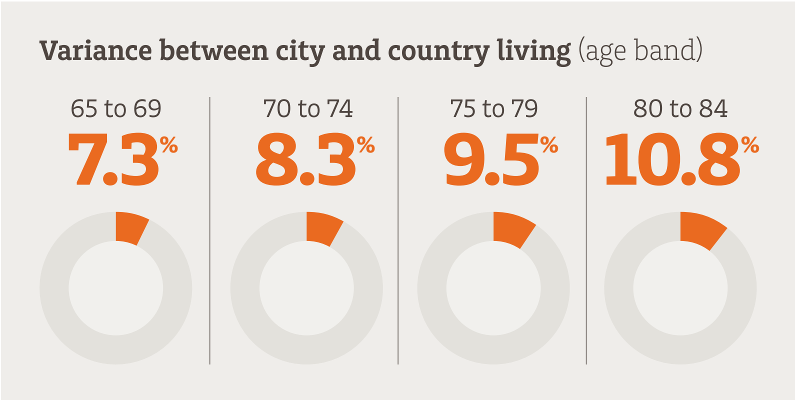
Source: Milliman Retirement ESP 2019

Location

This pattern is also explained in part by the fact that during the later years essential items make up a larger percentage of overall spending. Essentials' pricing varies more acutely between city and rural areas and this variance is more meaningful as a result.

So what does this mean for location choices that people make in retirement?

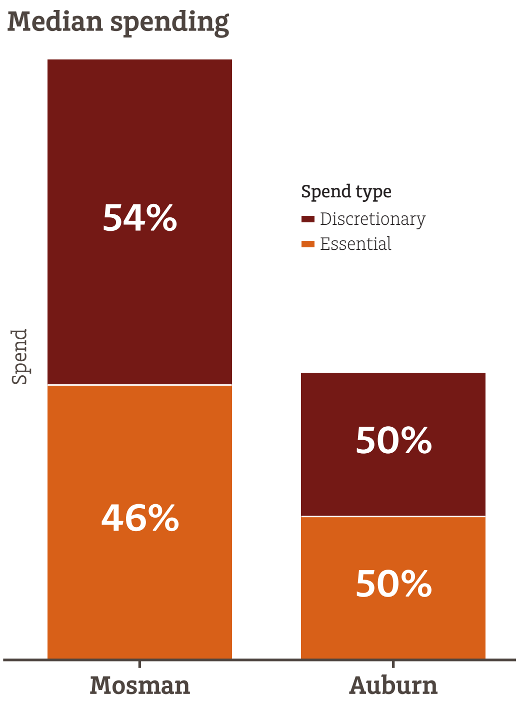
The concept of a sea change is a common one, and the figures certainly support the rationale and attractiveness of relocating for an improvement in retirement lifestyle. According to the Australian Bureau of Statistics (ABS), while 67 percent of Australians live in capital cities (and this is expected to increase over the next 20 years to 70 percent), only 63 percent of Australians aged 45 and over live in capital cities. Not only are overall retirement lifestyle factors more favourable in rural areas, but we can glean that moving for expenditure reasons might be as good a reason as wanting to be closer to the beach.



Source: Milliman Retirement ESP 2019

A tale of two suburbs

The location factor is not simply between city and country either. Individual suburb variances can play a significant part in expenditure analysis. As we can see in the chart at right, the figures from two suburbs in Sydney show quite a different picture when assessing the behaviour of the retirees who reside in different locations in the same city. While the overall proportions of discretionary and essential spending remain about the same between suburbs, the actual spending in Mosman is double in its entirety than in Auburn. In fact, the total spending in Auburn is only slightly more than the spending on essentials only in Mosman, leading to some interesting conclusions about lifestyle differences between wealth bands that play out on a location basis.



Source: Milliman Retirement ESP 2019

Mosmanite retirees spend 50% more than their fellow Auburnites, in pretty much the same proportions.

Health

While affluence may be the dominant lifestyle factor when it comes to retirement, it doesn't paint the entire picture. A retiree's health in the early years means that lifestyles are not that different to just before retirement, and with their newfound free time, retirees have the means to do more if they can afford it.

As highlighted earlier, one area of spending that markedly doesn't follow the overall trend is health care spending, which goes up as other areas decrease. In fact, declining health can be a serious handbrake on these other spending categories; in particular areas such as leisure, transport and travel.

The rise in health spending corroborates David Blanchett's paper on retirement expenditure patterns, indicating that these costs rise towards the end of retirement. The important distinction is that when it comes to the "retirement smile", the experience across different countries, such as between the US and Australia, can play out differently. This is largely a function of the role that government can have with respect to the support and financial costs associated with both public and private health care. Australia's public health system (Medicare) takes an increasing role and offers substantial financial benefits as retirees age, reducing out-of-pocket expenses seen in other countries with lower levels of government support.

In the US, the rise is larger and can be more transparently attributed to rising health insurance costs. However, in Australia retirees take advantage of Medicare, so the difference isn't as stark.

Notwithstanding the unique aspect of Australia's health care system, and even though overall spending shows a decline, Australian health care costs (over and above those borne by Medicare) still increase, and consequently contribute to a higher proportion of spending in the "Go-Slow" and "No-Go" years. This spending includes areas like out-of-pocket expenses for medical specialists, optometry, and expenditure at pharmacies. One area that does go down is dental. This expenditure decrease later in life may be explained by dentures and other longer-term dental solutions.

Health – the only category that goes up

Source: Milliman Retirement ESP 2019

Household composition

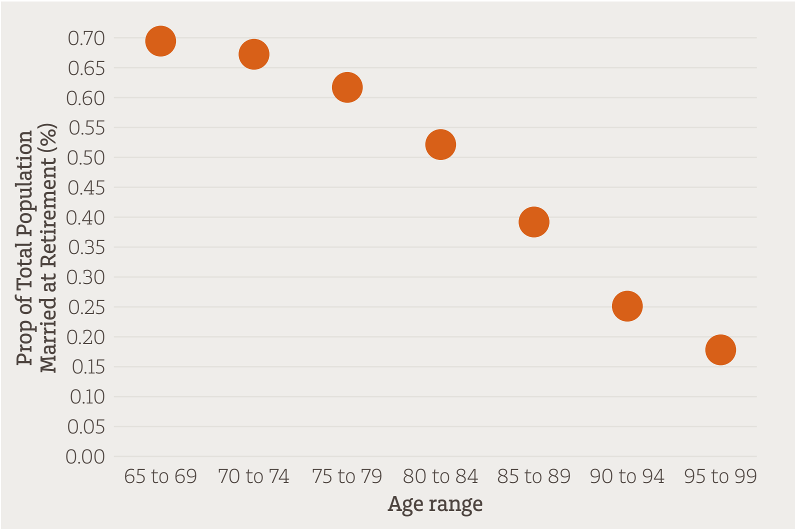
The more people share expenses in a household, the easier it can be to maintain a desired retirement lifestyle. Currently, 70 percent of Australians enter retirement as a couple (ABS). Through retirement, however, the proportion of couples declines as people age: 62 percent of 75-year-olds are still coupled, and the figure drops to 15 percent at 95.

Understanding these statistics is important when distinguishing the planning for couples and planning for singles. As a generally accepted principle, singles spend approximately 60 percent of couples' expenditure; the Age Pension, as an example, currently pays 66 percent of the couples' payment to singles.

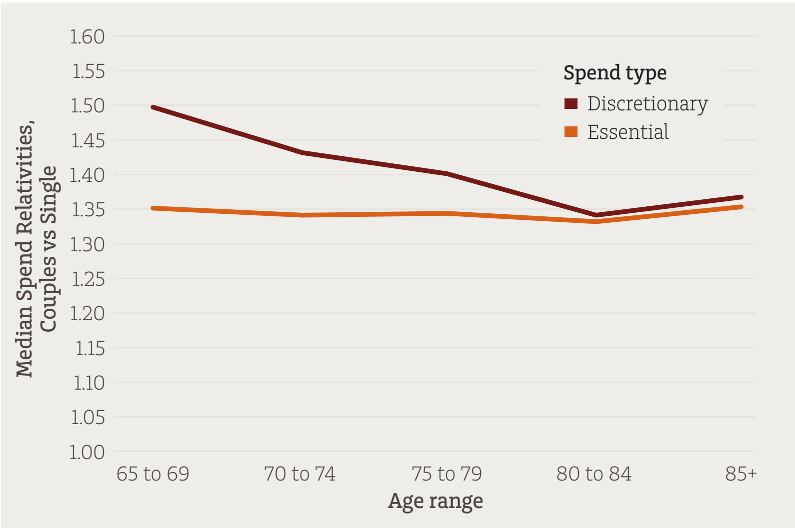
When it comes to essential spending vs discretionary spending, it's also important to note that at the beginning of retirement couples have a higher amount of discretionary spending between them – with more "play" money than singles. However, as we age and are less likely to be in a couple, the differences in expenditure converge, as discretionary expenditure decreases regardless of household composition.

So how do singles plan for retirement differently than couples? The simple fact of the matter is singles need to ensure they have adequate plans for covering their essential expenditure, while couples have the relative luxury of shared resources to be able to enjoy their "Go-Go" years a little bit more.

As a general principle, singles spend approximately 60% of couples' expenditure



Source: Australian Bureau of Statistics 2016



Source: Milliman Retirement ESP 2019

Navigating complexity: the need for advice

As superannuation balances grow and retirement planning becomes more sophisticated, the industry has developed a much greater understanding of the fact that accumulation targets are overly simplistic. Instead, we must look through a lens that understands the nuances that exist across the country. We must look beyond averages, which, as we've demonstrated, do not reflect the personal goals and objectives of individual retirees.

Without an understanding of their financial needs as well as their overall lifestyle goals, retirees cannot plan to either pay themselves an income during retirement, or allocate funds elsewhere, such as for bequests or helping the next generation within their families.

Armed with additional detail and insight when it comes to their personal retirement journey, retirees can draw comfort that they can move away from simplistic and unrealistic lump sum numbers and a one-size-fits-all approach, and can instead plan for the kind of lifestyle they really want in retirement.

Personalising retirement goals and implementing them to provide both an income during retirement as well as other financial outcomes, however, requires the help of a professional who is experienced in navigating the complex nature of financial markets and risk management as well as tax and estate planning.

In order to obtain better outcomes, people heading into retirement will benefit from discussing these issues with a financial adviser.

We must look beyond averages, which, as we've demonstrated, do not reflect the personal goals and objectives of individual retirees

About this paper

This paper has been provided by Milliman Pty Ltd ABN 51 093 828 418 AFSL 340679 (Milliman). For its research, Milliman has used the Milliman Retirement Expectations and Spending Profiles (Retirement ESP) and the Australian Bureau of Statistics, as well as other data sources.

Milliman, established in 1947, is a global independent actuarial management consulting firm. In Australia, it specialises in the retirement sector, where it partners with a range of organisations providing consulting, data analysis, and risk management services and solutions to financial industry participants. Milliman provides products and solutions that create better outcomes, designed to help people have a better retirement. For further information, visit **au.milliman.com**

Reference

1. Michael K Stein (1998). *The Prosperous Retirement: Guide to the New Reality.* Emstco Press
2. David Blanchett. *Exploring the Retirement Consumption Puzzle.* Journal of Financial Planning. 2014; 27 (5): 34–42.
3. Australian Bureau of Statistics 2016
4. Milliman Retirement Expectations and Spending Profiles 2019 (Retirement ESP)

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