CAMELOT
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The Silver Tsunami

The "greying" of New Zealand's population presents enormous challenges for the country. New Zealanders are getting long in the tooth, and we're not alone. The population of almost the entire world is undergoing a similar demographic shift caused by the combination of declining fertility rates and increases in longevity. The biggest challenge facing New Zealand society today is how to support an ageing population. The concept that the Government should take care of us when we retire is set in stone for many people however that expectation is becoming increasingly unrealistic.

So what are the facts?

- Between 1950 and 2011 life expectancy at birth has increased from 71.3 years to 81.1 years for females and from 67.2 years to 76.3 years for males.

- New Zealand fertility rates peaked in 1961 (the height of the baby boom) at 4.3 births per woman of child bearing age. In 1999 this figure was just 2.0 births per woman and this figure is expected to steadily fall.

- Based on this trend, by 2051 we will have a population with more elderly than children. Half of all New Zealanders will be aged 46 or older, and one in four will be elderly (aged over 65 years). Today we have only half this many. Even more importantly the elderly group itself is getting older. The old-olds (85 years and over) make up 9% of all New Zealanders aged 65 years or older. By 2051 this is expected to be 22%. There will be in excess of a quarter of million old-olds.

What does this mean?

We are now seeing increased debate about the implications of the silver tsunami for social and economic planning, especially in regard to superannuation and health services. The dependency rate tells an unfortunate story.

The dependency ratio compares the elderly population (65 years and over) to those in the working ages (15 - 64 years). This ratio was 18 elderly persons per 100 working age persons in the year 2000. By 2051 this is expected to increase to 43 elderly per 100 working persons.

It is unavoidable that the individual will need to take a greater responsibility. The tsunami is coming and we can't just get out of the way.

What is the impact on Superannuation?

New Zealand Superannuation is our single biggest social security expense. It accounted for $8.1 billion (41%) of our country's $19.8 billion social security spend over the 12 months to June 2011. This is 4.4% of GDP (Gross Domestic Product). With the coming of age of the baby boomers, this is set to rise to 8% of GDP. Anticipating this escalation the New Zealand Superannuation Fund (often known as the Cullen Fund) was launched in 2003. The objective of this fund was to put aside money today to help reduce the cost on taxpayers later. This seemed like a good idea in the days of budget surpluses. In 2009 the current Government suspended contributions ($2.0 billion a year since inception) due to major budget deficits. The current balance of the Cullen Fund is $16.0 billion and we don't anticipate further contributions until we return to budget surplus again in 2015 - 2016.

"By 2051 we will have a population with more elderly than children"

What else can be done?

1. The Retirement Commissioner has called for the raising of entitlement age for NZ Superannuation to 67. This is in line with a large number of other countries (including Australia). Most of us believe it is not a matter of if, but when. We are just going to have to work for longer.

2. KiwiSaver is a new initiative to induce New Zealanders to save independently for their retirement. After 5 years there are 1.9 million KiwiSaver accounts with $11.8 billion invested. There is some debate as to whether KiwiSaver has increased net savings, or just changed where people save. However, notwithstanding this debate, it is very difficult to say that KiwiSaver has not been a success.

3. Save independently and have less debt. A decade ago New Zealand had one of the worst percentages of net debt in the OECD. It was acknowledged that every man, woman and child owed more than they owned. Gladly this has changed in recent years as we all have attacked our personal balance sheets and repaid debt.

As advisers we are often asked the question *"how much do I need to save for my retirement?"* Obviously the answer to this question depends on a number of factors. Some of these factors we have control over (how much you save) and some we have no control over (how long you are going to live). Recently the Financial Services Council of New Zealand (FSCNZ) released a report on policy options for retirement. This report provided evidence based research and information on options available. This report had input from actuaries and was peer reviewed by retirement savings experts.

BUT! Like all these reports, it only tells us what we already know - that it will be harder to retire at 65 in the future, and that we will live longer and with less. Therefore we have prepared our own "future retirement" plan to see if a typical client can afford to retire in the future, based on the information available from various reports, and making some educated (and hopefully realistic) assumptions about the level of superannuation available from the government. **Will a smaller, and later, government funded New Zealand Superannuation sum and a normal KiwiSaver savings sum, be enough to retire on?**

Rede Advisers Future Retirement Calculations

Facts and Assumptions

1. Our typical young Rede Adviser client is educated, married with 1.9 children, and earning 150% of the average wage - say $82,000 p.a. They are aged mid-to-late thirties.

2. NZ Superannuation will be available however eligibility will not be until 68 years. The amount payable will be $500.00 net per week for our couple. This is $37.00 per week less than the current payment due to the unavoidable increase in tax rates that will have to be implemented in the future.

3. The income earner has contributed to KiwiSaver for 30 years at a rate of 4.0% p.a. matched by the employer at 4.0% p.a. with no government contributions. Again, we don't think government contributions are sustainable over the long-term.

4. We have assumed a real return of 3.0% p.a. (a net return of 5.0% less inflation of 2.0%). Again, this is lower than standard projections due to our belief that returns on capital will be lower in the future.

5. Our typical clients wish to retire at the new age of 68. If they were to retire earlier the funding for this will need to come from a combination of other savings, inheritance, state support (if any) and part-time employment.

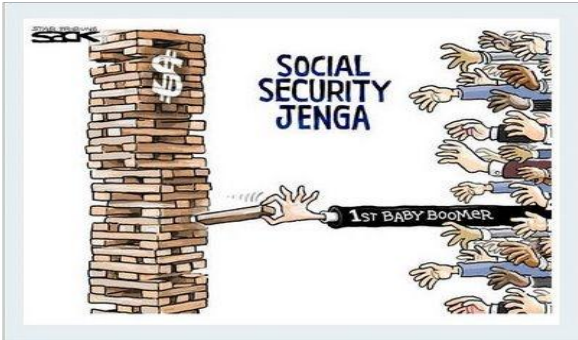
6. The FSCNZ report states the expected retirement income is $845.00 net per couple per week. Our clients accept they will need to spend capital, not just interest, and will want to see this annual sum CPI adjusted due to the knowledge they will live longer in retirement in the future. This means the KiwiSaver savings will need to contribute an extra $345.00 above NZ Superannuation. This annual net income is equal to 68% of their pre-retirement net income.

We have used todays PIE tax rates, current employer ESCT rates, and accepted net present value calculations to arrive at our final calculations. Our typical young couple will have the following to look forward to:

1. They will need to work to age 68 years before retirement
2. They will receive less from the government in net terms.
3. The KiwiSaver balance after 30 years of contributions will grow to $268,005 net present value (today's dollars).
4. The regular income that can be drawn from this lump sum is $345.00 per week (when added to the $500.00 per week from NZ Super gives us our total of $845.00 per week).
5. The lump sum will reduce from $268,005 at the commencement of retirement to nil after 20 years. Our clients' money will last until they are aged 88 years.

Conclusion

Our typical young clients can retire on a reasonable income using only KiwiSaver and NZ Superannuation. There will however, be no extra money for capital replacement, holidays or extra health spending. They also couldn't live beyond age 88 as their money would have run out. To be safe they will need to have other savings as well as KiwiSaver.



SOEs - Mixed Ownership Model

The Government announced prior to the election that they intend to partially float four state owned energy companies. There is significant controversy regarding the partial sale of these assets including claims to the Waitangi Tribunal and attempts to force a referendum. Despite this, the Government is pushing forward with its plans to apply the mixed ownership model to the following companies:

- Mighty River Power ($1.9b)
- Meridian Energy ($3.2b)
- Genesis Energy ($0.9b)
- Solid Energy ($0.9b)
- Air New Zealand – *extension of existing model where Govt currently owns 74%.*

Through this process, the Government have made certain commitments including:

- retaining majority ownership and control (i.e. retaining 51% - selling 49%).
- wanting strong retail investor participation.
- expecting 85-90% to be held by New Zealanders (including the 51% Government stake).
- limiting the maximum ownership for any one entity to 10%.

The first planned float is Mighty River Power due in the last quarter of 2012.

The Government has now announced details of how New Zealanders can participate in these Share Offers, including initiatives to put New Zealanders at the front of the queue for shares. These include:

- Minimum share application of $1,000.
- Guarantee that New Zealanders seeking up to $2,000 worth of shares will not have their application scaled back.
- Loyalty bonus shares for retail investors if they hold shares for more than three years.
- Appointment by Treasury of a retail syndicate of brokers and banks to help potential investors understand how they can participate in the share offer.

We will forward further details on the MRP float in the next issue.

Happy 5th Birthday KiwiSaver!

A recap … how does KiwiSaver currently work?

Anyone aged less than 65 years can join KiwiSaver however the full suite of benefits are only available for those aged between 18 & 65 years. So, what are the key features?

All KiwiSaver members receive an initial $1,000 kick start contribution from the Government on joining.	There is no cost to join KiwiSaver.
Individual wage/salary earners contribute 2%, 4% or 8% of their gross salaries.	Employers match employee contributions with at least 2% contributions, less ESCT (tax). This rises to 3% from 1 April 2013.
Non-salary earners (such as retire, or self-employed persons) can make voluntary contributions. We suggest $90 per month by direct debit to receive maximum Government contributions.	Annually, after 30 June, the Government will pay a $521.43 'member tax credit' to an individual's KiwiSaver account providing they contribute at least $1,042.86 (or 50c for every $1.00 up to $1,042.86).
KiwiSaver funds become accessible after you become entitled to NZ superannuation (currently aged 65), or have been a KiwiSaver member for at least five years, whichever is the latter.	Withdrawals are also available in other circumstances including for the purchase of a first home, where you are permanently emigrating, have a serious illness or serious financial hardship *(conditions apply)*.
In the event of death before maturity, KiwiSaver funds are paid to your estate.	Our preferred scheme (Grosvenor) has free $10,000 accidental death benefit for all adult contributing members.

To illustrate the benefits for someone aged 40 years of age receiving a salary of $45,000 p.a. their annual contributions into their KiwiSaver Account will be:

	KiwiSaver Contributions	Cost of Contributions
Your Contributions	1,800.00	1,800.00
Employer Contributions	742.50	-
Member Tax Credit (p.a.)	521.43	-
Net Annual Contributions	$ 3,063.93	$ 1,800.00
plus Government kick-start (one-off)	1,000.00	-
Total Contributions	**$ 4,063.93**	

Based on contributions at the same rate until retirement at age 65 this person's KiwiSaver will have grown to $168,154, or $90,701 in today's dollars. Based on the previous article, this alone is not likely to be sufficient to provide a reasonable retirement income.

Assumptions:
- wages, and therefore contributions, grow in line with a 2% rate of inflation
- employer contributions rise to and remain at 3% (less ESCT) from 1 April 2013
- Government contributions stay at up to $521.43 per annum (matching contributions of at least $1,042.86)
- investment returns on average of 4% net per annum

What is our role as your KiwiSaver adviser?

- initial advice on KiwiSaver including whether or not to join, what scheme to choose, how much to contribute, the joining process (who to notify, how etc) and choosing an appropriate investment portfolio.
- retirement planning calculations, including projecting future values (as above), and recommendations for savings outside KiwiSaver.
- annual top-up reminders to ensure Government tax credit entitlement.
- discussing criteria for withdrawals, including for purchase of first home.
- answering ongoing queries re contributions, investment (PIE) tax rates, balances.
- administration support including online access and contact detail changes.
- ongoing review of KiwiSaver savings over time as circumstances change.

What happens when your KiwiSaver scheme becomes accessible?

Once you have either reached 65 years of age, or are over 65 years of age and have been a KiwiSaver member for five years, you have a number of options including:

1. leave your funds in your KiwiSaver investment.
2. continue to contribute to your KiwiSaver from your wages
   (your employer can also 'opt-in' to continue contributing as well)
3. make a partial withdrawal.
4. take a regular withdrawal.
   .... *a combination of the above, or ....*
5. withdraw all your KiwiSaver funds.

We can discuss the above options with you and assist you in deciding the best course of action.

Frequently Asked Questions re KiwiSaver Retirement

Member Tax Credits - these annual Government Contributions (up to $521.43 p.a.) only continue as long as you are an eligible KiwiSaver member therefore they stop after the latter of you reaching 65 years or being a KiwiSaver member for five years.

Fees - KiwiSaver management fees are low compared to usual retail investment portfolios. There are no fees for partial or regular withdrawals providing a minimum balance of $1,000 is held in your KiwiSaver account after retirement.

Timeframes for Withdrawal - withdrawals will not happen immediately on maturity. An indicative timeline for a full withdrawal is set out below:

1-2 months before Maturity *Grosvenor will write advising your maturity date and your options.*	**On Maturity** *withdrawal form completed by you & signed in front of a JP or solicitor (as it is a Statutory Declaration)*	**20th of month following last wage *deduction*** *- IRD receives KiwiSaver contributions and forwards them to KiwiSaver provider.*	*Your KiwiSaver provider calculates your final Member Tax Credit entitlement and claims this via IRD.*	*KiwiSaver provider calculates final tax on your investment and pays out your net balance (including Govt contributions).*

Glossary

KIPPERS - **K**ids **I**n **P**arents **P**ockets **E**roding **R**etirement **S**avings
SKI holidays - holidays to **S**pend the **K**ids **I**nheritance

The moral of the story – avoid KIPPERS and take plenty of SKI holidays!

Does Having a Mortgage on a Rental Property Improve the Return?

We are often asked to evaluate returns on property investments that our clients are interested in. In partnership with our accountants HFK Ltd we have recommended a number of property investments that we have to regularly review and analyse. The investments that have produced the best results have contained a combination of investor capital and borrowed funds from the bank. The question most commonly asked by investors is "why does having a mortgage from the bank, as well as investor capital, increase the return?" There are a number of factors to take into account however we hope this simple model may assist investors in understanding the role of debt, or leverage, in an investment situation.

The following examples use a very simple model. The figures used have been selected to assist in showing the impact of debt on the total return, they are not intended to represent a current rental proposition:

• Rental Property Value	$200,000
• Rent paid annually	$ 10,000
• Investment time horizon	10 years
• Mortgage from the bank is interest only at	6.00% p.a.
• Property growth rate over the 10 years is	5.00% p.a.

1. Using 100% investor capital to purchase the property

Total rental received over 10 years	$10,000 x 10	$ 100,000
Property growth over the 10 years	5% x 10	$ 100,000
Total simple gain		$ 200,000

This is a **100%** return on investor capital of $200,000 over 10 years or a simple return of **10%** per annum.

2. Using 50% investor capital and 50% borrowed funds to purchase property

Total rental received over 10 years	$10,000 x 10	$ 100,000
Property growth over 10 years	5% x 10	$ 100,000
less interest payments to bank	$100,000 @ 6% x 10	- $ 60,000
Total simple gain		$ 140,000

This is a **140%** return on investor capital of $100,000 over 10 years or a simple return of **14%** per annum.

3. Using 25% investor capital and 75% borrowed funds to purchase property

Total rental received over 10 years	$10,000 x 10	$ 100,000
Property growth over 10 years	5% x 10	$ 100,000
less interest payments to bank	$150,000 @ 6% x 10	- $ 90,000
Total simple gain		$ 110,000

This is a **220%** return on investor capital of $50,000 over 10 years or a simple return of **22%** per annum.

With the increase in use of debt for a rental property purchase the simple return increases. Of course, with the increase in return there is an increase in the risks associated with holding the property. Changes to depreciation rules on rental properties, and also increased risks associated with natural disasters (Christchurch earthquakes) and insurance make rental property somewhat problematic currently.

QUIZ 

1. In what year did New Zealand change its currency from pounds and shillings to dollars and cents?

2. What was the name of the certificate given to children who successfully completed the decimal quiz?

3. How old do you have to be to be an "old old"?

4. What is the maximum age a KiwiSaver member can be and still receive the government contribution of up to $10.00 per week?

Answers will be posted under 'Latest Updates' on our website www.rede.co.nz

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Disclosure Statements under the Financial Advisers Act 2008 relating to Stephen Benton and Michael Shears are available on request and free of charge.
