A step by step guide to obtaining a long and prosperous retirement

Lesson 13 –Financial Gaps

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Introduction

This document is part of the training material written to assist Kiwi's in their 50's or 60's that are looking at retirement but have no idea what to do, what is needed, and how or where to get help. Or those that already have some ideas of how to survive retirement, are looking at alternatives, or just checking they are on the right path. They might even be looking on behalf of their 'elderly' parents, to ensure they are considering all options available to them.

This course provides a simple comprehensive step by step process to create your own retirement plan. It includes a summary guide, road map, lessons and discussion topics to help you prepare for your retirement, all from a very New Zealand perspective.

Course outline

This document is "Lesson 13 –Financial Gaps" of the comprehensive course material supporting our simple step by step approach to creating your financial retirement plan.

All material can be downloaded and printed from the downloads page on our website: http://www.bizxtra.co.nz/

Most people complete their retirement plan using just the Planning Guide, Roadmap and the Excel spreadsheet that supports the guide. Additional information is provided to support you along the way if you get stuck, don't understand a concept, or just need some further ideas to try out as part of your planning.

Lesson Contents

Latest Version

Market prices, superannuation and benefit rates, Government policies, inflation, costs of living, house values etc. all change on a regular basis. The numbers in this document have been updated to reflect the market position as at July 2025.

Lesson 13 – Understanding Financial Gaps

Now that you have completed the first steps, you are ready to continue planning for your retirement. You should now be up to the steps associated with fixing the gaps you have in retirement. As you would have learnt in "Step 3 - Calculate the Gaps":

> As "superannuation is not enough" to support any type of desired lifestyle in retirement, You will have gaps between what you hope to have in retirement, vs. what you currently have.

If you have entered the data from the Roadmap into the free retirement planning spreadsheet, any gaps identified will be displayed on the 'Retirement Plan' worksheet.

Before fixing them, you first need to understand what you are looking at. This financial lesson will explain how these gap calculations are performed and why they are important.

We have (almost) collected enough information to create our first attempt at a budget for our retirement. Our budget will form the central part of our retirement planning.

A budget is typically defined as "an estimate of income and expenditure for a set period of time".

We have already determined:

> *the period of time*: 'retirement date' through to 'end of both our lives': e.g. 30 years
>
> *an initial guess at expenditure*: e.g. $2,974,400 over those 30 years
>
> *an initial stab at where some income could come from*: Superannuation over 30 years at various rates, maybe some additional income through working during our retirement, and hopefully by utilising some of our assets to help generate any missing income.

A good budget should be balanced. A balanced budget shows that we have enough income over the period of time, to meet our expenses over that same period of time. Ideally, we should have more income in case unplanned events occur – but getting it balanced would be a good start.

If it is not in balance, then we have a gap we need to fill. If our expenses during retirement exceeds our income, then we have a problem.

We produce this budget in the format of a 'cashflow' (remember the crystal ball), and the numbers you enter into the spreadsheet are used to populate the budget.

To ensure we have a balanced budget during our retirement, we calculate and investigate two gaps:

1. Income Gap: Any gap between our weekly retirement lifestyle expenses and the income we know we will be receiving.

2. Investment Gap: Any gap between the income generating assets we *currently* own now, and the income generating assets we *need* to own at retirement, to generate any missing income. These are generally referred to as 'income generating assets'.

Calculating the Income Gap

The income gap is the easiest to calculate. It is basically the sum of all the income we have identified we will receive during retirement, less the costs we calculated for our retirement.

This is summarised below. This is followed by details of how each number has been calculated.

Income Gap	Total $'s in Retirement		Weeks Duration	Average $'s per week
Government Super	*$*	*1,047,247*	*1560*	*$671*
Working in retirement	*$*	*123,000*	*1560*	*$79*
Passive Income	*$*	*137,644*	*1560*	*$170*
Income identified	$	1,307,891		$838
Less costs of retirement	-$	2,974,400	1560	-$1,907
Income Gap	-$	1,666,509	1560	-$1,068

Table L3.1

The income gap calculation shows that just over a third of John and Janes retirement will be funded by the Government through Superannuation. Our children are contributing to our retirement by the tax they pay!

But this assumes Government funded superannuation is still around when we need it – and that we are still eligible to receive it. We need to remember to keep on checking and refining this (really important) assumption.

This also shows, that there is a gap between what John and Jane want for their lifestyle in retirement ($2.9 Million), and what is provided through superannuation, working, and their current income generating assets ($1.3 Million). This reinforces the understanding that superannuation is not enough to survive retirement and why almost a quarter of people over 65 need additional benefit payments just to survive retirement. And this doesn't yet include any debts needed to be repaid.

You don't have to be too far up the financial expertise scale to realise John and Jane had a problem. Like many pre-retirees, they appear to be a bit short of money for the lifestyle they want to live.

Information used to calculate the Income Gap

The estimated cost of retirement was calculated in Step 1 and is shown at the bottom of the 'Form 1' worksheet (for John and Jane this was previously shown in this guide). This is the initial estimate of the cost of our retirement, from the date we plan to retire through to the end of both our life expectancies, based on the lifestyle costs selected from the Massey University and Westpac report.

Name	Couple rate Per Person	Single Person Rate	Years in retirement	Weeks in Retirement (years * 52)	Weeks as a couple	Extra Single Weeks	Costs as a Couple	Costs alone	Total (costs as a couple + alone)
John Doe	$ 1,000	$ 1,650	22	1144	1144	0	$ 1,144,000	$ -	$ 1,144,000
Jane Doe	$ 1,000	$ 1,650	30	1560	1144	416	$ 1,144,000	$ 686,400	$ 1,830,400
Total									**$ 2,974,400**

Table F1.4 (repeated)

Passive Income is calculated by looking at our current assets, and determining if we do nothing to them, what income could they generate between now and the end of our retirement. For John and Jane this was calculated by:

- looking at their bank balances and the interest rate the bank was currently giving them,
- looking at their KiwiSaver funds and assuming that prior to turning 65, they will add more money into the fund, the fund will grow until they turn 65, and then they will receive interest at their current fund rate.

If John and Jane had any business or rental property then the net income per year (generated by these investments) would be added. If they had any other investments (Shares or managed funds) then a similar assumption as per their KiwiSaver funds would be made.

Remember we are only trying to calculate the size of the gap, not worry about strategies to fix it at this Step.

Government Super is calculated by looking at the number of weeks during retirement, and multiplying this by the current rate of superannuation we are currently entitled to receive. If we are eligible for any overseas superannuation we would also include that amount

	Number of Weeks	lifestyle Weekly rate Assumed	Expected lifestyle Costs	Super. Weekly rate Assumed	Super. Received from 65 Yrs
One receiving super	260	$ 2,000	$ 520,000	$ 479.51	$ 124,673
As a couple	884	$ 2,000	$ 1,768,000	$ 799.18	$ 706,475
Living Alone	416	$ 1,650	$ 686,400	$ 519.47	$ 216,100
Totals			**$ 2,974,400**		**$ 1,047,247**

Table L3.2

Working in retirement is calculated by multiplying the expected net remuneration each year in retirement, with the number of years we hope to receive it. This was calculated on Form 2.

Name	Net Earnings Pre Retirement	No of Years	Total Net Earnings Pre Retirement	Net Earnings in retiremen	No of Years	Total Net Earnings Early Retirement
John Doe	$ 77,952	5	$ 389,759	$ 15,000	3	$ 45,000
Jane Doe	$ 26,366	5	$ 131,830	$ 26,000	3	$ 78,000
Total			**$ 562,589**			**$ 123,000**

Table F2.4 (repeated)

While getting this far into our retirement plan, we have also looked at a few other things. We have looked at how many years we have until we retire, some trends that are occurring around us that we need to consider in our planning, and the fact that different circumstances impact the assumptions we use (e.g. single vs couple rates for superannuation, men and women have different life expectancies etc.).

The next area we need to look at on our journey of developing our retirement plan is where more money can come from – to bridge the gap John, Jane and many others have in their retirement.

Unfortunately money doesn't grow on trees, so we have to look for alternate sources of money we may already have, or are able to attain, to bridge this gap.

For some people this could be easy – they have time to fill the piggy bank to the brim. For John and Jane, they wanted to retire in 5 years.

Irrespective of the timeframe you have, your solution is the same, you need to create your own alternate money tree.

The answer to generating money (income for our retirement) is through obtaining assets that generate money for you. Of course you can always work for longer past your retirement date. But the whole point of retirement is that you don't 'have' to go back to work for money, your money should be working for you. You may choose to work to get some extra money so that this year you can fly 'business' class rather than 'coach' class, but you shouldn't 'need' to work in retirement.

Unfortunately many retirees need to keep working just to survive. Hopefully you are not planning to become one of them.

Calculating the Investment Gap

The most common way people bridge this income gap, is by making their assets generate income for them.

Having calculated our Income Gap and our Net Wealth, we can use this information to determine the size of any financial gaps we will have in retirement, and if we do have gaps, we can start formulating a strategy and plan to bridge these gaps.

To make this calculation we need to make an assumption on an interest rate we could use to make a high-level estimate of the 'income generating assets' we need for retirement. You made an initial guess on the bottom of Form 3.

What income can an asset generate on a good day?

Obviously, the first question we need to answer is *"how much income can our assets generate on a regular basis?"*.

This is a complex question and as we are still learning about many financial concepts, we will just tell you.

A general 'rule of thumb' is that it is 6%. This can be changed depending upon how many years you have until retirement, how much excess income generating assets you have in retirement, and the level of risk you are comfortable with.

For example, if you have between 10 to 15 years before you want to retire, you should be aiming for a return from your income generating assets (the income your assets will generate for you while you are asleep) at a rate of 6% of their net value. Some years it might be 10% or 12%, other years it might be 2% or 3% - or in the worst case even a negative return. On average over 10 years it should end up at 6%.

The longer you have until you retire, the more time you have for any investments you make to recover from any speed bumps they encounter along the way.

If you are already retired, or very near retirement then you will want to target a lower rate of return as that indicates you are wanting to take less risks with your investments.

With minimum skills and risk, you should be aiming for these average returns. We will drill into this number (and supporting assumptions) again in later sections of this guide, but for now let's just apply the general 'rule of thumb' to keep moving forward with our planning.

On Form 1, we identified the level of risk we were comfortable with in regard to managing money. We now need to translate this level of risk into an interest rate. We will refine this rate on a later Form, for now it is just an overall average interest rate and typically this rate is based on the number of years before you plan to stop working (and plan to live off your passive income)

Years until retirement		Suggested Rate	Level of risk
From	to		
15	100	7%	H
10	15	6%	H
5	10	5%	M
0	5	4%	M
-5	0	3%	L
-10	-100	2%	L

Table L3.3

The table above can be used to help determine a suitable interest rate that will be used in the next Step of our planning process. If you are unsure what to use, try using the 'Suggested Rate' based on the 'years until you plan to retire' and the level of risk you entered on Form 1.

Assuming as a couple we want to have a choices lifestyle averaging $1,907 per week during retirement, and so far, all we had identified as income in our retirement is $838 (Super, working and some passive income), then we need to find enough income to cover the weekly shortfall (after tax) as shown in the following table.

Names	Weekly Income needed as a couple in retirement	Less weekly income identified for retirement	Shortfall per week
John and Jane Doe	$ 1,907	$ 838	$ 1,068

Table L3.4

We can use this information to calculate the value of income generating assets we need to fill this gap (shortfall):

*Value of income generating assets required = Shortfall per week * 52 / Assumed rate of interest*

Using the data in the table above and assuming a 6% average return, the calculation is:

*$925,838 = 1,068.27 * 52 / 6%*

If we are not yet happy with the 6% interest rate value, we can use a range of values (or an alternate value). Using the range 5%, 6% and 7% suggests we need income generating assets in the range $793,000 – $1,111,000 to generate the shortfall of $1,068 per week depending on the interest rate we are comfortable with.

Assumed rate of Interest generated	Value of income generating assets required
5%	$ 1,111,006
6%	$ 925,838
7%	$ 793,576

Table L3.5

This means we can now calculate the 'Asset Gap' that can help bridge the 'Income Gap'.

We calculate this by taking the value of net income generating assets needed to bridge the income gap, and subtract the assets we already own:

Asset Gap = Value of income generating assets required – Net value of assets identified

We can do this for each of the 'interest rates' and 'asset values required' we just calculated:

Assumed rate of Interest generated	Value of income generating assets required	Less Current Value of all Assets	Asset Shortfall
5%	$ 1,111,006	-$ 747,574	-$ 363,432
6%	$ 925,838	-$ 747,574	-$ 178,264
7%	$ 793,576	-$ 747,574	-$ 46,001

Table L3.6

Currently this shows John and Jane Doe have identified they have net assets (at today's value) of $747,574, but when compared to what they need, they have a gap somewhere in the range $46,001 to $363,432. But at least they still have 5 more years before they retire. The gap is getting narrower.

We need to remember that for many people the majority of their current assets is usually the family home. And unless you are renting out rooms it is most likely not generating any income, and may not generate any income in retirement.