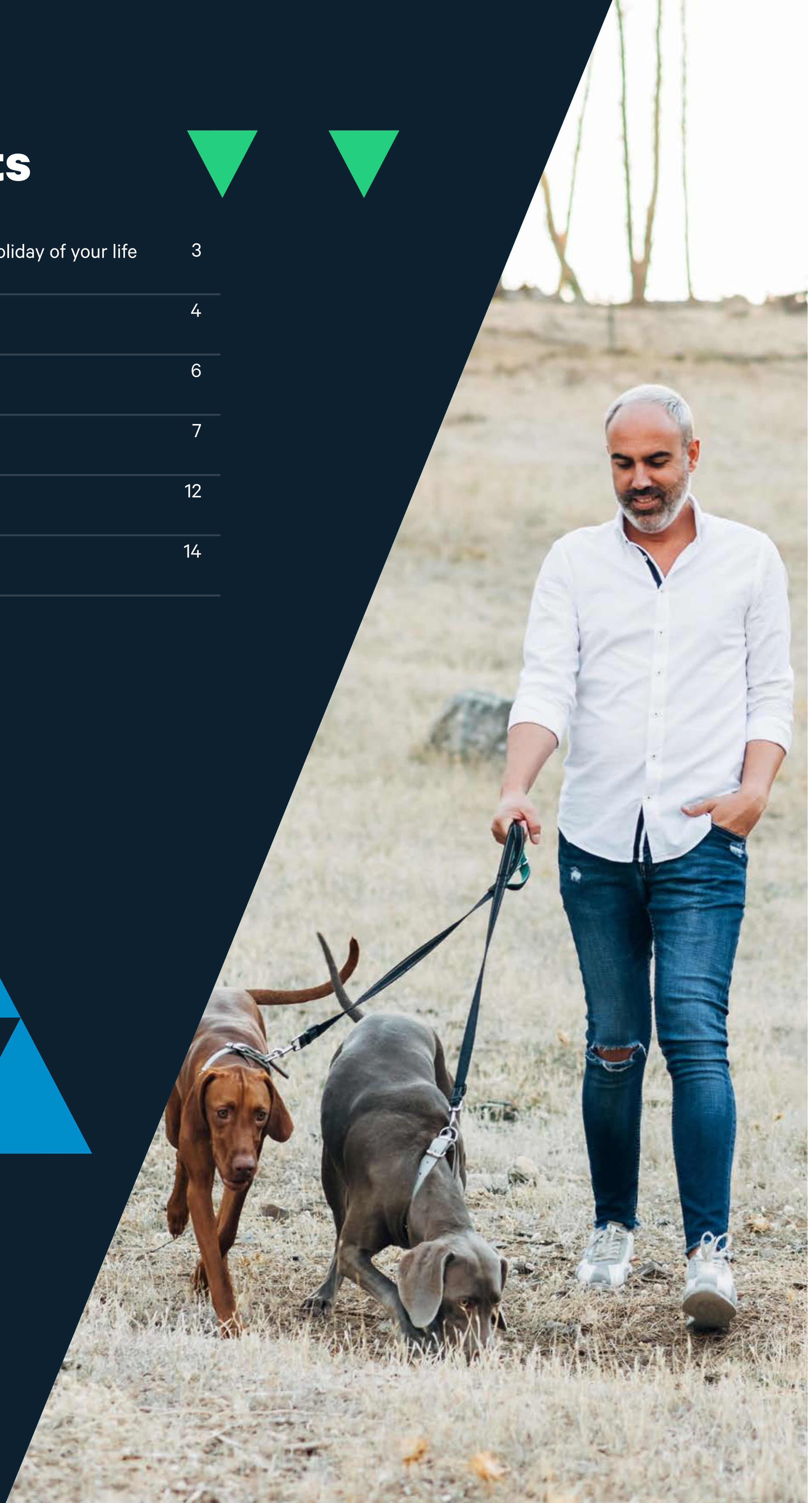
Retirement Planning

Start planning the longest holiday of your life

AZETS / Wealth Management

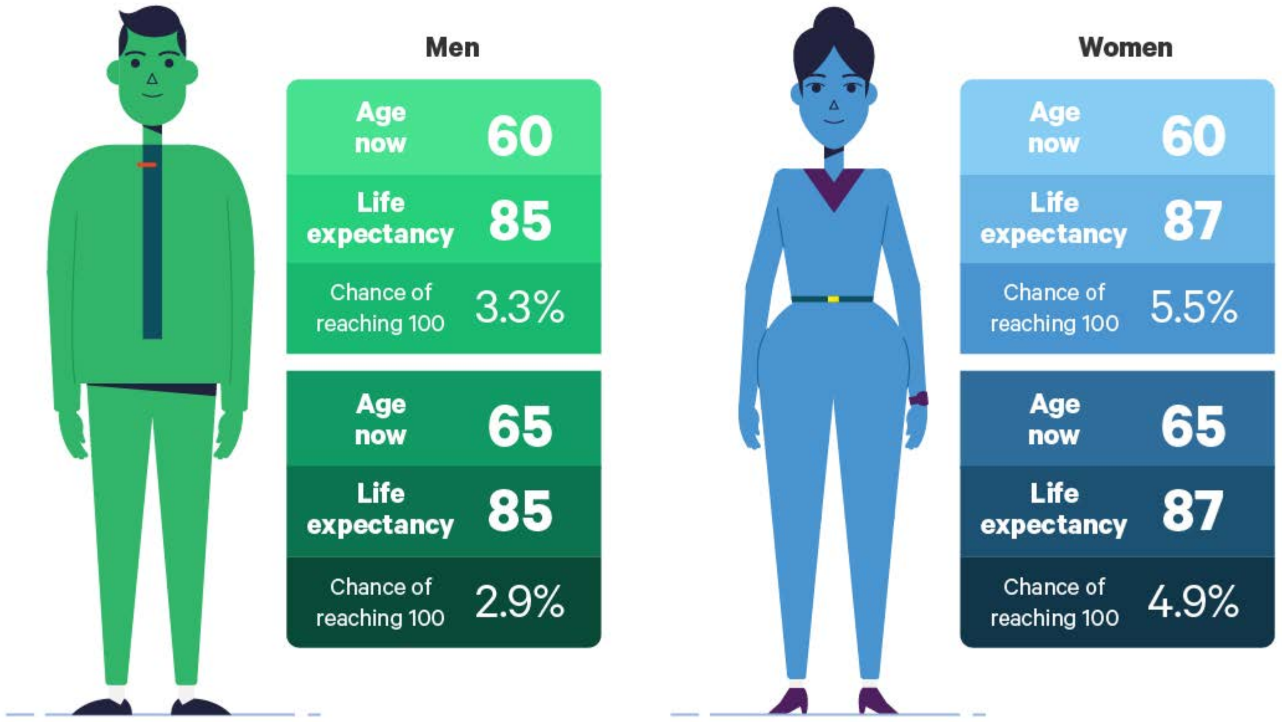
Contents



Planning the longest holiday of your Life

There comes a time when you stop working for your money and put your money to work for you. For most people, this happens at retirement and the decisions you make at this stage could have repercussions for the rest of your life. Recently, there have been some major changes to the choices you can make with your pensions which can have a knock-on effect on other retirement planning decisions.

The big question - how long will your retirement be?



Source: ONS Life Expectancy calculator (2021)

What is retirement planning?
It is ensuring you have enough money for the rest of your life, to have the best standard of living you can. Put another way, it is considering all your income-earning assets, including investments, property and pensions, and putting them to work the best way possible for your circumstances.

Where do I start?
A good starting point is to estimate what net income you will need in retirement by undertaking a long-term cash flow planning exercise. This exercise will take into account how long you estimate you will live based on average life expectancy, your own health and family history.

What income sources might I have?
You probably have a number of different investments and other assets that can provide income in your retirement and perhaps leave an inheritance for your family. There could be pensions from different sources.

You are likely to have a state pension and other pension entitlements that have built up over the years, perhaps from several employers. You may also have money you have accumulated from savings or inheritances over your working life.

You might own your home, which may now be larger than you really need and you could possibly use some of its value to boost your retirement income. And perhaps you have a second home you could rent out.

What might my income needs be during retirement?
Your income needs may evolve as you grow older. For example, in the early years of retirement you may be happy to continue working part-time and so may need to draw less than the full potential income from your pensions and other investments for a while.

But your income needs could start relatively high and then reduce as you get older, before rising again. This could happen if you have an active but non-working early retirement with relatively high income needs, which then fall as you get out and about less, before increasing again if you need later life care.

The decisions you make when you retire should take these possibilities into account. You might also want to consider how to minimise the inheritance tax on your estate.

How final are the decisions made now?
Some decisions you take for your retirement may be irreversible, for example if you decide to take a fixed income from your pension schemes. Others, like the investment of a retirement lump sum, may need to be regularly reviewed.

Making the right investment choices at retirement is crucial and you owe it to yourself and your family to take professional advice. It is often best to start at least six months before your intended retirement date, because gathering all the relevant information and weighing up the various options can be a slow process.

Key Planning Issues at Retirement

Investment planning when you retire can be more complicated than sorting out your finances at other times. Here are some of the issues you are likely to confront.

Your investment goals may be evolving, with the emphasis moving from growth to income.

Your spending patterns are likely to change with no travel to work, and more leisure time.

Your attitude to investment risk and your ability to absorb losses will probably change once you have no earnings coming in with which to make good any investment losses.

Prior to retirement, you could have a large one-off investment to make, such as a pension scheme lump sum. And you may well need to keep your pension fund invested to generate the right levels of long-term income as your needs change.

Your marginal rate of tax could fall when you stop work, as your full-time earnings come to a halt.

You may want to pay more attention to inheritance planning than you have before. From April 2027, most unused pension funds and death benefits will fall within the value of your estate for Inheritance Tax purposes (subject to the result of a technical consultation in 2025).

You may not be certain about the level of your future income if, for example, you are planning to undertake some part-time work.

You may have big costs to incur, for example paying off your mortgage or making significant renovations to your house – what funds do you access to do this?

Pensions

There are two main types of pension you might hold.

- A defined contribution (DC) pension typically comes either from a scheme set up by an employer or from a personal or stakeholder pension plan. The DC scheme has a fund, part of which you can draw as a tax-free lump sum. The remainder is taxable, whether taken as income or as lump sums.
- A defined benefit (DB) scheme will provide you with a scheme pension that your employer (or former employer) guarantees, and which is based on your earnings and how long you worked for the employer. It could also pay you a tax-free lump sum.

Defined Contribution Schemes
The fund built up in your Defined Contribution Scheme (DC) pension plan effectively gives you a pot of money. The fund is made up of contributions from you and/or your employer, plus tax relief and investment growth. You can use this to provide either:

- A tax-free lump sum, usually up to 25% of the total fund, and a taxable pension income. The income can be provided by scheme pension, or by purchasing an annuity, or by pension income withdrawals from your pension fund; or
- All income.

Income Choice
The decision about whether to buy an annuity or to take pension income withdrawal deserves careful thought. It is worth taking some time to consider the choices; some people are likely to be better off buying an annuity and others should draw their income directly from their pension fund. In some cases, it may be worth starting with pension fund withdrawals and buying an annuity some years later.

A broad rule of thumb is that you should try to cover your fixed income needs with a fixed (annuity type) income.

Pension Income Drawdown
Under pension income drawdown, you draw your income directly from your pension fund. This is much more flexible, and you are in total control of how much income you do draw. However, there are no guarantees that the fund will be able to pay out an income for the rest of your life.

In reality, pension drawdown income is a gamble. Given the amount of income you are likely to take from the fund to make it worthwhile, it is likely that your fund size will gradually reduce. You are effectively in a race against time – will the money last longer than you will? Flexible income may be the best solution for you to manage the different income needs you have across your retirement. You just need to understand the risks.

There are various options as to how a pension in drawdown can be inherited, such as a continuing pension drawdown arrangement, as a lump sum payment, or be used to purchase an annuity. There can be varying rules depending on the scheme administrators, as well as potential changes depending on legislation at the time of death.

Whatever you do, you should consider the tax consequences. Drawing down a very substantial amount from your pension fund could cause more of your income to be subject to higher rates of tax than if you release smaller amounts each year.

You might be able to plan your income so that you can take a substantial amount from your pension without an especially high tax charge.

There are variants of income drawdown that can provide some extra security. Flexible annuities guarantee a minimum income level, at a cost, while fixed term annuities allow you to secure income for a number of years and leave a pot of money at the end for future income.

Annuity
An annuity is simply a lifetime income that you can buy from an insurance company using your accumulated pension fund. The key choice you have to make if you buy an annuity is what form should the annuity take. Your annuity income could stay at the same level for the rest of your life or you could opt for a lower starting income that increases each year to protect you against the effects of inflation. You could also choose for income to be paid to your spouse, partner or anyone else you choose, perhaps at a lower level than your pension, if you die before them.

If you are under age 75 when you die, income for nominated survivors is paid tax free. The advantage of an annuity is that it is simple and guaranteed to last for the rest of your life – and your spouse or partner's life as well if you buy an annuity that includes this. The main drawback of an annuity arrangement is that it is not flexible.

Remember, this should be treated as a decision for life. Once made it cannot be undone. Advice regarding annuity selection is highly recommended.

Fund Withdrawal
An uncrystallised funds pension lump sum (UFPLS) allows you to withdraw money from your pension, up to the full value, without needing to access drawdown or an annuity. With an UFPLS, 25% will be tax-free, with the remainder taxed as income, although received as a lump sum.

While this option may seem attractive, withdrawing the full amount could take you into a higher income tax bracket, and may not be beneficial. It will also restrict future payments to DC pensions without tax charges. It is important to get advice if you are considering this option.

Defined Benefit Pensions (DB)
Defined benefit (DB) pensions are paid directly from the employer's pension fund and are based on the guaranteed income your employer/former employer's scheme will provide for you. Importantly, in almost every case, the income from a DB scheme will be significantly better than the annuity you could get elsewhere in the market if you took the capital value (transfer value) of your DB scheme and tried to "buy" that exact annuity.

In most defined benefit schemes you will have one simple choice to make about how you receive your main benefits: do you want to exchange some of your taxable pension for tax-free cash?

Cash and pension or just pension? Put that way, the answer might seem obvious, but in practice, cash might not be the better option. The terms on which you will be able to exchange some of your pension for cash are often far from generous. And taking cash means a smaller income for life. In public sector schemes, cash is often a fixed part of the overall benefits, although usually you will be able to commute a small part of your pension for extra cash.

Pension changes following the Autumn Budget 2024

- Annual Allowance will remain at £60,000 and the tapered threshold will remain at £260,000.
- The ability to carry forward unused allowances from the previous 3 tax years continues.
- Lifetime Allowance charges have been removed and there is currently no plan to reverse this.
- Those who have already withdrawn pension income will be subject to the Money Purchase Annual Allowance (MPAA) of £10,000.
- Tax Free Cash for defined contribution pensions continues to be 25% of the value of your pension or £268,275, whichever is the lowest.
- From April 2027 (subject to a technical consultation in 2025), most pension benefits will be included in the value of the estate for Inheritance Tax purposes.

Tax on gains (held outside of pensions and ISAs):

- Capital gains rates will increase to 18% for basic rate taxpayers and 24% for higher and additional rate taxpayers.

Investments

How could your investments supplement your income and capital requirements in retirement?

How to Use Investments to Generate Income
Broadly speaking, there are three ways in which you can take income from investments.

- You could just take the natural income. For example, dividend income. The hope would be that the dividends would rise in future and provide an increased income and even some capital gains. Of course, this is not guaranteed and income and capital values could drop.

- You could regard the total return from your investments as your income. In that case, you would regard both the income and capital gains as your spendable income. Clearly, this is a higher risk strategy because you cannot count on making gains on a regular basis, and there may be years when there are losses. It also reduces the potential inflation protection for the portfolio of investments.

- You could consciously aim to eat into the capital as well as drawing the income and gains. Clearly this is the highest risk, because at some time the capital will run out –possibly while you are still living.

It is very important to retain a quality financial adviser to help you manage these risks. Doing that will help you to pay less tax and make your capital last longer. If you are looking for natural income now, there are three main investment sources of income to consider – both in the UK and overseas.

- Fixed interest securities, which cover a wide area of investments from government bonds (gilts) to corporate bonds. Income yields vary considerably between different securities with, unsurprisingly, the highest yields from the riskiest bonds.

- Shares, which in the UK and many other countries now yield more than short-term deposits. Over the long-term, dividend income from shares has been less volatile than share prices.

- Rental income from commercial property.

Tax Wrappers
The three main investment sectors can be accessed through a wide range of investment funds (collectives). You can hold them directly (through an OEIC) or through other investment ‘wrappers’, such as ISAs and investment bonds.

The choice of investments, the appropriate wrappers and who should own what investments are all areas to explore with your financial adviser in the run up to retirement.

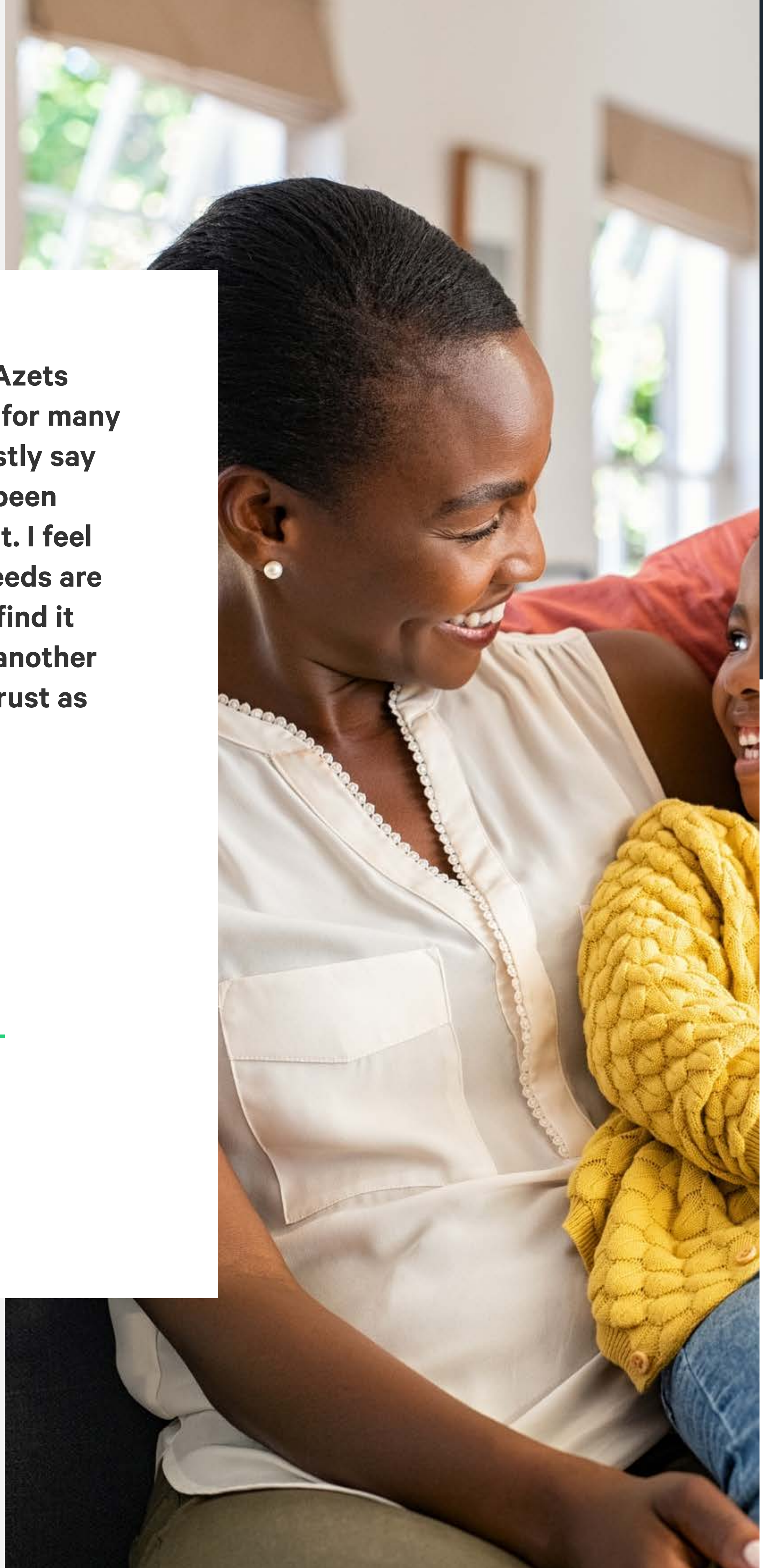
After that you should review your investments with your adviser regularly – usually once a year – to make sure that your objectives are still being met and to make any necessary amendments.

Using your home or buy-to-let in retirement planning
Planning for retirement should also take your property(ies) into account. Selling and downsizing could release significant capital from which to produce income. Alternatively, re-mortgaging and investing in a second property and renting one out is another possible option, although new tax laws on deductible expenses have made this less attractive.

For those with well-established rentable second properties this source of income could be invaluable. It is always wise though to compare net rental yields to other more liquid forms of investment to ensure you are getting the best use out of your capital.

"I have worked with Azets Wealth Management for many years and I can honestly say that the service has been consistently excellent. I feel that as a client my needs are put first and I would find it very difficult to find another adviser who I could trust as much as I do now."

Murray Hogg
Murray Hogg Limited



How can we help?

Preparing for your retirement is complicated, with many different things to take into account. We can help you with your planning and, in particular, we can provide advice on:

- Choosing between annuity and income drawdown, and finding the best annuity rate if relevant.
- The best provider, investment strategy and income levels for drawdown.
- Managing your liquid capital, including the pension lump sum, in a tax-efficient way that meets your needs.
- Inheritance planning.

This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before acting on any of the contents of this guide. We can accept no responsibility for any actions you take as a result of reading this document, where you are acting independently of financial advice.

Investment Warnings

- Investing should be regarded as a long-term strategy and should fit in with your overall attitude to risk and financial circumstances.
- Past performance is not a guide to future performance. The value of investments and income from them can go down as well as up, and you may not get back the original amount invested.
- Levels and basis of, and reliefs from, taxation are subject to change and depend on your individual circumstances.
- In retirement the level of capital is likely to drop because of the money you are taking out. It is vital that you ensure as far as possible that the money doesn't run out during your lifetime.
- The Financial Conduct Authority does not regulate financial planning tax or estate planning.

Follow us

www.azetswealthmanagement.co.uk

AZETS / Wealth Management