Advice Matters
FINANCIAL PLANNING

9 essential steps to prepare for retirement

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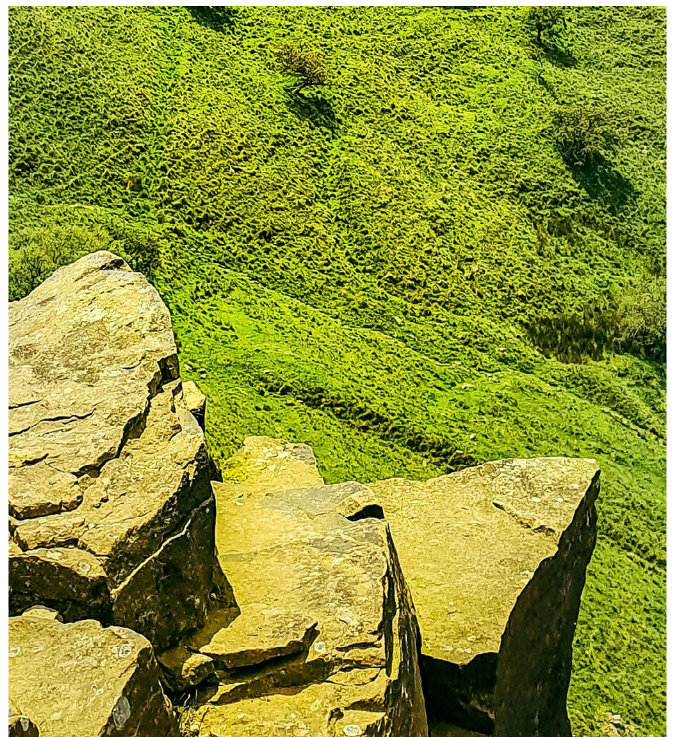
Introduction

No matter your age, if you're thinking about retiring in the next few years, there's quite a lot of planning involved. It's much more than dipping into your pension and starting to spend! From budgeting to tax considerations to think about, we've tried to make life a little easier for you. Here is our essential 9 step guide on how to prepare for your retirement.

1. Picture your lifestyle

First, the fun bit! Think about your goals and aspirations - what kind of retirement do you want to live? You might want to see the Northern Lights, learn a language, rally a classic car or ride a gondola in Venice. It could, quite literally, be anything. What's on your bucket list?



Picturing your future lifestyle now will help determine how much income you'll need in retirement to achieve those ambitions.

Some people overestimate what they will spend in retirement, thinking that they are likely to spend the equivalent of their income in employment. But, in reality, after surveying thousands of retirees about their outgoings, Which? found that households typically spend around £2,220 a month. That's equivalent to just £27,000 a year, and for a little more luxury with long-haul holidays and a new car every five years, you'll need around £42,000. Remember, you probably won't be bringing up children or repaying your mortgage by this point.

2. Do some (realistic) budgeting

Your money, ideally, should outlive you! The last thing you want is to run out of income in the later years of life. There are two very important factors when budgeting for retirement:

- The amount you will probably spend each month, and;
- How long you are likely to live, as morbid as that might be!

A study by Zurich found that only 34% of retirees taking flexible personal pension income calculated how much they need to cover day-to-day expenses. Even worse, just 22% had budgeted how much they need to cover non-essentials, like holidays and dining out, as well.

Once you've calculated your likely regular expenses, it's time for the morbid half of retirement budgeting… Many studies over time show that people largely underestimate their lifespan. In fact, the Institute for Fiscal Studies found that people in their 50s and 60s underestimated the likelihood of them living to age 75 by 20%.

Once you've done some budgeting, it's time to see if your pension savings and other income can support your desired lifestyle!

3. Find out how much State Pension you're entitled to

The State Pension often forms the foundation of people's retirement income. From 2018, men and women begin to receive their State Pension from age 65, but this is set to increase in the future. Depending on your birthday, you might not be eligible for your State Pension until 68 years old, so it's worth checking.

The amount of income you'll receive depends on how much National Insurance contributions you've paid. For the full State Pension entitlement, you'll need to have paid the equivalent of 35 years, either over time or by buying extra years and topping it up. In 2019/20 a full entitlement would usually provide an income of £168.80 a week - £8,767.20 over the year.

If you're planning to work part-time or flexibly into retirement, or have enough income from other sources, you can defer your State Pension to a later date and receive a higher level of income.

You can check your state pension age and entitlement on the **Gov.uk website**.

4. Review your personal pensions

If you are, or have been employed, you'll almost certainly have a workplace pension. You will hopefully have an additional personal pension or two as well! It's time to get them in order - you need to understand how much you will have saved and what income that can provide before you retire.

Currently, there are two types of pension and it's really important to understand the difference between them.

Defined Contribution pensions are a pot of money that builds up over time. It is available as a Personal Pension, where you pay all the contributions, or as a Workplace Pension, where you and your employer pay into it. Since Pension Freedoms that were introduced in 2015, Defined Contribution pensions are accessible from the age of 55 and you can spend it how you want.

The value of a Defined Contribution pension depends on how much you've paid in and how the underlying investment funds have performed. You'll also need to consider charges for administering the scheme and investments. Ultimately, you are responsible for choosing how to take your pension income, which can take the form of;

- Taking a lump sum
- Drawing a flexible income
- Withdrawing the whole pot in one go
- Purchasing an Annuity for a guaranteed lifetime income
- Leaving it invested

These options are not mutually exclusive; a combination of options might be most appropriate for you. You should always consult a Financial Planner before drawing on your Defined Contribution pension scheme as there are potential Income Tax consequences, depending on how much of your pension you take.

Defined Benefit pensions are also referred to as 'Final Salary' and are only available as workplace schemes by employers. They pay a specific income, from a set date, for the rest of your life. The level of income usually depends on your time with the employer and your salary when you retire. You may have read about huge transfer values being offered in exchange for forfeiting the guaranteed lifetime income. Whilst this may seem attractive now, it isn't always the best course of action. If you're offered to transfer out of a Defined Benefit scheme, it's a very important one-time decision that needs careful consideration.

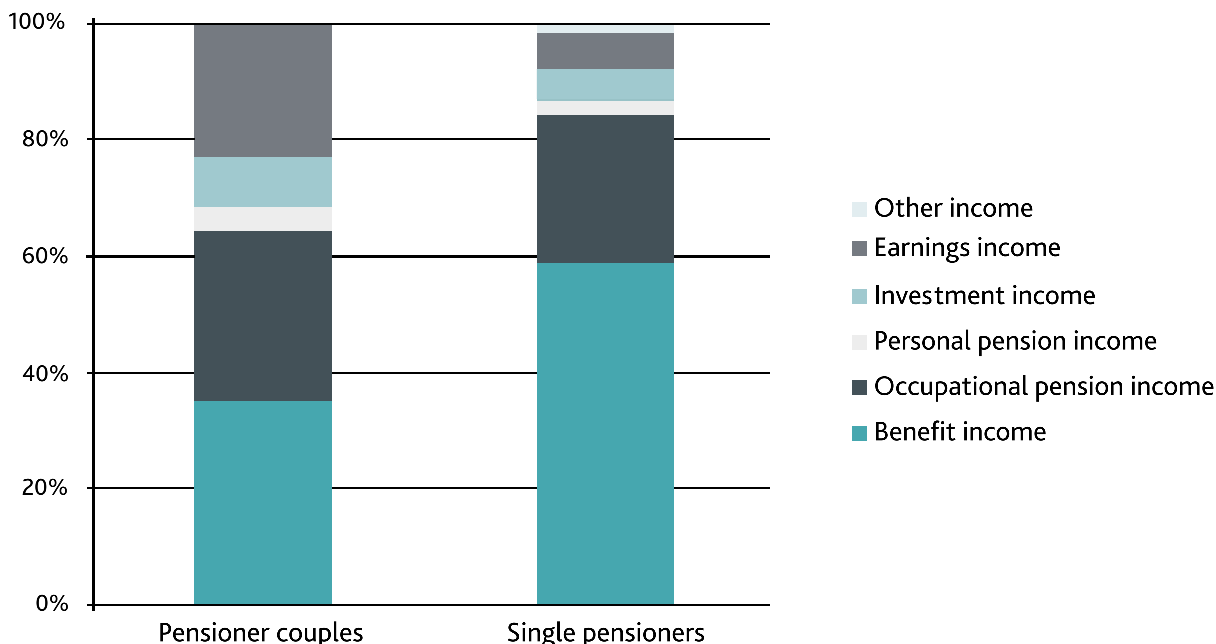
5. Stay out of debt

The lifestyle spending figures mentioned in step 2 assume one very important thing; you don't take a mortgage, loans or other debt into retirement. All debt, especially high-interest, should really be paid off before you retire, if possible. Not having a mortgage is important, given the large regular financial burden. This will mean your pension income can go towards achieving your aspirations, not paying bills.

6. Think about where other income will come from

Retirement income doesn't just have to come from your pensions. A recent ONS report found that more than one-fifth of pensioner couple's income came from earnings, as more people tend to work for longer, in more flexible roles. It's worth noting that 'benefit income' in these charts represents State Pension income too.

Percentage of gross mean income from different sources, 2017/18



Utilising property is another growing option for generating retirement income. Buy to Let investments have been traditionally popular, as they provide a regular income, but they are less attractive today thanks to revised tax rules and legislation.

For many people, their home is their largest asset. Equity Release products are gaining in popularity as a way of accessing the value locked in your home without having to downsize. There are currently unprecedented levels of product choice and flexibility too, and in the first six months of 2019, £1.85 billion of equity was unlocked by homeowners according to the Equity Release Council.

Equity release rates are also at an all-time low thanks to the increased competition, so depending on your circumstances, it could provide a cost-effective way of helping to fund retirement.

7. Think about your health

There's no escaping the fact that we are living longer, and a mounting social care crisis in the UK is worrying local authorities. Exacerbating the issue is the fact that, according to **Royal London**, only 50% of people taking from their personal pensions have a good likelihood of it lasting their lifetime, let alone being available to fund the cost of care too.

The average cost of a care home in the UK is around £30,000 a year, according to the Money Advice Service. This rises to £40,000 if nursing care is required and is likely to be higher still in the South East. Budgeting for these costs means you can choose the kind of care you would want in later life and exactly where that is provided.

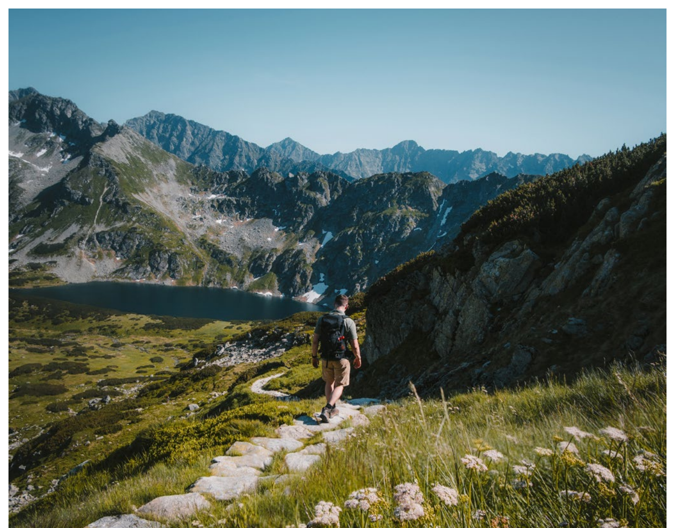
8. Start planning to reduce a possible Inheritance Tax bill

Inheritance Tax (IHT) is charged on the value of your estate when you die. It's currently at a rate of 40% and there are two 'Nil-Rate Bands' available, up to which you don't pay IHT. They are the Nil-Rate Band, which is currently £325,000 per person and planned to remain the same until 2021, and the Residence Nil-Rate Band, currently £150,000 and set to increase to £175,000 in 2020/21. To benefit from this additional allowance, you must pass your home, or at least a share of it, to your children or grandchildren.

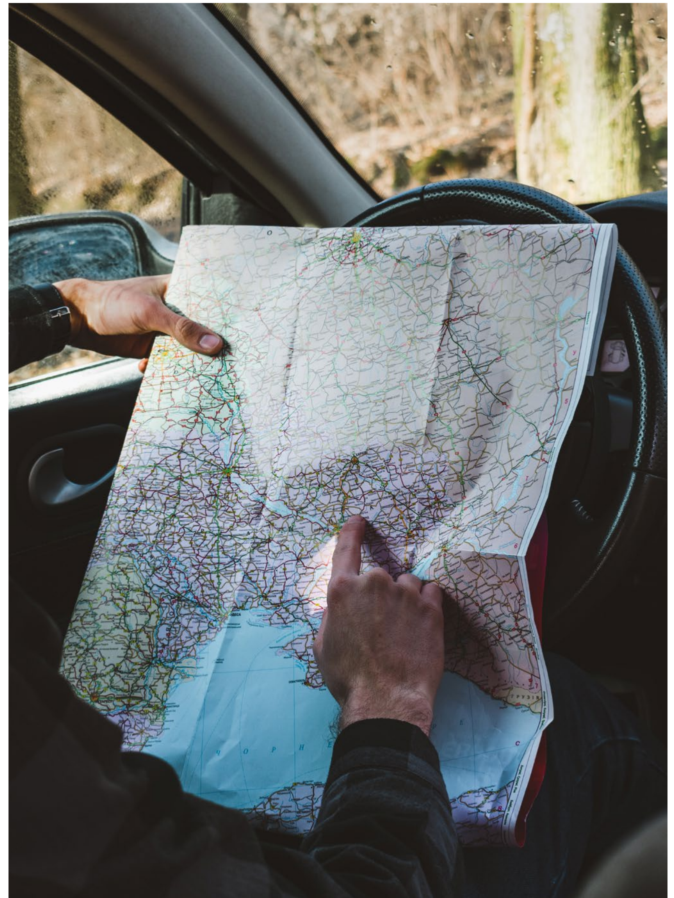
The earlier you plan to mitigate Inheritance Tax, the better. But unfortunately, not everyone is taking this advice. Over the past decade, the amount of Inheritance Tax paid has more than doubled to £5.2 billion in 2017/18 with around one in 20 estates liable for this tax.

If the value of your estate is above the Nil Rate bands, there are several ways you can reduce or eliminate an IHT bill. Options include;

- Writing a will - Amazingly, 59% of UK parents either don't have one or it's out of date according to Royal London. Not only will your estate be distributed how you want, but it's also a very simple way to reduce a potential tax bill.
- Leave your estate to your spouse. If you're married or in a civil partnership and leave your entire estate to your other half, they will pay no IHT. Better still, they will also inherit your unused Nil-Rate bands. Under current rules, that could mean their total IHT exemption is as much as £950,000.
- Make gifts - Gifting any kind of asset is exempt from IHT if you live for seven years after giving it. If you do die during those seven years, the gift may still be considered part of your estate. Under the Annual Exemption, you can gift up to £3,000 a year and it will be immediately outside of your estate, removing concerns about the seven-year rule. It also rolls over a year if you don't use it in the previous tax year, so you could gift up to £6,000 at once.



- Use a trust - If you put assets in trust, you are nominating them for the benefit of another. There are lots of different types of trusts in the UK designed to fulfil different purposes, one of which is mitigating IHT.
- Give to charity. If you donate to charity or include a donation in your will it's immediately exempt from IHT. You'll be doing a little good, whilst potentially saving tax. As an additional incentive, if you leave 10% or more of your estate to charity, the IHT rate is reduced from 40% to 36%.
- Specialist investments - Alternative Investment Market (AIM) shares are sometimes not liable for IHT thanks to an exemption called Business Relief. This is quite a complex area of financial planning and is often associated with a higher level of investment risk. If you'd like to discuss the use of an AIM portfolio to mitigate IHT, please get in touch.
- Insure against it - If you can't avoid IHT or don't want to use some of the methods mentioned, you have the option of taking out life cover to pay the likely tax bill. Just make sure this is written in trust and paid to a named individual, otherwise, the pay-out would increase the amount of tax due.



9. Speak to a financial planner

There's a lot to think about when preparing for retirement and we understand it could be a little overwhelming! The good news is you don't need to tackle it alone.

We plan to achieve your goals for the life you want, both now and in retirement. We use cash flow planning tools to work out your budget and where you stand now and in retirement. We'll also cover certain 'what-if' scenarios so you can be confident that your financial plan will hold-up, whatever life throws your way.

With effective, ongoing, trustworthy financial planning you can be safe in the knowledge that your financial wellbeing is in safe hands.

If you'd like to chat you can get in touch at:

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Alan & Karen Campbell from Shirenewton, Monmouthshire. Clients since 1986

Alan and Karen got married in 1986 in the Langdale Valley, Lake District. They met at work in the hotel where Alan was the hotelier and Karen worked in sales. After the birth of their two daughters, they bought their first house in the Lake District.

Being a hotelier, the family moved around a lot over the years, living in the Middle East, Ireland, Scotland and Europe. As a family, Alan and Karen needed to feel that wherever they were in the world, they always had a solid base to come home to.

What prompted Alan and Karen to seek financial advice?

Their goal was to make sure that their daughters had a good start in life, which included helping them onto the property ladder. At the same time, they wanted to secure their future and plan a retirement they could look forward to.

How did Chris help?

Chris initially advised them on their mortgage requirements, along with savings policies which remained through to maturity 25 years later. Gradually, their financial planning turned more towards options for retirement, with extensive pension planning, and to assist with their tax returns to claim higher-rate relief.

How have they benefited from the advice?

Alan says: "Chris has always been there from the start. You can ring him at any time, even when he's in France, which I have done on a few occasions. He has pointed us in the right direction many times. Without Chris, our financial future would not be as strong as it is today. We know we can relax."

"Chris is now advising our daughters, and we're delighted to know that they're in safe hands."

Steve from Manchester and a client sine 1992

Steve is a Director of an insurance business. He is married and together with his wife is a client of Advice Matters. Steve is keen on charity work and has recently completed a charity fundraising trek in Transylvania.

What prompted Steve to seek financial advice?

Whilst Steve had no financial concerns, he wanted to know if early retirement would be a possibility. As financial services was outside of his expertise, he knew that he needed to work with someone with experience and knowledge of the opportunities and possibilities in the market place.

How did Chris help?

With sensible step by step advice, Chris advised Steve and his wife as to what they should consider at various stages in their lives, and what they could afford to do at each stage. They started with building up their pensions, then looked at other options.

How has Steve benefited from our advice?

Steve and his wife have been able to carefully build a portfolio of investments which will enable them to be able to retire when they feel ready to do so.
Steve says: "This gives the option as to when or whether we want to do things. We won't need to work for the next ten years if we don't want to. The advice we've been given has enabled this to be possible and you can't ask for more than that!"

"We won't need to work for the next ten years if we don't want to."

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