Tideway
Wealth & Retirement

# 7 practical steps to secure your retirement income

A guide by Tideway, the wealth and retirement specialists

tidewaywealth.co.uk

## For many people planning for retirement is a daunting, and even surreal, prospect. There are many unknowns and often perceptions don't match reality.

In this guide we provide a system to create a realistic retirement plan tailored to your unique circumstances. It takes you step by step through assessing your retirement income needs, understanding your assets and future income sources, and making the most of your money.

It also explains the necessary shift in mindset from building your assets to making those assets work for you and highlights the philosophy behind successful investment management.

The guide takes you through the seven following topics:

1. **Assess your income needs**
2. **Value your assets and future cash flows**
3. **Plan to top up**
4. **Invest for stability**
5. **Use the tax planning opportunities**
6. **Set up to create regular income**
7. **Be prepared early**

Let's dig in.

1

# Assess your income needs

Knowing how much money you need for retirement is essential for sound financial or pension planning. It provides the focus for all further actions.

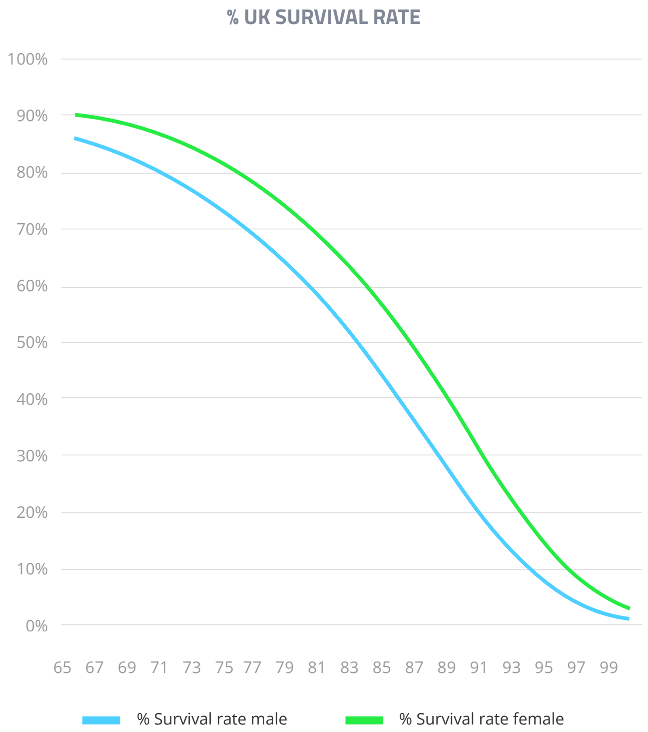
We begin the process by identifying these needs. This can be harder than it sounds because there's a lot to consider.

Keep the process as simple as possible by breaking it down into three core categories.

1. **Core needs.** Essential costs that enable you and your dependents to live, such as food, water and shelter. In the UK right now, this is generally around £1,500 - £2,500 per month depending on location.

2. **Basic lifestyle costs.** These are regular monthly expenses that support your lifestyle choices. For example, eating out, gym membership and annual holiday.

3. **Target discretionary spending.** This category covers those one-off lump sums you'd like to spend. For example, a 'bucket list' holiday, contributing to dependents' property, education or business needs. It could be an annual expense or a lump sum at a particular time.




Source: ONS National Life Tables (3 year) - England

## How long will you live?

So, now you have an estimate of what you need, the next practical question must be for how long will you need it?

Life expectancy in the UK is continuing to rise, albeit at a slower rate than previously.

The UK Government publishes life expectancy tables. However, these are complex to navigate. For pension planning simplicity, a basic assumption for a healthy person is to use the life expectancy age at which only 10% of the population would likely survive.

Moreover, as life expectancy is increasing, we assume that the younger the person, the longer they will live. In broad terms, only 10% of males survive beyond age 94 and 10% of females will survive beyond age 96.

## What about inflation?

In financial planning we use two terms for incomes: nominal incomes and real incomes.

'Nominal' incomes and expenditures are simply the pound values of incomes and expenditures today and in the future. Whereas, the term 'real' is used to express incomes and expenditures adjusted for inflation.

Essentially, the difference between these two terms is the rate of inflation. We expect future prices to be higher than today's prices by this rate.

When estimating future income and expenditure needs, we know the values will increase by inflation and we make allowances for this. However, it's always surprising how much more income is required to cover expenditure over a long period of time.

Our calculator spreadsheet "How much money do I need to retire?" will help you understand and calculate income needs after allowing for inflation.

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# Value your assets and future cash flows

Once you know your likely income needs, Step 2 is to value your current assets and estimate how much future income you can generate.

## Find out what your State Pension will be

The State Pension is a regular payment from the UK Government claimable upon reaching State Pension age.

You can find out your State Pension age by heading over to Check your State Pension age.

You can check the amount you are entitled to on this government website link.

If you don't want to create a Government Gateway account to get a precise figure, you can make your own estimate from understanding how it's calculated.

At this point you've got a figure. It should be around the basic State Pension value of £179.60 per week if you were entitled to a full state pension.

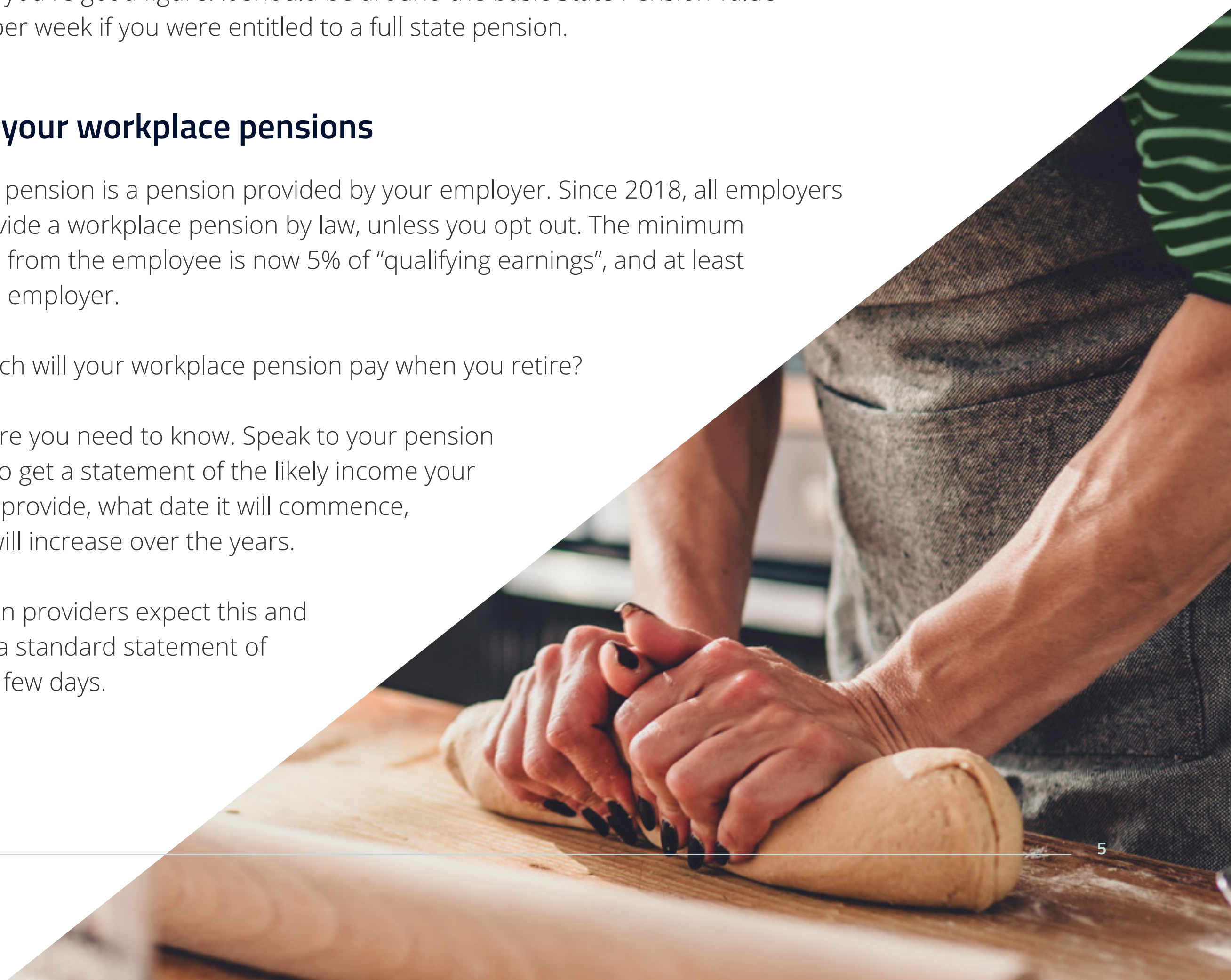
## Consider your workplace pensions

A workplace pension is a pension provided by your employer. Since 2018, all employers need to provide a workplace pension by law, unless you opt out. The minimum contribution from the employee is now 5% of "qualifying earnings", and at least 3% from the employer.

But how much will your workplace pension pay when you retire?

This is a figure you need to know. Speak to your pension provider(s) to get a statement of the likely income your pension will provide, what date it will commence, and how it will increase over the years.

Most pension providers expect this and will provide a standard statement of this within a few days.



## What about your property?

Upon retirement, you will probably have paid off some or all of the mortgage on your principal residence. This means that there will be equity tied up in your property that you may be able to release at some future point, either by downsizing to a less expensive property or by taking an equity release loan.

## Other sources of income and expense savings

Other sources of funds may be any Individual Savings Accounts (ISAs) and General Investment Accounts (GIAs) that you have built up.

ISAs are tax-free savings accounts, meaning the funds inside the account are not liable to income or capital gains taxes and can be withdrawn at any time. Currently, there is a strict limit of £20,000 each tax year for each person.

GIAs are general investment accounts with no particular tax wrappers that can be opened at a stockbroking firm. Funds may be invested in cash, stocks or bonds. They are exposed to normal income and capital gains tax at your marginal rate after salary earnings.

# 3

# Plan to top up

Many people will have opportunities for lump sum incomes that can be taken into account in retirement planning. Inheritance, redundancy, business or property sales are the most common situations.

## Inheritance

Although the deaths of older generations are unpleasant to think about, they can result in an inheritance tax lump sum for the surviving family. Whilst the timing of this income is never certain, the approximate amount can often be anticipated and form part of your long range planning.

## Redundancy

The response to the coronavirus pandemic resulted in increased redundancies across many industries. If you are in this position you may have been offered a redundancy package and be wondering how best to utilise it.

Depending on how much your package comes to, you may have several options.

### Tax free payments

The first £30,000 of any redundancy payment is tax-free. It does not count towards your taxable income and is often used to cover immediate capital and income requirements.

Redundancy payments in excess of £30,000 are taxable at your marginal rate of tax.

However, if your earnings and / or the redundancy payments are higher, the taxation of the payment can be more severe. Annual payments over £100,000 result in a reduction in your personal tax allowance, currently £12,570, by 1 for every 2 of income. The Government website publishes the latest and historic tax rates.

## Using a pension

Upon request, an employer can make any payments in excess of the tax free amount into a pension fund, such as your workplace pension, reducing your immediate tax liability.

In addition, any income and gains earned within the pension wrapper are also tax free. Up to 25% of these funds can be withdrawn free of tax, up to your lifetime allowance. Currently you can withdraw funds from the age of 55, although this may change in the future.

Funds can be drawn down over time in a tax-efficient manner, and to suit your income needs, maximising use of your annual personal tax allowance.

In addition, if you didn't previously maximise your pension funding, you can backfill the annual allowances for up to three tax years. This is known as carrying forward.

However, you must have been a member of a registered pension scheme at the time, and have made the maximum allowance contribution in the current tax year. This can mean boosting retirement savings by as much as £160k gross in a single tax year.

Although often challenging to calculate back allowances, if you have 10 years of pension data, the HMRC calculator will advise the upper limit to your contributions for the current tax year. It may be best to seek professional advice to make sure you get this calculation right and avoid unforeseen tax penalties.

## An added bonus

By making contributions to your pension plan, and not paying you directly via the PAYE system, an employer avoids paying Employer National Insurance contributions, currently set at 13.8%.

Employers will often share or pass on the full amount of these savings to staff, resulting in an uplift to a redundancy offer. If you are currently going through redundancy proceedings, make it a priority to speak with your employer.

However, there are additional factors that need to be considered by employer and employee before a pension contribution can be made. One such factor is age.

Under current rules, pension can only be accessed at age 55. If you are still relatively young, more readily available funds may be of more use to you. In addition, pensions are complex and any significant contributions will likely affect pension-related allowances, resulting in unforeseen consequences.

Receiving professional and experienced advice on your full financial situation, including any redundancy payments, is advised. It can help you to avoid any negative implications of pension related decisions, such as unplanned tax bills.

## Business Sale

Business owners are often able to release capital on their retirement by selling their business - and if they own more than 5% of the business, can avail of business asset disposal relief, commonly referred to as entrepreneurs relief.

In broad terms this enables you to pay just 10% capital gains tax on the capital gain up to a lifetime allowance of £1m. A conservative estimate of your post-sale after-tax income can be used for pension planning purposes. However, a business sale often takes longer than planned, so be conservative with time planning too.

## Property sale

Downsizing a main property is a popular option for tax-free equity release.

Buy-to-let properties may also be considered but the sale is more complex and will be subject to capital gains tax. In addition, the yield available to you from the property must be compared with the yield available from investing the funds in marketable securities.

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# Invest for stability

## How retirement income investments work

A popular reason for investing is to earn a higher return on your capital than a cash deposit account can provide.

However, many investments, such as property, are illiquid and require a lot of managerial effort. Fortunately, global investment markets offer more liquid investment securities that are bought and sold in smaller blocks.

The most popular securities are one of two types, shares or bonds. A share is a unit of ownership of a company that provides a method for profit sharing and also a capital gain if the price rises. Bonds are small packets of debt owed by a government or corporation and provide a fixed income to the bondholder.

Consequently, if you were seeking higher returns for retirement income, it might be sensible to switch funds from a bank deposit and buy a selection of investment securities instead.



With a huge investment universe out there, which investment securities should you buy and sell, and when?

To answer these questions requires investment knowledge, continuing research, steady nerves and a considerable amount of administration. It's a lot of effort and certainly not for the faint hearted!

Most people recognise straight away that they are out of their depth and need professional help.

Buying a selection of collective investment funds offers an individual investor a broad range of opportunities and more extensive management expertise than would otherwise be available.
It also enables the pooling of money in collective investments, sharing the investment risk.

So the second step of the investment process is to make a selection of funds through which you will hold your investment securities.

One major advantage of buying funds is the ability to divide your money between assets and fund managers. This diversification helps to protect your capital and lowers investment risk.

But there's another advantage to pooling money. And that's the minimum size of investments bought or sold commercially. Certain securities trade with minimum denominations. For example, bonds typically have a minimum purchase of £100,000. This puts them out of reach for many individual investors.

However, when capital is pooled, a fund manager invests the entire portfolio, providing each investor with proportional access to these minimum denomination investments.

Other good news for fund investors is the continuing price war between fund managers. Indeed, many funds are now cheaper to access, buy and sell than some individual securities.

Moreover, since 2012 Tideway estimates the average annual costs in funds have reduced from over 1.5% to under 1%. In many cases, costs have declined towards 0.5%, with some passive funds costing as little as 0.10%.

Plus - and it's one of the industry's better kept secrets - you are more likely to get a better manager looking after your money via a fund than employing an investment manager directly.

However, a few people still like to create and run their own portfolios on online execution-only platforms. But, although easier than buying securities directly, it's still hard work with many potential pitfalls.

Consequently, many people still prefer to employ a professional portfolio manager to select and manage a portfolio of funds for them.


Once you've created an investment portfolio to satisfy your income needs, it's important to consider the tax implications to optimise your wealth.

Many people will accumulate their savings via tax privileged accounts, often referred to as tax wrappers. Common tax wrappers include personal pension accounts, such as Self-Invested Personal Pensions (SIPP) or Individual Savings Accounts (ISAs).

In addition, valuable personal tax allowances exist, often making it tax efficient to hold investments directly in General Investment Accounts (GIAs). A couple may use all three of these tax wrappers and require money to be invested in up to six separately taxed accounts!

A good online investment platform enables you to set up and hold the funds in the most tax efficient wrapper accounts.


If all that isn't enough, there are more issues to think about. For example,

- Which funds are best held in which accounts?
- Which account should I spend first if I want to pass on money to my children?
- How do we best optimise our position as a couple?
- What about the pension lifetime allowance?
- How much money can I spend if I want to avoid running out?
- If I need my capital as a lump sum, how do I take it tax efficiently and without selling investments at a loss?
- What happened in the last budget? Do I need to change my funds and accounts?

Solving these questions and helping you to put the answers into practice is the job of a wealth manager.


### A complete solution

A wealth manager can provide you with a holistic solution to considering how you might invest for a secure retirement income. A wealth management service should incorporate financial advice, tax wrappers, specialist funds and portfolio management.

A wealth manager will take the strain of all these decisions for you, letting you sit back and enjoy your retirement. Moreover, a great wealth management service will provide you with the income you need, with the highest degree of certainty and the lowest risks.

## Avoiding capital losses with horizon planning

When you're 40, time is on your side!

You look forward to increased earnings, a growing business, or other opportunity to make money. You don't need to rely on your investments for income, and should the financial markets take a plunge, capital losses may only be temporary. You can recover.

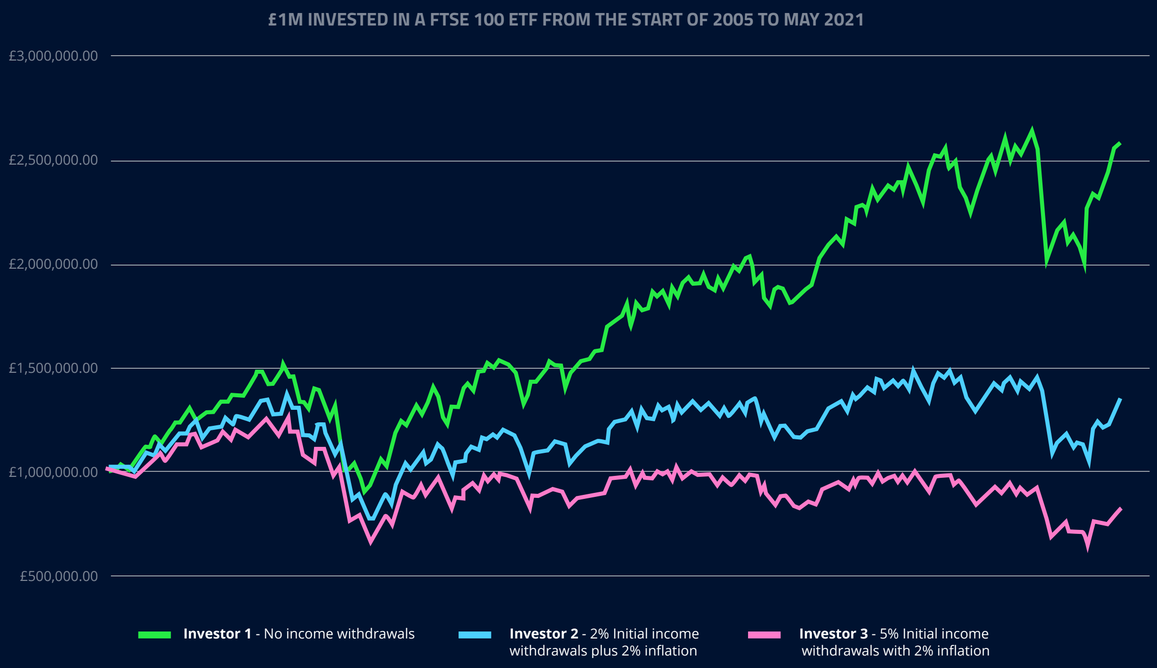
After all, you may have another 25 years before retiring. However, if retirement is only 5 years away, the opportunity to accumulate savings is diminished.

Your capital becomes irreplaceable. Once it's gone, it's gone and your ability to financially recover is reduced. Market plunges need to be avoided.

In practical investing terms it's time to take less risk with your investment capital. To understand the impact of early withdrawals on a growth portfolio, take a look a the chart below.

It illustrates the long term impact of taking income from an investment account prior to the market correction in 2008. The loss of return is magnified as the portfolio recovers strongly.

We advise taking professional advice on horizon planning.




## The need for predictable investment returns

When time is on your side and you work for a living, it's easy to be indifferent to the size, timing and composition of investment returns. After all, they're nice to have but not essential.

However, once you need a regular income from your investments, the ability to forecast for income and tax purposes becomes essential.

Generally, income returns from investments are more stable and reliable than returns from capital growth.

For example, income from bonds is usually fixed until the debt matures, providing the issuer remains solvent.

Moreover, although income from share dividends or property rentals may increase in line with inflation, the income is fairly consistent.

However, the share prices or property values themselves may fluctuate from year to year. Only in extremely poor economic conditions, or in the case of a permanent loss, will the income fall away. Consequently, it's important to accurately annually forecast your investment income after fees. This is your portfolio's natural income yield.

If you are fortunate to have a large amount of savings capital relative to the income you need, then you may be able to live off this natural income yield alone. This puts you in a very secure position and means you are not having to spend capital each year to meet your income needs.

However for most investors, the natural income yield will be insufficient. These investors will need to consume a level of capital over time to supplement the natural yield up to the level of income required.

When this happens, it's essential to understand what total returns might be generated by a portfolio, a combination of both income and capital gains.

Our calculator spreadsheet "How much money do I need to retire?" will help you understand the impact of different levels of return on your savings.

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# Use the tax planning opportunities

When planning retirement, ensuring you maximise your income by reducing your tax liability is essential.

To do this, it helps to understand the four main tax allowances available to a UK resident client:

1. Personal Income Tax Allowance. The first £12,570 p.a. of income is tax free for 2021/22;

2. Dividend Allowances. The first £2,000 p.a. of dividend income is tax free. Tax is paid on any dividend income over this amount. Currently, this is 7.5% for a basic rate taxpayer, 32.5% for a higher rate taxpayer, and 38.1% for an additional rate taxpayer.

3. Capital Gains Tax (CGT) Free Allowance. For 2021/22, any capital gains up to £12,300 are tax free.

4. Personal Savings Allowance. Basic rate taxpayers do not pay tax on the first £1,000 of savings income, and higher rate taxpayers on the first £500.

These allowances should be used first before exploring other opportunities.

There are many accounts available to help you use the allowances.
However, we prioritise three: pensions, ISAs and deposit accounts.

## Pensions, ISAs, Deposit Accounts

A 50-year old individual currently earns a salary of £80,000 per year, and has £20,000 in the bank account. However, he wishes to retire at age 60.

His options are:

**A.** Retain the funds in deposit savings accounts for the next 10 years. A high interest account may allow his returns to grow with inflation;

**B.** invest the proceeds into a diversified investment ISA and begin to draw down after 10 years, or

**C.** Invest the proceeds into a Self-Invested Personal Pension (SIPP) for 10 years, and then draw down.

In the table, we illustrate the difference in real return (i.e. the return after inflation) of investing in an ISA or SIPP account as opposed to leaving the money in the bank.

| £20,000 Investment | Deposit Account | Investment ISA | SIPP |
|---|---|---|---|
| Net Cost | £20,000 | £20,000 | £15,000 |
| Tax Relief Received | 0 | 0 | £10,000 ( £5,000 basic rate relief goes direct to SIPP, £5,000 claimed through self-assessment) |
| Gross Contribution | £20,000 | £20,000 | £25,000 |
| Annualised Real Return over 10 years | 0% | 2% | 2% |
| Withdrawal after tax in today's money | £20,000 | £24,379 | £28,403 |
| Real Return on net contribution | 0% | 21.9% | 89.4% |

## Option A - Deposit Accounts

In this scenario, the funds are placed in deposit accounts. These accounts provide a nominal return in line with the rate of inflation, thereby equalling a 0% real return on the funds.

However, in practice deposit accounts often deliver lower rates of interest than this, resulting in deflation reducing savings in real terms over the 10 years. The good news is that these accounts are unlikely to attract enough interest to pay tax.

After 10 years, the funds can be released showing no gain or loss. Although showing no return, this approach is suitable for someone with no investment risk appetite or who has short term needs for the monies.

## Option B - Individual Savings Account (ISA)

In Option B, funds are invested into a diversified investment solution, providing an annualised real return of 2% over 10 years.

The funds are withdrawn for £24,379 in today's' money with no tax liability because all returns and gains in an ISA wrapper are tax free. The real return on the net contribution after 10 years is 21.9%.

## Option C - Self-Invested Pension Portfolio (SIPP)

In the final scenario, £20,000 is invested into a SIPP.

The investor receives a 20%, or £5,000, uplift in the form of basic-rate tax relief. Without any investing, the SIPP value increases from £20,000 to £25,000. However, the individual is a higher-rate taxpayer earning £80,000 p.a. This allows an additional claim of 20%, or £5,000, higher-rate tax relief back on the gross contribution via self-assessment.

Consequently, the net cost of the SIPP is only £15,000, and the total tax relief claimed is 40%, or £10,000.

The individual then invests £25,000 and achieves an annualised real return of 2% over 10 years before withdrawing the funds. Upon withdrawal, there will be an income tax liability, due to the £25,000 fund increasing to £30,400.

However, if this is the only income taken in the tax year, using the 25% tax free cash allowance, the 0% personal allowance and only drawing the residual funds from within the 20% basic rate of tax, he will make a net withdrawal of £28,403 in real terms. And he will only pay £2,000 in tax.

This releases a profit after tax, on the net £15,000 contribution, of 89.4%.

## Conclusion

The above examples illustrate the tax efficiencies of investing in pensions, even when compared with tax-free savings accounts.

The SIPP outperforms the ISA by 67.5% over the 10 year period, even when invested in the same investment solution. And the deposit account shows no real return at all, and in fact would probably show a negative real return due to inflation.

Moreover, the compound investment returns of the portfolio only account for just over 20% of the total returns. The majority of the returns are from pension contribution tax relief, compounded over 10 years.

In an era of low interest rates, getting adequate consistent returns in excess of inflation is hard. Consequently, the returns available through prudent tax efficient investment, when accumulating capital, is a very powerful tool for optimising wealth.

Many Tideway clients are higher rate taxpayers when they make pension contributions and attract higher rates of tax relief coming into a pension. However, many also list maintaining income under the higher rate of income tax as a key objective in retirement.

So, they pay basic rate tax relief and benefit from the personal allowance and 25% tax free cash allowance on the way out.

## Offshoring? It's not a dirty word...

Mention 'offshore bond' and 'tax' in the same sentence and you'll hear a sharp intake of breath! However, despite the media hype, an offshore bond is not a tax avoidance scheme or even an aggressive tax planning product.

It is a well-proven financial planning tool, supported by UK tax legislation, and used for decades by financial advisers. It could be an ideal option if you've used up the main four tax allowances or are expecting a lower future income.

Offshore bonds work in a very similar way to a pension wrapper, often by deferring tax payments until the bond is cashed in. And just like pension, all profits obtained within the bond are taxed as income. You can even carry forward the annual tax-free 5% withdrawal allowance.

However, unlike a pension account, there is no tax relief on contributions to an offshore bond. In addition, there are strict rules around which investments can be purchased via the bond.

A reliable wealth management service can ensure these regulations are adhered to providing you with hassle-free and tax-efficient income, now or in the future.

# 6

# Set up to create regular income

This task is about how to arrange to receive funds from your pensions and investments to meet your spending needs.

Things you will need to consider:

1. How much money do I need to come into my current account each month to replace a working wage?
2. Where and how much will I retain on account for ad hoc spending?
3. What is my priority for withdrawing funds from my various accounts, my pension account, ISA or general investment account?
4. Can these withdrawals be met from the income from the investments, or will I need to access capital amounts on a regular basis?
5. If I am going to need to access capital, where will it come from and how do I ensure I'm not selling investments at a loss to meet my income?

These allowances should be used first before exploring other opportunities.

There are many accounts available to help you use the allowances.  However, we prioritise three: pensions, ISAs and deposit accounts.

## Helpful Tips

**Accumulation units and income units**
Most Investment funds have both Accumulation units where income gets automatically reinvested and Income units where the income gets paid out on a regular basis. Check which units you hold and switch to income units if you need regular income to cover your account withdrawals.

**Time Horizon Planning**
You can think about investments like a wine cellar. Certain wines are ready to drink almost straight away, others need longer to mature to get the best flavour. Similarly, some investments need more time than others to generate the best returns. This needs to be incorporated into your retirement income planning to avoid selling investments at a loss when markets are depressed which can damage your average returns and will deplete your retirement investments more rapidly.

**Tax Planning**
Considering how your withdrawals will be taxed is a vital part of this task. Utilising as many tax allowances as possible and staying on the right side of marginal tax rate bands will all help you minimise the tax you pay each year. A good wealth manager will help organise accounts and arrange affairs to deliver a regular income in the most efficient way.

# 7

# Be prepared early

Albert Einstein allegedly once said, “Compound interest is the eighth wonder of the world. He who understands it earns it. He who doesn’t, pays it.”

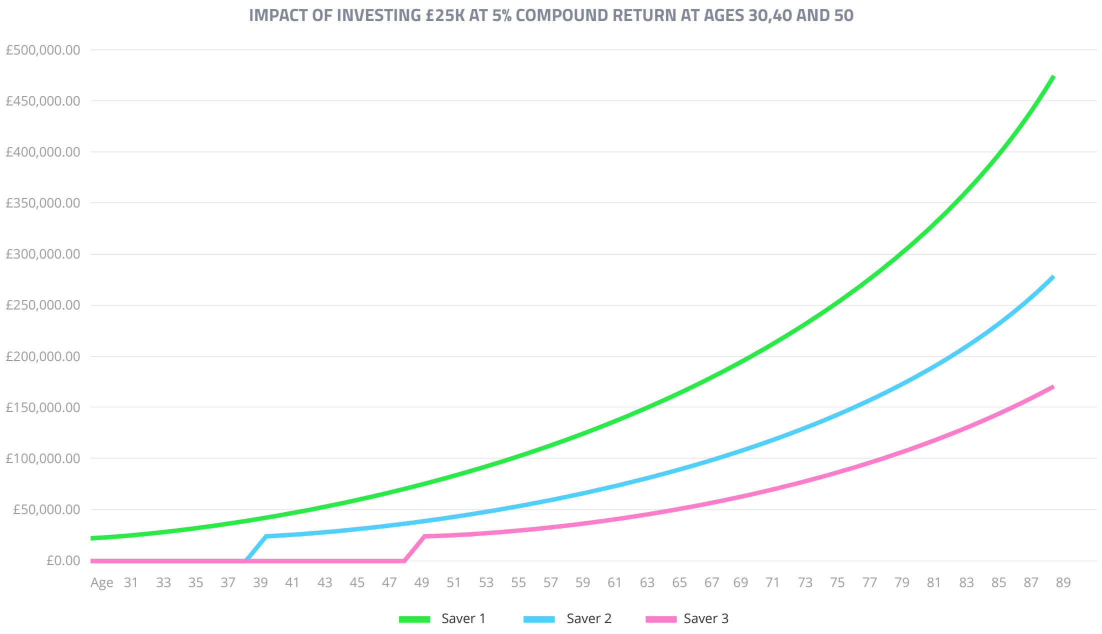
When used properly, compounding makes your money work for you and is an exponential way to grow your wealth.

Most people are familiar with earning periodic simple interest on a principal amount of money placed in a deposit account. When the simple interest is left in your account, the next time an interest payment is made, it is paid on the original principal amount and the additional interest payment.

Compound interest specifically refers to the amount of interest paid on the interest.

Over time, compounding causes the money in your account to snowball, making your money work for you. For example see the impact in the table below of investing £25,000 at age 30 vs age 40 vs age 50 at a steady annual return of 5%.

And the higher the rate of return, the more you will earn.




Consequently, to maximise its potential, it pays to start early. An untouched investment can result in a large sum of money, even if you never invest again.

# Conclusions

Wealth management is a broad and complex topic. With this guide you are now equipped to begin planning your future. Follow the 7 simple steps and you'll consider all the main factors required for a successful and secure retirement.

There's a lot to take in.

Of course, after reviewing the information you may wish to book a consultation with a wealth manager to ensure you're on the right track, or even to get started. You can do this by clicking on Make an enquiry on our website at www.tidewaywealth.co.uk.

Alternatively, ask further questions by booking a seminar and get the answers you need. Whatever you decide, you'll reap the benefits by starting planning as early as possible and by being prepared.

None of us can avoid getting older but it pays to make the most of it!

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