PENSIONS FREEDOM
Taking funds early for immediate needs could deplete future income

LANDLORDS FEEL BUY-TO-LET PRESSURES
Investors face interest rate rises and energy reforms

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AUTUMN 2022

Automatic enrolment ten years on

The unfinished pension revolution?

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In this issue...

The new Prime Minister Liz Truss has promised to act quickly on tackling rising costs and energy bills facing individuals and businesses. With an initial package and costings announced earlier this month, a full Budget is expected later in the year. Many have turned to savings to help meet their increased costs and in this edition we look at different aspects of the problem. For those eligible to draw down pension lump sums, the short term gain in funds could store up future problems in depleted income. Those who have managed to create a cash safety net will be in a better position but maintaining it at sufficient levels may be challenging. We also mark the first decade of automatic enrolment for workplace pensions. While almost 80% of those eligible are now enrolled, there is more to do to increase contribution levels and for those currently excluded or self-employed. And we highlight the continuing need for specific advice for those taking advantage of simpler divorce and dissolution rules to ensure the fair division of assets.

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PENSIONS

Interest rate rises lift annuities

It is not only bank interest rates which are on the up.

So far 2022 has been a year of rising interest rates in most of the developed world. The central banks of the UK, US and Eurozone all began the year with their main rates close to zero, and it seems likely that they will still be on an upward trajectory into 2023.

While the focus has been on base rate increases, and the knock-on effect on savings and mortgages, other interest rates have also been getting higher. For example, the yields on medium and long-term government bonds (UK gilts), corporate bonds and other fixed interest securities have all increased. Conversely their prices have fallen – yields and prices move in opposite directions.

One neglected sector has benefitted markedly from the fall in bond prices: annuities. For any given age, the annuity rates that insurance companies can offer are largely determined by what they can earn by investing in long-term bonds. In this instance, as bond yields go up, so too do annuity rates. The change has been greater than expected.

For example, at the end of last year, the yield on the 15-year gilt was 1.15%, whereas by late July it was almost 2.50%. Take a level annuity rate for a 65-year-old, for instance. By late July, the top rate was around 6.25% compared with 5% at the beginning of the year. This amounts to an increase in guaranteed income of a quarter. Similar rises apply at other ages, although the greatest impact is at younger ages.

Index-linked annuity rates have also improved, but they remain a high-end option. At 65 the current rate is 3.45%. This starting rate is quite a lot lower than a level annuity but consider what index-linking means at a time when inflation is forecast to exceed 11% by October 2022.

The jump in annuity rates has coincided with a bad first half for many of the world's investment markets. The combination has served as a reminder that, although flexi-access drawdown is currently the most popular method of drawing an income from a pension fund, it is not the only option and it comes with built-in investment risk. An annuity provides certainty, regardless of investment conditions or how long you live.

To find out the level of income an annuity could provide for you, please ask us for a personalised illustration.

✢ *The value of your investment and the income from it can go down as well as up and you may not get back the full amount you invested.*

Past performance is not a reliable indicator of future performance.

Investing in shares should be regarded as a long-term investment and should fit with your overall attitude to risk and financial circumstances

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INVESTMENTS

Buy-to-let facing headwinds

Some buy-to-let (BTL) investors are facing a costly future.

In the post-election Budget of 2015, the then Chancellor announced a change to the tax treatment of interest paid on BTL residential mortgages. Instead of the interest being fully offset against rent for income tax purposes, there would be a 20% (non-reclaimable) tax credit for interest paid. This reduced the tax relief received by higher and additional rate taxpayers to basic rate, halving or more than halving their tax savings.

To limit the immediate effect of the change, the new system was phased in over four years, starting in April 2017. The impact was also cushioned by very low interest rates, meaning there was less interest on which to lose tax relief. By autumn 2021, BTL investors were able to find two-year fixed rate mortgages with a headline rate of just 1%.

INTEREST RATE HIT

Twelve months on, the picture is rather different, and the best two-year fixed rates are around 3.0%. Even if the rate does not move higher – a distinct possibility – it can have a serious effect on net income for BTL investors, as the example calculation opposite shows, based on a 40% taxpayer. If the mortgage rate rises above 4.25%, then all net income will be eliminated.

The 2015 interest relief changes encouraged new BTL investors, particularly those owning more than one property, to purchase their properties via limited companies. In this structure, interest is fully offset against rent for corporation tax purposes. However, this route loses some of its appeal following the recent increase in dividend tax rates and the rise in corporation tax rates from 19% to 25%, currently due next April. For existing BTL owners, transferring to a limited company remains unattractive because of the capital gains tax and relevant property transfer tax involved.

	Mortgage interest rate	
	1.00%	**3.00%**
Rental income	£15,000	£15,000
Expenses (30%)	£4,500	£4,500
Next taxable income	£10,500	£10,500
Income tax @ 40%	-£4,200	-£4,200
Post-tax income	£6,300	£6,300
Interest (£185,000 loan)	-£1,850	-£5,550
20% tax credit	£370	£1,110
Net income after tax and interest	£4,820	£1,860

ENERGY RATINGS SHIFT

Additional interest costs are not the only extra expenses that threaten BTL owners. A year ago, the Department for Business, Energy and Industrial Strategy (BEIS) launched a consultation on improving the energy performance of privately rented homes in England and Wales. The consultation ended in January 2022, with regulations originally expected this autumn. BEIS's preferred option is:

- From 1 April 2025, a minimum energy performance certificate (EPC) rating of C would apply to properties with a new domestic tenancy or where an existing tenancy is renewed.
- From 1 April 2028, all tenancies would be subject to the EPC C rating.

EXTRA COSTS CONSIDERED

The consultation estimated that the average landlord would spend £4,700 per property to achieve the C rating. It also proposed an upper spending limit of £10,000, beyond which an exemption would apply from the rules.

The combined effect of higher interest rates and higher EPC thresholds – and a six month rent freeze in Scotland - is something BTL investors should carefully assess now and factor them into future planning.

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PENSIONS

Automatic enrolment ten years on

October marks ten years since the advent of automatic enrolment for workplace pensions. What's been learned in the last decade?

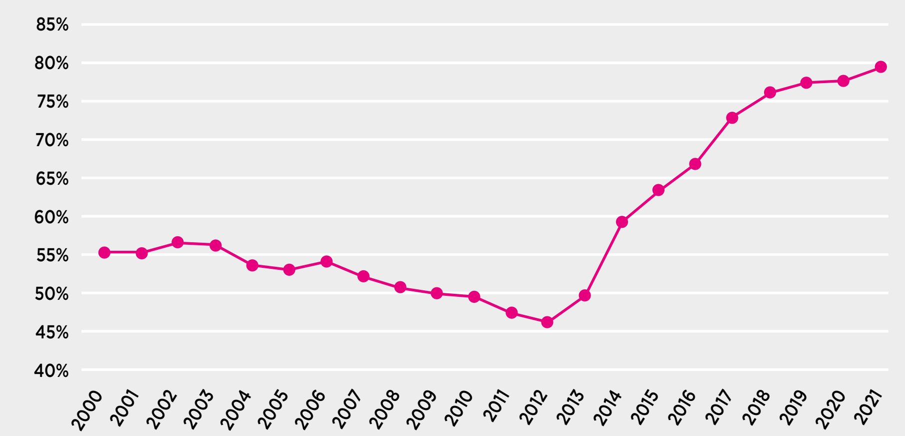
The automatic enrolment (AE) of employees and other workers into workplace pensions faced scepticism when its initial phasing in began in October 2012. Plenty of pension experts had witnessed the failure of earlier initiatives to increase pension take up. In the 2000s, the launch of stakeholder pensions ended with many employers nursing 'empty shell' schemes, mandated by law but devoid of members and cash.

SET UP TO SUCCEED

The outcome for auto-enrolment was dramatically different, as the graph shows. Much of that is due to careful design:

- Inertia plays a major role – membership is automatic, so deliberate personal action is required to opt out.
- Employer and employee contributions were initially pitched at a manageable low level, before two staggered increases.
- The first schemes were set up by the largest employers, who were best equipped to organise the roll out, with the smallest enterprises given the longest lead time to participate.
- The government established an arms-length default provider, the National Employment Savings Trust (NEST). By March 2022, NEST was managing over £24 billion on behalf of over 11 million members and nearly one million employers.

Workplace pension participation: 2000–2021



Source: ONS

Minimum contribution levels 2022/23

Earnings band	Employer	Employee	Total cash contributions	
			Highest threshold £50,270 or more	Min. threshold £10,000
£6,240–£50,270	3%	5% (before tax relief)	£3,522	£300

The membership of workplace pensions as at April 2021 was 79% of those eligible to join, a significant improvement on 47% in 2012. The chances are that if you are 22 or older, and your employer provides you with a pension, it is a workplace pension operating under auto-enrolment.

CONTRIBUTIONS GAP

However, the success of auto-enrolment pensions does not mean that the issue of adequate retirement funding has been solved, either for you personally, or the workforce in general:

- The minimum level of contributions is still widely considered to be too low. The Association of British Insurers (ABI) recently suggested that to be adequate, total contributions should rise to 6% each for employer and employee, with an increase phased over the next ten years.

- As the table opposite shows, no contributions are levied on the first £6,240 of earnings, which has a disproportionate impact on low earners. Without that restriction, total contributions for someone earning £10,000 would be £500 more.

- At present each employment is considered separately, meaning many people with more than one job could earn more than £10,000 in total, but receive no employer pension contributions at all. If the £6,240 exclusion were removed, then logically the current earnings trigger of £10,000 would also disappear.

SELF-EMPLOYED LOSING OUT

And one major group has been almost completely passed by when it comes to AE workplace pensions: the self-employed, who represent about one in eight of the UK workforce. While some gig workers have become eligible for auto-enrolled pensions following Employment Tribunal decisions, the self-employed generally are left to their own retirement planning devices. As a result, currently only 16% of self-employed workers are now saving in a private pension, down from almost 50% 20 years ago.

In the current economic environment, no government is likely to risk proposing an increase in the mandatory minimum contributions, however sensible that may be. You don't need to wait for the government to act to take action yourself. To find out if your current level of pension contributions, whether automatic or otherwise, are sufficient to meet your retirement goals please get in touch.

✢ *The Financial Conduct Authority does not regulate tax advice. Tax treatment varies according to individual circumstances and is subject to change.*

The value of your investment and the income from it can fall as well as rise. You may get back less than you invested.

Past performance is not a reliable indicator of future performance.

FRAUD

Steer clear of the scammers

Scammers and fraudsters conned people in the UK out of £1.3 billion last year, according to official figures.

The banking industry group UK Finance pointed out that many frauds were online scams, with victims often left out of pocket as they had seemingly 'authorised' fake payments. The group warned people to always double check before sending money or revealing financial details on the back of unsolicited emails, even if they appear to be from a familiar company or organisation.

ONLINE FRAUD CONSTANTLY SHIFTING

There was a significant rise in several different scams including:

- Bank transfer fraud where victims are tricked into sending money to an account controlled by criminals.

- Impersonation scams, where criminals send spoof emails, or set up fake websites, purporting to be from legitimate companies including banks, HMRC, government departments, the NHS or energy suppliers.

- Romance scams, where criminals approach victims on dating sites. These numbers have surged and can be financially devastating, with victims losing an average of £9,500.

ENERGY PAYMENTS LATEST TARGET

There is particular concern that fraudsters are exploiting fear and confusion around energy bills to trick people out of money. Research by *Which?* found that in the first quarter of this year, fraud cases that mentioned one of the big six energy firms were up by 10% when compared to the same period last year.

If you are suspicious of any online activity, be on your guard and check with relevant financial institutions who will never ask you for your financial details.

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PENSIONS

What price pension freedom?

Inflation is driving many to raid their 'rainy day funds' to cover rising energy and fuel bills. But there are particular concerns around the long-term consequences for some older savers who are also cashing in pension funds early to help make ends meet.

Figures from the Centre of Economics and Business Research (Cebr) show that over the past six months 16% of adults used all of their savings and investments to boost their income to ensure they were able to pay essential bills. For those at or near retirement, such actions can erode the value of their pension savings.

AUTONOMY OF CHOICE

Under Pension Freedom rules, introduced in 2015, anyone aged 55 or over can currently access part or all of their pension funds. While a quarter of their fund can be paid as a tax free lump sum, withdrawals over this limit will be subject to income tax (unless the total income, including these payments, is below the personal allowance — currently £12,570).

Since the introduction of pension freedoms, savers have enjoyed largely buoyant stock market gains combined with low inflation, effectively allowing them to draw money from these pots without seriously depleting the remaining funds which continued to grow.

However, as a new report from actuaries AKG highlights, the return of high inflation and increased living costs could jeopardise many people's future retirement plans.

Early pension fund withdrawals can lead to an unnecessary tax burden and the risk of running out of money later in life, an issue that is likely to be exacerbated by increased inflation.

The Bank of England is forecasting that higher than expected inflation could tip the UK into a long recession. Despite post-Covid rallies, the war in Ukraine and rising energy concerns continue to contribute to stock market volatilities over the year, and this is likely to dampen growth prospects and fund returns.

ADVISED STEPS

Those approaching retirement face complex decisions about how to use their pension funds and freedom. Far fewer people now choose to take an annuity, particularly before the age of 75, with most opting to draw down funds to supplement the state pension, while leaving the remainder invested. The question is what remains a 'safe' amount to withdraw to maintain funds through to later life?

Financial advisers can help investors with these complex decisions and explain how a pension might fare under different economic conditions, including higher inflation and/or lower stock market returns.

Data from the financial regulator, however, suggests not enough people are taking this option. Last year four out of ten people did not seek financial advice before accessing their pensions, the highest proportion since Pension Freedom rules were introduced.

Please do get in touch if you are thinking about the most suitable way to access your pension funds or for guidance on how your long-term pension planning might be affected.

+ The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

The value of your investment and the income from it can go down as well as up and you may not get back the full amount you invested.

Past performance is not a reliable indicator of future performance.

Occupational pension schemes are regulated by The Pensions Regulator.

SAVINGS

How much ready cash is enough?

As the economic strain ratchets up, what level of cash savings should you aim to keep to hand?

Building up a savings buffer is important to provide a resource should you lose your job, become ill, split from a partner, or simply need some reserves to dip into with bills rising far faster than earnings.

Many families do not have this, with The Resolution Foundation estimating that 1.3m families have no savings at all, while research by Moneyfarm suggests that one in three people has less than £1,500 saved. This can leave them struggling to pay unexpected bills, with more than one in eight adults admitting they would be forced to use credit cards or overdrafts to cover an out of the blue expense of £500.

Building a decent savings pot can underpin greater financial resilience, but the question remains, how much should you be looking to keep aside?

BUILDING A BUFFER

Financial experts say ideally families need to think beyond a one off large MOT bill, or boiler replacement and look to cover at least three or potentially up to six months of essential bills. This should provide some headroom in case of redundancy or sudden illness.

Saving enough to cover six months of mortgage repayments, energy and food bills may seem like a tall order. For households with two earners, three months may be a more realistic target.

Boosting savings at the current time is not easy, with higher bills taking a greater slice of wages. But building this buffer should be a longer-term project. Figures from the Office of National Statistics in 2020 show that the average Brit had savings of £6,757. However, for 25-34 year olds, this was £3,544, rising to £20,028 for those aged 55 or over.

KEEP UP PAYMENTS

Those looking to build savings at present may benefit from the slight rise in interest rates, giving them marginally better returns. But it could also be worth considering insurance policies, such as income protection, which pay out an income to cover essential bills in case of illness.

These are not low cost policies, so may not be appropriate for everyone, but those that already have them in place should think twice before cancelling them in the current climate. Any short-term saving on premiums could remove a valuable longer-term benefit in difficult circumstances.

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PENSIONS

Still time to increase your state pension

A deadline is approaching to boost pension benefits by closing any national insurance contribution (NIC) gaps.

Credit: fizkes/Shutterstock.com

Were you in full time employment or self-employment between 2006/07 and 2015/16? If the answer is either 'no' or 'not sure', time is running out for you to pay any missing NICs for that period.

You have until 5 April 2023 to plug the gaps, but before doing so you need to know which gaps to fill – some will cost less than others – and whether it makes financial sense to do so.

At best, if you are self-employed you could find a one-off payment of £163.80 buys you £275 a year extra state pension. At worst you could spend thousands, only to find what you have gained in state pension, you have lost in other state benefits.

Your starting point is to check your NICs record at www.gov.uk/check-national-insurance-record, which will require you to have a Government Gateway user ID.

+ Tax and benefit laws can change. The Financial Conduct Authority does not regulate tax and benefit advice.

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NEWS ROUND UP

Key October dates

5 October is an important and oft-forgotten tax deadline date. If you have a new source of untaxed income, are in your second tax year of self-employment or have capital gains in excess of £12,300, you need to register for self-assessment. *31 October* is the deadline for submitting a paper tax return for 2021/22, although you have another three months if you file online (as over 95% of those completing tax returns).

NS&I increases rates

In July National Savings and Investments (NS&I) increased rates on its Income Bonds, Direct Saver, Direct ISA and Junior ISA, all of which are available to new investors. NS&I also blew the dust off its fixed rate Guaranteed Growth Bonds and Guaranteed Income Bonds, which are only available for customers who have a maturing bond to reinvest. The rates on these had languished unchanged since November 2020 and consequently some jumped sharply. For example, the two-year Growth Bond's return rose from 0.15% to 2.25%.

STOP PRESS: Energy Price Guarantee

On 8 September the new Prime Minister Liz Truss announced an Energy Price Guarantee (EPG) set at an annual £2,500 for the next two years from 1 October 2022. This will apply on the same basis as the existing Ofgem cap, i.e. a regional based limit on standing and unit charges in England, Wales and Scotland, not on total bills. Northern Ireland will receive the same level of support. Businesses and other sectors will receive 'an equivalent guarantee' for six months, with additional targeted support thereafter.

LEGAL

No-fault divorce: don't skip on advice

The number of couples filing for divorce or dissolution has surged after simpler 'no-fault' divorce laws came into force this April. But the simpler process shouldn't mean cutting corners on financial advice.

Spouses or civil partners can now file for divorce (or dissolution of a civil partnership) jointly online, stating their relationship has broken down irretrievably. Before, one partner needed to prove the other has acted unreasonably or committed adultery. Online divorce applications have risen four-fold from a low of 2,000 a month to 8,000 a month.

While these divorces may be streamlined, separating couples should still seek financial advice, particularly if they are splitting assets like property and pensions.


Credit: Mariia Korneeva/Shutterstock.com

Evidence suggests that fewer than two in ten divorces or dissolutions have pension sharing orders, although these are often the most valuable financial asset, after the family home.

CAPITAL GAINS CONSIDERATIONS

Couples owning property jointly may also have capital gains tax (CGT) considerations, particularly if one partner is transferring their share to their former spouse.

Although there is normally no CGT on the sale of a primary residence, if a couple splits, and one now lives elsewhere, this tax might apply.

However, if the property is transferred within the tax year of separation no CGT is due. This makes it important to get the timing of a sale or transfer right, as it could potentially result in a saving of thousands of pounds.

New rules from April 2023 should make this aspect of life easier for splitting couples. Spouses and civil partners will have up to three years to make what are known as 'no gain, no loss' transfers of assets between themselves after they stop living together.

These changes should make the CGT rules fairer and give the parties more time to negotiate a fair split of assets, rather than rushing proceedings in order to meet an artificial tax timetable.

The new legislation will also introduce some rules for those who maintain a financial interest in their former family home after separation. This will allow a spouse or civil partner to claim private residence relief (PRR) when it is sold, meaning they won't have to pay CGT on this transaction.

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