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Case Study 7 – Cautious Investment Planner of the Year

1 INTRODUCTION

The case notes given have been used to prepare this report

2 OBJECTIVES AND PRIORITIES

Barbara and Gary wish:

(a) to know how to invest £134k

(b) to review the investments within their pension and investment portfolios

(c) to establish the following situations given their cautious attitude to risk

(i) whether they can afford to fund Hannah's further education for five years at a cost of £45,000

(ii) whether they can afford to retire early in 2017

(iii) whether they can afford for Barbara to give up work to look after Jean

(d) to consider the financial implications if Jean needs to go into a home

3 ASSUMPTONS

In this report the following assumptions will be made

1 Returns after charges

Asset	**Rate**
Inflation	2.5%
National average earnings	2%
Deposit rate	3%
Fixed interest	4.5%
Equities	7%
Property including rental income	6%
Annuity rate male 55 Female 52 2/3rds spouse Level income	5.15%
Annuity rate male 55/Female 52 2/3rds spouse rpi	2.54%

2 Barbara and Gary's expenditure will not increase more than their income

3 Currently Barbara and Gary require income of £3,000 net per month

4 In retirement Barbara and Gary will need an income of £2,500 net per month

5 Tax rates for 2010/11 used in the report prior to any changes in the emergency budget

6 State Benefits will continue as at present

7 Barbara and Gary are UK resident and domiciled for tax purposes

8 Hannah will go into long term education (HE)

8 Current legislation remains in place

9 Future Pension scheme/ISA asset allocation/returns after re-arrangement

Asset	%	Return before inflation
equities	20%	1.4%
Fixed interest	70%	3.15%
Cash	10%	0.3%
TOTAL	100%	4.85% (assume 5%)

4 ATTITUDE AND ASSESSMENT

ATTITUDE

1 Barbara and Gary are very concerned about the falls in the value of their investments in recent years

2 They do not want any further sleepless nights worrying about falls in investment values

3 They are concerned about the effects of inflation

4 They are now both cautious investors

ASSESSMENT

1 How to invest £134,000

(a) Barbara and Gary have sufficient funds in their cash accounts to pay off the mortgage. As the net interest they receive £1,155 pa is less than the mortgage interest £1,440, it makes no sense to keep the mortgage particularly now they have additional capital and Barbara is giving up work. Therefore rather than investing the money they should consider using this capital to repay the mortgage and invest their cash accounts to produce a higher return.

2 Reviewing investments

(a) Currently Gary's pension is 100% invested in equities of which 40% is overseas and this does not fit with his attitude to risk. Bearing in mind that he wants to take benefits in 7 years time, the investment strategy needs to be reviewed and the equity content reduced

(b) As Barbara and Gary describe themselves as cautious investors it is inappropriate that 56% of their non pension investments are in UK equities via equity income funds

(c) Barbara and Gary need to understand that if they move the pension and ISA assets to, say fixed interest securities, they have reduced the risk but at the same time the potential for growth has been lowered

(d) Barbara and Gary are anxious about the effects of inflation on their investments. Currently they have 57% of their non pension investment on deposit at a low rate of interest (1.5%). As inflation in May stood at 2.02% this means that they are currently losing the capital value of their investment.

(e) Apart from index linked gilts the only other method of hedging against inflation is by use of real assets, such as shares or property. So, if they are not happy with equities, they may need to increase their holdings in index linked gilts. This can be done directly or via national savings certificates

(f) Currently cash assets are split 50/50between Gary and Barbara. the opportunity should be taken to review these holdings and to place more in the name of Barbara so that she can fully utilise her personal allowance and pay only 20% tax on interest rather than Gary's 40%

3 Establishing affordability of HE for Hannah

(a) A fund needs to be established for Hannah. Part of this could be provided from her grandmother's capital. (£12,000)

(b) As Jean's expenses are likely to be low when she is living with her family, she could pay Barbara for nursing care, say £4,200pa .In turn Barbara could save this for Hannah plus an additional amount of £1,440 from the savings on the mortgage. It is likely that this level of savings will be sufficient to fund the fees (see points arising our of the recommendation)

4 Establishing the affordability of retiring early in 2017

(a) Gary will be aged 55 in 2017 so he will be able to take benefits from his personal pension at that time. However, Barbara is 3 years younger, so she cannot take benefits from her NHS scheme until 2020 and there would be a penalty imposed to take benefits early

(b) Gary will not receive the State pension until age 65 and Barbara will receive the state pension at age 66 as she was born after 6.4.60

(c) Therefore if they are to retire in 2017 they will need to rely completely on Gary's personal pension. If he pays no further contributions and reduces the risk in the portfolio, the estimated fund in 2017 is £635,964 which will buy a pension with 2/3rd' spouse's pension of £32,752 pa gross, £27,470 net pa or £2,289 per month which is just short of the required £2,500 net per month.

(d) A means needs to be found for Gary to pay additional contributions to make up the shortfall (see section below)

(e) If they used their fund to purchase an index linked (rpi) pension, the income would fall to £16,153 gross pa which is grossly inadequate. They will need to look to their state pensions and Barbara's NHS pensions to provide an element of inflation proofing (currently State Pensions increase in line with prices and the NHS pension includes an rpi link)

5 Establishing the affordability of Barbara giving up work to look after Jean

(a) If Barbara gives up her job Gary's net income is sufficient to support £3000 net per month. His gross income is subject to tax of £17,930 which after NI of £3,438, leaves net £48,632 which equates to £4,052net per month. This leaves surplus income of £1,052 per month which can be used to boost the pension contributions (see above)

(b) In addition Barbara needs to apply for attendance allowance for her mother, this is a tax free benefit and will amount to £47.80 per week if Jean needs care in the day OR night or £71.40 if she needs care in the day AND night.

(c) Once Barbara has given up work she may be eligible for carer's allowance. This is a taxable amount of £53.90 per week available to those with earnings below £100 per week, so Barbara would appear to qualify.This will also allow Barbara to obtain pension credits so she can qualify for a **full** state pension (minimum 30 years contributions), as currently she falls short by 6 years

(d) Barbara giving up work does mean that her NHS pension will be reduced but credit for being a carer should mean that she secures a full state pension

(e) Jean should pay Barbara £4,200 pa for caring for her.

5 Long term situation if Jean goes into a home

(a) As Jean has sold her house and moved in with Barbara and Gary she no longer owns a property and her assets are below £14k. Therefore she could be entitled to maximum financial help from the Local Authority. However, there is a possibility that the Local Authority could claim that Jean deliberately sold her house and gave the proceeds to her daughter to deprive them of access to these funds. In which case they could make a claim against Barbara for the cost of the care. However, it could be argued that Jean cannot look after herself and that Barbara as a medical professional is caring for her in her own home. They should seek legal advice on this point.

(b) As Jean will spend little when she is living with her daughter, It is important that the excess income does not build up as extra capital which takes her over the £14k level for help with long term care funding, hence the recommendation to pay her daughter for nursing care.

5 RECOMMENDATIONS

1 Use £122,000 of the £134,000 of Jean's capital to pay off the mortgage immediately

2 Jean should pay Barbara £4,200 pa for nursing care

3 Jean should give the remaining £12,000 to Hannah.

4 Barbara should use the the savings on the mortgage, £1,440 and the income from her mother a total of £ 5,640 to build up a HE fund for Hannah.

5 Gary should reduce the risk within his pension plan.

6 Garry should pay contributions of £1,052 net per month into a pension scheme.

7 Existing cash investments should be rearranged

Asset	**Barbara**	**Gary**
Cash ISA	£5,000	£5,000
NS&I certs 3 years index linked	£15,000	£15,000
NS & I certs 5 years index linked	£15,000	£15,000
NS&I fixed rate cert 2.25% 5 yrs		£15,000
1 yr fixed 3%	£25,000	
TOTAL	**£60,000**	**£50,000**

8 Existing equity income fund ISAS should be moved to fixed interest using index linked bond funds /corporate bonds

6 POINTS ARISING OUT OF THE RECOMMENDATIION

1 **Using The capital to repay the mortgage** – a check needs to be made regarding any penalties

2 By paying Barbara £4,200 pa for care, Jean is reducing the chance of increasing her capital for means testing purposes and enabling Barbara to give up work. Barbara will pay a small amount of income tax but in the 2011/12 tax year when the personal allowance is raised to £7,475 and the Building Society money has been transferred to more national savings certificates (see below) her income should be below the personal allowance

H E Funding

3 Hannah should invest her Grandmother's gift in a 5 year NS& I index linked national savings certificate which produces a tax free return of inflation +1%. This is suitable because security of capital is vital

4 Barbara should save £ 5,640 pa into a savings plan such as Principality Building Society "Regular Saver" at 4%gross.On the assumption that the full amount is invested for 3 years and then reduces (when Jean may go into long term care) the Further Education can be 86% funded as shown below. The interest rate is showing a real return over inflation and it is assumed that rates at this level can be obtained throughout the savings period. There should be sufficient savings (see below) to make up any shortfall

SAVINGS SCHEME

	Returns	**Returns**	**returns**		
Age/year	**Index Certificate**	**£4,200 per annum**	**£1,440 per annum**	**Fees**	**surplus**

15/16 (2010)					
16/17(2011)					
17/18(2012)		13,393			
18/19(2013)		13,928		9,000	4,928
20/21(2014)			6,246	9,000	2,174
21/22(2015)	14,160			9,000	7,334
22/23(2016)			3,000	9,000	1,334
23/24 (2017)			1,440	9,000	(6,226)

5 **Pension fund** – Gary needs to reduce the risk within his pension fund to suit his attitude to risk. His new contributions need to be invested 20% equities, 70% fixed interest 10% cash. He will also need to gradually switch his existing investments waiting for periods of stability in the equity and fixed interest markets

6 Gary should make regular contributions of £1,052 (net) per month to his scheme, £1,315 (gross). Gary can claim back a further £3,156 in higher rate tax relief from the tax he pays each January

The increased contributions results in an estimated fund of £741,511 in 2017. Using current annuity rates this produces an income of £38,187 pa gross. (based on a level pension with 2/3rds spouse's pension)After tax (using current rates) this leaves £31,712pa net or £2,642 per month. This means that they could afford to retire in 2017.

7 **Investments** –

Cash – the cash has been re-arranged using maximum investments into national savings index linked certificates.£15k in a five year fixed rate certificate gives Gary, the higher rate taxpayer an equivalent 3.75% gross . £25,000 in Barbara's name for one year can be moved to future issues of NS&I certificates

ISAS -. As Barbara and Gary hold cash ISAS, the equity ISAS should be split 80% Fixed interest/20% equity to reduce risk. Rearrangement should take place at periods of stability in the market

7 SUMMARY OF RECOMMENDATIONS

Problem	**Solution**	**Affordability**	**Risk**
Funding Jean's long term care	The reduction of her capital should mean that she is eligible for full local authority funding	n/a	n/a
Investment of £134k	Pay off mortgage	Yes	Low – suits attitude to risk
Review of investment	Reduce risk by moving	From existing fund	Cautious investors this

portfolio to reduce risk and provide hedge against inflation	ISAS from equity income funds to corporate bond and index linked bond funds		fits risk profile
Review of investment portfolio to reduce risk and provide a hedge against inflation	Re-arrange cash investments and make use of cash ISAS and index linked certificates	From existing funds	Cautious fits attitude to risk
Review of pension portfolio	Reduce risk in asset allocation but renew contributions	Excess income funds premiums	Cautious investor this fits risk profile
Funding Hannah's higher education	Can be achieved by regular savings and a gift from Jean	Income transferred to Barbara who uses it to fund the scheme	All cash investments NS& I Certificates provide some inflation proofing
Early retirement	Can be achieved because mortgage is paid off and pension provides sufficient income	yes	Can be achieved without undue risk
Affordability of Barbara giving up work	Carers' allowance Income from Jean	Yes	low

8 OTHER AREAS OF ADVICE

1 Has Barbara got an Enduring Power or Lasting Power of Attorney for her mother?

2 Have Barbara and Greg made a will?

3 Is Gary's income protected if he becomes ill – this is very important now that Barbara has given up her job and her income

4 We need to check Barbara's NHS pension – the figures are approximate because she has worked part time, the pension will be based on part time hours and equivalent full time pay

9 ACTION POINTS AND NEXT STEP

1 full details of the pension and ISA portfolio to check the availability of funds and charges

2 full details of the mortgage to see that there are no early repayment penalties

3 Seek legal advice for Jean

10 REVIEW

1 pension portfolio performance against target

2 cash situation – transfer to NSI certs

3 performance and asset allocation of the stocks and shares ISAS

4 changes in legislation/economy

5 income and expenditure

6 Jean’s situation

7 HE funding

8 Change in attitude to risk

Words 2,478

REPORT FOR G AND B KING