Crucial steps to ensure hopes for retirement don't take a holiday from reality

Retirement planning

The key to realising your dreams for life after work is to take control writes Jeff Salway

MOST people build up a picture in their mind of what their retirement will be like. Usually it involves ending their working days no later than the state pension age and relying on savings and the state pension to deliver the desired lifestyle. That much used to be taken for granted – but retirement ain't what it used to be.

Not only is the state pension age rising over the coming years but, as of this April, there's no longer a default retirement age. Meanwhile, final salary pensions are almost extinct in the private sector – and being downgraded in the public sector – with the onus now on workers to make sure they save enough.

Add lower investment returns, falling annuity rates and the devastating impact of low interest rates on savings income, and the challenge to the traditional retirement ideal stiffens.

Expectations are out of step with reality. The average Scot expects to be able to retire at 62, according to a report last month by Scottish Widows. Yet just 52 per cent of Scots are saving enough for a decent retirement income, a figure that plunges to a quarter when those with final salary pensions are removed.

If that sounds familiar, it's time to take control, especially if retirement is less than 20 years hence. You can still retire when you want and enjoy a decent standard of living – but now, more than ever, it's up to you to take charge of your retirement.

WHAT CAN YOU EXPECT?

A recent HSBC survey uncovered an "ostrich generation" of Britons who typically expect to wind down their working lives in their mid-50s before retiring at an average age of 62. Yet a fifth said they didn't know where they would get their money from in retirement.

So start by working out what kind of income you can expect. You can get a projection of your state pension by calling the state pension forecasting team on 0845 3000 168 or visiting www.direct.gov.uk/en/Pensionsandretirementplanning/StatePension/DG_184319.

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> *Hazel Brown*

Also get a valuation of any pension contracts you already have. If you've amassed several through different jobs, contact your previous employers and ask for a valuation and benefits projection for each one. Also consider consolidating them, particularly if performance isn't up to scratch and you're paying a lot in charges (as is most likely on older pension contracts).

HOW MUCH DO YOU WANT?

Once you have a rough idea of the pension you're in line for you can decide if it's going to be enough, said Hazel Brown, director of Edinburgh-based Carbon Financial Partners. "The main rule when planning retirement has to be: start with the end in mind. What do you need to live your ideal retirement? As well as day-to-day necessities, do you want to travel, make home improvements, and gift money to your children and grandchildren?"

Brown suggested creating a lifetime cashflow to work out how realistic your plans are and how to prioritise your spending.

"Using various assumptions you can see how long your existing income and capital will last before running out. This highlights whether you need to continue to work, for how much and for how long," she said.

"You may find you have more than sufficient and you may only need a very low level of investment return to support this."

HOW MUCH CAN YOU SAVE?

If you haven't started saving, do so as soon as possible because the cost of delaying can be high.

If your employer has a pension, that's usually the best place to start, particularly if the employer contributes too. Not taking advantage of that is akin to rejecting a pay rise.

You also get tax relief on pensions, with the government paying a rebate of £20 for every £80 saved by basic rate taxpayers and twice that for higher rate taxpayers. Supplement that with an individual savings account, which allows you to build up cash or stocks and shares savings tax-free.

The further away from retirement you start saving, the easier it will be to meet your target. A pension worth 50 per cent of final salary would require a funding rate of at least

23 per cent of earnings over a 40-year period, according to Hargreaves Lansdown.

If you don't start making contributions until you're 35 you would need to pay in a third of your earnings for a chance of getting half your final salary at retirement. With a starting age of 40 you'd need to pay in more than 40 per cent.

Matthew Robbins, an IFA at HW Financial Services in Edinburgh, said: "A retirement income of 50 per cent of salary at age 65 is unlikely to be produced by making contributions of 3 per cent of salary. Regularly aim to increase these contributions as your salary and retirement income expectations increase. Just because £200 a month was deemed sufficient ten years ago it is highly unlikely that it still will be sufficient today."

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Monitor your investments to ensure they're performing as you expected and not costing too much. This becomes more urgent as retirement approaches, when you need to de-risk your investments to protect your growth and avoid any late shocks from which there may not be time to recover. Advice is highly recommended; find an IFA near you at www.unbiased.co.uk.

CAN YOU CONTINUE WORKING?

Many people dream of retiring early but a growing number are now working beyond their pension age. Six in ten Scots due to retire this year are considering working on so they can bolster their eventual retirement fund, according to Prudential. The extra year or two can make a difference, particularly with some pensions still recovering from the market downturn.

For every five weeks you defer your state pension you can boost your weekly pension payment by 1 per cent. If you defer for at least a year, you get a lump sum plus interest of the base rate plus 2 per cent.

But if you work past your retirement age you need to ask it makes sense to keep paying into your pension. Jason Hemmings, a partner at Cornerstone Asset Management, said: "Although basic rate tax payers will get 20 per cent relief on their contributions they also have their pension income taxed at 20 per cent when they retire, so a pension might not be the best place for any extra savings. Instead, it might be better to stash £10,000 into an individual savings account and use the capital to supplement other income in retirement."

HOW CAN YOU GET THE BEST PENSION INCOME?

Take your time deciding how to use your pension pot when you do retire – the wrong decision could prove costly. Most people buy an annuity with their pension. The income from annuities has dropped in recent years, so it's vital to find the best possible deal instead of accepting the first offer from your pension company.

You could boost your income by up to 20 per cent by opting for the best annuity, and if you smoke or have a medical condition, you may qualify for an enhanced annuity, which pays out more on the assumption that the payout period will be shorter.

Escalating annuities (typically rising at 3 per cent a year) or RPI-linked annuities help your pension keep pace with inflation, although the starting income is lower.

Many workers have a sunny vision of their retirement but are doing little to ensure they will have sufficient income
Picture: Getty Images

Annuities are not the only option and there are ways of keeping some or all of your pension invested in retirement. If you have a large pension pot, other income to fall back on and are comfortable with the risk, drawdown allows you to remain invested and take money from your pension when you need it.

Brown said: "This retains the fund value for longer, allowing it greater potential for growth. Flexible drawdown can also allow access to more of your fund earlier provided you have minimum guaranteed income, of £20,000, by way of state pension or annuity payments."