

**Word Count Exactly 2500**

**Financial Plan  
For  
Malcolm and Brenda Bentley**

**Prepared by A.N.Other**

**Plan Prepared 2 July 2007**

## **Malcolm and Brenda Bentley**

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## 1. Introduction and Objectives

I have prepared your Financial Plan based on the information provided at our meeting of 1 May 2007.

The Plan belongs to you. Please read it and let me have any comments or questions.

You will recall the Financial Planning process comprises a number of steps:

1. Identifying financial objectives.
2. Collating all relevant personal and financial data.
3. Processing and analysing information.
4. Producing a written plan, describing how best to utilise what you have 'got' to achieve what you 'want'.
5. Implementing the plan.
6. Reviewing progress and modifying the plan to take into account changed circumstances.

This document represents the completion of Stage 4. If you are happy to proceed, the next step is Implementation (Section 5).

Your objectives

1. To have a coherent investment strategy to fund your retirement in 18 years and maintain your current standard of living thereafter, estimated cost £24,000pa in real terms. You do not wish to rely on a business sale for this.
2. To buy the new business premises, cost estimated at £1,140,000, in the most cost and tax efficient manner.
3. To have invested up to 55% of your investment wealth in real assets.

Un-stated but implicit objectives must be:

4. For the business to continue to make profits for the next 18 years and for you to extract them.
5. For the company to continue funding your income protection and private medical insurance policies, for the survivor to be financially secure on first death or in the event that one of you needs care.

## 2. Assumptions and Attitudes

### General

Assumptions are important in making projections about the future. As part of the Financial Planning process we will monitor these at review meetings so they remain relevant.

- **Price Inflation - 4% p.a.**

Price inflation measures the increasing cost of a basket of goods and services over a period of time, or put another way, the reduction in purchasing power of your money.

There are two measures of price inflation used in the UK, the Retail Prices Index (RPI) and the Consumer Prices Index (CPI). You are happy to use RPI.

The Bank of England's Monetary Policy Committee (MPC) must keep price inflation under control. Their current target for CPI is 2%. CPI is currently running at 2.5 and RPI at 4.5%.<sup>1</sup> On this basis I have used 4% in this report, which would seem reasonable.

- **Earnings Inflation – 5% p.a.**

The National Average Earnings Index (NAEI) measures earnings. The index has traditionally grown in excess of RPI. As we have assumed 4 % for RPI I have assumed 5% for earnings inflation i.e. 1% above RPI.

This will become significant at retirement. If your friends see their income rise in line with earnings, but your pension is linked to RPI, your comparative standard of living will decline.

- **Cash on Deposit – 5% gross p.a.**

You are only currently receiving 3%.

- **Fixed Interest – 5.5% gross pa**

In line with the long term rate on UK Government securities<sup>2</sup>

- **Real Assets (Property and Equities) – 7% gross p.a.**

Historically investors have received a risk premium for investing in real assets rather than the security of cash. A 3% premium seems reasonable.

### Assumptions

- You both enjoy good health and are non smokers. There is nothing to indicate impaired life expectancies.

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<sup>1</sup> Bank of England May 2007

<sup>2</sup> Financial Times 2 July 2007

- You wish to exclude the value of the business from calculations
- The business continues to make profits and pay salaries, dividends or bonuses at their current level. £500,000 is available now by way of bonus or dividend.
- Contributions by the company into your pensions are allowed by HMRC in the year of payment.
- To minimise costs you wish to avoid borrowing to purchase the property.
- Property costs of £100,000 include Stamp Duty. The company will meet the costs of relocation.
- Your mortgage, which has 20 years to run, is cleared before retirement.
- Your expenditure remains at its current level in real terms.
- I have assumed a cost of £600pw for care, increasing at 5%pa , based on local experience.
- **You have no children. I have assumed Inheritance Tax mitigation is not important. Please advise if this is incorrect.**
- You remain UK resident and domiciled.
- Cash is reserved equivalent to one year's expenditure, broadly met by your current cash holding.
- You don't anticipate any inheritances.
- Malcolm's deferred pension has a Normal Retirement Date of 65.

### **Attitudes**

You said you are 'relaxed about equity investments', my role is to quantify your attitudes. You will appreciate the difficulty in this, the question must always be 'compared to what?'

I have described your attitudes to risk relative to your objectives at Section 1:

- **To have a coherent investment strategy to fund your retirement.**

You need a plan, and have no tolerance to not having one in place.

- **To retire from the business in 18 years, maintaining your current standard of living.**

You must do this and have no tolerance to not doing so. Your retirement plans are totally dependant upon your existing pension funds and the future success of the business. To minimise the risk, you must aim to build your retirement fund sooner rather than later.

- **You do not wish to rely on a business sale to fund your retirement.**

Your retirement plan must ensure you have no dependence on a business sale, you have no tolerance for this.

- **To buy the new premises in the most cost and tax efficient manner.**

You would like to move to new premises and have seen an ideal location. This is important to you, but if the sale fell through, you could continue to operate from your existing premises. Your tolerance is therefore low but not zero.

- **Investment Risk**

Investment risk has two elements:

1. The short term risk that your investments fall in value
2. The longer term risk that you run out of money.

Short term risk can be reduced by investing in secure assets such as cash but this doesn't give you protection against inflation in the longer term. To achieve this, you must invest in growth assets (equities and property).

Equities carry two main risks, Systematic and Non Systematic. Systematic risk is the risk of being in the market. You cannot avoid this and will be exposed to it whether you invest in a tracker fund or an active equity fund.

Non systematic risk is individual company risk. An active fund must carry an element of this. The further the fund invests away from the market the greater the risk you take.

Likewise, there is a risk of investing in the property market. If the commercial property market falls, your property will probably fall in value and there is little you can do to stop this.

By investing in a single property you are exposing yourself to significant risk:

- If the business fails, all of your 'eggs are in one basket'
- If there is a fire, flood or similar, the property is at risk.

As with shares, the only way to reduce this risk, is by diversification, which is unrealistic in the current scenario.

You are prepared to invest 55% of your investment wealth in real assets. The balance will be invested in secure assets, primarily cash and fixed income (National Savings, Government Gilts and quality Corporate Bonds).

Your income protection and private medical insurance policies mitigate the financial risk of ill health.

We have not discussed the financial impact of:

- The death of either one of you. This is a major financial risk, for which you have no tolerance and must be addressed.
- You needing care at some time in the future. As you have no children to help, you will either have to look after each other, or pay for care. It must be assumed that you have no tolerance to being unable to meet care fees. This must be addressed.

### 3. Outline Strategy

This section will show you how to buy your new business premises in the most cost and tax efficient manner and set up a coherent investment strategy to fund your retirement.

#### The Big Picture

- You spend approximately £50,000pa, including £24,000 of mortgage payments, i.e. you will need £26,000pa, net to maintain your standard of living, which equates to approx £30,000pa of joint taxable income.
- Your joint pension funds are £1.26m. £30,000pa represents a yield of 2.4%. You could almost retire now!
- You don't want to retire now and can't take benefits from personal pensions until age 55 and Malcolm's deferred pension until 65.
- There is no need to take unnecessary risks in your retirement strategy, other than for their tax efficiency, there is no need to continue funding pensions, just saving your dividends/bonuses in the bank.
- Retirement income can be secured through both pension and non-pension vehicles. Pensions attract tax relief on contributions (subject to HMR&C limits) and tax free growth, but longer term you may lose the capital by annuity purchase, i.e. guaranteed income for life.
- Non-pension saving generally doesn't attract tax relief on contributions, but your capital should be preserved for future generations (not an issue for you).
- As you want tax and cost efficiency, I recommend you focus on pension funding until the Lifetime Allowance is approached, (£1.6m each 2007/08).

#### Property Purchase

- Property purchase increases your exposure to risk. Buying it personally, or through the company, means borrowing, which must be financed even if the business is not profitable. Your pensions can buy the property without borrowing, but on business failure, it must sell the property or be faced with a non-income producing asset.
- Understanding these risks, the options for property purchase must be evaluated against your objectives.
- Personal Purchase: Whilst you would own a significant asset, benefiting from Inheritance Tax (IHT) and Capital Gains Tax (CGT) reliefs, the capital element of loan repayments must be funded from taxed income. This is not tax efficient - **reject**.
- Company Purchase: Again, you could benefit from IHT and CGT reliefs but the capital element of loan repayments must be funded from taxed profit and the company may own an asset which a future purchaser may not want: **reject**.
- Pension Fund Purchase –**recommend**:

Your personal pension funds can be converted into cash and transferred into new Self Invested Personal Pensions (SIPP) which can buy the property. You get full tax relief on the purchase price.

- The SIPPs could borrow up to 50% of their value. I have rejected this as it would increase your exposure to risk.
- Rent paid by the company to the SIPPs is tax deductible by the company but tax free in the SIPP. Property growth is tax free.
- On business sale, there are several ways to access income from the SIPPs. These are beyond the scope of this report.

### **Retirement Strategy**

- You each establish SIPPs and transfer in your personal pension funds of £600,000 as cash. We will need to confirm that your existing pension providers do not charge an exit penalty.
- The company makes a contribution into each of your SIPPs of £250,000. We will need to confirm with your accountant that these contributions will be deductible.
- Each SIPP buys a half share in the property for £500,000, paying costs of £50,000, leaving cash within each SIPP of £300,000 i.e. £800,000 of assets against a lifetime allowance of £1.6m.
- At outset, each SIPP owns 62.5% growth assets (the property) and 37.5% secure assets (cash). This is above your stated risk tolerance, however including the Directors Loan accounts of £80,000 each as investment assets, this falls to 57% (growth), 43% (secure), which is better than the current position, 76% growth, 24% secure (Appendix A).
- The SIPPs lease the new property to the company at a commercial rent, which together with ongoing company pension contributions is invested in a balance of secure and growth assets within the SIPP. The secure assets will be a combination of cash and fixed income and the growth element will be made up of equity funds, given your existing exposure to property.
- The property value and level of SIPP funding is reviewed annually to ensure that the lifetime allowance is not exceeded.

### **Meeting Your Objectives**

By following the above strategy you will have:

- A coherent strategy to maintain your current standard of living in retirement, un-reliant on business sale. By reviewing your progress on a regular basis, you can have peace of mind about your future.
- Purchased the new business premises in the most cost and tax efficient manner, extracting £500,000 from the company tax and NIC free, in the process.
- Maintained (broadly) your desired exposure to real (growth) and secure assets.



#### **4 Other Issues**

- Confirm Wills and Enduring Powers of Attorney are in place
- Review impact of untimely death or ill health on the business
- Obtain enhanced return on cash
- With the company's profitability and your earnings, it won't take long to secure the standard of living you are seeking for life. We must review this. Do you want to retire early, spend more or benefit others, eg by establishing a charitable trust.
- Fees for advice – see separate letter.

### Summary of Main Recommendations and Actions

<b>Objective</b>	<b>Recommendation</b>	<b>Action</b>	<b>Who</b>	<b>When</b>	<b>Result</b>
Have a coherent retirement strategy	Use this document as basis for strategy	Accept recommendations, book review meeting to develop strategy	Planner	On completion of property purchase	Outline strategy encompassing property purchase
Tax and cost efficient property purchase	Establish new SIPPs. Transfer in personal pensions	Complete documentation	MB & BB	ASAP	Liquidity to purchase property
Tax and cost efficiency	Company contributes £250k into each SIPP	1. Confirm deductibility with accountant. 2. Subject to (1), make contributions	MB, BB & accountant	ASAP	Gross profit extracted to achieve 57% growth, 43% secure investment balance
Tax and cost efficient property purchase	SIPP buys property and leases to business	Brief solicitor	MB, BB & solicitor	On completion of (2) & (3)	Tax efficient property purchase
Have a coherent retirement strategy	Review financial impact of death or ill	Book review meeting	Planner	ASAP	Financial security in event of disaster

## Appendix A

### Assets and Liabilities

### Allocation

<b>Assets</b>	<b>Joint £</b>	<b>David £</b>	<b>Penny £</b>	<b>Total £</b>	<b>Secure</b>	<b>Growth</b>	<b>Total</b>
Used							
House	550,000			550,000			
Mortgage	200,000			200,000			
	350,000			350,000			
Investment							
Mountain Gear Ltd		0	0	0			
Cash	32,000			32,000	32,000		
Pensions		600,000	600,000	1,200,000	240,000	960,000	
Deferred		60,000		60,000	60,000		
<b>Total</b>	<b>1,132,000</b>	<b>660,000</b>	<b>600,000</b>	<b>2,392,000</b>	<b>332,000</b>	<b>960,000</b>	<b>1,292,000</b>
					26%	74%	

**Liabilities - none**

### Income and Expenditure

As income substantially exceeds outgoings, no calculations prepared at this stage.