MAY 2022 NEWSLETTER

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Putting a cost on retirement

£185.15 a week.

That is what the new state pension will be after the increase due in April 2022. By then, the uplift of 3.1% could be around half the going rate of inflation. Had the pension benefited from the temporarily abandoned Triple Lock, it would rise by 8.3%. Even with that increase the state pension would still not reach £200 a week, yet alone be enough to cover the frozen income tax personal allowance, equivalent to about £242 a week.

So, how much retirement income do you need?

The calculation of required retirement income has traditionally taken two forms:

- *Proportion of final earnings* This approach is the foundation on which final salary pension schemes were built. It assumes that your pension income before tax should be a fixed proportion of your earnings in the final year(s) of employment, The target fraction adopted by many pension schemes, both in the public and private sector, was two thirds.

- *Target living standard* The final salary calculation is arbitrary: it assumes that both the chief executive and the lowest paid employee both need the same proportion of gross pay. In practice, for the chief executive, the formula may produce an excessive figure, particularly once tax is allowed for, whereas, at the opposite end of the scale, two thirds of not-very-much can be far-too-little. To counter this potential distortion, some retirement experts ignore pre-retirement income and consider a post-retirement question: how much net income is needed to meet a given standard of living?

Neither method is designed to give as good an answer as an individual assessment based on personal expenditure. However, they provide a helpful starting point for generalised calculations.

The Pensions and Lifetime Savings Association (PLSA) basis

In 2019, the PLSA joined with Loughborough University to develop a table of target retirement incomes based on three different living standards:

- ***Minimum****,* a level of income which covered all needs, with ‘some left over for fun’;

- ***Moderate***, a higher level of income, providing more financial security and flexibility; and

- ***Comfortable***, the top level of income, giving more financial freedom and 'some luxuries'.

The PLSA considers six categories under each standard. For example, under the Transport category, the minimum standard makes no provision for a car, while the comfortable standard envisages a couple having two cars, each replaced every five years.

The latest results

Towards the end of 2021, the PSLA updated its tables, taking account of how prices and spending habits had changed since 2019. For example, a Netflix subscription was added to the minimum and moderate standards while the comfortable standard saw the inclusion of annual maintenance and servicing of a burglar alarm. The *net* annual income numbers are shown below:

	Minimum		***Moderate***		***Comfortable***	
	Standard	**London**	**Standard**	**London**	**Standard**	**London**
Single	£10,900	£13,200	£20,800	£24,500	£33,600	£36,700
Couple	£16,700	£21,100	£30,600	£36,700	£49,700	£51,500

Unless you aspire only to the minimum standard of living, the state pension will leave you with a significant shortfall. At the comfortable end of the retirement spectrum, tax can push up gross income requirements to high levels. If a couple living outside London are relying upon the income of only one spouse or civil partner, then he or she will need gross income of about £62,000 to reach the net income goal of £51,500.

Action

If the PLSA figures come as a surprise, then you might need to review your retirement planning.

A comfortable retirement living standard cannot be funded with minimum living standard contributions. Talk to us about how you can build the retirement fund you need to supplement that meagre state pension.

Footnote: A later state pension?

In mid-December the Government announced a review of state pension age (SPA), primarily focused on when this should rise to 68. At present, the SPA is 66 and is due to increase to age 67 between April 2026 and April 2028. Five years ago, the Cridland Report proposed that a SPA of 68 should be phased in between 2037 and 2039. Since that report, improvements in life expectancy have been less than forecast, which would point to the next but one (and possibly even the next) SPA increase being deferred. However, the Treasury would not be happy with any such move, given the extra outlay involved.

Capping social care costs in England

In early September, the Government revealed initial details of its long-awaited plans for funding social care in England. While the other constituent parts of the UK each have their own care funding rules, they are all influenced by the approach adopted in England. A little over two months later some unwelcome clarification on the new English framework emerged.

2014 re-visited

At the heart of the plan is a reworking of the structure created by the Care Act 2014, itself the product of the Dilnot Report produced in 2011. There are three key aspects of the new regime:

1. **Revised capital limits** At present, if your savings and other wealth (potentially including the value of your home) amount to more than £23,250, then you must meet all your long term care costs. However, if your savings and other wealth are below £14,250 you will not have to touch them, although you will still be subject to an income-based means test to assess any personal contributions to your care costs. In between those two capital limits, a sliding scale of capital contribution applies – effectively meaning contributions of 20.8% a year of any capital over £14,250.

   Under the new regime, the capital limits will rise to £100,000 and £20,000, with the in-between capital contribution still based on 20.8% of the excess over the lower limit. That could mean a payment of over £14,500 a year if you are assessed to have £90,000 of capital.

2. **Care cost cap** Your liability to pay for care will end once an £86,000 (index-linked) ceiling is reached. In September, the Government emphasised that this cap applied only to personal care costs, not 'hotel costs' such as accommodation and food. Two months later it confirmed that hotel costs would initially be set at £10,000 a year, regardless of the true cost. Not such good news was the simultaneous announcement that the basis of the cap had changed from that in the Care Act 2014. Instead of the £86,000 total applying to fees paid by the individual *and* their local authority, only the individual's outlay would count towards the cap. The implication was that many more people would never see the benefit of the cap, given the average stay in a nursing home is less than three years.

3. **Meeting the cost** To fund the reform, NICs for employers, employees and the self-employed will increase by 1.25 percentage points, meaning that basic rate taxpaying employees will face an NIC rate of 13.25% - just shy of two thirds of

their income tax rate. Dividend tax rates will also rise by 1.25 percentages points, e.g. from 32.5% to 33.75% if you are a higher rate taxpayer.

While the new capital limits and care cap for England will not take effect until October 2023, the NICs and dividend increases will bite (throughout the UK) from 6 April 2022. The theory is that, initially, the extra revenue will go to the NHS, but then gradually move across to funding social care as the new regime gets underway. In practice, many commentators have been sceptical that any Government will be able to take money away from the NHS once it has started to flow. Perhaps that explains why, from 2023/24, the extra NIC charge morphs into a separate Health & Social Care Levy.

2023 onwards

Once the new regime is in place, the burden of care costs will be reduced, but the changes are not as significant as some of the election-time rhetoric suggested. There is still a possibility that your home will have to be sold to meet your care costs; the 2023 system will simply defer that sale until after your death and bridge the interim period with a loan from your local authority.

Action

The new regime is no reason to assume you can forget about the cost of care.

There are many bar room lawyer stories about how to avoid meeting care costs. Most fall at the first hurdle, the law that prevents 'deliberate deprivation of assets' to sidestep the capital test. If care costs concern you, talk to us about how funding can be built into your retirement planning.