# Report for Harry & Joan [CS1]

*(prepared in August 2013 in tax year ending 05-April-2014)*

## Objectives

I understand you would like advice on:

1. Paying school fees for your nephews' four children

2. Arranging your Wills to provide bequests to your nephews and their children and exclude Joan's niece.

3. Arranging Lasting Powers of Attorney for you both and appointing suitable attorneys.

Other objectives identified include implementation of an investment strategy that better meets your objectives with greater tax efficiency and provision for potential future care costs.

## Assumptions

I have used the following assumptions in preparing this report.

| PA | |
|---|---|
| 2.50% | Price Inflation. HMGovernment's CPI target is 2%. Currently it is 2.7%. The Bank of England May 2013 Inflation Report projects inflation at 2% through to 2016. |
| 4.00% | House Price Inflation. In line with wage inflation assuming an approximate historic relationship of inflation +1.5%. |
| 0.50% | Interest rate for cash. Current Bank of England Base Rate. |
| 3.00% | Return on Index Linked assets (inflation +0.5%). |
| 2.00% | Return on Gilts (HMGovernment Securities) per redemption yields reported by Debt Management Office. |
| 3.00% | Return on Corporate Bonds assume approximate historic 1.0% credit spread over gilts. |
| 6.00% | Return on Equities assume approximate historic equity risk premium of 4.0%, being the difference between expected rate of return from equities and the risk-free rate from gilts. |
| 4.00% | Return on Commercial Property. The 1 year total return to 31/05/2013 per the CBRE UK Annual Property Index was 3.9%. |

All returns assumed to be total returns combining income and capital appreciation.

Average life expectancy is currently 82 for Harry and 85 for Joan.

## Assets & Liabilities

Your house is valued at £180,000.

Your cash savings are £140,000 of which £100,000 is in ISAs.

You have shares in investment trusts valued at £52,750 for Harry and £5,888 for Joan.

Your house contents including collectable items are £100,000. Individual personal possessions worth £6,000 or less at time of disposal may not attract Capital Gains Tax (CGT).

On second death your estate would be worth £478,638, which falls below the two nil rate bands for inheritance tax (IHT) which total £650,000.

There are no reported liabilities.

## Income & Expenditure

Your current income and expenditure position can be summarised as follows.

| | | Harry | Joan | Total |
|---|---|---|---|---|
| | | £ | £ | £ |
| **Income** | | | | |
| Harry's Local Government Pension | | 20,000.00 | | 20,000.00 |
| Joan's pension (assume level) | | | 6,000.00 | 6,000.00 |
| Joan's state pension | | | 5,727.80 | 5,727.80 |
| Savings account interest | | 200.00 | 200.00 | 400.00 |
| Cash ISA interest (assume 2.00% pa) | | 1,000.00 | 1,000.00 | 2,000.00 |
| Investment Trust dividends | | 465.61 | 215.88 | 681.49 |
| | | ------------------- | ------------------- | ------------------- |
| **Total Gross Income** | | **21,665.61** | **13,143.68** | **34,809.29** |
| Less | Income Tax | 2,198.56 | 307.15 | 2,505.71 |
| | Client Expenditure | 8,000.00 | 8,000.00 | 16,000.00 |
| | Holidays (assumed) | 3,000.00 | 3,000.00 | 6,000.00 |
| | | | | ------------------- |
| **Net Surplus Income** | | | | **10,303.58** |

I have assumed Joan's full state pension does not include entitlement to State Second Pension (previously SERPS).

I have assumed Cash ISA interest of 2.0% pa as Tesco Bank and Nationwide are both offering 2.0% pa on transfers-in to instant access Cash ISAs.

I have assumed investment trust dividends in line with reported yields, Baillie Gifford Shin Nippon nil, Witan Pacific 1.7% and Blackrock North American Income 3.3%.

There is no benefit in transferring assets generating taxable income between you.

I have assumed you will continue to take annual holidays costing £6,000 pa in today's terms.

## Attitude to Risk & Capacity for Loss

You describe yourselves as moderate investors being prepared to invest up to 65% in equities.

I suggest a cautious low-medium risk approach with 50% in equities would be appropriate.

Once some cash is set aside as an emergency fund, I will assume you are happy to adopt our asset allocation for a low-medium risk cautious portfolio for the residue.

I view your capacity for loss as low-medium. Whilst your index-linked pension entitlements meet your living costs, you may rely to some degree on your investments to fund school fees for your nephews' children and also potential future care costs.

## Proposed Portfolio Asset Allocation

I propose the following low-medium risk asset allocation:

| | FUNDS |
|---|---|
| 2% | Cash |
| 7% | Index-Linked Bonds |
| 21% | Corporate Bonds |
| 20% | Commercial Property |
| 50% | Equities |
| ------------ | |
| 100% | |

An allocation to cash is required to meet wrap platform charges.

I have not allocated to gilts as the outlook is unattractive. Similarly I have reduced the allocation to corporate bonds in favour of commercial property where the outlook is more positive.

The equities element would normally be invested 50% UK, 40% overseas and 10% emerging markets, however your existing investment trust holdings provide a bias to overseas equities until we can re-structure your portfolio.

Applying our investment return assumptions to the portfolio asset allocation the estimated return is 4.64% pa.

The reduction through charges is shown for the portfolio incorporating existing investment trusts, and also the proposed re-structured portfolio.

**ASSUMED RETURN PER ANNUM**

| | PORTFOLIO WITH EXISTING INVESTMENT TRUSTS | RE-STRUCTURED TARGET PORTFOLIO |
|---|---|---|
| Portfolio gross | 4.64% | 4.64% |
| Less on-going charges * | -0.95% | -0.62% |
| Portfolio net | 3.69% | 4.02% |
| *Net real return* | *1.19%* | *1.52%* |

* Comprising annual fund charges and fund expenses and wrap platform charges of 3 x £48 pa per account

Portfolio re-structuring will using CGT allowances in concert with Stocks & Shares ISA subscriptions will take two tax years.

If you receive an ongoing service from us, the cost of 0.5% pa is in addition to the assumed on-going charges.

## Pensions

Harry's state pension will commence from age 65 and prior to the new flat rate pension in April 2016. I recommend drawing the pension from 65.

I assume a full entitlement but Harry can check with The Pension Service who can also advise on entitlement to State Second Pension (previously SERPS).

Local Government and state pensions increase in payment with inflation. I assume Joan's other pension of £6,000 pa is level in payment with no spouse's pension.

On first death, where:

- Harry is the survivor his needs will be met by the Local Government pension plus the state pension

- Joan is the survivor her needs will be met by an estimated Local Government spouse's pension of around £10,000 pa together with her state pension and £6,000 pa employer pension.

## School Fees

You describe the costs as £10,000 pa in today's terms for 7 years, then reducing by 25% each year. I have assumed you have listed the children in age order with Ian as eldest and the £10,000 figure is in total, <u>not</u> per child.

The primary overhead with school fees is staff wages so I have assumed a rate of escalation in line with wages at 4.00% per annum, as opposed to using inflation.

The school fees can be projected as follows:

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **School Fees Planning** | | | | | | | | |
| 4.00% pa assumed rate of escalation of fees | | | | | | | | |
| Year | Ian 11 | Sue 10 | Matt 9 | Sally 8 | **Totals** | | **Discount Rate pa** | **Discounted Lump Sum** |
| 2013 | 2,500 | 2,500 | 2,500 | 2,500 | **10,000** | | 0.50% | 10,000 |
| 2014 | 2,600 | 2,600 | 2,600 | 2,600 | **10,400** | | 0.50% | 10,348 |
| 2015 | 2,704 | 2,704 | 2,704 | 2,704 | **10,816** | | 0.50% | 10,709 |
| 2016 | 2,812 | 2,812 | 2,812 | 2,812 | **11,249** | | 1.16% | 10,865 |
| 2017 | 2,925 | 2,925 | 2,925 | 2,925 | **11,699** | | 1.64% | 10,962 |
| 2018 | 3,042 | 3,042 | 3,042 | 3,042 | **12,167** | | 2.86% | 10,567 |
| 2019 | 3,163 | 3,163 | 3,163 | 3,163 | **12,653** | | 4.08% | 9,954 |
| 2020 | | 3,290 | 3,290 | 3,290 | **9,869** | | 4.08% | 7,460 |
| 2021 | | | 3,421 | 3,421 | **6,843** | | 4.08% | 4,969 |
| 2022 | | | | 3,558 | **3,558** | | 4.08% | 2,483 |
| | ------------- | ------------- | ------------- | ------------- | ------------- | | | ------------- |
| **Totals** | **19,746** | **23,036** | **26,457** | **30,015** | **99,254** | | | **88,316** |

In the most part the fees can be paid out of surplus income, the exception being the first three years which are prior to payment of Harry's state pension when around 1/3 of the fees would need to be paid out of capital, with a total figure over the first three years of £8,938.

I recommend funding the school fees on this basis.

For reference, if your estate was subject to IHT, fees paid out of surplus income can be treated as gifts out of income and exempt from IHT, and the capital payments would fall within your annual capital gift allowance of £3,000 each.

I estimate a lump sum investment of £88,316 with 52.97% cash, 18.22% fixed interest, 11.74% property and 17.07% equities would be required as a standalone arrangement. I do not recommend this basis given the allocation to cash.

## Cash Flow Analysis

The cash flow analysis uses the following assumptions:

- Local Govenrment and state pensions rise with inflation, and Joan's £6,000 pa pension is level

- Harry will draw a full state pension at 65

- Living costs of £16,000 pa and holiday costs of £6,000 pa rise with inflation

- Taking into account HM Govenrment's proposed changes to the income tax personal allowance and basic rate band, I have assumed Harry's personal allowance for income tax will rise from £9,440 this year to £10,000 next and then with inflation thereafter, and that Joan's enhanced personal allowance for income tax will remain at £10,500 until Harry's personal allowance catches up and then escalate in line with Harry's thereafter. The changes to the basic rate band will not have any affect.

- Cash ISAs totalling £100,000 transferred to Stocks & Shares ISAs and invested in concert with existing holdings to create overall portfolio with recommended asset allocation

- School fees escalate at 4.00% pa

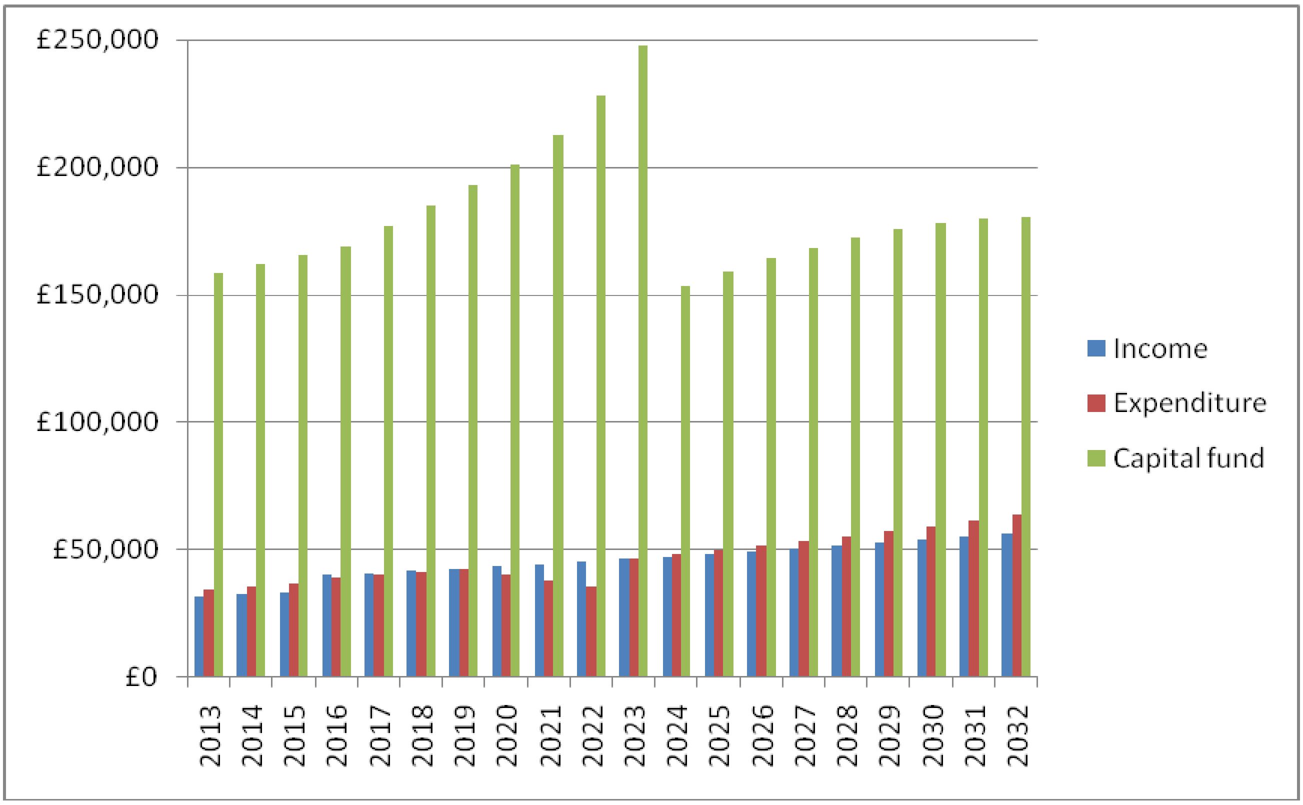
- Care home costs commence for both of you in 2023 and escalate at 4.00% pa (due to the primary overhead being wages) based on £24,336 pa in 2011/12 for a care home in the north-east (www.payingforcare.org). Care is conservatively assumed to last 10 years giving average life expectancy of 82 for Harry and 85 for Joan

- In 2023 your possessions (no rise in value assumed) and property are sold. The estimated £366,444 proceeds added to your capital fund to fund the purchase of immediate care annuities (cost £200,000 for Harry and £266,667 for Joan) to cover the projected care cost shortfall of around £40,000 per annum escalating at 4.00% pa

- Your general expenditure and holiday expenditure will reduce by ¾ from 2023

- Any deficit in retirement income is drawn out of, and surplus income invested into the capital fund run as a low-medium risk portfolio.

Assuming average life expectancy the cash flow analysis shows the capital fund will be worth £180,493 in 2032 and at all times prior to that will be worth in excess of £140,000 so there is adequate resource to meet your proposed bequests.




The bequests may have to be reduced if school or care fees turn out to be higher than expected or care fees commence sooner than 2023.

Your cash savings of £40,000 are not included in the cash flow forecast so there is reasonable provision for contingent measures.

## Investment Recommendations

I recommend your joint savings of £40,000 invested £20,000 each into NS&I Premium Bonds which, with average luck, should return 1.30% pa tax free. Premium Bonds are accessible paying out within 8 working days.

My investment recommendations are:

- Transferring 2 x £50,000 Cash ISAs to Stocks & Shares ISAs with Alliance Trust Savings (ATS), keeping in mind ISA rules do not allow a transfer back to Cash ISA later, and investing in the initial proposed portfolio listed below

- ISA holdings biased to fixed interest and property where income yield is gross tax free

- re-register non-ISA holdings to ATS Investment Dealing Account (IDA) in joint names.

The ATS platform charge is £48 pa per account and dealing charge of £12.50 per deal.

| INITIAL PROPOSED PORTFOLIO | | | | | | | |
|---|---|---|---|---|---|---|---|
| Asset Class | Allocation | Amount | | Account | | Fund Name | On-going |
| | | | Harry | Joan | Joint | | Charge |
| | | | ISA | ISA | IDA | | |
| Cash | 0.03% | £50 | | | x | Cash | 0.00% |
| | 1.01% | £1,600 | x | | | | 0.00% |
| | 1.01% | £1,600 | | x | | | 0.00% |
| Index Linked Bonds | 7.00% | £11,108 | x | | | L&G AllStocks ILGilt Index I UT | 0.18% |
| Corporate Bonds | 7.00% | £11,108 | | x | | Fidelity Moneybuilder Income Y OEIC | 0.56% |
| | 7.00% | £11,108 | x | | | L&G Fixed Interest I UT | 0.33% |
| | 7.00% | £11,108 | | x | | Jupiter Strategic Bond I UT | 0.75% |
| Commercial Property | 10.00% | £15,869 | x | | | TR Property IT | 1.04% |
| | 10.00% | £15,869 | | x | | L&G UK Property I UT | 0.64% |
| UK Shares | 6.50% | £10,315 | x | | | Vanguard FTSE UK Eq Income Index OEIC | 0.25% |
| | 6.50% | £10,315 | | x | | City of LondonIT | 0.45% |
| Overseas shares | 15.53% | £24,650 | | | x | Witan Pacific IT | 1.24% |
| | 17.71% | £28,100 | | | x | Baillie Gifford Shin Nippon IT | 1.53% |
| | 3.71% | £5,888 | | | x | Blackrock North American Income IT | 1.45% |
| **Totals** | **100.00%** | **£158,687** | | | | | **0.86%** |
| | | | | | | Portfolio on-going fund charge in £ | £1,362 |
| | | | | | | Plus 3 x £48 ATS account admin charges | £144 |
| | | | | | | | ----------- |
| | | | | | | Overall total on-going charge in £ | £1,506 |
| | | | | | | % | 0.95% |

Thereafter, over the next 2 years, I recommend re-structuring the portfolio gradually selling out of Witan Pacific, Baillie Gifford Shin Nippon and Blackrock North American Income trusts as CGT allowances permit and funding ISA subscriptions with the proceeds creating the following target portfolio.

CGT allowance is £10,900 each for 2013/14, and assuming no ISA subscriptions have been made, I recommend using disposal proceeds to fund full Stocks & Shares ISA subscriptions for 2013/14 of £11,520 each, and repeating next year and thereafter.

| TARGET PORTFOLIO | | | | | | | |
|---|---|---|---|---|---|---|---|
| Asset Class | Allocation | Amount | | Account | | Fund Name | On-going |
| | | | Harry | Joan | Joint | | Charge |
| | | | ISA | ISA | IDA | | |
| Cash | 1.00% | £1,587 | x | | | Cash | 0.00% |
| | 1.00% | £1,587 | | x | | | 0.00% |
| Index Linked Bonds | 7.00% | £11,108 | x | | | L&G AllStocks ILGilt Index I UT | 0.18% |
| Corporate Bonds | 7.00% | £11,108 | | x | | Fidelity Moneybuilder Income Y OEIC | 0.56% |
| | 7.00% | £11,108 | x | | | L&G Fixed Interest I UT | 0.33% |
| | 7.00% | £11,108 | | x | | Jupiter Strategic Bond I UT | 0.75% |
| Commercial Property | 10.00% | £15,869 | x | | | TR Property IT | 1.04% |
| | 10.00% | £15,869 | | x | | L&G UK Property I UT | 0.64% |
| UK shares | 6.50% | £10,315 | x | | | Vanguard FTSE UK Eq Income Index OEIC | 0.25% |
| | 6.50% | £10,315 | | x | | City of LondonIT | 0.45% |
| | 6.00% | £9,521 | x | | | Merchants Trust IT | 0.66% |
| | 6.00% | £9,521 | | x | | L&G UK Index I UT | 0.18% |
| Overseas shares | 7.50% | £11,902 | x | | | Scottish Mortgage IT | 0.51% |
| | 12.50% | £19,836 | | x | | Vanguard FTSE Dev World UK Eq Index OEIC | 0.30% |
| Emerging Markets | 5.00% | £7,934 | x | | | Templeton Emerging Markets IT | 1.31% |
| **Totals** | **100.00%** | **£158,687** | | | | | **0.53%** |
| | | | | | | Portfolio on-going fund charge in £ | £845 |
| | | | | | | Plus 3 x £48 ATS account admin charges | £144 |
| | | | | | | | ----------- |
| | | | | | | Overall total on-going charge in £ | £989 |
| | | | | | | % | 0.62% |

The target portfolio is in line with the proposed asset allocation and represents a more diverse portfolio which is a better match to your moderate attitude to risk and your objectives.

I have used a blend of index tracker and active managed funds for equities, with a bias to UK equity income so dividend yields can contribute to the total return. I have only used actively managed funds for corporate bonds, commercial property and emerging markets equities as I am not satisfied an index tracker fund is suitable at the present time. Where possible I have recommended investment trusts trading at a discount.

I have assumed any new investments in the portfolio will be made keeping to the same asset allocation.

I have assumed annual portfolio re-balancing.

Existing Investment Trusts

Your existing investment trust holdings can be summarised as follows:

| Investment Trusts | Investment Date | Holder | Share Holding | Your Book Price | My Book Price | Current Share Price | Current Value | Gain (My Book Price) |
|---|---|---|---|---|---|---|---|---|
| Witan Pacific | 11/07/2008 | Harry | 10000 | £0.8807 | £1.5500 | £2.4650 | £24,650 | £9,150 |
| Baillie Gifford Shin Nippon | 23/02/2009 | Harry | 10000 | £0.8030 | agree | £2.8100 | £28,100 | £20,070 |
| Blackrock North American Income | 18/03/2013 | Joan | 5000 | £1.1272 | agree | £1.1775 | £5,888 | £252 |
| | | | | | | | -------------- | -------------- |
| | | | | | | | £58,638 | £29,472 |

I have looked up the historic book prices for the investments and do not agree with Witan Pacific. Please confirm.

The investment trust holdings are pregnant with gains, £29,220 in Harry's name and £252 in Joan's.

I have recommended they are re-registered onto an IDA in joint names.

Witan Pacific invests in the Asia Pacific region and Baillie Gifford Shin Nippon in small Japanese companies. They may have done well but are high risk. Blackrock North American Income is also reasonably high risk.

## Wills

You wish to leave £50,000 each to your nephews Sam and Albert and £10,000 each to their children Ian, Sue, Matt and Sally.

You wish to exclude Joan's niece from any inheritance at all.

I recommend you seek advice from a solicitor on drafting your Wills.

A simple solution is mirror Wills leaving everything to the survivor on first death, and then the specific named bequests on second death totalling £140,000, with the residue to go to charity or whatever other beneficiaries you choose.

However as Joan's niece will be the sister of either Sam or Albert, the brother and sister may arrange a Deed of Variation in favour of your niece after you have both passed away.

If this concerns you, I recommend seeking advice on using a discretionary trust in the Wills naming your nephews and their children as potential beneficiaries, and no power to appoint further beneficiaries, and the use of an Expression of Wishes letter detailing your intentions to the trustees as a means to reduce the probability of Joan's niece receiving anything.

Normally I would recommend asking family members to be Executors and Trustees to reduce the legal fees. In this instance with your concerns over Joan's niece, I suggest appointing the solicitors' firm as Executors and Trustees for professional impartiality, subject to a satisfactory indication of their fees for such a role.

## Lasting Power of Attorney (LPA)

I recommend asking your solicitor to arrange LPAs for you, which are legal documents that let you appoint someone to make decisions on your behalf should you become incapacitated.

I recommend you each have a Health & Welfare LPA which allows your attorney(s) to make decisions for you about, for instance, your daily routine, medical care, moving into a care home or refusing life-sustaining treatment.

I also recommend you each have a Property & Financial Affairs LPA which allows your attorney(s) to make decisions for you about, for instance, paying bills or school fees, collecting benefits, selling your home.

The Office of the Public Guardian registration cost is £130 per LPA or £520 in total.

I recommend using two or more attorneys and choosing persons who are able to make decisions. This could be your two nephews plus a third attorney able to assist them in decision making, otherwise if not your nephews what about their respective spouses? The attorney(s) for your Property & Financial Affairs LPA should include someone financially astute.

If family members do not fit then consider friends or professionals, such as your solicitor or financial adviser, bearing in mind they will make professional fee charges, so subject to a satisfactory indication of their fees for such a role.

## Other Issues

Confirm decision to cut out Joan's niece and related issue.

Identification of capital expenditure items, for instance replace car, house maintenance, special holidays.

## Next Steps

| **Item** | **Who** | **When** |
|---|---|---|
| ISA Transfers & non-ISA re-registrations | Client/planner | Immediately |
| Wills and LPAs | Client/solicitor | Immediately |
| CGT allowance part-disposal & 2013/14 ISAs | Client/planner | 3 months |

Your plan will be reviewed annually.

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