Report for Marcus [CS4]

(prepared in August 2012 in tax year ending 05-April-2013)

Objectives

You have surplus income accumulating in your savings account and wish to arrange investments with more risk with a view to buying a larger house should you meet a partner and settle down, or if not then to purchase a barge in 10 years time at a cost of £8,000 in today's terms.

I have also identified the following objectives:

1. Review the tax efficiency of your remuneration package
2. Review your existing pension provision
3. Consider the potential impact of long-term sickness
4. Consider your parents' current situation and related issues.

Assumptions

I have used the following assumptions in the preparation of this report.

PA	
2.0%	Price Inflation. HMGovernment's CPI target is 2%. Currently it is 2.4%. The Bank of England August 2012 Inflation Report projects inflation at 2% through to 2015.
3.5%	House Price Inflation. In line with wage inflation assuming an approximate historic relationship of inflation +1.5%.
0.5%	Interest rate for cash. Current Bank of England Base Rate.
2.5%	Return on Index Linked assets (inflation +0.5%).
2.0%	Return on Gilts (HMGovernment Securities) per redemption yields reported by Debt Management Office (DMO).
3.0%	Return on Corporate Bonds assume approximate historic 1.0% credit spread over gilts.
6.0%	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.
4.0%	Return on Commercial Property. The 1 year total return to 31 July 2012 per the IPD UK Annual Property Index.
2.0%	Annuity Interest Rate in line with current redemption yields on long dated gilts reported by DMO.

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

Average life expectancy is currently 79 per 2009 Mortality Tables.

Inflation linked pension annuity calculated using PA90 tables, downrated 10 years.

You wish to retire at state pension age on the state pension plus a gross income of £3,000 per month in today's terms.

State pension age depends upon your date of birth. If before 6 April 1977 it is 67, if after 5 April 1977 it will be between 67 and 68. I have assumed state pension age 67.

Assets & Liabilities

Your main residence is worth £200,000 and has an offset capital and repayment mortgage redeeming in 2032. You have £60,000 in cash savings offset against the mortgage. I assume the outstanding loan element is currently £140,000.

Subject to confirmation, the apparent value of your personal pension is around £56,000.

Income & Expenditure

Your current expenditure is £35,000 pa. I calculate £2,880 relates to net pension contributions (i.e. £3,600 gross) and £1,680 to car lease payments.

Your current income and expenditure can be summarised below, with a surplus income of £1,499 pa.

The second and third columns propose alternative remuneration structures that reduce salary in favour of dividends and include employer pension contributions of £3,600 pa.

	Current Basis	**Basis 1**	**Basis 2**
Earnings	£50,000	£42,475	£24,000
Dividends	£0	£4,963	£25,988
P11D			
	---------------	---------------	---------------
Total gross income	£50,000	£47,438	£49,988
LESS			
income tax	-£9,164	-£8,487	-£7,468
employee NICs	-£4,337	-£4,186	-£1,969
living costs	-£30,440	-£30,440	-£30,440
net pension premiums	-£2,880	-£0	-£0
car lease payments	-£1,680	-£1,680	-£1,680
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Net surplus income	**£1,499**	**£2,645**	**£8,431**
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Employer gross pension premiums		**£3,600**	**£3,600**

Each remuneration structure has a similar employer cost of £55,867 in terms of salary, dividends, employer National Insurance Contributions (NICs) and for the second and third columns, pension contributions.

Basis 1 assumes gross employer pension contributions of £3,600, earnings use up the basic rate income tax band and further income taken as dividends taxed at 32.5%. The dividends have been limited to keep the same overall total employer cost, and their use reduces income tax and NICs. The net surplus income increases to £2,645.

Basis 2 assumes gross employer pension contributions of £3,600 and that earnings are reduced to a defendable market value, for which I have estimated £2,000 pm. Additional income is again taken as share dividends. Again the dividends have been limited to keep the same overall total employer cost. The net surplus income increases to £8,431.

Further improvement to net surplus income might be achieved by having the business pay the car lease as a taxable benefit.

Reducing salary in favour of dividends can be a legitimate business planning tool to aid cashflow. However it is essential that you consult your accountant to ensure the appropriate administrative procedures are accurately followed to prove the dividends are genuine dividends.

The potential increase in surplus income can be applied to meet your financial planning objectives.

Attitude to Risk & Capacity for Loss

Concerning your proposed investments, you describe your attitude to risk as mildly adventurous and are prepared to invest more than 50% in equities although you would like to retain access to the money.

Whilst in good health with reliable earnings you have a reasonable capacity for loss as you will not be reliant on your investments to meet your living costs or short term capital expenditure.

You are concerned about inflation.

I have assumed the medium risk balanced portfolio asset allocation strategy with 70% in equities would be acceptable.

By comparison your pension fund has very high exposure to risk, whilst I would assess your capacity for loss as fairly high.

Proposed Portfolio Asset Allocation - Investments

I propose the following medium risk strategy for your new investments:

	FUNDS
5%	Index-Linked Bond
20%	Corporate Bond
5%	Commercial Property
70%	Equities
100%	

The recommended funds already have small allocations to cash removing the need to allocate to a separate cash account. The recommended fund platform does not presently require the use of a cash account either.

I have not allocated a proportion to gilts as the outlook is unattractive, giving a bias to corporate bonds.

The equities element is invested 50% in UK, 40% overseas and 10% emerging markets.

Applying our investment return assumptions the portfolio has an estimated return of 5.13% pa, reduced by charges as follows:

	ASSUMED RETURN PA
Portfolio gross	5.13%
Less net TERs*	-0.61%
Portfolio net	4.52%
Net real return	*2.52%*

* Total Expense Ratio – a more accurate description of the annual charge for an investment fund

If the rate of interest charged on your offset mortgage exceeds the net assumed return of 4.52% pa, I would recommend accumulating your cash savings to offset against the mortgage over proceeding with any investments.

Please note if you receive an ongoing service from us, the cost of 0.5% pa is in addition to the assumed net fund TERs.

Planned Capital Expenditure

You wish to provide for the cost associated with purchasing a barge in 10 years. The cost in today’s terms is £8,000. Escalating this cost with inflation gives an overall sum required in 10 years of £9,561.

Using the above return assumption, this cost can be met by investing:

- regular monthly savings of £62 pm
- a lump sum of £6,145.

Investment Recommendations

Money is accumulating in your savings account which you wish to invest for the future.

Your savings account presently has a balance of £40,000 and your current account £20,000.

Assuming your offset mortgage will allow up to 90% loan to value, the £20,000 in the current account cannot truly be regarded as liquid emergency funds as it must be kept on deposit to meet the loan to value requirement.

I recommend you limit your investment to £20,000 from the savings account, leaving behind £20,000 to act as a liquid emergency fund.

I recommend investing the £20,000 as follows:

Asset Class	Allocation	Amount	Fund Name	TER pa	Rebate pa	Net TER pa
Index Linked Bonds	5.00%	£1,000	L&G All Stocks IL Gilt Index Trust	0.25%	0.00%	0.25%
Corporate Bonds	20.00%	£4,000	M&G Strategic Corporate Bond	1.16%	0.25%	0.91%
Commercial Property	5.00%	£1,000	M&G Property Portfolio	1.66%	0.50%	1.16%
UK Equities	35.00%	£7,000	L&G UK Index Trust	0.56%	0.25%	0.31%
Overseas Equities	28.00%	£5,600	L&G International Index	0.88%	0.25%	0.63%
Overseas Equities	7.00%	£1,400	First State Global Emerging Market leaders	1.58%	0.50%	1.08%
Totals	**100.00%**	**£20,000**		**0.88%**		**0.61%**

All of the funds are unit trusts or open-ended investment companies which I recommend are accessed through the Cofunds platform where there is presently no initial charge and the only annual charge is the net TER.

I recommend any unused ISA subscription from the £11,280 allowance for 2012/13 is invested in the M&G Strategic Corporate Bond and Property Portfolio funds on the grounds of tax efficiency. These have the highest income yields which will be tax exempt under the ISA. Any remaining ISA subscription should be in L&G UK Index Trust where the yield of over 3% attracts higher rate tax at 32.5% unless held through the ISA. Higher rate tax on the dividend yield is a greater consideration than the Index-Linked Gilt fund with an income yield of 1.3%.

After 5 April 2013 the remaining holdings worth £8,720 can be moved into a 2013/14 ISA.

I prefer index tracker funds for equities. Research suggests actively managed funds rarely outperform over the longer term. Also trackers have substantially lower cost. I have 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 present.

I recommend you consider further investments of £200 pm, the cost of which can be met through savings associated with a more tax efficient remuneration structure. Future monthly investments after 5 April 2013 can be directed to the ISA. As this is a modest amount it may not be possible to invest in all six funds in the recommended allocations. An alternative single fund solution with similar asset allocation is AXA Framlington Managed Balanced, with net TER of 0.83% pa.

These investments are all accessible and can be sold without any product penalties with proceeds payable within 5 working days to assist with purchasing your barge or moving to a bigger house.

Pensions

Please confirm self-invested personal pension (SIPP) details for:

- the £8,000 investment in JPM Mid Cap in August 2008 which exceeds the cash accumulated since May 2008 assuming contributions of £300 pm

- the £38,280 invested in ICI shares in June 2011 which exceeds the cash available. Also ICI plc delisted on 4 January 2008 after being acquired by Akzo Nobel.

The Marwyn Value Investors holding is a very high risk Cayman Islands based fund, at a large discount and heavily geared with substantial holdings in just a few European companies, somewhat lacking diversification. The reported TER is 0.23% pa.

JP Morgan Mid-Cap is high risk and heavily geared, investing in UK shares in the FTSE mid-250 index. The shares are at a discount to net asset value (NAV) by around 15% and the TER is 0.72% pa.

Worldwide Healthcare is high risk and also heavily geared, investing in global shares (with a bias to the US) focused on biotechnology/life sciences. The shares are at a discount to NAV of around 6% and the TER is 1.09% pa.

These holdings go far beyond the attitude to risk of "mildly adventurous".

The SIPP charges are more expensive than a stakeholder pension which on NIL commission terms has a single product charge of 0.6% pa or less.

I recommend transferring to a stakeholder pension and investing entirely in medium-high risk equity funds where there is little or no gearing and greater diversification across a wide range of sectors and geographical areas. Once the pension fund value is over say £100,000 it can revert to a SIPP but aiming for a medium-high risk portfolio, being wary of highly geared funds lacking diversification.

In preparing projections of pension benefits I have used the apparent current value of £56,094 and a lower estimated value of £20,000. I have assumed future contributions will increase in line with earnings. I have projected these funds forwards to assumed state pension age 67 at an assumed annual net return of 5.4% pa (equity return 6.0% less 0.6% annual stakeholder charge). Your effective SIPP annual charge is probably higher than 0.6% pa.

I have assumed a target gross pension in today's terms of £36,000 pa (i.e. £3,000 pm) in addition to the state pension (currently £5,587.40). You may also be entitled to some SERPS / State Second Pension, I recommend obtaining a forecast from The Pension Service.

The projected pension figures can be summarised as follows:

Current Value	£56,094	£56,094	£20,000	£20,000
Starting Contribution pa	£3,600	**£7,425**	£3,600	**£8,866**
Projected Fund	£829,435	£1,372,609	£624,708	£1,372,609
Projected Pension pa	£40,996	£67,843	£30,877	£67,843
Discounted Pension pa	£21,754	£36,000	£16,384	£36,000

An increase in existing pension contributions of between £3,825 and £5,266 pa gross is required.

Moreover, whereas your existing contributions have remained at £3,600 pa since 2008, these future contributions need to increase each year.

In summary I recommend you replace your personal pension contributions with employer pension contributions starting at £750 pm (i.e. £9,000 pa) and increasing each year with national average earnings index.

This additional cost can be met through savings associated with a more tax efficient remuneration structure. If you do not wish to make additional investments through your pension, then I suggest increasing the monthly investments in ISAs / OEICs by £450.

I recommend reviewing your SIPP charges and transferring to a stakeholder pension to reduce charges.

Protection

The main risk to your financial planning objectives is loss of income through ill-health.

I recommend that you establish income protection that will provide a replacement income in the event of long-term sickness. In view of your current savings I recommend a deferred period of 12 months meaning the policy will not pay out unless you have been off work for 12 months.

The cheapest policy on smoker terms written to age 67 with tax free insured income benefit of £25,000 pa escalating with inflation is offered by PruProtect with a guaranteed premium on NIL commission terms starting at £40.06 pm.

I recommend you consider Private Medical Insurance to obtain potentially faster treatment times than the NHS to speed up a return to work from ill-health.

You could also consider critical illness cover although this is a lower priority.

Other Issues

Looking ahead I suggest that you engage a solicitor to establish a Will and Lasting Power of Attorney.

Concerning your parents, if their UK visits average more than 91 days in a tax year, they may be considered UK resident. Perhaps you could plan regular visits to them in Cyprus.

I suggest you enquire with about whether they have Power of Attorney arrangements in place, and a Will in Cyprus as well as in the UK.

Finally, if your parents wish to give cash to you, consider accepting and using it to help fund your pension.

Next Steps

The next steps needed to implement our recommendations are:

Item	**Who**	**When**
Remuneration structure	Client/accountant	Immediately
Proposed investments	Client/planner	Immediately
Pensions changes	Client/planner	After accountant
Income protection	Client/planner	Immediately

Your plan will be reviewed annually.

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