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What is a £5,000 a year pension worth?

If you have pension benefits from an old private sector final salary pension scheme, they could be much more valuable than you think. So how much is the right to a £5,000 a year prospective pension actually worth?

One of the answers to that £5,000 question – and there are many – is "a transfer value of 30 times the pension, in other words - £150,000".

Two years ago such a transfer value figure would have been about £100,000 close to retirement. The main reason for the increases in transfer values is the sharp drop in *long term* interest rates. Final salary pension schemes use long term yields to assess the value of their pension liabilities and as bond yields fall, so the value of those liabilities increases.

Exchanging £5,000 of pension for £150,000 of pension fund can have several advantages, but, there are significant disadvantages, too. The decision on whether to transfer is a complicated one. If your transfer value is more than £30,000 – which could mean a pension of £1,000 a year – under government rules your pension provider must make sure that you have taken regulated financial advice based on your own particular situation before allowing any transfer to be made. We think that makes sense for any transfer.

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LISA reappears after a summer redesign

The Lifetime ISA is back in the spotlight, having disappeared over the summer.

In what proved to be his final Budget, George Osborne announced the launch of a Lifetime ISA from April 2017. The LISA, as it was generally labelled, was widely seen as a stalking horse for future pension reforms, which might still emerge from the government.

When Philip Hammond replaced Mr Osborne in July, it was unclear whether the LISA would survive. It was therefore a surprise when the government introduced the Savings (Government Contributions) Bill in early September, setting out a broad LISA framework. The Bill was accompanied by an "updated design note" for the LISA, setting out the basic LISA structure.

There has been some debate about whether a LISA contribution is better than a pension contribution (under current rules). If you are in the position to choose between the two next April, then personal advice based on your particular situation is essential. While a LISA and a pension have the same tax benefits during the investment period, at the stages of making contributions or drawing benefits, tax rules are distinctly different.

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Time for an ISA review?

Investors placed over £73 in the cash component for every £100 they subscribed to ISAs, according to recent HM Revenue & Customs statistics for the tax year 2015/16.

Overall, about half of all ISAs by value were held in the cash component.

However, near zero interest rates mean the tax savings from cash ISAs are correspondingly small. With the advent of the personal savings allowance in this tax year, you may not even need an ISA to receive tax-free interest.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

Salary sacrifice rules to be tightened

If your employer allows you to exchange salary for benefits, such as a mobile phone or a company car, you may be paying more tax from 2017/18.

HM Revenue & Customs is consulting on a revised treatment for salary sacrifice arrangements. The proposals are that income tax and employer's NIC's should be levied on the greater of the salary foregone and the taxable value of the benefit (which might be nil).

Fortunately, pension contributions made by salary sacrifice will be exempted from the new tax rules.

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Finding income in a tricky savings climate

Real interest rates may not rise much above 1% – even in the longer term according to the Bank of England. If the Bank is right about this, where can investors find income now?

Last December the bank asked how far 'real' interest rates (that's after allowing for erosion by inflation) have fallen globally, and how likely they are to stay at their current low levels. The Bank argued that the fall in real interest rates over the last 30 years was driven by a mix of changes including population aging and increased levels of saving especially in emerging markets. They thought these trends would persist for some time and didn't see interest rates rising much for some time either.

Both cash and fixed interest securities look unpromising at the moment – yields are at or near all time lows. That doesn't mean that there is no place for holding cash and bonds as part of a diversified investment portfolio. But it does mean that investors should be looking for income from shares and property as well.

Dividends from equities (company shares) have traditionally provided the answer for investors wanting a reasonably dependable income. This involves them giving up some of the capital security provided by cash deposits or even some fixed interest securities. The value of their capital in shares can go down as well as up, and the dividends aren't guaranteed either. But with equities there is also the prospect of some possible long-term capital growth, which can be very important in boosting investment returns over the years. The difference between income and capital growth is that the income is usually reasonably regular, while any capital gains tend to come in spurts – with years of no gain or even losses followed by sharp up-turns.

Most people cannot just live on the income from their investments – it's necessary to have a diversified investment portfolio. The total returns you get from such a portfolio should provide a sustainable stream of spendable income. We are here to help so please get in touch.

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A third quarter investment lesson

Short term stock market movements are very hard to predict and the third quarter of 2016 was a salutary reminder of this for all investors.

If you had been asked at the start of 2016 what would happen to UK shares in the July-September quarter if the Referendum vote had favoured Brexit, the chances are you wouldn't have predicted a 6% rise. And that almost certainly wouldn't have been your response if you had been asked the same question at the start of the third quarter – just a week after the vote.

But the fact is that the FTSE 100 achieved a rise of 6.1% over the three-month period, leaving the index 10.5% higher than when the year began. It is a reminder that trying to second guess what the stock market will do over a relatively short timescale is extremely difficult. It can also be costly, as those investors who rushed for the exits after 23 June now realise.

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