Chapter 1

Building Your Retirement Dream

In This Chapter

- Identifying and diffusing the age time bomb
- Setting your future financial goals
- Constructing your retiring wealthy plan
- Monitoring your big plan
- Using property and pensions
- Understanding the task ahead of you

You probably have an image of what life should be like once you retire. Perhaps sun, sea, and sangria appeal or a round the world cruise. Maybe you're looking forward to spending your autumn years pursuing a hobby or enjoying time with the family.

But many people don't start to think seriously about retirement until it's virtually upon them. Up until that age they may have bigger fish to fry. Perhaps they are concentrating 100 per cent on bringing up a family or pursuing their career. If you were to ask a hundred people in their twenties, thirties, and forties what their life goals are, you can bet that planning for a wealthy retirement would come far down the list.

But you've picked up this book – better hurry to that checkout! – which means you're already ahead of the pack. Believe me you're right to take time out to think long and hard about how you're going to pay for your golden years.

In this chapter I explain why it is more important than ever to be the man (or woman) with a plan for your retirement. Fail to plan and you may find that your retirement dreams remain just that – dreams, never making it into reality.

Ticking Away . . . the Demographic Time Bomb

People in Britain – like most people in the western world – are having fewer babies and having them later in life. Boffins have given all sorts of reasons for this phenomenon, from the advent of the contraceptive pill to men wearing tight jeans in the 1970s – don't go there, you don't want to know, believe me! But whatever the reason, the truth is that Britain is an ageing society, where the average age of its citizens is inexorably rising each year. No bad thing you may say – fewer kids means smaller queues at Alton Towers and perhaps the extinction of that most delightful phenomenon, the supermarket aisle tantrum.

However, fewer people being born has a huge impact on your retirement plans and the younger you are the bigger the impact is!

At the same time as fewer people are being born we are all, on average, living longer. A British man can now expect to live into his mid to late seventies while a woman can expect to clock up over eighty years.

These two factors – fewer children and living longer – mean that the ratio of workers to pensioners falls dramatically over the next few decades. In fact by 2050 nearly one in three people living in Britain will be over the age of 60.

The upshot of this change is that the burden of supporting more retired people falls on fewer workers.

This has been dubbed the demographic time bomb, because those in work in 2030 or 2050 – today's children – are not going to want to hand over great big piles of cash to support you in retirement.

Different countries are finding their own way to diffuse the demographic time bomb. The French government is paying couples to have children, while in Britain we have a far more open immigration policy, hoping to attract young people to 'Cool Britannia' with the promise of work.

WARNING!

Don't presume that the state help that is available to retired people today will be available to you when it's time for you leave work. By then the burden on taxpayers of an ageing society may be so great as to mean that a state pension or free NHS healthcare will no longer exist. The key is to be prepared for the worst-case scenario.

Diffusing the demographic time bomb

There may be little you can do about the falling birth rate – no matter how great an effort you put in – but ways do exist for you to copper-bottom your finances to ensure that when the demographic time bomb goes off it doesn't blow your retirement dreams off course.

You need to adopt the know-it-all approach. The saying goes that no one likes a know-it-all, but when it comes to planning for your and your family's future it's best to ignore this and be a bit of a smart Alec. Make sure that you:

- **Know what you have.** In order to plan for a hopefully wealthy retirement you need to work out what you're worth – in pounds, shillings, and pence – and what you're likely to be worth when it comes to waving goodbye to the working world. See Chapter 3 for how to work out how much you're worth.
- **Know what you need.** You have to be realistic about the future. What do the state and your employer (through a company pension) provide for you and what do you have to fund for yourself? How much are you going to need to cover the basics such as food, heating, clothing, and a roof over your head? And if you have any debts, such as a mortgage, are they going to be paid off before you get to retirement?
- **Know what you really want.** This book isn't just about providing for retirement, it's about retiring wealthy. If you have dreams, you need to put a price on them. What, for example, will it cost for you and your loved ones to take the motorhome around Europe, buy that second home in the sun, or take that luxury cruise in the Mediterranean each winter? Once you know what your dreams cost you can more easily gauge if your finances are in shape for you to be able to afford them.

Being a know-it-all helps you answer the burning question that some workers probably ask themselves day in, day out: When can I retire?

Here's some good news: You're probably richer than you think. Spend a little time assessing how much your assets are worth – this gives you an idea of where you're starting out from in your retiring wealthy project. See Chapter 3 for tips on how to assess your financial worth.

One good thing about retirement is that the bills tend to get smaller. Think about it – no longer do you have to pay to commute to work or fork out for overpriced work lunches. What is more, most people have paid off their mortgage by the time they retire, which is a big expense out of the way.

Most people reach the pinnacle of their career and income earning potential in their late forties and fifties. This is also the time when mortgages are paid off and the darling little treasures have flown the family nest. This golden scenario – high income combined with low outgoings – can lead to a sudden injection of wealth, which helps provide for a comfortable retirement.

Avoiding the 'living longer, growing poorer' trap

People are living longer than ever before – I bet you haven't stopped celebrating that one – and this trend is set to continue. Average life expectancy may rise to ninety within a generation.

All this means that you may end up spending nearly as long retired as you do working. And you're going to need to build up enough money while at work to pay for your golden years.

Do the sums: If you live until you're 90 but retire at 65 you need to support yourself for 25 years. If you started work at 21 you have 44 years in which to build up enough cash to see you through at least 25 years. And that's presuming you only have an average life expectancy. Say you keep on going strong until you get the telegram from the Queen – you would have been retired for only nine years less than you would have worked.

Many people, understandably, find the prospect of having to provide for such a long retirement very daunting. But fear not, there are lots of things you're likely to have going for you that help you cross the wealthy retirement finishing line:

- **Your home.** If you're a homeowner – particularly if you've been one for a good few years – you have a good chance of having a lot of equity in your home. You can free up some of this equity at retirement to provide a healthy retirement income or even borrow money to invest elsewhere – perhaps in a buy-to-let property. See Chapters 13 and 14 for more on using your home to boost your retirement wealth.

- **Time is on your side.** To a certain extent, time is your biggest asset. Usually savings and investments grow in value over time by more than prices. Savings benefit from compound interest, where interest piles up year after year. See Chapter 10 for more on how compound interest works and Chapter 12 for stock market investment.
- **Getting an early start.** The time factor is crucial to growing your money pot and achieving a wealthy retirement. It therefore follows that a little bit of money saved in early life can grow into a large amount by the time you reach retirement. It has been estimated that every pound you pay into a pension fund in your twenties will, when you retire, be worth double every pound you pay in when you're in your forties.

Interest earned on savings is automatically taxed at a rate of 20 per cent (you have to pay more if you're a higher rate taxpayer at self assessment time). But there are several ways you can reduce the amount of tax you have to pay on your savings.

- If you don't earn enough to pay income tax you can claim the tax deducted on your savings back from HM Revenue and Customs.
- In addition, every UK citizen over the age of 18 is allowed to pay up to £3,000 a year into a mini cash Individual Savings Account (ISA). Money held in an ISA grows tax-free.

Check out Chapter 10 for more on ISAs and other tax efficient savings.

CHEAP CHIC

The golden rule with saving is that you must aim to get a rate of return higher than price inflation. If you fail to beat inflation then you find over time that the amount of goods and services your savings can buy falls. It's best to aim to beat inflation by at least a couple of percentage points – therefore if price inflation is running at around 3 per cent, go for savings accounts which pay at least 5 per cent. Inflation-beating savings accounts don't grow on trees, you have to shop around and study the best buy tables. Check out the moneyfacts Web site at `www.moneyfacts.co.uk` for a list of the highest paying savings accounts.

Setting Your Retiring Wealthy Target

Try spending some time thinking about what you'd like your later life to be like. Do you want lots of foreign holidays, do you have a hobby you'd really like to pursue and need to fund, or is your idea of bliss merely having enough in the larder, sitting in your garden, and having the grandchildren around?

The richer your tastes the more money you need and the harder you have to save and invest.

Above all, try to be realistic about your goals. If you're on an average salary then, unless you scoop the lottery or win big on the Premium Bonds, you're unlikely to be able to be able to spend winters in Mustique and summers cruising round Monte Carlo in your yacht. See Chapter 2 for more on figuring out your retirement goals.

Financial advisers reckon that in order to have a comfortable retirement, you need an income around two-thirds what you enjoyed during your working life. Therefore, if you earned £30,000 a year on retirement you should aim for an income in later life of around £24,000.

Roping others into your plan

It's likely there is someone special you'd like to take along for the retirement ride. However, you need to talk to this special someone about what you have in mind. And of equal importance, you need to listen to what they have to say on the subject.

It's likely that your ideas won't be identical at first – no worries, you just both have to compromise a little to come up with a joint plan.

Sit down and discuss what you want to achieve, what high value goods you have your hearts set on, and what you are willing to sacrifice to get there. If you have children you probably want to discuss what sort of inheritance you'd like to leave them.

You have a better chance of retiring wealthy if there are two of you with your shoulders to the wheel. Having two incomes coming in means you should have spare cash to save and invest. Couples with two incomes also find that they can afford larger, more expensive, property than singletons; this is because they can borrow a sum based on combined salaries.

A change in the law means that same-sex couples now enjoy the same tax and legal rights as married heterosexual couples. However, to access these rights same-sex couples have to go through a civil partnership ceremony.

Aiming for the retiring wealthy stars

Having said that you should be realistic about your retiring wealthy goals, there is nothing wrong with a little ambition. Okay, you're not going to live the life of Roman Abramovich or the Duke of Westminster, but if you start early, and save and invest hard, with a dash of good investment fortune you can enjoy a bit of the high life.

Think about one big ambition – perhaps you want a home in the sun or you want to extend and improve the family home. Cost this ambition and then go for it.

One of the biggest barriers to retiring wealthy is taking on unnecessary debts. Borrowing big to fund 'here today gone tomorrow' purchases is a mug's game. The rate of interest charged by credit card, store card, and loan providers tends to be very high. Nearly every day I come across people whose lives are blighted by having splashed out cash they didn't have. It may seem very mother henish of me but the simplest advice is, if you can't afford to buy it from your savings or current income, then don't buy it!

The pension image problem

If you played a word association game with someone a few years ago and said 'pension' to them, they probably would have blurted out the following words: boring, complex, solid, and reliable.

Play the same game today and 'boring' and 'complex' would crop up again – but this time so would 'unreliable' and 'crisis'.

Pensions have a major image problem and the reasons for it are not hard to fathom:

- **Mis-selling:** In the 1980s and 1990s thousands of people were advised by financial advisers to stop paying into their workplace pensions and instead invest in expensive personal pension plans. This advice was terrible and as a result the pensions industry has had to pay out billions in compensation.
- **Underperformance:** Most pension funds invest heavily in shares and as a result suffered huge losses when world stock markets crashed between 2000 and the spring of 2003. Some of this damage has since been put right as markets have bounced back, but it hasn't stopped pension saving getting a reputation for being unreliable, particularly as providers kept on levying whopping fees even when investment return was falling through the floor. Pension underperformance has been thrown into sharp relief by how well property investment has done, causing many people to ask why they bother with pensions when property can bring home the bacon.

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- **Workplace woes:** In the past few years companies have been falling over themselves to cut the amount of money they pay into their workers' pensions. Some company schemes have actually gone to the wall, resulting in tens of thousands of workers losing most of their pensions. Outside the public sector, the old final salary scheme – where workers were guaranteed a pension based on their salary and length of service – has all but disappeared and been replaced by schemes where the workers bear all the investment risk.
- **State pension shrink:** Back in 1980 the government abolished the link between the state pension and wages. This wasn't seen as much of a problem at the time, but now the chickens are coming home to roost. The problem is that inflation is generally lower than rises in average wages. This means that the state pension as a proportion of the average wage is shrinking. Today the state pension is worth around only 18 per cent of average salaries; if things go on as they are it's estimated it will be worth just 6–7 per cent by 2050.
- **Falling annuity rates:** You now need far more money than you used to need to secure a substantial retirement income. This is partly because interest rates have been falling, but it's also due to the fact that people are living longer and subsequently annuities need to last much longer than in the past. Many people have grown to dislike pensions as they often entail the purchase of an annuity.

Despite all this bad news surrounding pensions, it's worth bearing in mind that they come with absolutely terrific and unique tax breaks. Save in a pension and your government – and sometimes your employer too – gives you free money! Check out Chapters 6 through to 9 for the low-down on pension saving and what role it can and should play in your big plan.

Constructing Your Big Wealth Plan

If you want to enjoy a wealthy retirement you need a plan. Part of this big plan is assessing where you are financially today and where you want to be at retirement. Another key aspect is how you are going to get there.

Rather than invest on a whim, you're best off having an overarching strategy in place. Mostly, it's about deciding your approach to risk. Before you save and invest in anything, ask yourself how it fits in with your strategy.

Your strategy needs to take into account the following:

- **Your know-how.** Warren Buffett, the world's most successful stock market investor, has a simple mantra: If you don't know what you're buying, don't buy it. This doesn't mean you have to be able to clone Dolly the sheep before investing in Biotech company shares, but it does mean that you ought to have some grasp over what you're putting your money into. This book should help you get a handle on most things in the world of saving and investment.

- **Your age and means.** If you're poor and old then you can afford to take fewer risks than if you're young and well-off. The older you are the less time there is to make up any loss on an investment.
- **Your risk comfort zone.** Most financial experts reckon that because you're younger you should take more investment risk, but it doesn't necessarily follow that you must go against what you feel inside. If you don't like risks then don't take them. There is nothing wrong with protecting what you already have. Just be aware that to retire wealthy you're either going to have to take a few risks along the way or rely on earning plenty of cash and saving a high proportion of your income.

Check out Chapter 4 for different strategies you can adopt and how you can tailor your plans to be flexible enough to take advantage of investment opportunities.

TIP

One way of guarding yourself and your retiring wealthy plan from the unexpected is to take out insurance. You can insure yourself against virtually anything these days, from illness or injury to whether your wedding day will be spoiled by the rain.

Your money pot is not just for retirement

Charles Dickens' Mr Micawber said 'Annual income twenty pounds, annual expenditure nineteen, nineteen, six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds, nought, and six, result misery.'

Ask anyone with substantial savings and they can tell you it provides a really liberating feeling. Okay you may not be able to tell the boss where he or she can stick your 9–5 job, but having savings gives you options and the chance to invest in your future, or if things go wrong – say you suffer injury, redundancy, or ill health – keeps the wolf from the door.

Most financial experts reckon that before you start ploughing money into property, shares, or exotic investments you should have the equivalent of at least three months' salary in a deposit savings account. Some experts go further and reckon you should have at least six months' 'rainy day' money tucked away.

TIP

Obtaining independent financial advice can really help you see your plan through. A good independent financial adviser looks at your present circumstances and recommends what you should be investing in to reach your long-term wealth goal. See Chapter 5 for how to find an adviser.

Keeping a close eye on your plan

One of the keys to bringing off your retiring wealthy plan is to regularly review how well you're doing.

Sit down at least once a year and cast your eye over your savings and investments. Check for the following:

- **Has the interest rate on your savings account fallen?** If so, perhaps you should look to move to another provider. Regardless, check out the best buy tables again to see if there is a more lucrative home for your money.
- **Are you making full use of your tax free savings allowances?** You can save up to £7,000 a year in shares tax free or alternatively £3,000 in a mini cash ISA and £4,000 in a mini shares ISA. You should always look to make use of this tax break, particularly the one relating to mini cash ISA.
- **Is your mortgage rate the best?** People go to huge trouble to get an extra 1 per cent on their savings but leave their mortgage in an uncompetitive deal. Regularly reviewing whether you are with the best and cheapest mortgage provider is one of the smartest financial plays you can make and can save you thousands.
- **How well are your shares performing?** This isn't simply a case of checking out the share price to see if it's gone up or down. Check to see if any of the company fundamentals have changed, whether it is still making money and crucially paying a good dividend. See Chapter 12 for more on how to read a company share.
- **Do your investments suit your present circumstances?** Investments that are right for you in your thirties may not be right in your forties or fifties. For example, as you near retirement you should move out of high-risk investments such as shares and look instead to put your money into safer bets such as savings accounts and bonds.

TIP

With riskier investments such as shares or derivatives you may be best reviewing your holdings at least once a month. This is because the market can move against your investment in double-quick time and it may be necessary to sell up in a hurry.

Taking note of collective investments

Direct investment in shares isn't for everyone. Unless you know what you're doing you can lose your money, fast. But even though you're not some red-braced City wide-boy it doesn't mean you have to forgo share investing altogether. You can put your money into a collective investment vehicle, such as a unit trust or investment trust.

Collective investments pool investor cash to buy shares in lots of different companies. The idea is that a spread of investment lowers risk for the investor, while the fund manager brings his or her expertise to bear in choosing the right stock.

Unit and investment trusts are hugely popular and most financial experts believe that collective investments can give retiring wealthy goals a real push in the right direction.

There are literally thousands of unit and investment trusts on offer. Some invest in the shares of big companies in large economies like the UK or US, while others specialise in buying up stock in small firms or in emerging economies such as China or India.

Unit and investment trusts are not the only types of collective investment. You can find bond funds which – surprise, surprise – invest in bonds issued by lots of different governments or companies. Alternatively, with-profit bonds invest in both shares and bonds. On the wilder, riskier margins of the investment universe there are venture capital trusts, which invest in lots of different start-up and small companies. This type of collective investment is looked at in Chapter 17.

Building up a large holding of shares can be expensive and take a very long time. An alternative to going it alone is to pool your money with friends or work colleagues to buy shares. Investment clubs can be both profitable and fun. See Chapter 5 for how to get one up and running.

Understanding the state's role

Each day that you work and make National Insurance contributions you are building up entitlement to the state pension.

The state pension may not seem like much – it is slipping in value relative to average earnings – but it's still likely to play a big role in your retiring wealthy plan.

The state pension gets a bad press, but it actually has a lot going for it:

- It provides a guaranteed income for life with annual increases linked to prices, known as *index-linking*.

- As long as you keep making contributions (over 44 years for men and 39 for women) it doesn't matter if you're a City banker or a bus driver, you're entitled to the same level of basic state pension.

The danger with the state pension is that people pin all their hopes on it.

At present, on average, the state pension makes up just over 40 per cent of the income of people aged between 65 and 74.

Ideally, if you're serious about retiring wealthy, you should aim for the state pension to account for far less than 40 per cent of your retirement income.

Currently, the state pension is worth £82.05 a week for a single pensioner; that's equivalent to just £4,266 over a year (for the 2005–2006 tax year). If you target an income of £25,000 a year – hardly a king's ransom – then the state pension would account for less than one fifth of this sum.

It's up to you to put the pensions, savings, and investments in place to top up what the state pension provides.

TIP

You can get a free estimate of how much state pension you have earned to date from the government's pension service. Write to The Retirement Pension Forecasting Team, Room TB001, Tyneview Park, Whitley Road, Newcastle upon Tyne, NE98 1BA.

TIP

For more information on the state pension you can check out the government's pension service Web site on `www.pensionservice.gov.uk`.

Becoming a Property Tycoon

For many people property ticks a lot of boxes as far as finding a good solid long-term investment is concerned.

Here's what property has going for it:

- **It's easy to understand.** You buy at one price, you sell at a higher one (hopefully). If you do buy-to-let your aim is to earn more money in rent than you would have done if you'd invested the money elsewhere.

- **It meets a basic need.** Put simply, if you don't own your own home you still have to live somewhere, which means paying rent. In short, a property kills two birds with one stone.
- **Its value is transparent.** It's a cinch to tell how much a property is worth – all you need do is check out your local newspaper adverts or estate agency windows.
- **It provides equity.** Your home is a major asset and you can use it to secure a higher retirement income – through equity release – or as collateral for funding other property purchases or undertaking home improvements.

TIP

You can check out how much property in your neighbourhood is selling for by logging onto the Land Registry Web site at `www.landregistry.gov.uk` and doing a property price search.

Property investment, whether in the form of your own home or, particularly, through buy-to-let, is not all sweetness and light. Drawbacks include the following:

- **You can't get your money out quickly.** It takes time to sell property. Unlike shares and savings accounts which can be accessed in no time, even when the market is buoyant it can take months to sell property; when it isn't homes can stay on the market for upwards of a year and in some horror stories even longer.
- **You put too many eggs in one basket.** Buying property is the biggest investment most of us ever make. Many people are putting themselves at undue risk by having all their cash tied up in bricks and mortar. It's all very well when the market surges ahead but several times in the past the housing market has crashed leaving homeowners in negative equity.
- **Your income fluctuates.** This only applies to buy-to-let property. The reality of life as a landlord is that there are bound to be times when you don't have a tenant paying rent. In landlord speak this is called a *void* period. All the time, though, you still have to fork out for the upkeep of the property, the council tax, and repayments on the mortgage.

REMEMBER

Buy-to-let investors have potential additional headaches to cope with such as problem tenants damaging property and not paying rent. See Chapter 15 for how to deal effectively with problem tenants.

Spicing Things Up with Collectables

Investing for your future doesn't all have to be shares, savings accounts, and property. You can mix fun with finances by buying into collectables.

A whole universe of collectables is out there which you can invest in. The main areas include:

- Classic cars.
- Art and antiques.
- Stamps and gold coins.
- Fine wine.

Long-established markets exist in all the above areas, with specialist auction houses buying and selling collectables of all shapes and sizes. And the traditional auction houses have been joined by a new kid on the block – eBay. The online auction site has millions of users around the globe and you can find just about anything you'd ever want advertised there.

With collectable investing it's crucial that you know what you're doing – it's all too easy to pay over the odds. The golden rules are don't invest if you don't know and invest in what you like.

You need to bear some other factors in mind when it comes to investing in collectables:

- **Markets tend to be quite volatile.** In some ways the market in collectables is akin to that in shares – if you get your timing right and buy something which captures the imagination of collectors you can soon see your purchase soar in value. On the other hand, however, buy a collectable which subsequently goes out of fashion and you can be left nursing heavy loses.
- **Markets are susceptible to economic downturn.** Collectables are a bit of luxury and when money is tight, markets tend to suffer. For example, back in the 1980s the classic car market motored away, only to crash when the world economy slowed in the early 1990s.

- **Collectables are strictly long-term investments.** Because the market in collectables is quite volatile and dictated by fashion, you have to be prepared to hold on to your investment for a long time. Collectables aren't wise investments for anyone who may need the money they have invested in a hurry.

TIP

Generally, you should not have more than 10 per cent of your retiring wealthy pot in collectables. In fact, you may be best off having far less than 10 per cent of your money tied up in collectables, unless it's a real passion and you know exactly what you're doing.

WARNING!

The world of collectables has more than its fair share of con artists. Lots of people operate collectable scams looking to part the unwary with their cash. Scams are particularly prevalent in wine and art – the two most sophisticated collectable markets. See Chapter 16 for how to spot one of these scams.

Understanding the Task Ahead

This book contains no quick retiring wealthy fixes – they don't exist. You have a big task ahead of you, if you want to enjoy the high life in later life.

Even if you enjoy only average life expectancy you're on course to spend over 20 years in retirement. In short, the 40 years or so of your working life are going to have to yield enough cash to pay for your autumn years.

But you do have a lot going for you and you can be successful. Just try to bear the following in mind:

- **Have a spread of investments.** Keeping your finger in a lot of investment pies can be a very savvy move. The big idea is that if one of your investments underperforms you may well find another performs well and comes to the rescue.
- **Remember patience is a virtue.** You should aim to keep most investments for the long term (more than five years). I say this because the passage of time helps smooth out performance peaks and troughs. Times of underperformance are balanced by periods when the investment does well and over the long term it should all, hopefully, average out. Being a long-term investor means you don't incur fees and charges through chopping and changing investments.

- **Get help when it's needed.** Lots of professionals, from stockbrokers to independent financial advisers, really know their onions. As soon as you find yourself reaching the limits of you knowledge, call in the professionals.
- **Boost your knowledge bank.** Read newspapers, check out Web sites – read this book! – anything to expand your investment know-how. In the world of getting rich, knowledge really is power. The more knowledge you have the better the chance of making lots of lolly and truly retiring wealthy.