Retirement Expense Tool

Case Study

September 2018

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For adviser use only

Please note:

This is a case study to help inform advisers only. It should not be relied upon by anyone else.

The adviser is ultimately responsible for the way in which they incorporate this into their advice process.

Every client's circumstances will be different and require advice.

Standard Life accepts no responsibility for advice that may be formulated on the basis of this information.

Any references to legislation and tax are based upon Standard Life's understanding of law and HM Revenue & Customs practice as at September 2018.

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James and Sophie – a case study

James and Sophie are both aged 55 and plan to retire in 5 years time at age 60:

- James earns £80,000 gross a year
- Sophie earns £40,000 gross a year

Their adviser is taking them through the DB transfer advice process and is planning to use cashflow modelling to stress test a range of income sustainability scenarios.

While trying to establish their income needs in retirement, it becomes clear that neither James or Sophie had given it any thought. Completing a review of their current incomes and outgoings could establish income needs, however this is likely to be time consuming.

Using the Retirement Expense Tool available on Adviserzone, the adviser can demonstrate the spending needs of a typical couple like James and Sophie.

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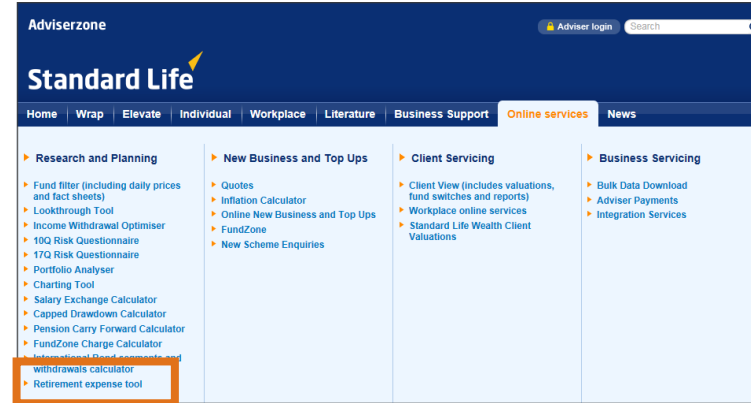
Using the Retirement Expense Tool

With only three pieces of information:

- James and Sophie are a couple
- Their current joint gross household income is £120,000
- Their tax jurisdiction – Scotland or the rest of the UK

The adviser can provide an initial indication of how much income James and Sophie may need in retirement to sustain an *average* lifestyle for their current income bracket.

Inputs		Type	
Couple or Individual		Couple	▾
Current gross household income	£	120,000	
Applicable tax bands		England Wales & NI	

How to use:

(1) Choose from Individual or couple
(2) Enter gross household income (i.e. if couple enter joint gross incomes)
(3) Enter the country for the appropriate tax bands to use in the calculation
(4) Use the personal adjustment percentages to personalise the retirement expense for your client
(5) Where the input is Couple the tool assumes that one person earns all the household income. See point 5 under limitations and assumptions for more detail.
(6) if using the output to complete cashflow modelling, use the appropriate 'gross' or 'net' figure depending on the basis of the cashflow modelling tool to use

Income summary in retirement		Amount	
Gross household income required	£	60,000	

Any queries please see note 1 below for more details and a link to more information

Commodity or service	Net expense using ONS figures	Personal Adjustment	Personalised Net Expense
	Net expense		
Food and non-alcoholic drinks	£ 5,246	100%	£ 5,246
Alcoholic drinks, tobacco and narcotics	£ 1,126	100%	£ 1,126
Clothing and footwear	£ 1,716	100%	£ 1,716
Housing(net), fuel and power	£ 4,604	100%	£ 4,604
Household goods and services	£ 3,999	100%	£ 3,999
Health	£ 1,429	100%	£ 1,429
Transport	£ 6,909	100%	£ 6,909
Communication	£ 1,013	100%	£ 1,013
Recreation and culture	£ 8,315	100%	£ 8,315
Education	£ 144	100%	£ 144
Restaurants and hotels	£ 4,415	100%	£ 4,415
Miscellaneous goods and services	£ 3,734	100%	£ 3,734
Other expense items	£ 4,982	100%	£ 4,982
Total	£ 47,632		£ 47,632

Where do these figures come from?

These categories and values are derived from the ONS figures.

If you would like to find out how these figures are calculated and what each category includes, the ONS has created a pdf which explains the figures in more detail.

Click here for more information

The pattern of expected expenditure is derived from the Office for National Statistics. This comes from 'expenditure analysis of retired households' report using tables A25 and A31 for individuals and couples respectively, which is broken down into 5 groups based on income levels from those with the lowest incomes to those with the highest. The retirement expense tool uses the net income to pick the appropriate group from one of the five and scales it up or down based on actual net income. Because this is scaled it won't be exact but this should be used for indicative purposes only. The link to ONS data above is to overall data and methodology. In order to deliver more relevant data the tool uses the five groups as described earlier

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Using the Retirement Expense Tool

- The adviser points out that the default position is 100%, meaning everyone typically has the same spending needs. However James and Sophie are likely to have specific aspirations and plans and the tool can be adjusted up or down to reflect this.

- For example, they would like to help fund their children through university but also plan to do a lot of travelling while they are in good health.

- **Housing (fuel & power)** to 50% as they'll be away a lot of the year

- **Transport** to 50% as they plan to give up their second car

- **Recreation & culture** – i.e. holidays increase to 150%

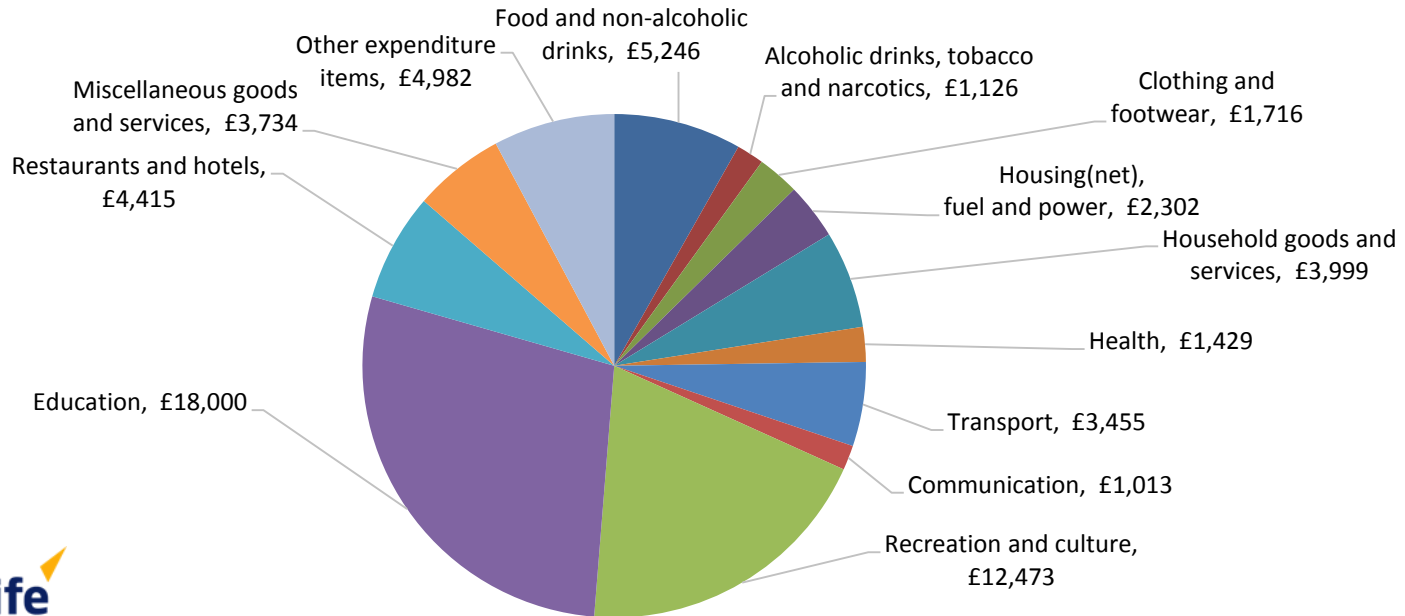- **Education** (for university costs) up significantly

This gives James and Sophie an indicative net expense need of c.£64,000. James and Sophie understand from the adviser that this can only be indicative, as based on average spending patterns of people with similar income – based on government assumptions on income needs in retirement from those while working and does not take into account all tax circumstances.

They are comfortable that the figures give them a good basis for planning.

Commodity or service	Net Expenditure		
	Net expenditure using ONS figures	Personal Adjustment	Personalised Net Expenditure
Food and non-alcoholic drinks	£ 5,246	100%	£ 5,246
Alcoholic drinks, tobacco and narcotics	£ 1,126	100%	£ 1,126
Clothing and footwear	£ 1,716	100%	£ 1,716
Housing(net), fuel and power	£ 4,604	50%	£ 2,302
Household goods and services	£ 3,999	100%	£ 3,999
Health	£ 1,429	100%	£ 1,429
Transport	£ 6,909	50%	£ 3,455
Communication	£ 1,013	100%	£ 1,013
Recreation and culture	£ 8,315	150%	£ 12,473
Education	£ 144	12500%	£ 18,000
Restaurants and hotels	£ 4,415	100%	£ 4,415
Miscellaneous goods and services	£ 3,734	100%	£ 3,734
Other expenditure items	£ 4,982	100%	£ 4,982
Total	£ 47,632		£ 63,890

Using the Retirement Expense Tool

The adviser can export the chart from the tool to use in the client recommendation letter or simply store within the client file.

Food and non-alcoholic drinks, £5,246
Other expenditure items, £4,982
Alcoholic drinks, tobacco and narcotics, £1,126
Clothing and footwear, £1,716
Miscellaneous goods and services, £3,734
Housing(net), fuel and power, £2,302
Restaurants and hotels, £4,415
Household goods and services, £3,999
Health, £1,429
Education, £18,000
Transport, £3,455
Communication, £1,013
Recreation and culture, £12,473

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Anticipating future changes

- The adviser can prompt James and Sophie to think beyond their initial retirement plans. For example, to a time when they are no longer supporting university costs

- Assuming all other expense remains the same, this gives a 2nd income period of expense of c.£46,000 (adjusted for inflation)

- This exercise can be repeated several times throughout to give an indication of a typical retirement. For example, overseas travel may become less appealing for James and Sophie so recreation and culture costs would reduce. The flip side of this is likely to be an increase in cost of housing (fuel & power)

- The adviser can then use cashflow modelling to assess income needs over different time periods against available assets. The cashflow modelling tool also offers the ability to run a series of stress tests to assess whether or not a sustainable income can be achieved to maintain the clients lifestyle

- Once the modelling exercise is complete the adviser could consider adopting a withdrawal policy to document the strategy that has been agreed and have James and Sophie sign it so both adviser and client are clear on what has been agreed

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Further information

Additional notes and information

- For more information on the source of data used in the calculations click <u>here</u>

- ONS determines future expense based on tiers of current gross household income, e.g. clients with higher gross house income pre-retirement will, on average, spend proportionately less of their income on essentials even though this represents a higher £ amount than those on lower incomes

- The tool uses ONS expense tables, A25 & A31, to estimate the retirement expense of the average UK household and therefore does not account for regional variations

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