

Comparison between a pension and a standard investment

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Contractors who want to save and invest for the future to ensure that they have sufficient funds for a comfortable retirement have a number of options to choose from.

"Contractors must choose the right blend of diversified investments while they are working and earning that can build a level of capital wealth to produce an income or which can be drawn down at retirement," says [Contractor Wealth's](#) pensions and investments expert [Angela James](#).

"These investments can feature cash savings in an ISA, property, financial instruments such as equities or mutual funds, and a pension. When you look at the numbers over time and compare different options, pensions consistently prove to provide one of the optimal solution for retirement, largely as a result of their tax efficiency."

Examples of investments for retirement – property

James suggests starting with a hypothetical contractor with the following features:

Age 40

Plans to retire at 65, so has 25 years to save

Needs an income on retirement of £45,000 a year (about £30,000 in today's money).

"One option for a retirement income is property, and contractors like property because it seems to be more tangible than other investments," continues James. "To provide an income of £45,000 a year, a contractor would need at least three average buy-to-let properties.

"If the contractor wants to live off the income, then they need to pay down the mortgages before retirement, over 25 years. Let's say each property is £200,000 and costs £950 per month to pay off over 25 years.

"That works out at £3,000 per month, or £36,000 per year, repaying the mortgages. The contractor has the rental income to help to cover the mortgage costs, of course, but will also pay tax on this income."

James highlights that property can be limiting if the contractor needs a sudden capital sum during retirement: "You can't sell a house a brick at a time. If the contractor needs cash, say for an emergency or to help their children, then they have to sell a property, or remortgage and the mortgage options for retirees with no earnings are limited.

"That means losing the rental income from one of those properties, eating into the £45,000 a year income."

How do other investments compare?

The same contractor can also choose other investments, as James explains: "A contractor's cash can be invested into an ISA, a pension, bonds and general investments such as equities, property funds or other managed funds – there are a huge range of possibilities.

"To provide a £45,000 income each year in 25 years time would require a £13,000 investment into an ISA or a general investment account.

"However, and this is where comparing the options really shows the value of pensions, you only need to invest £10,800 a year into the same pot via a pension to get the same result. The rest is coming from the tax relief that the government provides. This is worth £67,500 over the 25 year period."

The tax relief can account for 20-40% of a contractor's pot, which is why it is so much cheaper to [invest in a pension](#) compared to other options to get the same result.

"If someone said to you 'put £10,000 away each year for 25 years and at retirement we'll give you £67,000', you'd take it, wouldn't you?" adds James.

But everyone knows pensions don't perform, don't they?

"The pensions industry seems to suffer from more myths than most and one of these is that somehow pension funds perform less well than other types of investments," continues James. "But in fact pensions perform on average as well as any other kind of investment."

Contractors can currently invest up to £40,000 a year and still benefit from tax relief. They have a lifetime allowance of £1m that can qualify for tax relief.

James warns that this is not as much as it sounds: "This might sound like a lot, but if a contractor were to retire at 55 with a £1m savings pot and take 5% of the cash as income for 20 years – that's only £50,000 a year – they would run out of money at 75."



Angela James

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Angela is a qualified Senior Financial Planner at Contractor Wealth and specialises in pension advice and financial planning for contractors.

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James concludes: "A pension is a great way to build capital wealth as part of a diversified investments and savings portfolio. The pension reforms of April 2015 mean it can be used to dip in and out of and support other investments, such as a property portfolio, at the same time as being highly tax efficient.

"The state pension is currently £6,000 per year, so contractors who are used to earning averages of £100,000 per year should do the maths and take action now by talking to a financial adviser."

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