Pensions – how much to save

Contractors who want to secure a well funded retirement should start saving for their pension as soon as possible, and should set aside as much as they can afford.

This is according to Contractor Wealth's pensions and investments expert Angela James, who highlights that without the right advice, most contractors will be underfunding their pension.

"A rule of thumb is to halve your age and then save that percentage of your income in a pension. Depending on auto-enrolment to fund a pension, which saves only 8% of a worker's income, won't maintain the lifestyle that contractors are used to when working and desire when they retire.

"In practice, a contractor's financial adviser should create a personal cashflow projection that will identify exactly how much each contractor should save for a pension to fund the lifestyle they want during retirement."

How to calculate a personal cashflow projection

According to James, a sound understanding of personal finances now is what underpins a sensible pensions and investment strategy for the future: "As part of creating a personal cashflow projection, an adviser will look in detail at the contractor's current income and expenditure.

"Analysing a contractor's expenditure should include all outgoings. These could feature household bills such as utilities, food and communications costs, cars, mortgages and servicing other debts, other investments and expenses such as school fees. They also include lifestyle and leisure expenses, such as gym subscriptions, eating out, holidays, and hobbies."

Having established the contractor's lifestyle costs for today, James then removes the costs that, although necessary today, most likely won't be paid out during retirement. These would typically include the mortgage, car and other loans and, if a contractor has children, the many costs associated with raising a family.

Contractors' lifestyle costs may actually increase on retirement

James also identifies any liabilities that may increase during retirement. These could include current costs, such as healthcare insurances. Or they could be additional lifestyle and leisure pursuit costs, including meals out, holidays and hobbies.

"With so much extra time on their hands and a previously very active working life, counter-intuitively many contractors will actually see some of their forecast overall expenditure increase as they seek to fill their time with leisure pursuits.

"And some contractors can find themselves devoting much more time to expensive hobbies that previously cost much less when they were working because they did not have so much time."

Many pensions commentators claim that a typical worker needs two thirds of their final income as their pension income to maintain their lifestyle. Some manage with as little as 50% of their income when working. James' message is that contractors should not assume that they will need less money once they retire.

Projecting lifestyle costs through to retirement age

The final element of the personal cashflow projection is to crunch the numbers: "We start with the contractor's annual living costs in today's money. Then we allow for inflation and the decrease in the value of money over time projected through to the contractor's target retirement age.

"As a rule of thumb, we also usually assume draw down of 25% at age 55. These numbers enable us to estimate the amount of money the contractor needs in their pension pot, less the value of any other assets, such as pensions from previous employment or property."

Having a total sum of money to aim for and a deadline then enables James to work backwards to calculate what percentage of their income a contractor should be putting by now.

Funding retirement through diversified investments

James notes that a pension should form only one element, albeit a large one, of a diversified package of investments for retirement: "The attraction of pensions is that they are highly tax efficient. However, contractors should also consider other investments as part of a diversified portfolio.

“A financial adviser can advise on the optimal investment portfolio that delivers the contractor’s required returns and according to their preferred appetite for risk,” she adds.

Angela James

Pension Specialist

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

Contractor Wealth are a specialist in offering tailored financial solutions for contractors, together with the building of excellent client relationships. **Read Full Profile...**

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James urges contractors who have made not provision for retirement, or who are concerned they may not be saving enough, to **take action now**: “The sooner you start saving for a pension, the more affordable it is. You still need the same amount of money at the end, so give yourself the longest possible opportunity to save for it.”

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