VouchedFor EXPLAINS...

Retirement Income

2025

How to make the next stage
of your life the best it can be

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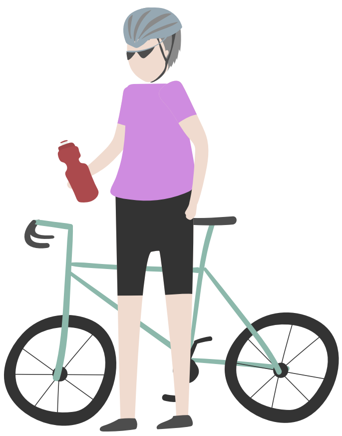

Introduction

For most of your working life, ‘retirement’ was probably something you thought of in the abstract. You knew you wanted to have enough money that you could afford to stop working one day. But it’s only as that day approaches that you can start to think about what the R word actually means for you.

Maybe you want more time to focus on you, to pursue hobbies and discover new interests, or prioritise your health. You might want to travel, spend more time with loved ones, volunteer, or learn new skills.

Or maybe you don’t want to give up work entirely, and want to know what your options are when you reach retirement age but are still employed.

And of course you may have one eye on setting money aside to pay for care down the road, or to leave a legacy.

This guide looks at the pros and cons of different retirement options, and how a sound plan can help you get more out of your retirement savings and the years you have left.

Pros and cons of different retirement options

As you near retirement, your focus will naturally shift from how much money you're putting into your retirement fund, to how best to get it out to fund your desired lifestyle.

There are a number of different approaches you can take, such as buying an annuity, taking a lump sum, or drawing money from your pension pot as you go. You can also combine more than one approach.

The following pages highlight some of the main pros and cons for each one.

With all retirement planning the devil is in the detail. It's a good idea to speak to an adviser to work out which option or combination of options is best for you.

STRATEGY #1
ANNUITY

HOW IT WORKS

- An annuity pays you a guaranteed income for the rest of your life.
- You can buy an annuity using some or all of your pension pot – how much you use will dictate how much income you receive.
- There are also fixed-term annuities that pay a guaranteed income for a set period, followed by a lump sum, and cash-out plans, which allow you to withdraw your whole pension pot tax efficiently as regular income.
- You can usually take up to 25% of your pension pot as a tax-free lump sum. The most you can take is £268,275.
- Age 55 is typically the earliest you can do this.

PROS

- Removes the risk of having your retirement savings run out before you die.

CONS

- Can be inflexible, with no ability to adjust it once bought.
- Inflation can reduce your income's purchasing power over time. You can buy annuities that adjust for inflation but these cost more.
- Any money left over when you die usually stays with the annuity provider. You can't pass it on to your beneficiaries.

Pros and cons of different retirement options

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STRATEGY #2
LUMP SUM

HOW IT WORKS

- You can usually take up to 25% of your pension pot as a tax-free lump sum. The most you can take is £268,275.
- Age 55 is typically the earliest you can do this.

PROS

- You get access to some of your pension earlier.
- You have complete control of these funds, and can use them to pay off debt, a mortgage, help family members, etc.

CONS

- Increases the risk of overspending and running out of money.
- You may have to pay tax on any pension contributions you make after you take a lump sum.

STRATEGY #3
DRAWDOWN

HOW IT WORKS

- Drawdown means you withdraw what you need from your pension while keeping the remaining funds invested.

PROS

- Provides flexibility, as you can adjust withdrawals to meet changing needs.
- Remaining funds have the potential to keep growing as they stay invested.
- Any remaining funds can be passed to beneficiaries when you die.

CONS

- There's a risk of withdrawing money at an unsustainable rate, leaving you without enough in future years.
- Market downturns can deplete funds that remain invested, meaning you may need to change how much you withdraw to keep it sustainable.

How to secure a great retirement

First and foremost, you want to plan your withdrawals from your pension and other sources at a sustainable rate, so that you don't run out of money during your retirement.

But a good plan does more than make sure you can pay the bills. It can be the springboard for living your best life.

The basic steps for making your plan are as follows:

1. Work out your current spending habits
2. Set aside an emergency fund
3. Set goals for how you want to spend your time
4. Create a financial plan
5. Regularly review your plan & amend it as necessary

1. Work out your current spending habits

Look at what you spend money on each month and break it down into essential spending and discretionary spending. This gives you a baseline, and also identifies where you might make changes to fund other things that are more important to you at this point in your life.

2. Set aside an emergency fund

An effective way to prepare for unexpected expenses is to build an emergency fund specifically for your retirement. This fund should be easy to access and big enough to cover unexpected medical costs, home repairs, and other emergencies that might arise.

By having a financial cushion that's separate from your other retirement savings you can avoid drawing down on your pension and investments too quickly. It also frees you up mentally to think about other things you want to do, confident in the knowledge that your rainy day fund is in place.

How to secure a great retirement

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3. Set goals for how you want to spend your time

Now that you've reached retirement, what do you want to do?

An experienced adviser who specialises in retirement will have worked with other people in your position, and will have a good idea of what is and isn't possible.

They can help you identify what's most important to you, the sorts of financial products and investments you're comfortable with, and how you can get the most out of the savings you built up during your working life.

4. Create a financial plan

Once you've established your spending habits, set aside an emergency fund, and identified how you want to spend your retirement, the next step is planning how you will use your savings to fund your expenses.

A useful tool advisers use is a cashflow forecast, which shows how long your money is likely to last in retirement for a given level of spending. This not only helps you to make withdrawals at a sustainable rate, it can also avoid you missing out on life's opportunities by being more frugal than you actually need to be.

5. Regularly review your plan and amend it as necessary

Even with an emergency fund, there may be times when it's necessary to withdraw additional income from your retirement savings. Cashflow forecasting is useful at such times, as it helps you recalibrate your plan.

More generally, it's a good idea to review your spending habits and income needs regularly and make adjustments if needed. This can prevent you from getting into difficulty. Just as important, it can avoid you missing out on things you could actually afford to do.

CASE STUDY

Why one couple’s later life is exceeding expectations

It started with a modest goal: a more comfortable retirement. Now Chris and Jackie Thorne are able to make regular trips to see their son and grandchildren in Australia, while also taking holidays in Europe with their daughter and her kids.

The difference wasn’t some unexpected windfall. Nor did they make a high-stakes bet that happened to pay off. What made the difference for retired garden centre manager Chris, 69, and former office worker Jackie, 70, was the financial planning they did with adviser Jonathan.

Smith started working with the Thornes shortly after they downsized their home in Bedfordshire, freeing up a lump sum that they could invest. He took them through a questionnaire to learn more about their attitude to risk, before guiding them to some lower-risk investment options they felt comfortable with.

That was the start of an ongoing working relationship, with Jonathan guiding the couple.

And it's thanks to this knowledge that Chris and Jackie feel confident making the most of their retirement, and enjoying the wealth they've spent a lifetime building up.

"Working with Jon has given us peace of mind," says Chris. "We know exactly where we stand financially."

How does tax work in retirement?

Income received from a pension or an annuity, including from the State Pension, is generally subject to income tax at your marginal tax rate.

One consequence of this is that if you make large withdrawals, that might push you into a higher tax bracket, meaning a bigger percentage of that income is subject to tax.

It's important therefore to plan your withdrawals strategically. For example, consider using ISAs or cash savings as a first resort. ISA withdrawals are tax free, while savings you already hold as cash are not income.

Make use of personal allowances each tax year. Balance withdrawals between taxable and tax-free accounts. Try to avoid large withdrawals that will put you in a higher tax bracket.

What about inflation?

Retirees can be vulnerable to rising living costs. If your income is fixed at a certain amount per month, then it will buy less over time as prices go up.

The State Pension is linked to inflation, but many private pension schemes and annuities are not. It is possible to buy annuities that offer inflation-adjusted payments, but keep in mind that these will come at a higher cost, meaning you receive a lower income in today's money for the same amount paid to the annuity provider.

Another strategy to consider is holding investments that, over the long run, have tended to outpace inflation, such as shares in companies. This way your money can keep growing as prices rise, maintaining the purchasing power of your savings. The trade-off is that you're putting capital at risk, and your investments will go up and down.

What next steps can I take?

There is a lot to think about when planning your retirement. It's a good idea to speak to a financial adviser, who can walk you through your options and help you make decisions that are right for your circumstances.

You can find one near you here.

This content was produced by VouchedFor, home to the UK's most trusted advisers.

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