The cost of retirement has risen - how to plan

Steep increases in the cost of living mean the average retiree needs to build up £90,000 more in pension savings than previously estimated.

The Pensions and Lifetime Savings Association (PLSA) recently calculated that the average single person needs £37,300 a year after tax to fund a 'comfortable' lifestyle in retirement[1]. That's 11% higher than the PLSA's previous estimate of £33,600 in October 2021. Over this period, inflation has touched 41-year highs as supply chain disruption and the war in Ukraine sent energy and food bills soaring.

If you're approaching retirement, the figures may make for worrying reading. However, there are several steps you can take now to boost your chances of enjoying the retirement you've been hoping for.

Understand how much you need to save

The first step is to work out what size pension pot you're likely to need to fund your retirement. If we use the PLSA's figures as a guide, our analysis suggests a 67-year-old retiring today with the full state pension would need to have built up £630,000 in workplace and private pension savings if they wanted to fund a comfortable retirement until age 100[2]. This would allow them to withdraw a net £26,700 a year, with the additional £10,600 a year coming from the state pension (2023/24 tax year). This assumes annual investment growth of 5% after charges and that their income increases annually with inflation (at 2% a year).

The analysis means the average retiree needs to build up an additional £90,000 in private and workplace pension savings than they did a year ago. Under the PLSA's previous projections, our calculations indicate that a pot worth £540,000 would have been sufficient.

Don't rely on average figures

The amount you actually need to save for retirement will be completely personal to you. The PLSA's projection is based on a retiree spending £144 a week on food, up to £1,500 a year on clothing and footwear, holidaying in Europe for three weeks every year, and replacing their kitchen and bathroom every ten to 15 years. Your version of what constitutes a comfortable retirement could be completely different to this. You might be happy with a more modest lifestyle or want something a bit more extravagant.

It's also worth bearing in mind that our £630,000 calculation assumes the individual stops working at age 67 and spends three decades in retirement. If you're planning to retire earlier than this, your money may need to last longer and so you might need a bigger pension pot. Our figures are also based on someone receiving the full state pension. The amount of state pension you're entitled to will depend on how many years of National Insurance contributions you've made or been credited with. You can find out how much you're likely to receive by getting a state pension forecast.

Rather than simply relying on average figures, a financial adviser can help you work out exactly how much you need to save for retirement, taking into account your individual needs and goals, as well as things like expected investment growth and inflation.

Take stock of your current finances

Once you have a better understanding of how much you need to save for retirement, you can begin to assess whether you're on track to reach that goal. Working out how much you've built up in pensions can be tricky, as you might have multiple different pots with different providers. A financial adviser can help you get an accurate valuation of all your pensions.

It's also important to check how much money you have in other savings and investments. ISAs, savings accounts, share portfolios and property could all form part of your retirement savings pot. In fact, drawing money from ISAs before pensions in retirement could prove tax efficient. You don't pay any tax on ISA withdrawals, whereas pension withdrawals above your 25% tax-free lump sum are taxed at your marginal rate of income tax. ISAs also form part of your estate for inheritance tax (IHT) purposes, whereas pensions usually sit outside of your estate and so can be passed on to your beneficiaries free of IHT.

Check where your money is invested

Rising prices mean it's more important than ever to check your money is working as hard as it should be. If you have too much money in cash or you're in a default pension fund, you could find your retirement savings run out sooner than expected. Remember, your savings might need to last for several decades in retirement.

Although the stock market is volatile, history shows that over long periods it tends to perform better than cash and grow above the rate of inflation, thereby giving your money the opportunity for real long-term growth. A financial adviser can help you build a portfolio that suits your needs and goals.

Make the most of pensions

Making the most of your pension annual allowance could be a really effective way of increasing your retirement savings. Personal pension contributions benefit from tax relief at your marginal rate of income tax, providing an immediate boost of 20-45%. You can receive tax relief on personal pension contributions until age 75. Most people can contribute up to 100% of UK relevant earnings or £40,000 per year (whichever is lower) rising to £60,000 a year from 6 April. Your annual allowance could be lower if you have a very high income or have already accessed your taxable pension benefits.

Consider delaying retirement

If it still looks like you could be facing a shortfall in your retirement savings, another option is to consider delaying your retirement by a couple of years. This would give you more time to save into your pension and hopefully benefit from further stock market growth.

Some retirees choose to take a 'phased' approach to retirement, whereby instead of stopping work completely, they work part-time or on a consultancy basis. If you opt for this approach, you could consider using non-pension savings to top up any income gaps, while still investing in your pension and benefitting from tax relief.

Next steps

Working out how much you need to save for retirement is a really complex calculation, and that's where getting some smart advice comes in. A financial adviser can demonstrate how much you're likely to need, whether you're on track to achieve that sum, and the steps you can take now to increase your chances of a secure and fulfilling retirement.

1 www.retirementlivingstandards.org.uk/

2 A 67-year-old woman has an average life expectancy of 87, but has a 5.1% chance of living to 100, according to the Office for National Statistics.
