Insight

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Lockdown savings boost

A surprising number of people have picked up the savings habit in recent months as lockdown has curtailed opportunities to spend. How can this unexpected nest egg be put to good use?

In some cases, the savings have been substantial, with average households holding on to £2,879 during the 13-week lockdown. According to Bank of England figures, the population saved £16.2bn in April, the first full month of lockdown. The average in the six months to February was just £5bn a month.

It is not hard to see where these savings have come from: commuting costs have been slashed and holidays have been postponed. Meanwhile, those day-to-day expenses — a coffee on the way to work or a pint afterwards, haircuts, theatre and cinema trips — soon add up over a period of months.

Of course, for some people, lower spending has been offset by more serious reductions in income, from salary cuts, redundancy and straitened times for the self-employed. But for those able to work from home or whose income has been supported by the government's furlough scheme, the question is how to make the most of this temporary savings boost.

Surplus uses

Many have used these funds to clear debts. The Bank of England figures also show a record £5bn of credit card debt cleared in April, significantly more than the £300m cleared in a standard month.

For others it may make sense to use some of these surplus funds to boost longer-term savings, top-up pensions and add to investments, either through a one-off payment or by increasing regular monthly savings.

Of course, before putting additional funds into share-based investments it is important to consider whether you are likely to need this money in the shorter term. Those concerned about their employment status in the months ahead should look to build up cash savings, even if interest rates are low.

Whether you choose to reduce debt, build up a cash safety net or boost pensions and investments, it makes sense to think about where and how you have saved money during the lockdown and whether you can make more permanent changes to your spending habits.

Most of us won't necessarily want a 'staycation' every summer, but cancelling unused gym memberships or cutting out the cappuccinos as we resume our old routines can help turn these 'unintended savings' into a more thoughtful budget that could bolster your finances over the longer-term.

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Looking to the next Budget

The second Budget of 2020 could mark the start of a round of tax increases.

When 2019 passed without a Budget, it seemed an unusual year. 2020, already out of the ordinary, will more than make up for it with two.

The first Budget of 2020 took place on 11 March, the day that the World Health Organisation declared Covid-19 a pandemic. At the time, the Office for Budget Responsibility (OBR) calculated that the UK government would need to borrow around £55bn in 2020/21. By mid-July, the OBR updated its projections, and that estimate rose to £322bn – almost six times the original figure.

No government can continue to borrow at such a rate and many economists regard the autumn Budget as the moment when the brakes will start to be applied. The Chancellor is somewhat constrained by his party's 2019 election manifesto pledge not to increase income tax, National Insurance contributions and VAT rates. However, as his predecessors have consistently demonstrated, there are many ways to increase tax that do not involve changing the rates. In particular, three areas of reform are already being considered.

Pensions

The gross cost of income tax relief for pensions has been put at over £37bn by HMRC in its latest figures (for 2017/18), with a further £16.5bn for employee and employer National Insurance contributions relief.

The government launched a consultation in July 2020 on a technical aspect of pension income tax relief, a move that could be a precursor to a broader reworking. A flat rate of tax relief for all pension contributions has long been argued over by a variety of stakeholders.

In the March Budget, the Chancellor added to the cost of pensions tax relief by relaxing the annual allowance rules. There is a now a distinct possibility that, in his next Budget, the Chancellor could try to claw some money back by reducing tax relief for higher and additional rate taxpayers.

Inheritance tax

A report was commissioned over two years ago by the then Chancellor, Philip Hammond, on simplifying inheritance tax (IHT) from the Office of Tax Simplification (OTS). The OTS issued two reports, but no action was taken in the subsequent Budgets.

Matters may be different, come autumn 2020. Recent statistics from HMRC show that last year IHT receipts fell for the first time since 2017/18. The drop is possibly attributable to the impact of the Residence Nil Rate Band (RNRB), introduced in April 2017. The OTS reports did not make any recommendations about the RNRB on the grounds that it had only just come into being, but it did note widespread criticism of its complexity.

A Chancellor with an eye towards a 'levelling-up' agenda and a need for more revenue could pick and choose from the recommendations in the OTS reports to collect more IHT.

Capital gains tax

Out of the blue, the Chancellor gave the OTS another tax review to undertake in mid- July 2020. Capital gains tax (CGT) was the subject and this time there was less emphasis on simplification and more on ensuring 'the system is fit for purpose'.

There's a real possibility that CGT rates will once again be aligned with income tax rates, which could see the top CGT rate increase from 20% (28% for non-exempt residential property) to 45%.

Ahead of the Autumn Budget, there are mitigating measures that could be taken in any of the three areas mentioned here. However, pre-Budget tax planning requires advice to avoid unnecessary or inappropriate actions.

The levels and bases of taxation and tax reliefs are subject to change and their value depends on individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

ESG investment comes into its own

Taking a more principled approach to investing doesn't mean you necessarily have to sacrifice returns.

This year has been a rollercoaster ride for investors, with markets falling sharply in March as the economic effects of the Covid-19 pandemic became clear. There has been some recovery, although prices remain volatile.

Yet certain funds seem to have fared better than others during this period of turbulence. In many cases, these are funds that engage with a range of environmental, social and governance (ESG) factors alongside standard financial metrics for selecting shares. This is also often labelled 'responsible investing'.

Whereas some ethical funds (see text box) automatically avoid whole sectors, ESG funds do not. Instead they assess how, for example, a company's environmental policies — or lack of them — might impact its future share price. These are investment judgements, of course, so may not always turn out to be correct in retrospect.

Ethical vs ESG funds

ETHICAL FUNDS: These funds may screen out whole sectors or companies. For example, many ethical funds avoid investing in tobacco, alcohol or armament companies for moral reasons. Guidelines vary from fund to fund. Some ethical funds take a 'best of breed' approach, particularly about such issues as climate change.

ESG FUNDS: Rather than making moral judgements, ESG investing relies on a screening or risk assessment tool, that the fund managers use to assess potential risks and opportunities. They analyse a range of environmental, social and governance factors to see how these might affect share prices.

ESG funds have generally weathered the recent market storms well. Research from Morningstar shows that in the first quarter of 2020 70% of ESG funds were ranked in the top halves of their investment categories which consist of funds invested in the same assets or geographic region. By contrast, just 11% of ESG funds were in their category's bottom quartile, indicating that they performed better than funds that did not look at these wider ESG factors when selecting stocks.

Bear in mind that this information covers a very short timeframe and there is no guarantee that ESG funds will continue to outperform.

However, there are several reasons why these funds may have performed better during recent volatile markets and may continue this trend in the coming years.

One factor is that many have less exposure to oil companies, which have been hit by collapsing oil prices. The Covid-19 crisis has boosted other sectors too, such as those delivering technology solutions to help businesses and people work remotely. This may play into ESG themes about reducing travel and carbon emissions.

While much of the focus around ESG is on environmental issues, it's important to remember that the selection process most of these funds undertake also considers how well a company is run and its corporate polices on such issues as executive pay, gender equality and transparent supply chains.

Over the longer term it remains to be seen whether ESG fund managers will identify the companies that will prosper in future, but with many more people thinking carefully about where to invest their savings, ESG investment is no longer a fringe area. As with all investment decisions, you should take expert advice.

The value of your investments and the income from them can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance. Investing in shares should be regarded as a long-term investment and should fit with your overall attitude to risk and financial circumstances.

A buy-to-let opportunity?

Cuts to stamp duty land tax (SDLT) and its Scottish equivalent have reduced the purchase costs of buy-to-let property. But property investors should also evaluate other factors.

In his Summer Statement, the Chancellor increased the nil rate threshold for SDLT in England and Northern Ireland from £125,000 to £500,000 for all purchases until 31 March 2021. At most that means a saving of £15,000 in SDLT on a property purchase.

The Scottish Government then increased its equivalent nil rate threshold from £145,000 to £250,000. Both governments kept their surcharges on the full purchase price for buy-to-let (BTL) properties and second homes (3% in England and Northern Ireland and 4% in Scotland). Wales took a different stance and excluded BTL and second home buyers from the new Welsh £250,000 nil rate threshold (up from £180,000).

The higher thresholds prompted press headlines suggesting that the BTL market would enjoy a recovery (outside of Wales). While the tax saving can be significant, particularly in London and south east England, investors should consider the other tax changes from past years before making a BTL purchase:

- *If you are borrowing money to make the purchase, then you can no longer offset the interest you pay against the rent you receive for income tax relief at your highest marginal rate. Instead you will be given a tax credit equal to the basic rate of income tax on the interest charged. This could mean that all the rent is included in your income tax calculations, minus non-interest expenses, resulting in more income tax or even tipping over one of the tax system's income thresholds.*
- *Capital gains tax (CGT) is levied at a higher rate on disposals of non-exempt residential property than on other assets. Higher and additional rate taxpayers face a 28% tax charge once they have used up their CGT annual exempt amount.*
- *Any CGT due on residential property is now payable within 30 days of the completion of the sale, along with an appropriate interim tax return.*
- *The days of a 10% 'wear and tear' allowance for furnished properties are long gone: relief is now only given for actual expenditure.*

More changes could be coming in England on the non-tax front. Last year the government consulted on "resetting the balance of rights and responsibilities between landlords and tenants". The consultation's proposals included the potential abolition of assured shorthold tenancies and an end to 'no-fault evictions.' Both measures could reduce the value of BTL property in England by making it less readily saleable.

The tax holiday may already be driving up prices. Nationwide reported a 1.7% monthly increase in July 2020 after taking into account seasonal factors, more than reversing the 1.6% fall in June. If you are considering investing in BTL property in the current market, however, take advice on alternative investment options first. As ever, you shouldn't let the tax tail wag the investment dog.

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Women's state pension shortfall

More women should ask the Department for Work and Pensions to check their state pensions, according to former pensions minister Sir Steve Webb.

Rumours abound ahead of the expected Autumn Budget that the government may need to loosen the pension triple lock to help recover stretched public finances following the Covid-19 pandemic. Meanwhile, research from a leading law firm has highlighted how relying on the intricacies of the state pension system could mean many are losing out.

Under the previous system, married women who reached state pension age before 6 April 2016 were able to claim a basic state pension of 60% of the full rate based on their husbands' contribution record, if this was larger than the pension they could get based on their own contributions.

This uplift in the state pension should have been given automatically since 17 March 2008, but before then a married woman had to make a 'second claim' when her husband reached age 65 – and many women did not make this claim.

The Department for Work and Pensions (DWP) is checking its records, but the chances are that many women will miss out and should call the department to see if they have been underpaid.

The main groups of people affected, according to the research, are:

- *Married women whose husbands turned 65 before 17 March 2008 and have never claimed the 60% uplift.*
- *Widows with pensions that weren't increased after their husbands' deaths.*
- *Widows who think they may have been underpaid when their deceased husband was still alive, even if their pension is now correct.*
- *Women in their 80s receiving a basic pension of less than £80.45 per week, if they satisfied the basic residence test at age 80.*
- *Widowers and heirs of women who have now died but were underpaid state pension while alive.*
- *Divorced women who might not be benefiting from their ex-husbands' contributions.*

Some married women who did not realise they needed to make a claim for the uplift pre-March 2008 are planning to make a complaint of maladministration to the Parliamentary Ombudsman. They will say that the DWP failed to make sure that they knew about the need to make the second state pension claim when their husband turned 65. Currently the payments for women in that category can only be backdated 12 months rather than the 12 years or more of pension uplift that has been missed.

If you think you or someone in your family may be affected, please get in touch.

HIGHER EDUCATION COSTS:

to pay or not to pay?

The Covid-19 pandemic has changed the way higher education is delivered, with a new emphasis on online learning mixed with some in-person teaching. But this hasn't reduced the cost of going to university and the debt that will come with it.

This autumn sees the latest intake of undergraduates begin their studies. Most students in England will have taken out tuition loans (of up to £9,250 a year) plus maintenance loans to cover living costs. Different systems apply in the devolved nations, with Scottish students charged up to £1,820 a year in tuition fees at Scottish institutions.

In general, it usually makes sense to use surplus funds to pay off debts early. But graduates – or parents looking to help out – should think carefully before using capital to repay student loans. This is because of the way repayments are structured, with any outstanding debt wiped out after 30 years.

Student loans attract interest like any other debt. This is charged when students are studying, at a rate of the Retail Prices Index (RPI) plus 3%— giving a current rate of 5.4%, with rates afterwards dependent on earnings.

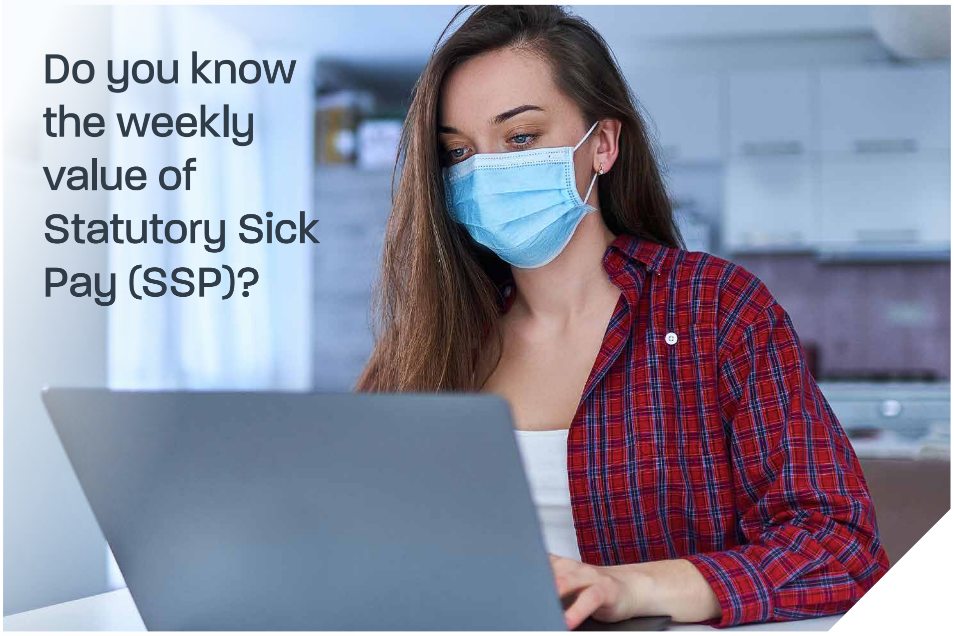
Repayments on student loans only start once graduate salaries reach a certain threshold. For the 2020/21 year this is £2,214 a month — or around £26,500 a year. Students then pay 9% of their salary over this amount. So those earning £3,000 a month will pay 9% of £786 — or £70.74 a month. This is the same monthly repayment whether they owe £20,000 or £80,000 — so paying off a chunk of capital will not reduce this monthly bill.

The larger the loan, the longer it will take to repay. But this still does not necessarily mean students will pay back more overall, as current projections suggest that 83% of students who have taken out a loan since 2012 (when this system was introduced) will not repay the full amount.

For these students there may be little financial benefit to paying part of this debt off early: it will not reduce monthly repayments and may simply mean a smaller sum is written off at the end of the term

Pandemic lessons

The Covid-19 pandemic has highlighted the low level of social security benefits.



Before Covid-19, most people would probably have struggled to give even a half-accurate answer. Now that so many people have received SSP for the first time, there is an increased awareness. The size of the sum was a surprise for many – just £95.85 per week for up to 28 weeks. The same could be said for other benefits that came under the spotlight because of the pandemic, such as Universal Credit (UC) and Employment and Support Allowance (ESA).

The government's partial response was to increase some benefits temporarily, e.g. adding £1,000 a year to the UC standard allowance. More important was the introduction of the furlough scheme, which meant that over nine million people remained 'employed' on up to 80% of their pre-pandemic pay. Without the scheme, a large group of its beneficiaries could otherwise have lost their jobs and received the markedly smaller UC payments.

The furlough scheme is due to close by November, while the rest of the temporary social security increases are set to finish next April. One of the many lessons from the pandemic is that the UK's social security system supplies minimal benefits and these are often subject to means-testing. Another lesson is that private insurance cover, such as income protection which pays out if someone is ill and unable to work, can have a vital role in filling the gaps.

Sharp fall for dividends

UK dividends were down more than 50% in the second quarter of 2020

The pandemic has hit the global economy hard and devasted the dividend payments of many leading UK companies. Between April and June 2020, total UK dividend payments were 57.2% lower than in the second quarter of 2019, according to Link Asset Services. Many companies – notably the big banks – stopped dividend payments altogether.

Despite the cuts, Link's worst-case-scenario is that UK shares will provide an income yield of 3.3% over the next year – still much better than current deposit rates.

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To discuss any issues raised in this newsletter, or any other aspect of your financial planning, speak to your dedicated Wealth Professional Adviser or Client Support Team at: -

Wealth Professional CFP, 2 Old Well Court, Wester Inch Business Park, Bathgate, EH48 2TQ E: enquiries@wealthlprofessional.co.uk T: 0131 600 0166 F: 0131 600 0167

www.wealthprofessional.co.uk