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It won't pay to delay buying that annuity

Income rates are set to stagnate, so now may be the time to buy a plan. Patrick Collinson and Rupert Jones look at the options

Patrick Collinson and **Rupert Jones**
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If you are about to retire, the good news is that annuity rates have nudged upwards slightly in the last fortnight. But if you are holding out for a big rise in rates, you may be better off making a move now, because some specialists reckon we will see little change this year in terms of the income for life you can buy with pension cash.

What £100,000 buys you

A 65-year-old man with a 65-year-old wife - level annuity	
Aviva	£6,580
Aegon Scottish Equitable	£6,505
Canada Life	£6,480
Legal & General	£6,464
A 65-year-old man with a 65-year-old wife - RPI annuity	
Aviva	£4,040
Prudential	£3,936
Canada Life	£3,900
Scottish Widows	£3,835

Assumes pension savings of £100,000 and a partner's pension of 50%
Source: The Annuity Bureau

Annuity rates determine the income you get from a pension fund built up via a money-purchase occupational scheme or personal pension plan. They are heavily influenced by interest rate movements; as the base rate has fallen, so have annuity rates. Last August they were at a six-year high, but have since dipped by around 10%.

However, the downward trend has been bucked of late. "There have been upward movements in the last week or two," says Bob Bullivant, who runs retirement income specialist Annuity Direct. But he describes these more as tweaks and adjustments, adding: "The outlook for annuity rates for the rest of this year is neutral. Our view is that we are probably in for a period of relative stability."

So, what do you get for your money?

A conventional "level" annuity

These pay a fixed annual income, with no increase, to the person until they die. Level annuities pay a higher starting income than other types but, due to inflation, the buying power of that annual amount will reduce each year.

If you opt for a "single life" annuity, the income will cease on your death and your partner gets nothing. A "joint life" annuity pays your partner a portion of the income you were receiving.

A 65-year-old man with a fund of £100,000 could use this to buy an annuity giving an annual income of £7,220 from the current best provider (this example assumes a single life level annuity), according to figures from another firm, the Annuity Bureau.

Inflation-proof annuities

If inflation really surges – and specialists worry the chancellor's quantitative easing may do just that – then you can protect yourself fully by taking out an RPI-linked annuity. Every year your pension increases in line with inflation.

The chief drawback is that RPI annuities are hugely costly. As the table shows, a married couple aged 65 will get an annual £4,040 for each £100,000 of pension savings if they opt for RPI protection – 38% less than the £6,580 they'd get by choosing a level income.

An "escalating" annuity is cheaper. These increase your income by a fixed amount each year, usually 3% and up to 5%. But they are still expensive. For our married couple with a £100,000 pension pot at 65, the annuity would start at £4,668 with a 3% guarantee. The Financial Services Authority estimates it would take around 14 years for a 3% escalating annuity to catch up with the income from a level annuity.

All the other drawbacks of annuities apply; if you die, the annuity dies.

New "third way" annuities

You choose a guaranteed minimum level of income from pension savings, but leave the money invested, giving the chance of an uplift. Perhaps the biggest attraction is that, if you die, the money goes into your estate rather than being gobbled up by the pension provider. Big providers include Aegon and MetLife. But the maximum guaranteed income is low, and high charges mean investment gains can leak away.

Aegon this week launched a Secure Lifetime Income annuity. It has a maximum guarantee of 4% (£4,000 income from a £100,000 pot) at 65. Peter Chadborn at adviser CBK reckons this type works well with larger pension pots where you can split it between, say, a conventional annuity and "third way" annuity, while leaving the tax-free lump sum in an accessible Isa. Tom McPhail at Hargreaves Lansdown worries the charges, sometimes 2% of your pension pot or more, make them too expensive.

Other options

If you have a condition that will reduce your lifespan (such as cancer, diabetes, heart disease, high blood pressure, kidney failure, multiple sclerosis or stroke) then you may get a higher rate. Other options – "phased retirement" and "drawdown" – offer more flexibility but require serious financial advice.

The Financial Services Authority has an extensive guide to annuity options and online comparison tables