

JANE KING
& MARY CAREY

PERSONAL FINANCE

2ND EDITION

OXFORD

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SECOND EDITION

JANE KING
MARY CAREY

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PERSONAL FINANCE

FINANCE

SECOND EDITION

ROBERT HARRIS

OXFORD

UNIVERSITY PRESS

To Richard, Sam, and JJ, with love.

Jane King

For Adrian, Sarah, Jon, Chris, and Maddy, with love.

Mary Carey

Michael Lee
ICAEW Chief Executive

Foreword

Empowering young people to develop financial skills in preparation for work and life is crucial. The inclusion of financial education in the National Curriculum since 2014 was a positive step towards ensuring people are equipped with the knowledge, confidence, and skills to manage their money properly—vital skills for both the present day and the future.

As the UK's leading professional membership body, supporting over 147,000 chartered accountants around the world, we understand the important contribution financial literacy makes to our social and economic progress.

Financial capability is at the core of what our members do. They are the biggest source of business advice in the UK, reaching over 2m businesses. At the same time, unsustainable personal debt is a cost to growth and the UK's long-term economic stability. The ability to have the right finances in place and plan financial matters effectively is a skill for major events—whether planning for university, buying a house, or when starting a business.

Responsible financial management is required, not only in business, but also for governments and consumers.

We have seen the impact that having no financial education has on the most vulnerable in society, but people must learn to take responsibility for their finances or face being left behind. The introduction of universal credit, the reductions in, and changes to, housing benefit, and the continued increase in total household debt highlight the pressures people will have to face. In the face of such issues it quickly becomes clear how important it is to be financially literate; such consumers are therefore key to ambitions for a sustainable UK economy.

Financial education comes in many different forms. For example, ICAEW Chartered Accountants volunteer to promote sustainable financial education in schools. As an organization, we also work with community associations and vulnerable residents. We have found that simple tools can help to enhance the financial capability of those that need it most, to help them deal with everything from basic bank accounts to coping with debt.

Personal Finance takes the fear out of financial planning. Taking control of finances is both empowering and positive and these are life skills that will ensure that the best decisions are made from the cradle to the grave. Whether it is which bank account to choose, information on pensions, or deciding on a mortgage, we continue to be faced with personal finance decisions on a regular basis and this looks set to increase. Having the confidence to deal with these choices is key.

Michael Izza,
ICAEW Chief Executive

Preface

This book is targeted at students, particularly first and second year undergraduates, and other young people. Its principal goal is to equip them with a sound understanding of many key personal finance issues. The authors have many years of experience in delivering personal finance modules at Oxford Brookes University.

The book aims to help its readers develop confidence and ability in dealing with personal finances so that, both during their time as students and after graduating, they can take practical steps towards taking control of their personal finances. The book is intended to equip readers with the knowledge and confidence to make informed decisions regarding financial planning and products, including those relating to savings, mortgages, investments, and pensions.

Personal Finance hopes to make the subject clear and accessible, limiting the use of jargon and explaining it where necessary through the use of key terms. In addition, the text includes a number of case studies, used throughout the chapters, that are designed to illustrate the practical application of theory and bring the subject to life. Readers have the opportunity to use the knowledge and techniques learned to inform financial decisions in common real-life situations.

As a society we often lack confidence when dealing with our personal finances. Many people worry that the issues are too difficult to handle personally and prefer to hand over responsibility to someone else to make decisions on their behalf. Whilst financial advisers can be an extremely useful resource, it is important for individuals to understand the issues involved for themselves, so that they can consider any advice carefully and make informed choices. The history of financial product mis-selling in the United Kingdom shows how important it is to have a clear appreciation of personal finance issues. *Personal Finance* aims to help students develop their confidence and understanding in order to build up their personal financial literacy skills.

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We would like to thank everyone else who has read chapters and provided feedback and encouragement on a more informal basis.

Disclaimer

This book aims to inform and educate the reader on certain financial issues. Nothing in this book should be construed as specific advice and it should not be relied upon as a basis for any decision or action. It is sold with the understanding that neither the authors nor the publisher are engaged in rendering professional financial services. The authors and the publisher do not accept responsibility or legal liability for any errors in the text, for the misuse or misapplication of information in this work, or for any outcomes arising from its use.

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How to use this book



Learning Objectives

After studying this chapter, you should understand:

- The need for each individual to take responsibility for their personal finances
- The fundamental steps needed to control an individual's personal finances
- How inflation is measured and why it is important to consider

Learning objectives

A bulleted outline of the main concepts and ideas indicates what you can expect to learn from each chapter.



Ponder point

How easy would it be for you to cope with a large unforeseen expense to replace your computer?

Planning for the unexpected is one of the keys to successful finances. If there is a financial plan in place and a strategy for unexpected events, then it should be possible to weather some financial

Ponder points

Regular 'Ponder points' encourage you to stop, think, and check your understanding of the key ideas covered in the chapter.



Key term

The Financial Conduct Authority (FCA) is the organization responsible for regulating financial services in the UK, ensuring that financial markets and firms operate in a way that consumers are protected.

The FCA has a general objective to ensure that financial markets function efficiently and that consumers are protected. The organization

Key terms

Key terms boxes explain the technical terms you will encounter when dealing with your personal finances.

Case study—Oliver

Oliver graduated with a degree in drama studies a few years ago and has been acting ever since. He has had a number of acting jobs since that time. Each role that he has been cast for has lasted between two and eight months but he has also had similar periods when he is unemployed.

Oliver, who lives in London, is a very keen concert goer and he attends many music festivals as he can fit in. When he is not working, tickets for these events are usually paid for by credit card.

Oliver has the following debts:

Case studies

Each chapter features a set of case studies and questions to work through, giving you the opportunity to apply the theory you have covered to a range of practical problems. Scenarios are built around recurring characters and are carefully placed within the text so that you have all of the necessary information to understand the cases as they appear.

Example 4.8

A homebuyer is considering two potential properties, one of which one is valued at £235,000. The homebuyer has saved a deposit of £35,000 for each of the properties?

Property valued at £170,000: Loan = £170,000 – 35,000 = £135,000

$$\text{LTV} = \frac{135,000}{170,000} \times 100\% = 79\%$$

Examples

Frequent and clear examples are used to illustrate key concepts and encourage you to consider these ideas as you learn.

Practice questions

A variety of end-of-chapter questions presents the opportunity to check your understanding of the topic covered and to apply what you've learned to a range of problems. Answers to some of the questions are provided at the back of the book, but answers to those marked with an asterisk (*) are available only to your lecturers.

Question 2 Vikram

Vikram wants to check whether he has paid the right amount of income tax. He has gathered together all his paperwork and produced the following income:

- Vikram's salary was £24,000 per annum on which he paid income tax
- He received interest on an ISA of £300 and interest from a savings account
- He received dividends of £480 during the year.

How to use the Online Resource Centre

www.oxfordtextbooks.co.uk/orc/king_carey2e/

The Online Resource Centre (ORC) comprises resources for both lecturers and students, including:

The screenshot shows the Oxford University Press Online Resource Centre for the textbook 'King & Carey: Personal Finance 2e'. The page has a dark header with the Oxford University Press logo and 'online resource centres' text. A search bar is on the right. Below the header, a breadcrumb trail reads: Home > Business & Economics > Economics > King & Carey: Personal Finance 2e. The main content area is titled 'King & Carey: Personal Finance 2e'. It features a 'Select resources by chapter' section with a dropdown menu labeled 'Please select a chapter'. Below this, there are three main resource categories: 'Student resources', 'Lecturer resources', and 'Updates'. The 'Student resources' section includes 'Updates' (Up-to-date information on tax, national insurance, and some of the key changes to financial products) and 'Web links' (Selected links direct you to a range of sites to provide further information and help develop your understanding of personal finance). The 'Lecturer resources' section states: 'The following resources are password-protected and for adopting lecturers' use only. Not yet registered for a password? Complete the registration form to choose your'. On the right side, there is a sidebar with social media links (Facebook, Twitter, LinkedIn), a book cover image for 'PERSONAL FINANCE', and a section titled 'About the book' which says: 'Find out more, read a sample chapter, or order an inspection copy if you are a lecturer, from the Higher Education website'. At the bottom of the sidebar, there is a 'Keep me updated about this site' email subscription form.

Student Resources

Free and open-access material available:

The website of the students loans company:

<http://www.slc.co.uk>

A website providing information on student loan

<http://www.direct.gov.uk>

This is a useful website for researching current

Links to relevant websites

Carefully selected links direct you to a range of sites to provide further information and help develop your understanding of personal finance.

Updates

Updates covering recent developments will be alerted when a new update is added by clicking

☒ [Keep me updated](#)

Online updates

Up-to-date information on tax, National Insurance, and some of the key changes to financial products keeps your text as current as possible.

Lecturer Resources

Free for all registered adopters of the textbook:

Learning objectives

After studying this chapter, you should understand:

- Reasons why it is important to have savings
- Risks associated with saving

PowerPoint slides

Each chapter is supported by a suite of customizable slides to be used in lecture presentations.

Solution 3 Chelsea

a) Table 2.8 Chelsea's monthly cash budget, first draft

	£
Income:	
Net earnings (take home pay)	1.50
Expenses:	
Rent, utilities, and food	1.40

Solutions to selected questions in the text

Solutions to the asterisked (*) end-of-chapter questions are available here, allowing these to be used as assessments or seminar questions.

Gavin Case Study

Gavin graduated ten years ago with a degree in mathematics and has since that time to training and competing as an international athlete. He represented his country at the highest level culminating in reaching the men's 110 metre hurdles final at the London Olympics. He developed

Extended case studies

Two extended case studies and their suggested solutions are available to help develop student understanding of how to apply theory to practical, real-world problems.

Indicative rates

Writing a personal finance book is rather like shooting at a moving target. Rules, rates, and applicable dates are liable to change and this can occur with little warning. This book does not use exact figures for every allowance but rather uses indicative rates that give an indication of the size of a particular figure and are usually given as round sum amounts that make demonstrating the principles clearer and examples easier to follow.

This book aims to explain the key principles underpinning personal finance issues and once these are understood, the current rates and allowances can easily be referred to and inserted into any computation.

Whenever indicative rates are used, an **iR** symbol is used. In any chapter that uses such rates, references are given that will allow readers to find the current figures that apply.

iR Indicative rates

Table 1

Income tax		
Personal allowance and tax bands		
Personal allowance	£12,500 per annum	
	Income tax rate	Income tax rate for dividends
Personal Savings Allowance	0%	—
First £1,000 of savings income (available to basic rate taxpayers)		
Dividend Allowance	—	0%
First £5,000 of dividend income		
Tax bands		
First £32,000 of taxable income (Basic rate/Dividend ordinary rate)	20%	7.5%
Next £118,000 of taxable income (Higher rate/Dividend upper rate)	40%	32.5%
Above £150,000 of taxable income (Additional rate/Dividend additional rate)	45%	38.1%

Table 2

Car and fuel benefit		
CO ₂ emissions (grams/kilometre)	Appropriate percentage (petrol car)	Appropriate percentage (diesel car)
From 0g/km to 50g/km	9%	12%
From 51g/km to 75 g/km	13%	16%
From 76g/km to 94g/km	17%	20%
100g/km to 104g/km	19%	22%
190g/km and above	37%	37%
Amount used for fuel benefit calculations	£22,500	£22,500

Table 3

National Insurance contributions Class 1—payable by employees	
	Earnings per month
Primary threshold	£700
Upper earnings limit	£3,700
National Insurance contributions	
On earnings between the primary threshold and the upper earnings limit	12%
On earnings above the upper earnings limit	2%

Table 4

National Insurance contributions Classes 2 and 4—payable by the self-employed	
Class 2 small profits threshold	£6,000
Class 2 rate	£3.00 per week
Class 4 lower profits limit	£8,000
Class 4 upper profits limit	£44,000
Class 4: rate on profits between lower and upper limit	9%
Class 4: rate on profits above upper limit	2%

Table 5

Capital gains tax Exemptions and bands	
Annual exemption amount	£12,000
Personal possessions exemption	£6,000
Taxable income band	Capital gains tax rate
Standard rate	10%
Standard rate residential property	18%
Higher rate	20%
Higher rate residential property	28%

Table 6

Inheritance tax	
Nil rate band and rate	
Band	Inheritance tax rate %
Nil rate band	0
0–£325,000	
Main residence nil rate band	0
Next £175,000	
Remainder of estate	40
Gift exemptions—indicative amounts	
Exemption	Amount
Small gifts	£250 per person
Gift from parents	£5,000 on marriage
Annual exemption amount	£3,000
Indicative rates of tax on potentially exempt transfers (PETs)	
3–4 years	20% reduction in tax due on gift
4–5 years	40% reduction in tax due on gift
5–6 years	60% reduction in tax due on gift
6–7 years	80% reduction in tax due on gift
More than 7 years	100% reduction in tax due

Table 7

Student loans starting after 1 September 2012	
Maximum loans (full-time students)	
Tuition fees loan	£9,000
Maintenance loan	Variable
(The maximum depends on whether the student lives at home or in London)	
Interest on student loans	
During the course	RPI + 3%
On graduating, if earning less than £21k	RPI
On graduating, if earning between £21k and £41k	RPI + between 0 % and 3%, depending on income
On graduating, if earning more than £41k	RPI + 3%
Loan repayments	
On earnings over £21,000	9% of earnings over £21,000

Table 8

Annual ISA allowances	
Individual under 18 years old	Cash and/or shares Junior ISA Limit of £4,100
Individual aged 16–18 years of age (Can invest in a Junior ISA at same time)	Cash ISA Limit of £20,000
Individual aged over 18 years	Cash and/or shares ISA Limit of £20,000
Individual aged 18–40 years	Lifetime ISA £4,000 (subject to overall limit of £20,000 for all ISAs)
Individual aged over 16 years	Help to Buy ISA £2,400 (subject to overall limit of £20,000 for all ISAs)

Table 9

Financial Services Compensation Scheme
£75,000

Introduction

Most people agree that it is important to look after their health and fitness, and are happy to take personal responsibility for this. Many have a healthy lifestyle throughout their life. Knowing that your personal finances are in a similarly good condition will assure you that they need to be looked after continuously and from a young age.

There has been a great deal of education about the limited financial literacy skills that seem to be fairly prevalent in the population as a whole. Personal finance can also be relatively straightforward, but it is a barrier to understanding. Sometimes subjects that ought to be easy to understand remain unexplored because of this barrier.

The difficulty is not only that people do not have the time to spend on issues that do not appear to be urgent. Finding up-to-date or researching financial products can easily be seen as something that can be done next week, next month, or next year, especially when the pressures of work and home life leave little free time to relax. There may be a temptation to consider that if, for example, an individual can afford to make his debt repayments, is making some pension contributions and has no immediate major concerns, that person does not need to engage in financial planning with any urgency. The fact that the debt may be serviced at a high interest rate or that the pension savings are inadequate will go unnoticed, unless that individual takes the time to explore his personal financial situation.