What should I do with my lump sum?

AIC 20 –
Q N S T

Although many of us have wondered what we would do with an unexpected windfall of money, most of just think about buying holidays or fast cars. Now that you're in the position of actually being likely to have an unexpected sum of money to manage, here are some tips and hints about things we would recommend you consider, and the order we think you should consider them.

One - Pay off your debts

This is the first thing anyone should do if they get a large sum of money. The interest on things like car loans and credit cards means that it's actually just a way of saving you from having to pay a huge amount of interest in the future if you can wiped those debts off now.

What about student loans? – Student loans are a funny case. Although they are a loan, and you do end up paying interest on them, you only have to pay your student loan back when you're in a job. That means that – unlike a credit card, say – you are never going to get in arrears on them: they are even taken out of your pay at source. What this means is that it's worth thinking about paying off your student loans only once you've gone through the rest of this list of options.

How about my mortgage? – It's a difficult one. Some mortgages have penalty charges if you pay them all off early: most lenders allow you to pay 10% of your mortgage balance as an overpayment per year, but overpaying more than this will probably lead to a charge. This means that it might be better to keep a large rainy day fund and then pay your mortgage as usual.

On the other hand, not having to make regular mortgage payments or pay interest can be a huge financial relief.

Speak to a financial adviser about this.

Two - Build up a *serious* rainy day fund

First things first - Now that you're out of debt, give yourself a decent buffer in your current account: this could be £100 or £1000, it's up to you. Now use your account as normal but always try to keep it so that your buffer of £100 (or whatever) is roughly what you have there just before your payday.

Next is to have a real rainy day fund set up. This means having a second account – preferably a savings account – where you can put some savings aside in case of emergencies. This could be because for a faulty boiler, or an unexpected car accident: whatever it is, this money should be much easier to access than an investment, but separate from your day to day current account.

Three - Start a savings account

An ISA is an Individual Savings Account – Martin Lewis has a great explanation of one [here](http://www.moneysavingexpert.com/savings/ISA-guide-savings-without-tax) at http://www.moneysavingexpert.com/savings/ISA-guide-savings-without-tax but it is basically a great place to save your money. It does the following two things:

- It protects it from getting taxed.
- It offers you higher interest than your current account, meaning that you can protect your money from inflation costs

You can put up to £20,000 into it a year, and there are different types of ISA. Your adviser can discuss these with you.

Keep in mind – depending how much you have – you may rather put the money in a high-street savings account which offers you more interest. That's fine: either way, just make sure you treat this money as for absolute emergencies. That doesn't mean a faulty boiler: this is more for things like dealing with ill-health, or buying a house.

> *Remember - Up to £85,000 of your money is safe even if the bank collapses (thanks to the Financial Services Compensation Scheme). This compensation limit applies per authorised firm, not by banks. Some banks are actually part of a single firm, and if your combined accounts go over £85,000, the extra bit is not covered. You can check bank brands on the FCA website [here](https://www.fca.org.uk/consumers/deposit-savings-protection) at https://www.fca.org.uk/consumers/deposit-savings-protection*

Four - Start thinking about retirement

If you have a pension, it's worth getting some advice as to whether you should top it up or make extra payments. A financial adviser can offer you more information on this.

Five - Think about getting a new car

We know, this sounds extravagant. However, if you upgrade a second-hand car that needs a fair bit of regular maintenance to a new, better model – and if you pay cash rather than by finance - you can:

- Negotiate for a great deal on a car
- save on road tax (it's based on emissions, and newer cars are more efficient)
- Save on maintenance costs
- Avoid paying any interest as you haven't taken out finance

To be honest, whether this is the best decision depends on your circumstances, but don't feel that you shouldn't consider it!

Six - Set up a savings fund for your children

This can be for anything, but a good goal to have is to look at supporting them with their university fees. Many high-street banks offer quite competitive savings accounts or trust funds for exactly this purpose: not only can you start it off with a healthy chunk of money, friends and relatives can always contribute to it at birthdays and Christmas if they want.

Seven - Enjoy yourself

Okay, let's be realistic: if you've done the steps above and still have money left over, you probably deserve a reward. Don't go over the top, but a holiday or small shopping spree is something you can have without any guilt.

Eight - Give some away

This might sound off, but you may well have friends or family that are in real financial difficulties. If you do want to give them money, make sure you do it discreetly and ask them not to tell anyone about it: you could end up in the horrible position of having lots of distant friends and relatives asking you for money afterwards.

Another benefit of making gifts of the money is that can help to reduce any future inheritance tax bill your family faces.

Remember - Any gifts you make will be free of inheritance tax if you live for seven years after making them.

Careful – if you try to offer the money as a loan, and then charge interest when they pay it back, you will be breaking the law! You can't charge interest without a license!

Remember - There is also a £3,000-a-year gift allowance that has no tax implications: your adviser can get you more information on this, or you can look here at https://www.gov.uk/inheritance-tax/gifts.