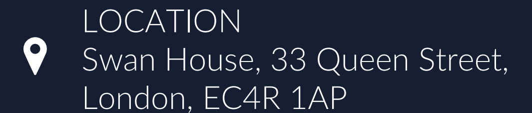
Investing In Property For Retirement



Both pensions and property investments can deliver long-term growth and, when it comes to funding your retirement, both could have an important role to play. Here we weigh up the advantages and limitations of both property (Whether buy-to-let or your own home) and pensions as a source of income.

WHAT ARE THE PROS OF PROPERTY INVESTMENT?

When it comes to picking an investment most likely to grow over the years, property has been seen as a good choice. The UK property market has been famously bullish, despite the occasional slump typically lasting a few years. And as property values have continued to soar over recent decades, some investors have indeed capitalised on the trend of building property portfolios worth hundreds of thousands of pounds.

In addition to this, the demand for buy-to-let properties remains high and, because demand outstrips supply, property investment can offer a huge opportunity. Along with the rental income, the potential increase in value of the property over time can deliver a sizeable profit when you come to sell.

The combination of rental yields and capital growth means you have both immediate income and the potential for long-term profit. You also have the option to sell the property at any point and invest in money in other ways. Those are the main advantages of this kind of investment – however property isn't without its draw backs too.

WHAT ARE THE CONS OF PROPERTY INVESTMENT?

Like any financial asset, investing in property carries risk. Burgeoning house prices have often produced a great return, but this isn't guaranteed. When working out the rental yields you could expect from a property, you'll need to consider the costs – such as maintenance, repairs, insurances, tax and other fees. Capital growth – how much the property is likely to be worth when you come to sell compared to what you paid for it – is also an important factor.

Liquidity may be your biggest problem – that is, how easy (or hard) it is to get your money out when you need it. Selling a property can take many months, so if you are relying on the proceeds for your retirement then you'll need to plan this well in advance. You'll also need to back-up plans in case sales fall through or the markets crash.

If you are planning to fund your retirement from rents alone, bear in mind that these may not be enough to bring you the income you need, especially if you still have mortgages to pay on the properties. Also bear in mind that being a landlord isn't an easy job, and you may not want this responsibility as you grow older/ You can of course get an agency to handle most of it, but this will eat into your income.

Property also isn't very flexible. You can't just put an extra £10,000 or so into property – it forces you to invest in chunks of many tens or even hundreds of thousands of pounds. This can limit your ability to expand your portfolio unless you are already very wealthy

TIPS FOR CHOOSING THE RIGHT PROPERTY

Investing in the right property, in the right location with the right mortgage is essential for a high rental return. If any of these factors aren't spot on, your investment is unlikely to give you the financial results you're after.

Choosing the right location is often the most important thing when it comes to investment growth. For example, Liverpool remains a clear contender for the best place to invest in property in 2021. With an average property price of &186,527, the average rental yield is 5.3% with a price growth in five years of 8.4%. Other high rental yield locations include Bradford, Sunderland and Middlesbrough. By contrast, London, the Southeast and West Midlands are performing less strongly in terms of growth. Stratford-upon-Avon for example has an average yield of just 2% and asking average prices at just over half a million.

Is Buy-to-let still worth it? Lots of people choose buy-to-let as a retirement income, often taking tens of thousands of pounds out of their pension pot to fund it. If you're considering this, it is essential to speak to a financial adviser first because raiding your pension pot can have big implications and potential tax penalties.

Despite some challenging conditions in the property market, there are still advantages to buy-to-let including:

- ✓ You'll earn rental income (though possibly less than in previous years). In some areas of the UK, such as Liverpool, Glasgow and Leicester, rental yield is as high as 8%, while other areas are around 3% mark
- ✓ At the same time, you could generate capital growth as your money grows as your property value increases
- ✓ You can take out insurance to cover against loss of rental income, damage and legal costs.

But you'll need to consider the disadvantages too:

- Your tax bill will be higher than it once was, eating your profits
- If you don't have the right insurance in place, you might not generate an income if the property is unoccupied
- If the property prices fall, your capital will reduce. And if you have an interest-only mortgage, you'll need the make up for shortfall if the property sells for less than you bought it for
- You'll need to factor in the costs of stamp duty, insurance and wear and tear
- You'll have the responsibility of being a landlord

Its important to note there are a number of taxation changes that affect landlords, including:

- Landlords used to be able to offset mortgage interest payments against rental income, but in 2015 the government announced this was being phased out
- In 2017-18 the tax relief you could claim reduced to 75%. Then, in 2019-20, it was only 25%. Now it is gone completely. The government has replaced this with a 20% tax credit which isn't as beneficial for higher-rate and additional-rate taxpayer.
- The government increased the capital gains tax allowance for 2020-21 from £12,000 to £12,300. So, if you're selling a second property you get to earn more tax-free. But the capital gains tax rate is higher for landlords - 18% for basic-rate taxpayers, and 28% for higher and additional-rate taxpayers. The capital gains tax system is currently under review, so there may be further changes

- Private residence relief has changed. Previously, if you lived in your property before letting it to tenants, you'd get private residence relief when you came to sell. This meant you wouldn't pay any capital gains tax for the time you lived in the property, plus an extra 18 months after you moved out. But under the new rules this has reduced to 9 months.
- The £40,000 of lettings relief (which you can claim if you rent out a property that's been your main home) will only apply to landlords who share an occupancy with their tenants.

WHAT ARE THE PROS OF INVESTING IN YOUR PENSION?

A pension is basically a long-term investments plan with tax relief. Getting tax relief on pensions means some of your money that would have gone to the government as tax goes into your pension instead. Most pensions today are defined contribution schemes (though some employers offer salary-related defined benefit schemes, mainly in the public sector). Both however, enjoy the same tax advantages, making them more efficient investment vehicles than any other mainstream product.

As you save into a pension pot, it builds up compound interest over a period of years. The earlier you start investing in a pension, the more you'll benefit, as the interest itself earns more interest and the whole pot grows faster.

If you have self-invested personal pension (SIPP) you can take more control over the types of investments you include in it. You can even invest in (commercial) property via your SIPP, so it's not an either-or question about pension or property – you can invest in one using the other.

WHAT ARE THE CONS OF INVESTING IN YOUR PENSION

The only real disadvantages of putting money into a pension is that you cannot access it until you're at least 55. But given that the whole purpose of a pension is to invest for retirement, this shouldn't be considered a drawback. If you expect to need access to additional funds before you reach 55, you should set up other investments in addition to your pension – a financial adviser can help you there.

Given that your pension will be invested in stocks and shares, there's risk involved. However, this risk is significantly less than with other similar investments, since tax relief adds such sizeable bonus. Also, you can move your pension into less risky investments as you approach retirement age, to reduce the risk of last minute loses.

The main area of risk with pensions occurs if you choose a drawdown scheme. This keeps your pension investment in the stock market during your retirement. However, with the right advice you can mitigate the risk here too.

WHICH OPTION HAS MOST TAX BENEFITS?

Pension contributions benefits from tax relief. Once contributed, the investments in your pension are sheltered from income and capital gains tax, which can make a significant difference to the value of your pension pot over the years.

The tax rules on property have been getting less generous. When buying a property, you'll need to pay stamp duty land tax, as well as other fees for conveyancing and surveys. There is an additional 3% stamp duty charge for residential property if it is in addition to your primary residence – this is on top of the normal stamp duty rates that apply for primary residences.

In addition, income from buy-to-let needs to be declared as part of your self-assessment tax return. The tax on your income is then charged in accordance with your income tax banding – 20% for basic rate taxpayers, 40% for higher rate, and 45% for additional rate.

When the time comes to sell your investment property there may be capital gains tax to pay if the value of the property has risen. In short, when it comes to tax, pensions win hands-down.

WHICH IS LESS RISKY?

Property price growth has slowed in recent years, making buy-to-let riskier than it has been in the past. If you have a mortgage, you could be left in negative equity if house prices fall, meaning you've paid more for the property than it's worth.

Turn to pensions, some defined benefit (final salary) schemes in the private sector have come under scrutiny recently. The collapse of firms including construction giant Carilion and department chain BHS - and the resultant effort on their pension funds – has led many people to question whether their pension schemes are as safe as they once thought. Fortunately, pensions are protected. However, if your employer goes bust before you retire and you have a final salary pension, you may lose 10% of you pot.

If you have defined contribution pension, it won't be affected even if your employer goes bust, as it is not connected to them in any way. It can lose value if the stock market falls, but over a long period its growth is likely to be positive – as likely as property growth, anyway.

WHICH HAS BETTER POTENTIAL RETURNS?

Investment income is money that someone earns from an increase in the value of investments. It includes dividends paid on stocks, capital gains from property sales and interest earned on savings accounts. So how do property investment and pensions compare?

In recent decades, property values have shown phenomenal growth. UK average house prices increased by 8.5% over the year to December 2020 to stand at a record high of £252,000, up from £57,726 in April 1990, according to the Land Registry. However, changes in how property is taxed has meant that the big gains from rising house prices may be harder to replicate in the future.

It's unlikely you'll end up with less that you've put into a pension, although this is a risk with any type of investment. In 2018, 95% of pension and drawdown funds saw positive growth, according to Moneyfacts (not counting tax relief).

CAN I USE MY HOUSE AS A PENSION?

The real question is, "Can I use my house to fund my retirement?" since a house is not a pension (Because pensions get tax relief and houses don't). Property is one of the least 'liquid" of all assets, which means it's not always easy to turn it into spendable cash, especially if you're living in it at the time. The money in your property is locked away in bricks and mortar.

However, a house does give you the option of equity release to fund your retirement. Equity release is the process of turning some (Occasionally all) of the value of your home into spendable cash, while continuing to live there. Many people approaching retirement age may be fortunate enough to have 100% equity, having paid off their mortgage. Although equity release can be a useful way to release the stored-up value in your home, it's important to consider all the implications. By choosing equity release you would be reducing the amount your children and other beneficiaries would inherit. Sometimes this arrangement can work out very unfairly for the homeowner.

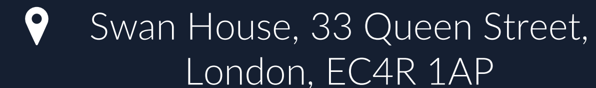
If you intend to sell your property to move int a smaller place, the smaller home will also have risen in value – so you may not have as much money left over as you hoped.

Pensions retain many advantages over property, including tax relief (effectively money back from the government), employer contributions (in the case of most workplace pensions), lower volatility (as they invest in a broad range of assets), and greater accessibility and flexibility.

SHOULD I SEEK PROFESSIONAL ADVICE

Planning how you'll fund your retirement requires a great deal of thought, so you'll have peace of mind that you've made the best possible decision. It's always best to take finance advice first. Please get in touch with one of our advisers here at Humboldt, by sending your query to info@humboldtfinancial.co.uk

LOCATION



CONTACT