Chamberlyns

In Perspective

Pension or Property?

Swapping Pension
for Buy-to-Let Property
Part 1

April 2015

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Many over 55s will be tempted to cash in their pensions to invest in Buy-to-Let property, as guaranteed easy riches and a happy life await. Don't they?

As you will almost certainly know, the 6th of April 2015 ushered in seismic changes in pension legislation, the main tenets of which are generally very helpful for anyone wishing to sensibly plan for and manage their retirement income, their tax position and the passing of wealth to those they care about in the future.

Where does Buy-to-Let property come in?

There has been much speculation in the media – as well as the inevitable dubious encouragement from those with vested interests – about over 55s cashing in their pension assets in order to invest in Buy-to-Let property, which has long been something of an obsession for the British.

So, what's the problem?

The concern is that our national property 'tunnel vision' (often based on a multitude of misperceptions, misjudgements and factual inaccuracies), along with the relentless encouragement to jump on the bandwagon and now unfettered access to potentially significant sums of money, means there is a serious risk of very poor decisions and accordingly, long-term outcomes, for people who should otherwise be enjoying a more secure and comfortable retirement.

Let's take a look at some of the key issues:

Tax on pension withdrawals

While a proportion (usually 25%) of any withdrawal from a pension fund will be free of tax where no benefits have previously been taken, any withdrawal in excess of this amount will be liable to income tax at the individual's highest marginal rate.

By way of example, if a higher rate taxpayer withdraws, say, £100,000 from their pension, £75,000 of this would generally be taxable at 40%, which would amount to a tax liability of some £30,000.

Tax along the way

Unlike with Drawdown pension income (or fixed term annuities), rental income cannot be controlled and adjusted, which often means it is not possible to receive this income in a particularly tax-efficient manner.

In addition, it is important to remember that the underlying investment funds within a pension account suffer no Income Tax or Capital Gains Tax while they remain invested, which can be of considerable long-term value.

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Tax on sale

Property cannot generally be sold in chunks or moved out of the tax net gradually to mitigate Capital Gains Tax, so a future tax bill might be rather larger than expected or desirable, particularly if the rates of Capital Gains Tax are increased (as has been mooted) from their current relatively benign levels.

Tax on death

For those with an estate in excess of the Inheritance Tax 'nil-rate band' (currently £325,000 per individual), the value of a Buy-to-Let property could well be taxed at 40% on death, whereas following recent changes to pensions legislation, it is quite possible that the value of one's pension could suffer no tax at all on death, or at least a lower rate of tax than 40%.

Costs – the more obvious ones

There can be significant costs associated with Buy-to-Let investments, which are often poorly understood or dismissed. Initial costs can include, for example, stamp duty, legal fees, estate agents fees and furnishings. Regular ongoing costs can include insurances, service charges and replacing white goods and carpets, to name but a few.

Costs – the less obvious ones

In addition to the regular ongoing costs, there will be longer-term amortised costs, which can be notable since property is a naturally depreciating asset (it will fall to pieces over time if not looked after properly) and as such, it should be expected that the investment of hard cash will be required to maintain or grow its value.

As such, if you're thinking of pursuing a Buy-to-Let strategy and feel it's reasonable to assume you'll be able to own a property for 20+ years and never need to spend any money on the bathroom / kitchen / wiring / driveway / roof / boiler etc., it may be wise to think again.

Hassle – and more costs

Many buy-to-let investors eventually sell their properties because it ends up being a real headache dealing with the many and varied associated issues. In the meantime, however, to mitigate these hassles, many investors use agents to manage their property – which in turn typically costs between 10% and 15% of the monthly rental income – and of course, there may well be void periods when no suitable tenants can be found, which can not only be stressful and worrying, but can also lead to potentially significant monthly costs having to be borne by the investor.

In part two of 'Swapping Pension for Buy-to-Let Property', some of the risks of this strategy are explored and conclusions reached as to the merits of property and pensions in the context of one's retirement income.

Best regards

Michael

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In addition to being a Chartered Financial Planner, Michael holds the globally recognised Certified Financial Planner qualification and is a Fellow of the Personal Finance Society. Michael also sits on Chamberlyns' Investment Committee and produces the firm's regular series of concise 'In Perspective' articles, which consider, and provide perspective on, a range of current and timeless wealth planning issues.

Chamberlyns provides a refreshingly different Wealth Management service for executives and professionals, who want to make the most of their money and the life that lies ahead of them.

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