ACTIVE PRACTICE UPDATES
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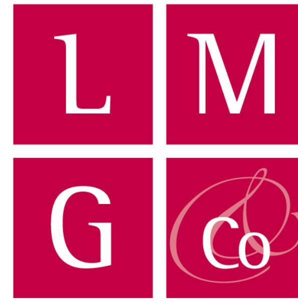

PROPERTY AS AN INVESTMENT FOR LANDLORDS

With low interest rates, property remains attractive.

As the global financial crisis began to bite in 2008, central banks in several nations took action, attempting to shock the world economy back to life by slashing base interest rates.

The idea behind this kind of stimulus is to make saving less attractive, hopefully prompting people to spend instead – to buy that new car, extend the loft or, indeed, to purchase a completely new home.

In the UK, the Bank of England reduced interest rates to 2% in late 2008 and to 0.5% in early 2009, where they sat until 2016 when they dipped yet further, to an astonishing 0.25%.

A decade on from the recession, they've yet to recover in any meaningful way, sitting today at a meagre 0.75% – a far cry from 14.88% of 30 years ago this month.

If you take into account inflation, which runs at around 2% in the UK, then the value of any savings at 0.75% interest is falling: it will effectively lose value the longer you leave it in the bank.

Similar downward slides can be seen on the interest rate graphs of many developed economies, including Japan and the USA, and it's the universal nature of this phenomenon that has had such a stark effect on the value of property worldwide.

In short, for many people with money to invest, property feels like one of the few opportunities that can provide a reliable, substantial return over time.

Equally, letting any property go while values continue to rise can feel foolhardy, so those who might traditionally have sold a flat to buy a small house and then sold that in turn to pay for a larger home are nowadays keeping those smaller properties to rent.

As a result, some who might not have had any ambition to become professional landlords have ended up as multiple property owners almost by accident.

For the sake of easy comparison, let's imagine somebody with a £280,000 lump sum in 2008.

Based on Land Registry statistics, a terraced house bought in London for the then-average price of £281,000 could now be worth almost £500,000 – a 78% increase in the value of their investment in 11 years.

If, on the other hand, they'd found a savings account offering the equivalent of 1.5% interest, that original lump sum would be worth a little over £330,000 today – an increase for sure, but significantly outpaced by inflation.

COULD THE BUBBLE BURST?

There are reasons to be cautious. The more property is treated as an investment, the more likely it will attract speculators, especially from overseas.

This is a classic sign of an investment 'bubble' when the core value of a given asset – in this case a house or flat – is exceeded by its price.

In other words, the market value of a three-bedroom terraced house in Streatham might be £1 million, but only because demand is outstripping supply – not because of the quality of bricks and mortar.

If interest rates begin to rise, or foreign property investors find themselves subject to new taxes or laws, they might withdraw from the UK market en masse, pricking the bubble.

Or a future government might decide to invest in large scale social housing projects, increasing supply.

It's also worth reflecting on the relative value of property in different parts of the country.

Until July 2019, when the largest annual house price growth (4.2%) in the UK was recorded in Wales, property in some parts of South Wales had barely increased in value at all in the past decade, for example, while house prices have actually fallen in some places, such as County Durham.

Of course the value of the property itself isn't everything – the revenue it generates is important as well.

Bubble or not, the lack of housing has led to a corresponding demand in the rental sector, with an increase of 60% in the number of households renting between 2007 and 2017, according to the Office for National Statistics.

However many rental properties you own, whether it's just one flat or 50 houses, there are certain financial implications of which you need to be aware.

RESTRICTED INTEREST

In 2017, the Government began to phase in a measure restricting relief for the costs of finance on residential properties.

It means that, by 2020/21, things such as mortgage interest, interest on loans for furniture and fees on mortgages or loans will no longer be deductible from property income for the purposes of calculating property profits.

Instead, landlords will only be able to claim a basic-rate reduction from their income tax liability for those costs.

Tax year	Finance costs permitted
2017/18	75%
2018/19	50%
2019/20	25%
2020/21	Nil

This measure only applies to landlords who let residential property as individuals, though – not to those who let furnished holiday homes, or through a limited company.

With that in mind, if you are managing a number of properties setting up a limited company for your rental business might make sense.

Be aware, though, that this won't work for everyone, and is likely to incur costs transferring the properties, even if there are certain tax advantages.

PROPERTY TRADING

Most landlords hold onto their properties for long stretches of time for the aforementioned reasons, but some landlords churn properties more frequently.

In that case, HMRC might treat their business as a trade rather than investment. This could apply to you if you:

- manage properties owned by others
- buy and sell within short periods
- buy and renovate to sell at a profit.

If HMRC decides to treat your property business as a trade, any profits you make from selling properties will be subject to income tax rather than capital gains tax.

You might also have to register for VAT if your annual taxable turnover exceeds £85,000, and pay national insurance contributions on your business profits.

CASH-BASIS RECORD-KEEPING

Individual landlords have to keep records of income and expenses relating to their property business and those with an annual turnover of up to £150,000 are expected to use the cash basis by default.

Otherwise, they have to follow the same standards and accounting conventions as any other business, known as GAAP – or generally accepted accounting principles, to give it its full name.

Cash basis means that only transactions completed within the tax year or accounting period are recognised in the accounts.

Debts owed by customers can be ignored until the amount is paid. Similarly, expenses are not taken into account until the bill is paid.

In general, this keeps things simple, but individual landlords can opt out and use GAAP if they wish.

PROPERTY PORTFOLIO CAREER

For most landlords, property is just part of a more complex mix of investments and income, which means strategic tax planning is vital.

Ideally, you should talk to your accountant as soon as you acquire your first additional property, so you can lay sound foundations for what might grow to become an empire.

Talk to us for advice on property taxes.