A PROPERTY INVESTOR'S GUIDE TO SURVIVING AN ECONOMIC DEPRESSION

This month's article was inspired by a post on the fantastic Property Tribes website (http://propertytribes.ning.com). A key risk facing property investors is the effect of much higher interest rates on their business – since finance interest is usually, by far, an investor's largest expense.

Specialist property accountant Stephen Fay ACA considers how property investors can survive if interest rates don't gradually rise, but rise much more quickly, and even 'overshoot' the so-called Bank England 'neutral rate' of 5%.

MAINTAIN GOOD CASH RESERVES

Cold hard cash reserves are essential to ensure survival in a high-interest rate world. Many investors think this means a having £2-3k in their current account. Realistically, this may not last long! Consider aiming for 6 months to a years-worth of mortgage payments, plus 50% extra for voids & maintenance. That's a 'running balance', to be restored as and when dipped into.

Remortgaging, using life-time low-rate credit cards, cheap long-term personal loans, & using an equity drawdown mortgage, are all ways to maximise cash in the bank. Whilst, for me, this goes against the grain (I want to reduce, not increase, debt), the purpose is to bolster cash reserves.

Rampaging inflation will erode debt, but surviving higher interest rates & rent payment issues (see below) will separate those that survive, from those that perish. Try paying for that new boiler with your tied-up equity!

Tax Tip: Interest on ANY borrowings to finance a working capital fund is tax deductible. The borrowings are treated as business debt, regardless of where the funds are secured.

DUMP THE DOGS

Analyse your portfolio – are all your properties able to generate a decent yield to pay the mortgage, maintenance and bills? If not, either accept that you will need to lower the debt, or consider selling any properties that have a poor rental yield. While I would be prepared to carry a good but negative-cashflow property in periods of high interest rates, it's risky to drain cash reserves by funding poor-yielding investment properties.

Depending on achieving a decent price, consider selling off enough property to increase reserves / lower debt to within a 'comfort zone'. This is pure survival - most investors don't want to sell, but sometimes you may have to move one step back (during the depression) to move two steps forward (after the depression).

Tax tip: Work with your accountant to analyse your portfolio & work out which sub-standard properties would cost the least amount in tax to dispose of, while also raising the maximum funds after repaying the mortgage.

PAY DOWN (SOME) DEBT

Many investors are sat on fantastic mortgages (what Robert Kiyosaki would refer to as 'good debt'). Personally I have mortgages with 9 different banks, many of which are on 1.75-2.0% over the Bank of England (or LIBOR) rate. There seems little point in repaying such business debt, given the interest is tax-deductible, & remortgage rates and prices in the future are likely to be higher.

But! Personal loans, credit cards, mortgages on lender Standard Variable Rates, are all usually worth paying down to put you on a firmer footing.

Tax tip: Don't pay high interest rates on debt just to get a tax deduction – analyse your various debts & use spare cash to repay 'bad debt' – AFTER you have built that all-important cash reserve, of course.

CAN RENTS BE RAISED?

Consider if rents can be raised - slowly but surely. Squeeze tenants as much as possible – but don't kill the golden goose! On the other side of the coin, review the payment history & take a view on each tenant - & dump any that can't or won't pay the rent in full & on time - sorry, it's a 'dog eat dog' world during a depression! Also, consider converting props from single to multi-let if suitable, to increase net rental income. Or, develop the property be cost-effectively (e.g. alter the layout) to generate a higher rent. Think about all options!

Tax Tip: Higher rents mean more profits – and more income tax. Work with your accountant to ensure every possible expense, claim and allowance has been identified. Ultimately, good profits means some tax is inevitable – don't refuse £100 income just because £20 of tax is due!

PROVIDE A SUPERIOR PRODUCT

Maintain properties fastidiously - this also helps with raising rents. Well-maintained properties mean satisfied tenants, justification for better rents, and lower voids.

Talk to your tenants – would they appreciate some additional storage, fresh carpets, some redecoration? Would they mind paying £10-20 per month extra if you were to do the works they would like? Just £20 per month extra rent across a 10-property portfolio means an extra £2400 per year – the equivalent of carrying £48k less debt at 5% interest. Think about that!

Tax Tip: Most simple maintenance work is deductible from rental profits. But paying cash and not obtaining a receipt can end up costing more if the trade discount isn't at the same % as your highest tax rate!

INCREASE INCOME FROM NON-PROPERTY RENTAL SOURCES

That means maximising your income from your job, or business. Get a pay rise, ask for extra cash instead of non-cash benefits, hack at every business expense possible, raise prices any way you can – be brave!

Tax tip: Not all income is taxed equally – for example, dividend income for Basic Rate taxpayers is tax-free, and employment income is subject to 'top-rate' National Insurance whereas NI is not payable on rental profits at all. Work with your accountant to co-ordinate your 'taxable income strategy'.

COMMISSION A TAX REVIEW

Examine your tax strategy (if you have one!) & check with your accountant that all possible options to increase income & reduce costs, including tax, have been considered. It's a rare client that has nothing at all that can be improved! Property investors have umpteen options to save on what can be a massive expense – taking 40-50% of your net profits for Higher Rate taxpayers.

Tax tip: Professional fees are fully tax-deductible against rental profits. DIY tax-planning is not advisable for portfolio investors!

RUN YOUR BUSINESS PROFESSIONALLY

Some investors talk a good game about being 'serious investors', but the reality is that many don't give this business the time and effort it deserves. Time spent 'minding your own business' is time well spent.

Time spent on maintaining that all-important 'tenant rapport', checking if any works are needed on properties, improving financial management processes, and generally taking a proactive & hands-on approach, will be well worth it. Property investing is not 'passive income', as some would have you believe (if only!).

Tax tip: Any costs incurred 'wholly and exclusively' for business purposes can be claimed as an allowable expense – provide you have good records & the costs isn't specifically excluded as a tax deduction (e.g. 'tenant entertaining'!).

BUY MORE PROPERTY

A final suggestion – high interest rates will cause many homeowners & investors pain - & they will be looking to offload their 'problem property' - quickly. If you are able to fund deposits, and stay mortgageable, there will be bargain properties for sale. It's a sad fact that not every investor will be able to survive – for those that do, the extra reward will be the opportunity to source property at significant discounts.

Tax tip: Remember – investors are taxed on the profits of the whole portfolio – so upfront costs associated with new purchases can be used to offset profits from existing properties.

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