

YOUR HOME IS AN ASSET KIYOSAKI WAS WRONG!

By specialist property accountant Stephen Fay FCA



In my experience, many property investors neglect their own home as a key part of their property asset base, which can be a serious wealth-building mistake. The 'Rich Dad Poor Dad' books written by Robert Kiyosaki make the case that your home is a liability rather than an asset. In this article, I make the case that the opposite is true (sorry Robert! – although I do still generally agree with your focus on income – or 'putting cash in your pocket' views).

What's all this about my home not being an asset?

Robert Kiyosaki, in his inspirational investment book 'Rich Dad Poor Dad', set out a new way of investment thinking about a home, ie that a home is a liability since it takes money out of your pocket, or in other words is cashflow-negative. An asset, in contrast, puts money in your pocket, ie is cashflow-positive.

This thinking was a new way of considering how a home impacts on an investor's finances and – quite rightly in my view – puts the investment objective firmly on income generation rather than uncertain capital appreciation. This is at odds with the financial position of 'Joe Bloggs', in that their home is by far their biggest asset in terms of capital value – but is also by far their biggest liability in terms of the cash required to pay for the home. In other words, having a large / expensive home can keep you in the rat race, rather than set you free. Or can it...

OK – convince me that my home is as asset, not a liability

Firstly, I would like to confirm that my own personal investment philosophy is that investment is more about income generation than capital appreciation. However, I also have an eye on the future in terms of accumulating wealth as I have a seven-year old severely autistic son who will require financial support beyond my own lifetime. This means that I appreciate the benefit of current income, but also the benefit for the future of an increasing capital asset base – assuming that there is generally a trade-off between the two.



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1. Your home can be your seed capital

In my experience, a large majority of successful income-focussed property investors began their investment career by leveraging the equity in their own home. And, the value of the home was often enhanced by the re-design and refurbishment, as well as market appreciation.

Therefore, I think it's rather disingenuous to be quite so dismissive

of a home as a source of income, as for many investors ultimately their current portfolio income was derived initially from their own home equity.

2. Accessing home equity is cheap

Assuming a home-owner is credit-worthy, mortgaging a home can be the cheapest finance available, and at the highest Loan to Value available. So, in addition to the being able to benefit from capital appreciation, actually being able to access that capital appreciation can be remarkably cheap and easy.

This is in stark contrast to other capital-appreciating assets such as pensions and share portfolios (whether or not in an ISA) – leveraging (financing) such assets is extremely difficult.

3. Private Residence Relief = no capital gains tax

As most property investors know, the UK offers 'Private Residence Relief' (PPR) to provide an unlimited tax exemption for a person's owned home being subject to capital gains tax. Compared to some countries such as the US, this exemption is generous as other countries set caps on the relief available, eg the US has a \$250,000/person PPR cap.

This means that in the UK growing the value of one's own home is very tax-efficient – in a way that is less so in the US for example.

4. Favourable Inheritance Tax regime for home-owners

From April 2020, the Inheritance Tax 'nil rate band' is set to increase by £175,000 per person, and from then on increase in line with the Consumer Price Index (CPI). This means that there is a £1m allowance for passing on a family home to heirs, for a married couple (£325,000 each nil rate band plus £175,000 each residence-specific nil rate band).

Outside of London and the South East (mainly), a £1m Inheritance Tax-free allowance for a couple is quite generous, and so it encourages more of a person's wealth to be 'allocated' to their home.

5. Property taxes on a home are low in the UK

Again, in contrast to some other countries, ongoing property taxes are fairly modest in the UK, being mainly council tax plus insurance costs. This means that even fairly expensive properties can be used as homes (rather than rental properties) at a

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reasonable cost. As a general rule, most US states impose fairly onerous property-holding taxes compared to the UK.

6. No loss of income while improving a home

Unlike the refurbishment of a rental property, when a property investor improves their own home and adds value, there is no loss of rental income – in contrast to the costs of refurbishing a rental property (council tax, loss of rental income). This means that improvements, repairs, extensions, etc can be completed at a more leisurely pace, as funds allow.

Of course, in the current era of low interest rates, 'investing' spare funds into improving one's own residence can be a good use of funds, since the value created can be mortgaged out, and the value increased is unlikely to be taxable (whether a lifetime sale and PPR is claimed, or the residence forms part of one's estate in death and subject to the £1m IHT allowance).

Summary

For many property investors, having a home that increases in value, and can be developed to add value, is a useful way of creating some initial investment capital with which to invest in income-producing property. Far from being a liability, in such circumstances the home is as asset, albeit producing income indirectly.

But, make no mistake – many, many property investors would not be where they are today in terms of their portfolio without the capital having been mortgaged out of their own home. With the CGT and IHT benefits – especially generous in the UK – associated with one's own home, property investors should be careful not to neglect this important aspect of their overall property wealth.



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