The **REAL** reasons why cash reserves are important

By specialist property accountant Stephen Fay ACA

Property investing is a big-money business to be in and mistakes can be costly both in money and wasted time. So many investors choose to educate themselves using paid-for property programmes and mentors.

Actual cash reserves are something of an unknown concept to some property investors. Every investor can relate to that 'itch' about wanting to make their cash work for them and so want to buy another property whenever they have spare cash – beware!

This article has one main aim – to highlight an often-forgotten key benefit of carrying strong cash reserves – namely, the ability to take advantage of occasional fantastic investment opportunities that present themselves.

So, how much cash should I be carrying?

This article is about WHY you should carry significant cash reserves – just like many of the world's most successful investors do.

By 'significant', I am not referring to the modest amount needed to cope with the daily fluctuations in funds i.e. as rents come in and mortgage payments go out. Typically these funds - known as 'working capital' – might be twice the total monthly outgoings (less depending on whether you like to live life on the edge!).

Instead, I am referring to carrying much more significant funds - as a rough guide, a 'significant' sum of cash for investment might be in the range £30k-200k, depending on your total property wealth / number of properties / borrowings.

Isn't it quite expensive to carry large cash reserves?

Simple answer – yes, usually.

The 'cost' of carrying cash reserves is two-fold:

- **The opportunity cost of the lost investment return - since funds need to be kept 'liquid' (i.e. immediately available), the interest earned is often pretty minimal.**
- **The interest earned if the cash reserves are borrowed.**

Regarding point 2 – it's perfectly acceptable to borrow to boost cash reserves.

Generally the interest payable will be tax deductible (assuming your 'capital account' maximum has not been reached – for discussion with your accountant!).

Some large property companies refer to this as 'financial capacity' – meaning their ability to raise cash quickly through liquid cash reserves and guaranteed credit facilities.

So, what ARE the real reasons why cash reserves are important?

The real reasons for carrying significant cash reserves are two-fold:

- **To capitalise on fantastic (only) investment opportunities that present themselves – especially in recessions and 'down markets'.**
- **To protect against credit markets closing.**

It really is as simple as that!

Can you explain further?

To cover each in turn:

1. Buying fantastic assets

In the current market, many investors are able to find good deals, but lack the cash to capitalise on the opportunity. This is a classic investor mistake – running out of capital so that they are in the same boat as every other investor – unable to access cash to buy fantastic assets (or should I say, assets at fantastic prices!).

Many properties are now half the price they were – some investors are filling their boots due to their prudent cash management, while others are struggling to find the funds at a reasonable rate to invest.

I am approached on a weekly basis by investors who didn't 'keep their powder dry' and so now can't buy property that is available cheaply because of vendors who failed to maintain cash reserves to protect themselves … see point #2!

2. Protection against credit markets closing

When a recession hits, it is common for lenders to 'shut up shop'. Lending criteria tightens, unused facilities are reduced or withdrawn, and if your business is caught out, it can cause major issues.

As a trivial example – imagine if your overdraft facility (which is repayable on demand) were withdrawn – how easily could you repay it?

More importantly, imagine if mortgages were withdrawn tomorrow – or set at a maximum of 50% LTV. Couldn't happen? Imagine if the 'PIGS' (Portugal, Ireland, Greece, Spain) went through a 'disorganised default' on their debts (economist-speak for a country going bankrupt).

Even if this happened temporarily, it would lead to LIBOR rates spiking, and lenders hoarding cash and calling in facilities – could you cope?

Summary

Very simply – many wealthy people built their wealth by biding their time and only spending precious cash on assets that are an exceptional bargain.

Also, by ensuring that they are able to 'stay in the game' when times are tough.

This means maintaining cash reserves that may feel a little excessive – but come in very handy when the others sail too close to the wind and have to liquidate assets in a hurry – at a discount, naturally.

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