USING RENTAL INCOME TO DRIVE LONG-TERM WEALTH

Property investment is a tried and tested asset class with which to generate long-term wealth – but few investors put in place a business plan and financial budget to achieve their aim. Being financially disciplined and committing to a long-term plan can lead to financial security sooner than you think …

Specialist property accountant **Stephen Fay FCA** considers how property investors can become wealthy by investing wisely in residential property.

Part of the attraction of property investing is that 'Joe Average' can build a moderate-sized portfolio to provide a solid asset base and income stream for life, and to pass on to family.

1 WHAT EXACTLY DO YOU WANT TO ACHIEVE?

Some large-portfolio landlords now wish that they bought fewer properties – they failed to plan and now have a 'property management headache'. For most people, simply owning ten mortgage-free properties would provide a good income and an index-linked capital base.

Set an income figure that you would be happy with – let's say £60,000 per annum. Work back from the gross rents, and deduct (say) one-third for letting costs. This would mean a 'gross' annual rent roll of £90,000 – meaning each property must rent at £750 pcm. Tweak the figures until you have your own combination of properties / rents / net income that suits you.

Realistically, £60k is a fantastic income for most investors – and eminently achievable – and is far more useful as a target than a poorly-defined plan to become a 'property millionaire'.

2 GET TO WORK!

Buying property takes time and money, so set a portfolio-build timeline that is realistic – remember, these days cash deposits are required, so for most investors, building their portfolio slowly but surely is the best approach. Too many investors are in a hurry; better to build a business based on solid foundations than to rush things – when things go wrong in property, they tend to go badly wrong!

A realistic timeline might be to acquire two properties per year for (say) seven years (more on that later). The old proverb 'measure twice, cut once' is sound advice – property is an expensive business to be in, so make sure the property you do buy has a good yield and is bought at a keen price.

3 COPY SHARE INVESTORS – RE-INVEST PROFITS

Using rental profits to pay down debt is a slow but powerful way to use compounding to your advantage. Like a repayment mortgage, it's a simple yet powerful process of chipping away at the debt, which in turn means lower interest bills, and in turn higher profits. This is where buying property which is in good rental demand, and is cheap to maintain, will enable consistently high rental profits to be made.

Try to differentiate yourself and your property – and so command a premium rent. Across a portfolio, the compound effect of superior rents can have a fantastic debt-busting impact.

The basic model is a static or reducing cost base (mainly mortgage interest), combined with a rising income (rent), resulting in an ever-widening gap between income and costs.

4 SELLING PROPERTY TO IMPROVE LTV, CASHFLOW, AND EQUITY

A powerful way to accelerate the debt repayment process is to sell off some properties that have appreciated in value, especially where the rental yield has not kept pace with the capital value. A good strategy is to run a portfolio that is larger than the planned 'end portfolio'.

In the example above, buying a total of fourteen properties, and selling off four of them once a decent capital gain has accumulated, will often dramatically reduce debt. It may be that developing existing property (e.g. adding additional rooms) can increase the rental yield.

5 BE TAX-WISE, BUT DON'T GET TAX IN PROPORTION

Many investors will refuse to pay down debt or sell property because they are unwilling to pay tax on profits and gains. No-one likes paying tax! But, there are lots of strategies to minimise the various taxes the investors may pay.

Many investors are only ever going to pay 20% income tax (there is no National Insurance on rental profits), and so will actually receive 80% of their profits – sometimes more. Using a property company is a good way of 'parking' profits and avoiding Higher Rate income tax – for later tax-efficient withdrawal.

Tax is a fact of life – minimise it, but don't let tax concerns override good business sense.

6 THE FINAL FEW YEARS…

Imagine the personal satisfaction of making that final mortgage payment – no more debt, no more interest rate worries, no more direct debits and lender hassles. Many investors find that they haven't quite been able to pay off all mortgages, so then need to decide whether to sell off a final property or two, or extend their property plan a year or two. It's a personal decision. Would owning nine mortgage-free properties rather than ten make that much difference?

SUMMARY

Good property selection, financial discipline, and a patient long-term plan can mean a mortgage-free small portfolio in 15-20 years. For most investors starting in their early 30s, this can mean financial security by their mid-40s. It's not a sophisticated plan – but it does work! Like many business plans, it's 80% perspiration and only 20% inspiration!