LANDLORDS:

How many properties is "enough" for you?

By specialist property accountant **Stephen Fay** ACA

Some property investors build large property portfolios that can become a major management headache, others don't invest enough to earn a meaningful income, and others build up 'just enough' to satisfy their income needs, and maybe even wants, and achieve their property ambitions. This article looks at the pros and cons of building a large vs small property portfolio.

Nobody can buy an unlimited number of properties!

Every property investor is restricted by the availability of purchase deposits and the ability to obtain mortgage finance … which means that there is a natural cap on the number of properties an investor can buy.

The "Section 24" mortgage interest restrictions, now fully in force, mean that only a flat-rate 20% tax credit can be claimed for finance costs, putting an effective cap on the number of properties that most investors can buy in their personal names, although using a company can allow for larger portfolio growth.

Many investors with 50+ properties built their portfolio in the days of easier credit … higher loan-to-values, easier lending criteria, lower SDLT cost, as well as no mortgage interest restrictions.

Times have changed, and so it is now more difficult to create a large property portfolio. This may be no bad thing, however, as while it may be a dream for many investors to own 100 properties, how many people really want the hassle and risk that go along with that? And how many have the work ethic and business skills to find, fund and manage that many properties?

Most investors prefer to aim for a smaller, good quality portfolio, and in that sense buy-to-let is still 'the poor man's private equity', ie the ability to use high (typically 75%) amounts of borrowing to buy property valued at much more than the investable cash available.

Not everyone wants to be the next Duke of Westminster!

What are your property investing goals?

Often, people become property investors to replace a day-job; others just want a safe long-term investment that they understand. The former is more concerned with rental profits, while the latter is often more interested in passive capital gains.

Replacing a day-job of (say) £3,000 per month might require eight-ten single-let properties, or perhaps three-four multi-let properties. Dividing a monthly target income by the number of properties is a simple way to work out how many properties are needed to reach a target income.

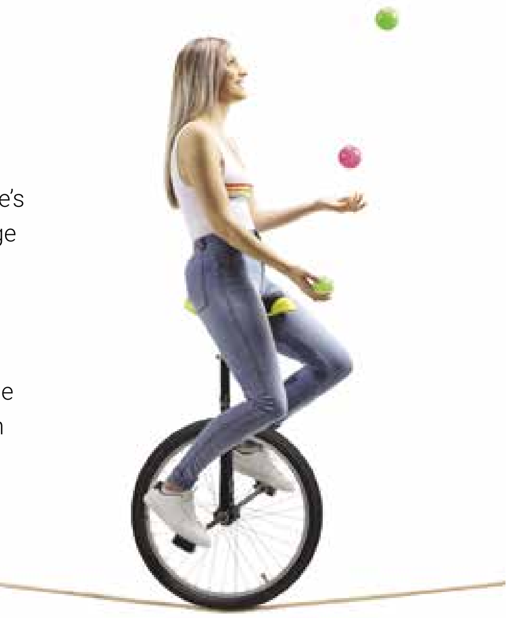
Some landlords are not disciplined enough with their purchases, and settle for rental yields that don't meet their target criteria – whereas they should only buy property that meets their stated objectives (though there is always the exception, eg the property with a development angle, but which doesn't work as a rental property).

Low-yield properties mean more properties (and more investable capital) are needed to generate the same income.

How much of a risk-taker are you?

More properties mean more risk. A large portfolio usually means larger mortgage debt – are you OK with that? Some people aren't, and some people's spouses and partners aren't! Are your likely rents enough to pay the mortgage interest if mortgage rates rise, plus allowing for repairs and other costs? For larger property portfolios, there is less scope for the owner to 'swallow' any financial issues that may arise in the short / medium / long-term.

For example, 85% was the standard single-let loan-to-value, whereas after the credit crunch of 2007/08, the typical loan-to-value dropped to 75%. This then meant that after the initial fixed period of the mortgage, some landlords had to put in 10% extra equity to be able to remortgage, or they reverted to a much higher standard variable rate



How much investable funds do you have?

Buying property requires capital, as lenders won't fund 100% of a property's purchase price. Most landlords are not independently wealthy, and so the amount of investable funds usually puts a natural cap on the number of properties that an investor can acquire.

Expansion beyond this will therefore require an ability to raise finance – which means it is even more crucial to build a good portfolio, to demonstrate to outside investors that you are a 'safe pair of hands'.

Larger portfolio = larger profits

The elephant in the room … more properties equals higher rental profits, and more total capital gain over the longer term (usually, at least!).

With a 5% net rental profit (say), and 3% average house price inflation (say), a £2m portfolio will deliver a £100,000 annual net profit, and increased equity of £60,000 per year … both of which should compound over time as both rents and capital tend to be 'sticky' upwards.

For those with the capital, ambition and work ethic, a similar £4m portfolio will, all things being equal, provide £200,000 net profit, and £120,000 per year capital growth.

Ultimately, most people like money and how it can improve quality of life, so there is a balance to be struck between how much rental profit and capital gain is enough to provide what **YOU** want out of property, and whether you can commit the money and energy to make it happen.

How much time and energy are you prepared to commit to your property portfolio?

Researching, viewing, putting in offers, mortgage applications, dealing with brokers and solicitors … all takes time and energy to build up a portfolio from property #1 to your target portfolio size.

And, most of us have a job or business, spouse or partner, family, non-property interests … finding the time and motivation to create a property rental business is not as easy as it sounds. In addition, are you prepared to limit your personal spending – a smaller home, cheaper cars and holidays – to fund your investment pot to grow the portfolio?

These are some of the tough decisions that need to be made if investors want to build a large portfolio in the 'post credit crunch era'.

Summary

Landlords in the early days of investing often focus on buying their first few properties, but after that initial stage is completed, it's time to think about how much of their time, money and energy they want to devote to their property portfolio.

Growing a property portfolio can be a time and capital-intensive task, so be sure that you are following your own dream, and not somebody else's. We are all different and there is no 'one size fits all'.

Above all, build your portfolio on solid foundations – Rome wasn't built in a day, and carefully selected and financed residential property, in rental demand, and maintained and tenanted over the years is a great investment. It's one of the few ways that 'normal' people can become wealthy over time, and in a relatively safe and predictable way.

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