INTEREST RATE RISES ARE COMING – ARE YOU READY?

The Bank of England Governor, Mark Carney, has publicly stated his surprise at markets thinking that interest rate rises are not likely until 2015 – instead stating that 2014 could easily see an interest rate rise. Since interest rates are the major determinant of most landlords' property profits, preparing for rising interest rates is vital to ensure financial security into the future.

Specialist property accountant Stephen Fay FCA looks at how property investors can avoid the irony of becoming tomorrow's distressed sellers.

WHAT'S THE PROBLEM? INTEREST RATES ARE AT A RECORD LOW AND HAVE BEEN FOR FIVE YEARS...

As we all know, interest rates have been at a 300-year record low for over five years, and for many landlords this has resulted in a hugely welcome increase in rental profits – albeit unexpected! However, interest will rise at some point, and so how much and how fast rates rise is the major external factor affecting landlords with mortgages (i.e. the vast majority of landlords).

Mark Carney, the Bank of England Governor, has stated publicly that interest rates may rise in 2014, albeit at a slow and steady rate. This is bad news for most landlords! On the other hand, while many commentators have regarded 5% as 'normal', Mark Carney has indicated that a medium-term rate of 2-3% may be the 'new normal'; and that an increase from 0.5% to 2-3% would be a slow and steady progression, rather than an overnight step-change. This much-lower-than-history Bank Base Rate would still be of huge benefit to landlords, but unfortunately will cause problems for those whose business model relies on a 0.5% Base Rate.

THAT'S ALL VERY INTERESTING, BUT WHAT EXACTLY CAN LANDLORDS DO TO PREPARE FOR RISING RATES?

Challenge #1 Be honest: are your property yields good enough?

Not all properties offer a good yield: and poor rental demand = poor rental yield = rental losses. After maintenance costs, voids, letting fees, etc., many properties become a financial millstone, not a route to financial freedom.

These properties need to be sold – just one or two of these can seriously drain cashflow. There are millions of properties to choose from, so be choosy. If your main aim is long-term capital appreciation, ensure that you survive that long!

Challenge #2 Cashflow is reality but gross rent is vanity

As the old saying goes "Turnover is vanity, but cashflow is reality".

Cashflow is the lifeblood of your business, which means gross rents **LESS** costs! Too many investors still refer to their property "income" being their gross rents – **NO!** Our website has a **FREE** CashFlow Tracker tool to help investors manage their cashflow, after factoring in **ALL** costs. Only then can you get a handle on your property profits, and understand which properties NET you a good return, and which cost you money.

Challenge #3 Look after your property finances!

If you are not checking your property bank account at least once per day, you are not close enough to your portfolio finances. A separate bank account should be used to operate the property rental business; if you are not a company, then just a simple personal current account, with online access, cheque book and debit card.

Make it part of your daily routine to check your business income and expenses – some investors have become lazy in this era of low interest rates, and need to be more diligent about checking the on the financial health of their portfolio.

Challenge #4 Working capital makes life easier

Working capital is the term for the amount of cash needed to keep a business working day in, day out. Investors should estimate the amount needed by considering the number of properties, value of rents and costs, likely maintenance spend, and their personal 'comfort factor'.

More working capital means fewer cashflow problems. This needs to be balanced against the low return that on-hand cash will provide. Beware of relying on credit lines for urgent access to cash – if these are pulled, could you survive?

Challenge #5 Income, income, income

A property portfolio is a 'fixed cost business' (like hotels and airlines). Profitability is tied to 'bums on seats', i.e. high occupancy at decent rates. Know your local competitors' rents, where your property sits in the 'pecking order', and price accordingly. Treat tenants like the customers that they are.

Consider rental incentives, moving the rent date to suit the tenant, and being flexible with rent proposals.

Challenge #6 Optimise your borrowing position

Every investor should know the details of their borrowings inside out – the amount, the rate, fixed or variable, the revert rate, portability, etc.

Although most lenders insist on direct debit, many are flexible as to which date the payment is made. Spreading payments between the 1st, 15th and 31st of the month will reduce the working capital needed, and allow investors more flexibility. Check with your lender if they will move the direct debit date – this could free up a month of income.

If cashflow deteriorates, stay in contact with the lender. Lenders generally don't inform credit reference agencies about missed mortgage payments if the payment is made before the end of the month (hence the need for a debit card for those last-minute mortgage payments!).

Challenge #7 Get your admin sorted

What can you do to make running your portfolio easier? For example:

- setting up a single portfolio insurance policy, paid for by monthly direct debit, with all policies renewing on the same date
- setting a single 'Gas Safety Renewal Date' for the portfolio, to avoid needing to track multiple dates (this will involve a little extra expense as each certificate date is synchronised).

There are only so many hours in the day. Could yours be spent on new income strategies, cutting back on costs you needn't incur, and generally working to boost your property profits?

IN SUMMARY

Interest rate rises are coming – without a doubt. This will reduce cashflow for all landlords with borrowings, but the time to prepare for winter is when the sun is shining! Ultimately, any business has income and expenses; increasing profits is about increasing income and decreasing costs, and the practical ways of doing this can be quite mundane and routine. The best businesses have the best managers – and the best managers work hard **AND** smart.