Teachers Financial Planning

Property investment

This guide looks at ways to invest in property and how it can form part of an investment portfolio

Before stock markets, property was one of the only asset-backed investments available. These days it can be a way to diversify an investor's portfolio because it offers different characteristics to other asset types. For example:

- The price of property is affected by supply and demand, as well as changing economic and financial circumstances
- The prosperity of an area can have an impact on prices
- Tenants of commercial property have to pay their rent even if they are making a loss. But if a property becomes vacant it can become a drain on resources
- The range of property available to invest in is broad and the commercial and residential markets usually display different characteristics
- An investor could purchase property directly or through a collective investment scheme
- The asset-backed nature of property means it may provide long-term protection against inflation.

Residential property investment

Residential buy-to-let became a popular investment in the late 1990s for a number of reasons, such as falling yields on equities and bonds and easier access to buy-to-let mortgages. Since then the housing market has been through turmoil but buy-to-let is starting to see a resurgence.

Taxation

Residential property that isn't the owner's main residence is subject to the following rules:

- rental income is taxed as investment income
- the expenses of letting and interest on improvement loans can be deducted from the taxable rental income
- any gain on disposal will be subject to capital gains tax
- relief for wear and tear of furniture may be claimed on furnished properties.

Drawbacks

Some potential drawbacks to property investment are:

Valuation

When markets are slow or volatile it can be difficult to accurately value property.

Lack of liquidity

Property is relatively expensive to buy and sell when you take stamp duty and agents' fees into consideration. The sale of a property can take a long time too, especially when the market is poor.

Management issues

Letting property is like running a business and requires the administrative, financial and marketing skills needed to run a small enterprise. Managing a property without an agent will save fees but, unless you have an aptitude for the work, this may not be advisable.

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Void periods

The risk of loss of rent could arise if you find yourself without a tenant or if your tenant fails to pay their rent. A landlord is protected by property law but this will involve the services of a solicitor, which could see you incur further costs.

Choosing a property

The following should be considered when choosing a residential property investment.

Stamp duty

When a residential property is bought stamp duty is charged at varying rates depending on the sale price. These are currently:

Purchase price	Rate
£0 - £125,000	0%
£125,001 - £250,000	1%
£250,001 - £500,000	3%
£500,001 - £1,000,000	4%
£1,000,001 - £2,000,000	5%
Over £2,000,000	7%

Expected yield

Rental yields vary between different properties and locations and also depend on the economic climate. As a general rule, the bigger the property the lower the yield and expenses will need to be considered when calculating the yield.

Prospects for growth

One of the main attractions with property investment is the prospect for long-term growth, although this ebbs and flows as the property market changes.

Commercial property investment

The commercial property market is divided into three main sectors:

- retail
- office buildings
- industrial properties.

Investing in commercial property tends to be specialised and a large proportion of the market is occupied by insurance companies and pension funds.

Investment considerations

The quality of the tenant and their ongoing ability to pay the rent is an important consideration. While property has intrinsic value as a potential source of income even without tenants, it is worth more with a financially secure tenant.

For this reason commercial property investors prefer long leases, although there has been a move to shorter leases in recent years, particularly following the 2003 amendments to stamp duty, basing it on the net present value of rent.

Commercial properties are traditionally valued as a multiple of the rent they produce, although valuations can change with market expectations of future growth.

Unlike residential property, leases on commercial property usually pass full responsibility for maintenance and insurance costs onto the tenant. This means that net income is generally higher.

Drawbacks

There are potential shortcomings associated with investing in commercial property, including:

- sale and purchase is relatively slow and complex
- income growth is phased as rent reviews are in stages
- a property is not always easily divided into segments
- the market can be difficult to analyse
- there can be a time-lag in increasing supply to meet demand, which can lead to oversupply.

Stamp duty

When you buy commercial property the following stamp duty rates apply:

Purchase price	Rate
Up to £150,000 - annual rent is less than £1,000	0%
Up to £150,000 - annual rent is £1,000 or more	1%
Over £150,000 to £250,000	1%
Over £250,000 to £500,000	3%
Over £500,000	4%

Investing in property can be complex and high risk so it is important that you seek professional advice to ensure that it is right for you and your investment portfolio.