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In Perspective

Pension or Property?

Swapping Pension
for Buy-to-Let Property
Part 2

April 2015

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Many over 55s will be tempted to cash in their pensions to invest in Buy-to-Let property, as guaranteed easy riches and a happy life await. Don't they?

The key issues continued...

Risk – 'leverage'

Property investing provides an easy opportunity to 'leverage' one's capital (borrow significant sums of money against an initial – often much smaller – outlay) and for those who go down this route, it is important to remember that borrowing to leverage assets cuts both ways, since it is possible to lose more than the value of your equity capital.

Indeed, this is the curse of negative equity and as such, if you find yourself needing to sell the property for some reason, you could be forced to accept a hefty loss, or find that the illiquid nature of a residential property means that a sale in the timeframe you desire is not possible, which would not only be very frustrating, but also potentially put further downward pressure on the price at which you can ultimately sell.

Risk – poor diversification

Perhaps the biggest risk of piling (more) money into Buy-to-Let property is the concentration of risk in not just one narrow asset class – residential property – but in one house or flat, on one street in one town. Particularly where a notable proportion of your wider wealth is comprised of residential property (your home and perhaps other Buy-to-Let property), this lack of diversification is an unattractive attribute for a sensible plan to deliver a comfortable financial journey through retirement.

Risk – misinterpretation and extrapolation of past returns

There is a perception that net rental yields are very attractive and that the returns from property over the last 30 years or so have trounced those achieved from equity-based investments. However, perception is not reality, as the returns from the UK stock market during this time, with dividends reinvested, has significantly outperformed the unleveraged returns from property, and net rental yields are often nowhere near as high as people imagine.

This being said, Buy-to-Let property has, on the whole, delivered good returns during this time, but not only are these returns wrongly assumed to be higher than any other form of investment, but they are extrapolated into the future as if they are certain to be repeated ad infinitum and in a smooth, uninterrupted, risk-free fashion, which they are not. Rather, property should more sensibly be assumed to have an expected long-term return somewhere between bonds and equities.

Risk – small pots and annuities

The data suggests that the average pension pot in the UK is only around £40,000 at retirement, which might imply that the average person seeking to use their pension to help fund a Buy-to-Let purchase may well have to withdraw all of their fund, which, as outlined above, is likely to raise the prospect of a tax charge and / or borrowing to facilitate the purchase.

A lack of diversification is an unattractive attribute for a sensible plan to deliver a comfortable financial journey through retirement.

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However, it may also imply that for someone in these circumstances, it would likely be very sensible to seriously consider purchasing an annuity, which will provide a secure income for life and will ensure one is not exposed to the vagaries of the property (or investment) market, which is likely to be important for someone who, in truth, probably does not have the financial capacity to absorb the risks associated with them.

What about someone with salary-related pension benefits?

While there are circumstances in which a transfer out of such a scheme might conceivably be appropriate, in almost all cases this will be an unwise course of action and leaving a secure salary-related scheme to help fund a Buy-to-Let property purchase is likely to be foolish in the extreme. In short, do not even contemplate doing this without seeking professional advice first (if the transfer value is £30,000 or over, you must receive professional advice in advance of any actions being taken).

So, to summarise all of the points from both Part 1 and Part 2 of this article:

Property and pensions are not mutually exclusive

Property can certainly have a place in an investor's wealth plans, but this does not have to be at the expense of all other retirement income vehicles and nor does it have to involve highly concentrated and unnecessary risks. Indeed, property ownership / exposure does not only have to be in the form of Buy-to-Let; instead, or in addition, exposure might simply be through one's residential property or through an allocation to commercial property, as part of a well-balanced and diversified pension portfolio.

Pension income should remain as a core pillar of retirement

Buy-to-Let ownership should certainly not be regarded as a quick and smooth road to riches. It has material costs, risks and downsides unacknowledged by many who embark on such a course. It demands to be managed like a small business (which holds a depreciating asset that needs constant love and attention in order to achieve an expected rate of long-term return somewhere between bonds and equities) and while for some that is an enjoyable pastime, for others it becomes a headache, a chore and a source of stress.

In Chamberlyns' view, converting one's pension funds (or a proportion of them) into a secure lifetime annuity will be the safest, most sensible course of action for many over 55s, while for those with appropriate circumstances, making the most of the significant planning opportunities provided by pensions and investing in a sensibly structured, globally diversified pension portfolio will continue to make enormous sense, and is likely to remain at the centre of a well-considered and balanced retirement / wealth plan.

Final thought

As a final thought, what price can you place on the time that you free up to do the really important things which enrich your and others' lives, by not overburdening yourself with the hassle of managing properties, especially in the years when you should be living life on your own terms?

Best regards

Michael

The significant planning opportunities provided by pensions are likely to remain at the centre of a well-considered and balanced retirement / wealth plan.

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In addition to being a Chartered Financial Planner, Michael holds the globally recognised Certified Financial Planner qualification and is a Fellow of the Personal Finance Society. Michael also sits on Chamberlyns' Investment Committee and produces the firm's regular series of concise 'In Perspective' articles, which consider, and provide perspective on, a range of current and timeless wealth planning issues.

Chamberlyns provides a refreshingly different Wealth Management service for executives and professionals, who want to make the most of their money and the life that lies ahead of them.

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