

Client Newsletter Spring 2005

Prepared by Graham Clarke, Senior Partner

Market Review of Q4 2004

The Cambridge Residential Letting Market carried on enjoying its best autumn for many years. Due to an increased demand by prospective tenants, many of the properties that were proving difficult to let were more easily let during this period. This extra activity was helped by uncertainty in the sales market, encouraging those in doubt to rent rather than buy.

Self-Invested Pension Plan Schemes (SIPPs)

Further information has been gleaned since my last article, and the latest analysis goes as follows: The Chancellor has confirmed that his proposed inclusion of residential properties within individuals' private pensions, in addition to commercial properties that are currently allowed, is to go ahead from April 2006. Will this be an opportunity for investors to transfer their existing residential portfolios into a Self Invested Personal Pension? I expect the answer for the majority to be "No", unless they are able to pay small amounts into either a FSA approved fund or a private consortium. This is because for the average UK taxpayer there will be too many hurdles to climb over, including having to pay Capital Gains Tax on any gain before transfer, plus stamp duty, and an individual's SIPP can only borrow up to 50% of the value of the pension fund. (Whereas under the old borrowing rules for commercial property, the SIPP could borrow up to 300%). Furthermore, as the average capital value of a residential property in the UK is now in excess of £150,000, and in Cambridge nearer £200,000, the SIPP must already be holding in excess of £100,000 in "pension" funds, just to acquire one residential property. Nevertheless, forecasters are predicting that between now and April 2006, savers are expected to stockpile in excess of £10 billion in their private pension funds, ready to buy property when the new tax breaks come into force in April 2006. The residential investments that will qualify include buy-to-lets and holiday homes. Once in the pension fund, the tax breaks for a higher rate tax payer would almost double the current returns. Although under pension tax rules the cash can not be accessed until the individual is aged 50, rising to 55 from 2010, at which time you can take out 25% of the pension fund value as tax free cash and the remainder has to be used to purchase an annuity to provide a taxable income. Thereafter, you can continue to work whilst receiving the pension. However, if the property is not needed to be sold for an income (other sufficient income available from alternative sources), the property(ies) can be held in a "family SIPP" and the property(ies) can be passed onto other members of the pension fund when you die-including your heirs. This will apply even after the age of 75, because the Government will no longer require that an annuity is purchased, subject to some restrictions.

At present, this transfer to heirs would be free from inheritance tax, but the Chancellor is expected to close the loophole of this tax perk. The potential flood of extra money into the residential market in Spring 2006 (10-15% extra) may be expected to result in a tax driven uplift in residential property capital values, perhaps warding off some forecaster's prediction of continuing falls in capital values over the next few years, as demand may be expected to fast outstrip supply. Especially in those areas where there is already limited supply and a strong demand for rented accommodation, such as major cities and university towns.

Tenants' Deposits

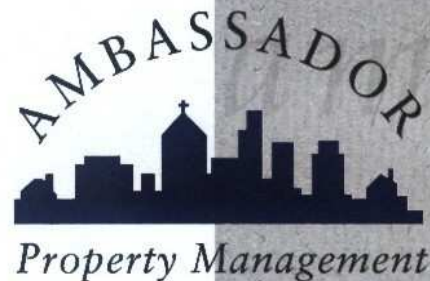
All UK landlords need to be made aware that from April 2006, only "approved" agencies or landlords will be permitted to hold tenants' deposits in a new government controlled Tenancy Deposit Scheme, to be formed under the 2005 Housing Act. Ambassador will, of course, be "approved", but it is unlikely that any of our landlords will be, so those whose properties we have let and the landlord is currently holding the deposit (mostly let only landlords), will need to lodge it with us before the end of March 2006. We will be writing to all these landlords with further details later this year.

Houses in Multiple Occupation

The 2005 Housing Act will create further regulations to be enforced by local councils, on properties where there is more than one "household" in residence. The Act will try to define a "household" more clearly, but we expect to still be uncertain as to whether friends sharing will be classified as one household. To date, it has been a regular practice by local letting agents to let properties to a group of sharers from 2 to 5 persons, whom are let a property under one Joint & Several Liability Assured Shorthold Tenancy Agreement. The Act may classify all of these groups as more than one household. We may expect the Housing Standards Section of local councils to carry out random checks of properties in their area, especially in Cambridge. Three storey properties let to sharers will definitely be classified as a HMO, so any current landlords whose properties fit this criteria may expect a call from their property manager later this year, to explore future options.

Buy-to-Lets

Property prices have finally started to level out – good news for first-time buyers perhaps, but what does it mean to those looking to invest in a second or further property on a buy-to-let basis?



Residential

Letting & Management

Repair & Maintenance

Investment & Sales

Survey & Valuation

Consultation



Chartered Surveyors



Association of Residential Letting Agents

Senior Partner:

Graham Clarke BSc MRICS MCH
ARLA (Ind)

Financial Consultant:

David Robinson FCA

General Manager:

Rosemary Tomlinson ARLA (Ind)

The irrepressible rise in property prices in Cambridge over the last decade has meant a windfall for some owners and investors, while others have struggled to get that first foot on the property ladder. But with most commentators predicting that prices have peaked and will remain stable for a few years at least, it's not immediately obvious how this impacts on buy-to-let investors. With house prices stabilising, it can seem less attractive to buy a property right at the moment – there's no quick return on your capital investment. However, when the sales market stagnates, it usually means the lettings market will pick up instead. So this all bodes well for the discerning investor in buy-to-let properties who is not looking simply to make a fast buck through a quick resale, but is looking at a longer term investment of five years or more and can appreciate the value of a good rental yield. For an example of how such an investment might work, take the purchase of a one-bedroom city apartment for £150,000. Buy-to-let lenders would normally be looking for investors to put down one-third of the total property value as a cash deposit. In this case, with a £50,000 deposit, the remaining mortgage of £100,000 could be arranged on an interest-only basis of 5.25% per year, resulting in an annual repayment of £5,250. As a general rule, lenders would expect property owners to be able to charge rent totalling 130% of mortgage outgoings before agreeing to such a deal. In our specific case, this works out at a rental value of £625 per month bringing in a total of £7,500 per year – or 5% of the total property value, a figure referred to as gross rental yield. Significantly, however, there has been a recent shift of policy among lenders, which will increase opportunities for buy-to-let investors. Many lenders now realise that buy-to-let investors are some of the most reliable clients they have. As a result, there has been a move towards lowering the proportion of rental yield in relation to mortgage repayments from 130% to 125% – meaning it's now easier for new investors to secure a loan on a second property on a buy-to-let basis. Clearly, it should be borne in mind by any investor that although rent from tenants may cover their mortgage, it is the owner who is responsible for expenses such as repairs and upkeep. Furthermore, property improvements can of course push up the rental value and in turn increase the overall rental yield. Another point to consider is that typically at any given moment, the gross rental yield decreases as a percentage as the overall value of a property increases. What this means is that the investor could potentially make better returns from renting out two properties bought at £150,000 each than from a single property bought for £300,000. With interest rates and property prices subject to general economic trends, there is no absolute guarantee of exciting financial returns for the buy-to-let investor. Nevertheless, it can still prove a very sound proposition for those willing to do their homework and bide their time. While the capital value of a buy-to-let property may not increase as dramatically as it might

have done in years gone by, we should also remember that it's never been cheaper to borrow money to make such an investment – and that can make all the difference in the longer term.

Maximising Profit by Minimising Costs

Minimising costs is a major factor in increasing income (or profit) to any business or individual. This may seem obvious but is sometimes overlooked. As a Buy to Let Landlord, one crucial factor in maximising profit, & hence income, is to ensure you are paying no more for your property finance than you have to. To help our Landlords ensure their costs are minimised in respect of any borrowing, we are able to offer the services of a completely independent mortgage broker, whom has access to the whole of the available mortgage market, plus any associated insurances you may need. To date, he has been able to save our Landlords an average of over £1,000 per annum in interest paid. Thus, less cost directly translates into more income i.e. an average of over £1,000 each year. If you wish to know more about this service, please call Graham Clarke directly on 07802 44 89 43.

P.S. Please note that this service is also available to review any residential mortgage(s) you, your family or friends may have.

Forecast for the remainder of 2005

The year has started more quietly than expected. However, by the end of February, the rate of enquiries by prospective tenants had started to increase. The forecast for the remainder of 2005 is for capital values to continue softening whilst rental values become more firm, and by the end of the year an anticipated 5+% uplift in rental values does not seem unreasonable.

This newsletter has been prepared from a combination of Ambassador's experience in the Cambridge market place and information in the public domain. However, no responsibility can be accepted for any errors or omissions in this newsletter.