

Bricks Should Not Blind You To Pensions

Property may not always be the most tax-efficient or secure investment for retirement. Pensions are also sturdy and attractive, writes Martin Haugh, managing director of HLD Actuarial Consultants Ltd.

Most of us work very hard and look forward to the day we can relax and enjoy some of what we have worked for all these years. With this in mind, more people are investing in property to fund their retirement. The 2003 Gunne report on The Residential Property Market claims that 76% of respondents said their investment objective was to provide a pension for themselves or their partner. This decision is often based solely on the recent history of strong returns from property, with little consideration of the alternative investment possibilities. Many investors, therefore, are losing out on some considerable advantages – in particular the taxation incentives offered to investors in pension plans.

For the majority of investors who are trying to accumulate a retirement fund, there is a need to start building up your pension fund at as young an age as possible. Only the minority with significant disposable incomes will be able to accumulate the large funds required to provide fully for their retirement. Even investors in their mid-30s need to contribute an estimated 15% of their income per annum to provide a pension of between one-half and two-thirds of their pre-retirement income.

For a typical married person retiring at 60, a pension fund of between €250,000 and €300,000 is required to provide a modest income of €10,000 per annum for life, with an allowance for a spouse's pension in the event of death. Very substantial levels of retirement savings are

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required to provide a comfortable retirement – in future, even larger funds will be required as inflation erodes the value of savings funds.

With such substantial commitments required to provide for retirement, many investors are investing in property and relying on these investments and the equity in their own homes to provide for that retirement.

One of the principal drawbacks of such an approach is that most property investment occurs outside the pensions environment and therefore does not benefit from the tax advantages associated with pension funds. For instance, the money used to fund a property purchase is taken from net income (income on which tax has already been paid), whereas any money paid into a pension fund benefits from full tax relief at the investor's higher rate. For example, a higher rate taxpayer contributing €100 to a pension fund will be able to claim €42 in tax relief. This means that your fund starts from a higher level on day one: a level that will attract growth in the future and hence accelerate the growth of the eventual retirement fund.

The tax advantages do not end there: while the fund is growing, there is no taxation payable by the fund. Over the life of a typical property investment, tax will be paid on rental income and capital gains tax will be paid when the property is sold.



Additionally, at retirement, 25% of a pension fund can be taken tax-free, with the balance available to provide retirement income. No such tax-free deal is available on a property purchase.

Recent investors in the property market have taken substantial loans to finance property purchases. Many of these are on an interest-only basis, which means that the full amount of the loan will have to be paid when the property is sold. So, while an investor may own a valuable investment property, the actual amount that can be realised after repayment of the interest-only mortgage is likely to be substantially lower. With the current low level of rental yields, such investors are increasingly reliant on significant capital gains to provide a return. Investors relying on these investments to fund their retirement need to ensure that they have sufficient time before retirement for these gains to materialise and provide the required level of retirement fund. While high levels of capital gains have been the norm over the last ten years, even the most bullish of commentators are predicting considerably lower levels over the next ten. An over-reliance on capital gains growth to provide a significant retirement fund may result in disappointment.

A structured approach to retirement

saving that makes the best use of the incentives that are available is likely to work best. The initial priority should be to secure a minimum level of retirement income that can then be depended upon should other more high-risk investments perform poorly. Typically, this will involve some level of contribution to an employer's pension scheme or a PRSA, where the premiums are invested in investment funds that are suitable for the investor's age and risk profile. There are many cleverly designed low-risk investment funds that give upside exposure to the investment markets while limiting downside risk. Once an investor has this base-level of pension coverage, they can then think about being more adventurous with future investments, either contributing higher levels to their pension fund (and choosing more high-risk/higher-return investment funds to invest in) or possibly considering non-pension investments such as buy-to-let property schemes or property syndicates.

Recent changes to pension legislation have meant that pension schemes have more freedom when it comes to borrowing to fund investments. Many investors – particularly those who have control over their own pension schemes, such as propriety directors – can enjoy the best of both worlds: they can borrow to fund property purchases and then place their

properties within their pension funds to enjoy the significant tax benefits. Insurance companies and investment brokers are putting together property syndicates specifically to take advantage of the expected increased demand for this type of product. Funding property purchases in this way can add up to 50% to the potential returns available.

Investing solely in property for retirement purposes, particularly if that property is your main residence or your only significant investment, can lead to disappointment if you happen to retire at a time when the property market is depressed. In this situation, unless you have other retirement savings on which to fall back, you may be forced to sell at an inopportune time, leading to a low level of retirement income.

As medical advances continue and society in general becomes more health-conscious, people are living longer in retirement than ever before. Therefore, tomorrow's pensioners will need even bigger retirement funds to provide for their longer lives. Underestimating the level of assets required to provide for retirement will force people to work for longer and retire with a lower standard of living.

Those choosing to bypass the taxation advantages of pension funds in favour of property investment should think carefully about whether they can afford to forgo the helping hand offered by the taxman. ■

Investing in property can lead to disappointment – especially if the market is depressed when you retire



Pensioners must take shelter under the umbrella of tax-efficient pensions.
Typically, a married person retiring at 60 requires a pension fund of
up to €300,000 for the modest income of just €10,000 per year.

