How To Find The Best Home For Your Pension Cash

A Day is coming. Noel Duffy looks at the proposed changes to pension legislation and the practical implications for would be investors in property.

The freedom to buy property with a pension aroused a great deal of interest, but will it be worthwhile and what's the best way to go about it – a fund or a straightforward buy-to-let?

Why should I put a property in a pension?

- The tax breaks will give a significant boost to the overall return.
- The property will be free from tax on rental income and capital gains. You also get tax relief on contributions paid into the pension.
- Hargreaves Lansdown has calculated that higher-rate taxpayers who used £150,000 of their pension money to buy a £200,00 property would earn an average annual return of 9.7% if they held it for 10 years. This assumes house price growth of 3%. If they just held the same property outside a pension, their return would be just 4.5% a year.

How easy will it be?

If you want to buy a property yourself, it won't be that easy. You will need a fairly large pension fund to purchases even relatively low value properties.

The new rules allow investors to borrow only up to half their fund value to buy an investment property. If you have a £100,000 fund you will be able to apply for a loan of £50,000, giving a total of only £150,000. Obviously many people will find this too restrictive. The average buy-to-let investor borrows 80% or more of the property price.

How much will it cost?

Running a SIPP is not cheap. Investors will typically use a self – invested personal pension (SIPP) to invest in property because they offer the greatest investment freedom.

On average it costs £290 to set up SIPP, then £455 a year in administration fees.

Each property transaction typically costs another £550 in fees to the SIPP provider and it will charge an annual property fee of about £600. That's nearly £1900 in the first year. Then there are legal fees and stamp duty on purchases made by the pension fund, plus mortgage charges.

If you transfer an existing buy-to-let into your pension you could also face a capital gains tax bill.

It gets even more expensive if you buy a holiday home. You will have to pay commercial rent to your pension fund if your family stay in the property for all or part of the year.

As an alternative, you can pay a benefit in kind tax to the Revenue. This is 40% of the market rent – but the proceeds go to the tax man rather than your pension fund. If the

holiday home is overseas you may still have to pay in the foreign country. There will be no skimping on costs because it is the duty of the SIPP trustees to manage the property properly.

So will property funds be a better way into the market?

Advisers say yes for most investors – although they should wait until after A-day.

Funds tend to be less risky because they invest in a spread of properties and typically require a much smaller investment. While you would need a fund of £100,000 to buy a £150,000 property directly, the minimum investment into the city living fund is just £20,000 and for that you would get a share of a spread of properties.

It should also be much easier to get in and out of a fund, although investors need to be aware of exit restrictions in particular the requirement to pay fund charges on top of any SIPP fees.

Are there any disadvantages to a fund?

Yes, if you want an element of control over the properties in your portfolio. A fund is likely to have a broad spread so returns may gravitate towards the average. Some investors will therefore want the freedom to use their local knowledge to pick growth areas.

The above advice is given in good faith. Individual circumstances differ, no action should be taken without regard to these personal circumstances. Accordingly, please consult your professional adviser. If you wish to talk to one of our partners or tax consultants, please do so. The first hour is free and without obligation.