Mortgage MONITOR

> "If you started with just two properties, in the 20th year you would have 16 without putting any more of your own money in. This would certainly make retirement a little easier."

# Mortgage monitor

## In this article Tony Taylor discusses some portfolio construction ideas and also some potential exit strategies.

**How things have changed since my last article. Interest rates have risen rapidly in the UK due to inflationary pressure; we have had the Tenancy Deposit Scheme enforced upon us, as well as the other wonderful invention – the Home Information Pack. Also, Dominic has probably found another five countries with great investment potential. It never gets boring in the world of property investment, does it?**

As Darwin said: "The only thing that is constant is change." He also said in his great book The Origin of Species, it will not be the fastest or the biggest animal that will survive, only the most adaptable. How true that statement is in relation to ants, rats and crocodiles.

We must apply this theory to ourselves as property investors. In changing times we have to be adaptable. If we set a course to financial freedom via the vehicle of property, we cannot be deflected from our mission just because interest rates rise, property prices fall, legislation increases or the social or demographic profile of our market changes.

We touched on a little taxation advice last time, but this time I would like to disregard the taxation element and leave that for you to have an extremely interesting conversation with your accountant. Suffice to say borrowed money is tax-free.

If you have a substantial amount of cash or equity in a residential property, you can use this as a deposit for multiple properties. However, these resources sometimes don't exist or soon become depleted. If that is the case then we need to build a portfolio using a combination of forced appreciation, capital appreciation, leverage and further borrowing. We like to call this 'rinsing' because we rinse the equity out of each property as we build the portfolio and leave none of our own money at risk.

Let's cover this in more detail. Forced appreciation is where we would 'force' extra value into the property, normally by refurbishment, reclassification of use or increasing the living space. This can sometimes be achieved in a couple of weeks. For example:

- We buy a property for £100,000 in a road where the ceiling price is £130,000. We put in new windows, central heating, new carpets, freshen up the paint and cut the grass. This costs us £10,000 and the house can now be re-valued at £130,000. So we have 'forced' in £30,000 of extra value.

  This can also be achieved by 'capital appreciation'. In this case we may not have to do any refurbishment at all as we have created the extra £30,000 by:

- Buying the property at below market value (BMV)
- Buying a property off-plan and seeing the value rise over the build period
- Buying a new-build property at a discount
- Buying a property in a hotspot area with a rapid price increase.

If we have managed to increase the value of the property by this margin we can then refinance the property and 'rinse out' our money that we originally invested. This would normally be at 85% loan to value, thus leaving 15% equity retained in the property. The magic number we need to work with is 1.18. Let me explain. We take the ceiling price of the property (£130,000) and we divide it by 1.18. For example:

- £130,000 / 1.18 = £110.170

So £110.170 is the maximum we can spend on buying the property and refurbishment. If we now multiply £130,000 by 85% (standard buy-to-let mortgage LTV) we get a figure of £110,500. In the example above, this means we pay off our original finance (or get our invested cash back) plus our refurbishment money.

We have now refinanced the property, created 15% instant equity, have none of our own money in the deal and we have our money back to move on to our next deal. We will repeat the process as many times as necessary to achieve the goal.

As this property goes up in value we effectively have an infinite leveraged return.

We are making money as the property rises in value long term and also potentially on a monthly basis if we have geared the property well enough to give some positive cashflow. But we have none of our own money invested (no money down). So this gives a demonstration of how we can build up a substantial portfolio by using the same start-up capital and 'dunking' it into each property and then 'rinsing' it out. This strategy relies on finding BMV properties (which is getting harder and harder) or investing in a property market where there is both a rapidly rising growth cycle and an efficient mortgage market. However, the fact remains that you can build a large portfolio with a little money.

How fast the property market rises would depend on how often you can repeat this process. But if you can 'rinse' the portfolio even every five years and double it up, if you started with just two properties, in the 20th year you would have 16 without putting any more of your own money in. This would certainly make retirement a little easier.

So when we have built the portfolio, how do we turn that into cash? One of the most popular ways is to sell all or some of the properties on retirement and move abroad, making use of the non-ordinary residence rules (speak to your accountant). This means as long as you do not return within five tax years you will not pay any capital gains tax.

> "Forced appreciation is where we would 'force' extra value into the property, normally by refurbishment, reclassification of use or increasing the living space."

There is another way. For example, if you had 10 properties, you could sell five and use the net proceeds from those to pay the mortgages off on the other five properties, thereby retaining all the rental income with no financing costs. This, of course, would only apply if you had interest-only mortgages on the properties or repayment mortgages that had not been paid off in full.

There is one important point to realise with an exit strategy from a portfolio: rental income is taxable, whereas (currently) borrowed money is not. So a really clever way to extract tax-free income from your portfolio would be to re-mortgage the properties onto a flexible drawdown account and then release equity as and when required. This would obviously increase the mortgage payments, but at this stage you have probably owned the property for a considerable amount of time and the rental income would have increased substantially. So you decrease your taxable profit from your property business by increasing your financing costs, but the byproduct of that is that you have tax-free cash. You could potentially continue to do this through your retirement years until the mortgage was back up to 85% LTV (where it started at) and then pass the portfolio on to your children before or on death, with an obviously much reduced inheritance tax bill. They could then continue the cycle again for the next 25 years.


**Reading this?**

**So are 20,000+ other readers so imagine what this space could do for you?**

If you are interested in advertising in the only FREE property magazine for the serious investor contact us for a media pack and receive some favourable rates.

**For further information call:**
**+44 (0)151 482 5551**
**or Email: info@jet-to-let-magazine.com**