MONEY

THE FALL IN HOME TRANSACTIONS IN JULY
41%
COMPARED WITH SAME MONTH LAST YEAR

RISE IN HOUSE PRICES ACROSS IRELAND
0.3%
IN THE YEAR SINCE JULY 2019. SOURCE: CSO

How to use property to build your pension

Investing your nest egg in bricks and mortar can yield a solid return — but be aware of potential hurdles before you leap, writes *Eithne Dunne*

While some pension investors will run a mile at the mere suggestion of putting money into bricks and mortar – among them surely former landlords sick of the hassle – for others it offers a rare degree of control and visibility. And despite the inherent risk of putting a chunk of money into one asset class, with values and rents proving resilient, it has the potential to put money to work.

"With increasing costs in the buy-to-let market, it looks like using a pension will become one of the main ways regular people will be able to buy investment property profitably," says Ralph Benson, co-founder of the investments platform Moneycube.

Pension buy-to-lets

Properties bought within a pension are exempt from income tax on rent. And while usually anyone who sells an investment property will pay a huge chunk of capital gains tax (CGT) – 33% – on any uptick in value, there is no capital gains tax if you do it in a pension.

Apart from the tax benefits, some are drawn to buy-to-let for less tangible reasons. "Some people feel they have no visibility over their pension," says Emer Kirk, head of business development and marketing at Harvest Financial Services. "They want a sense of ownership and control. With a buy-to-let they have that line of sight, and they can make the decisions on rent, when to sell."

Although buying a buy-to-let through a pension is tax efficient, it still incurs all the usual costs of buying and letting. There will be one extra expense, in that while you might not normally hire a property manager, you are obliged by Revenue to do so if buying from a pension. This should minimise the hassle that can often make buy-to-let less appealing, although it will not eliminate it.

Hurdles

There is an arm's-length stipulation; in other words you cannot buy a property that has any connection to you or those close to you.

"People want to buy a business premises, a holiday home or an apartment their children can use when they go to college," says Kirk.

Another issue is the fact that some people keen on a pension buy-to-let simply lack the funds. And while you can technically borrow via a pension, it can be a pricy – and risky – strategy, says Kirk.

"If someone comes in with €100,000 in their pension wanting to borrow to buy, we'd see that as off the scale in terms of risk. They would be overexposed if rental income or values fell."

If you do borrow, you pay substantially higher interest rates. It is "limited recourse" lending – in other words, the bank has no recourse to your other pension assets – and because of this there is a premium on the interest. You could be looking at rates upwards of 5%, which is far more than what you might pay on a regular mortgage.

"You'd have to select a property where the rent would be able to cover both this interest rate and capital repayments; it takes it into a whole different risk category," says Kirk.

You could investigate the Rental Accommodation Scheme, whereby you buy a property and enter into an agreement with a local authority, which will take a long lease and pay rent directly to you. You get slightly less than market rent, but it is guaranteed, and the local authority looks after maintenance.

Income or capital value?

While there is always hope that a property's capital value will increase, pension investors now are generally more interested in income. Rent varies hugely depending on what and where you buy.

"One person might pay €500,000 for a two-bed in Ranelagh and get €2,000 rent a month, while someone else might use it to buy two three-beds out by the M50, and get €1,500 a month on each," says Kirk.

A financial adviser will do cash projections that may help you weigh up the buy-to-let option against others, such as investing indirectly through property funds or real estate investment trusts (Reits). Kirk recently did two projections for a client with a pension fund of €1m. In the first, all the money would be left in multi-asset funds at an assumed 4% rate of return; in the second, €600,000 would go into a buy-to-let with an assumed net rental yield of 6%. The client was interested in the income, as opposed to capital value, and in this example they would run out of money at the age of 92 in the first scenario, while there would still be funds in their ARF on their 100th birthday in the second.

This may not be the case for the next person – and it is all dependent on what the actual yield and returns are – but it is a good place to start.

Peer-to-peer lending

Peer-to-peer (P2P) platforms such as Property Bridges or Initiative Ireland lend to a developer for a house-building or refurbishment project of your choice. These aim to get a decent return in a short space of time while helping tackle the housing shortage. The interest rate ranges from 7% to 9%, with most about 8%, with the typical term being 18 months. At the end, the initial amount plus interest is paid back into your pension.

The platform lists about two new investment opportunities each month. One of its latest is a social housing project in Dunboyne, Co Meath, with a 12-month term and an interest rate of 7%.

To get involved, sign up to the platform, supply details including the name of your financial adviser, the type of scheme you are in, and the name of the trustee, and it proceeds from there. There is no charge. If you do not have an adviser, Property Bridges can organise one for a 1% annual fee.

> **You cannot buy a property that has any connection to you**

Founder David Jelly says one of the reasons pension holders are drawn to invest in property this way is that there are few other options that are not heavily taxed.

"People are not incentivised to invest in the stock market, and the government doesn't encourage people to become private landlords either."

Initiative Ireland focuses exclusively on social and affordable housing, and pays 7%-8%. To invest, open a pension lending account, log in and see what projects you would like to support. You can choose how much to lend, and spread it across several projects if you wish. In many cases, you can view site videos from your chosen investment.

Its recent projects include Oakwood Park and Cluain Dara in Derrinturn, Co Kildare. It also funded an interesting social housing development for the Paddy McGrath Housing Project in Dublin 1, involving nine apartments and a training centre for those living with HIV/Aids.

Initiative Ireland charges a one-off set-up fee of 0.5%, but no annual fees.

Buy-to-let or P2P?

These are very different prospects, so speak to an adviser to figure out which might be best for you.

Lending money is the more passive option. "With buy-to-let, there's always the risk of your property being empty, and there's no obvious point at which you exit [the investment]," says Initiative Ireland chief executive Padraig Rushe. "What's nice about [the P2P] model is that you earn passive income of 7%-8%, your costs are relatively small, and the timeline is shorter."

And if it is social impact you want, he says your money will go further if you spread it around a bit.

"You could take your money, buy a house and let it to one family, or you could use it to help develop multiple homes each year."

On the other hand, lending is considered higher risk than purchasing a property yourself. "However, the returns would be higher as well, so you're getting paid for the higher level of risk," says Jelly.

Rushe says if you invest through Initiative Ireland you get at least 133% collateral security. "In other words, if you lend through us, for every €100,000 of value in a property, you are lending €75,000, whereas if you invest in one property the most collateral you'll have is 100%."

Property Bridges and Initiative Ireland say they do everything possible in terms of due diligence and risk reduction before presenting loan options – but they also make clear that there is always an element of risk involved. These are not regulated investments.

There will be a free webinar on pensions and property this Wednesday at 1pm as part of Pensions Awareness Week; pensionsawarenessweek.ie

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QUESTION OF MONEY

I have a personal retirement savings account that I set up about six years ago; I'm self-employed so every October I write a cheque for 25% of my earnings from the previous year (I'm in my early forties) into my pension account. Separately, I have saved up about €20,000, which is sitting in my bank account earning nothing. I'd like to direct this into my pension — is there any way I can do this and, if not, have you any advice as to what I should do with this money?

EW, Co Wicklow

As you are contributing 25% of your self-employed earnings into a pension each year before October 31, you are currently maximising your annual pension tax relief allowance.

From age 50, this allowance will increase to 30% of your earnings, then to 35% from age 55, and 40% from age 60 so there is excellent scope for contributing additional pension contributions at these stages and receiving tax relief at your marginal rate of income tax — that is 20% or 40% — on your contributions.

The maximum amount of earnings that can be considered for calculating tax relief is €115,000 per year.

As you are currently maximising your pension contributions, there is one other attractive scheme worth considering that can provide you with tax relief — the employment incentive investment scheme (EIIS).

It is a four-year tax relief incentive scheme providing individuals who have at least €5,000 of income at the higher rate the opportunity for income tax relief of 40%. This is achieved by a higher-rate taxpayer investing a minimum of €5,000 in certain qualifying Irish companies. It complements rather than replaces a pension.

An individual who pays income tax at the 40% rate in the year in which the EIIS investment is made can obtain tax relief on the following income: self-employment or PAYE earnings, income derived from property held in a personal capacity, distribution income from approved retirement funds (ARFs)/foreign income and Irish dividends. Tax relief on pensions is only allowed on earned income.

The 40% tax relief is provided in the year following the investment, and the investee company will provide a "promise" of a return after the four-year period for the use of the monies. Typically the return is capped as a percentage of the investment under most schemes.

However this scheme does carry risk. The company the investment is with must be under seven years old and must increase its employment levels in the four-year period. Some of these investments are regulated by the Central Bank of Ireland, however the majority are not, and therefore it is vital to consult your financial adviser.

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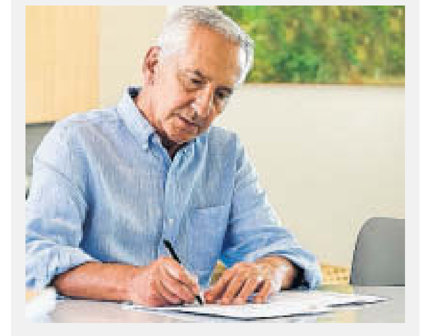
Send your personal finance or consumer-related questions to money@sunday-times.ie



Eoghan Gavigan

Die is cast for demise of defined benefit schemes

If I asked 10 people on the street how long they thought pensions had existed, what do you think they would say? Since the 1960s, the formation of the state, or Victorian times? Pensions have been around much longer, since the year 13BC when the first Roman emperor, Augustus Caesar, established a pension that granted a lump-sum payment of 13 times a legionnaire's salary to those who had served a minimum of 20 years in his forces.

Some speculate that the reason was to quell possible revolt by retired soldiers. Yet in AD6, Augustus even had the foresight to set up a fund called the "aerarium militare" to meet future liabilities. This arrangement would now be called a non-contributory funded defined benefit scheme.

Perhaps indicative of future problems, Augustus's scheme contributed substantially to military spending, which became one of the many reasons for the fall of the Roman Empire.

Despite being part of some workers' remuneration packages, it has been decreed that a defined benefit pension is a promise, not an obligation of the employer, and this promise can be broken without consequence. If the employer hasn't the will or, in the case of the Roman Empire, the ability to meet shortfalls in funding, the scheme creates only the illusion of security in retirement. While pensions have become more complex since Roman times, the principles are largely the same. The 20 years of service required to maximise the member's lump sum hasn't changed since the reign of Augustus, but a multiple of 13 times final salary may have been too generous.

Augustus may have overpromised because he projected that the percentage of workers who would collect such a benefit would be low, in such a dangerous occupation. Greater than anticipated longevity has proved to be part of the undoing of modern defined benefit schemes, too.

Life expectancies have increased in recent times because of advancements in medical science, thereby putting a strain on scheme resources.

Today's retirees receive a lump sum at retirement equivalent to only one-and-a-half times their final remuneration; not enough to motivate one to carry out the duties of a centurion, but a valuable staff-retention tool nonetheless.

Augustus paid the pension in full at the point of retirement, perhaps to prevent a coup. I regularly see the disappointment in a client's face when they are told that they have to place a portion of their pension in an approved minimum retirement fund, from which withdrawals are restricted for a period of time. I'm not sure if I would like to deliver the same news to a heavily armed centurion. Some 2,000 years later, we are still trying to design the perfect pension scheme. Like legionaries, our public servants are well catered for; less so for the general populace.

Defined benefit schemes are in decline, having become too big a draw on funds in recent years, and despite the generous tax relief on offer to savers in defined contribution schemes, not enough people have deferred their consumption to provide a replacement income for when their earned income ceases. Given the unsustainable nature of the state pension, plans have been afoot for several years to introduce auto-enrolment to stimulate saving. Yet the effects of the pandemic on employers will surely slow down progress.

If and when auto-enrolment does happen, under current proposals it will start with a combined worker and employer contribution of only 3% of qualifying earnings each year, rising to 12% after nine years. As such it is likely to be part of the solution only for younger workers, who have time on their side. It won't bridge the pension gap for most older workers, many of whom will be approaching retirement by the time it is fully operational.

Having been classified as a promise, the die has been cast regarding the demise of defined benefit schemes. In the future, they would be largely impractical anyway given worker mobility. Yet for many workers of a certain age, they still form a sizeable part of their retirement planning provision.

Nobody can force employers to maintain the funding of the schemes that remain and whose – mainly older – members won't have time to make alternative retirement provisions. Government supports granted to large companies in response to the pandemic could be made conditional on undertakings from them to keep their defined benefit promise.

Never waste a good crisis, as they say.

Eoghan Gavigan is a certified financial planner and the owner of bestpensionadvice.ie