

PROPERTY INVESTING FOR BUSY PEOPLE

PART
2

Seven Tactics to Optimize Your Portfolio for Multi-Generational Wealth

By **Jo Jamison da Silva**

Welcome back to my YPN series dedicated to helping time-poor investors buy more properties in the coming years. For anyone juggling multiple business interests, one of the biggest concerns that I hear about is their worry that they aren't doing enough in property to create multi-generational wealth. This article seeks to answer that question.

Everyone discusses the elusive goal of creating a portfolio for retirement and passing it on to their children. However, there is a lack of resources to help visualise the future of your portfolio and avoid potential pitfalls during ownership. Discussions rarely delve into numbers, with minimal emphasis on portfolio forecasting for 10, 15, or 30 years ahead, leaving many unsure about the number of properties needed in their portfolio and what their cashflow might look like in retirement.

Furthermore, the industry predominantly focuses on cashflow, advocating for rapid acquisition of properties and aggressive value enhancement through intricate and costly strategies, emphasising continuous fund recycling for portfolio expansion. But what are the long-term implications for multi-generational wealth following this path throughout one's career? And what path can people follow if they are hesitant about or limited in their capacity for such intensive work, especially those inclined towards investing in straightforward buy-to-let properties? What does their retirement look like? What might their children inherit when the time comes?

Imagine if you found the answer and you realised that you required fewer properties than initially assumed. This would undoubtedly provide you with a sense of assurance that you can achieve enough and can now relax and enjoy life a bit more with your loved ones.

To address these queries, I have analysed two distinct scenarios involving Rachel

and James, imaginary individuals who have independently developed their portfolios. While Rachel and James are fictional characters, their situations mirror real-life experiences that many can relate to. It's important to note that I am not a tax advisor or financial planner; I am merely extrapolating industry data on capital growth and inheritance tax.

Here's the portfolio that we'll base our two scenarios on:

- **Two separate investors, Rachel and James, have coincidentally built the exact same size portfolio. They've each separately bought 10 properties ranging from £115,000 to £180,000 in value each, so they've each separately created portfolios worth £1.39 million at purchase.**
- **They've both left their portfolios for long enough so that the GDV triples in value to £4.185 million over around 25 years¹.**
- **The value increase over time for both is £2.79 million and it is this value that inheritance tax (IHT) is based on.**
- **When the inevitable happens and their children inherit their portfolios, their children will have to pay an IHT bill of 40% of the value increase within 10 years of their passing. In this instance, they'd each have a separate IHT liability of £1.116 million.**

How will the kids pay for it? Through their own savings or, if they've been shrewd, from the equity that's been left in the property. But this is only if Rachel and James have made the right decisions in choosing the right location and the right asset management decisions whilst owning them.



Here's where we're going to explore their two very different scenarios.

Rachel

Rachel has opted to strategically maximise her portfolio by investing in high-demand areas, which we at Flex Property Education call hotspot postcodes, resulting in significant early capital growth. By promptly reinvesting all funds and maintaining a mortgage liability equivalent to the original purchase price of the properties (£1.39 million), she has decided not to release any more equity for the foreseeable future.

This deliberate choice to keep the mortgage liability constant over an extended period has gradually decreased her loan-to-value (LTV) ratio to 33% LTV, as the compounded inflation continues to boost the value of her portfolio annually. Maintaining a low LTV as her portfolio appreciates offers her family a significant advantage: even after the inheritance tax (IHT) is settled, her children will receive a more substantial inheritance compared to if alternative decisions had been made during her ownership.

James

James, unlike Rachel, has maximized his portfolio leverage to 75% of its total value. This decision stemmed from a combination of deliberate choices and circumstantial factors:

- **James made his purchasing decisions based on price. He bought very cheap property in very cheap areas because he thought he was getting more value for money. What he didn't realise was that by doing so, he was accidentally buying in low demand areas (they were low prices for a reason), which meant he didn't see the early surge in value that Rachel saw. This consequently meant that he was much slower to be able to release equity. Whilst Rachel released equity quickly and left compound inflation to erode the debt, James didn't have this option available to him, so his LTV remained high throughout the rest of his ownership.**



- He made no provision for funding for replacing items in the properties such as boilers, kitchens and bathrooms and had to refinance his properties to secure the additional funds required.
- For certain HMOs in his portfolio, he obtained loans based on higher commercial valuations. However, upon passing these properties to his children, they were revalued at lower brick-and-mortar values, resulting in lower equity overall.

Regardless of the rationale behind his actions, James is leaving a highly leveraged portfolio with a 75% LTV ratio to his children, in contrast to Rachel's 33% LTV and he passed down to his children a mortgage liability of £3 million.

What's left after inheritance tax is paid?

James' high gearing sets his children's future story apart from that of Rachel's. Her portfolio has accumulated equity of £2.790 million, while James' equity stands at £1.046 million. Despite the seemingly large amounts, after factoring in the IHT due for both investors at £1.16 million

(40% of the value created), James' portfolio falls short in covering his IHT obligation. His children will need to sell the portfolio to settle the £1.16 million IHT bill and still face a deficit of £69,000 which they need to pay.

In contrast, Rachel's children can cover the IHT through refinancing the portfolio. Doing so at a 75% LTV ratio would generate £3.139 million, enough to settle the historic mortgages (£1.39 million), clear the IHT (£1.19 million) and leave £627,750 from the portfolio remortgage for other uses.

These scenarios illustrate real-life situations of people we have spoken to. They are the children of the James' of this world, who are now in their 50s and 60s, have inherited portfolios worth millions but are forced to sell up due to the financial constraints arising from decisions made during their parents' ownership.

It is heart-breaking to hear of such stories which were effectively down to poor planning by the owners. There are however ways to reduce the risks of this happening to you.

The Two Different Scenarios of a £4.185 Million portfolio upon inheritance

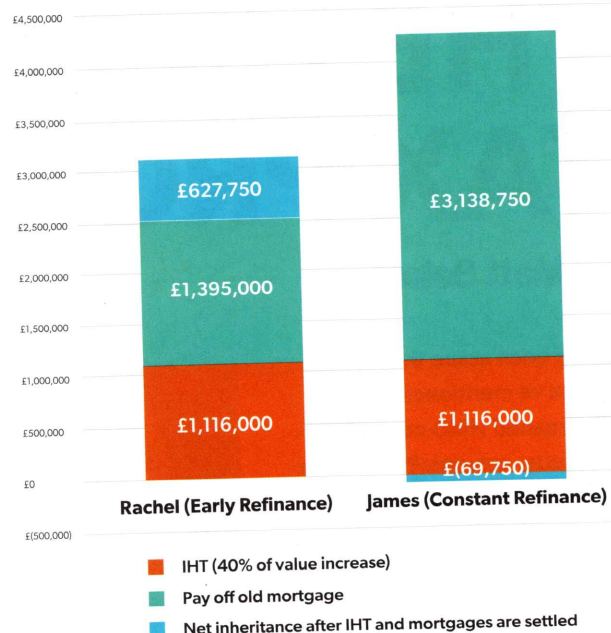


Table to show the comparable scenarios:

	Rachel	James
Scenario	Early refinances	Constant refinances up to 75% LTV of end value
Starting value of portfolio	£1,395,000	£1,395,000
Value of portfolio upon inheritance	£4,185,000	£4,185,000
Mortgage liability upon inheritance	£1,390,000	£3,138,750
Equity available	£2,790,000	£1,046,250
Value created in the portfolio (end value minus purchase price)	£2,790,000	£2,790,000
IHT (40% of value created)	£1,116,000	£1,116,000
Net equity remaining after IHT is paid and all mortgages are settled	+£627,750	-£69,750

How to be more like Rachel?

Here are seven tactics to maximise what is left for future generations:

- 1 Opt for properties in high-demand locations to capitalise on initial growth and let the portfolio appreciate steadily through compound inflation. If you need help on this, we at Flex Property Education can assist you on finding those high demand hotspots that typically see surges in value due to simple supply and demand economics.
- 2 Release equity early on and avoid the temptation to repeat much later in ownership.
- 3 For HMOs, consider the long-term effects of releasing equity by obtaining commercial valuations. Plan the exit strategy for these assets meticulously to account for potential lower valuations without proper planning status.
- 4 Conduct renovations with foresight to minimise future maintenance costs.
- 5 Establish a maintenance fund from rental income to cover future replacements like bathrooms, kitchens, and boilers without relying on refinancing.
- 6 Manage assets strategically by investing in high-demand areas that consistently yield higher rents, allowing for increased profits for reinvestment or retirement.
- 7 Seek advice from a regulated tax professional to structure your portfolio effectively for future generations to enjoy.

If you've enjoyed reading this article and would like to find out more about these tactics, please don't hesitate to get in touch. I'm always happy to chat.

Contact

If I can be of any help in your property journey, please don't hesitate to get in touch.

Jo Jamison da Silva

Flex Property Education

clients@flexpropertyeducation.co.uk

