'Don't pin all your hopes on property'

By Neesa Moodley-Isaacs

The high returns on residential property between 2003 and 2008 may prompt you to wonder why you should risk your retirement savings on shares when you could potentially earn more from property. At the last meeting of the acsis/Personal Finance Financial Planning Club, Shaun Latter of acsis pointed out that you should not be relying on just one asset class for your retirement.

After its recent downturn, residential property looks set to rise again and, because of the phenomenal returns this asset class was providing a few years ago, you may be considering buying property to fund your retirement. However, Certified Financial Planner Shaun Latter of acsis warns against relying too heavily on property as a retirement investment.

According to the Absa House Price index, nominal (before-inflation) house prices are set to rise by about six percent this year, after a year of declining prices in the residential property market.

But beware: the price increase does not imply a return of the boom years of 2003 to 2008, when house prices doubled and even trebled.

Latter says: "To understand the long-term behaviour of property prices, or any asset class for that matter, you should first step back and take a look at the long-term history, of at least 30 years. This would take us back to about 1980."

Looking back, house prices lagged inflation for many years before a huge uptick in 2003.

"The lack of public confidence and resultant lag in house price movements can be attributed to a number of political factors," Latter says. "First, in 1985, sanctions were imposed on South Africa.

"Then, in 1990, Nelson Mandela was released from prison and a number of South Africans thought it was the beginning of the end for our country.

"In 1994, the ANC came into power and Mandela became president, something that seemed to further compound the negative sentiment. Many people were loath to invest in an asset of such a fixed nature, opting for more liquid options that allowed them to be more 'light-footed'.

"In 1998, the prime interest rate (which determines home loan rates) shot up to a high of 25 percent, leaving the average consumer stretched to the limit and, in some cases, unable to service the debt repayments on their homes.

"Then in 2003, almost 10 years after our first democratic election, sentiments changed and people became more positive about our government and the future of the country. After two decades of house prices lagging inflation, property was cheap in relative terms. This, coupled with a more positive outlook and very low interest rates, meant that it was not long before people started buying up property, fuelling the boom that was to come," he says.

Latter says that during this period, many who saw the opportunity bought second and even third residential properties, renting them out to earn income and, in the process, enjoying capital
appreciation far exceeding the norm.

However, over the 30-year period, from 1980 to the end of 2009, residential house prices beat inflation by only 0.75 percent a year.

"If you look at residential property as an asset class, then, according to the Absa House Price index, it has delivered returns of nine percent a year over the last five years, 15 percent a year over the last 10 years (bearing in mind that this period includes the boom of 2003 to 2008) and 11 percent a year over the last 30 years," he says.

Comparing this performance with other asset classes, the JSE All Share index (Alsi) has given investors annualised returns of 20 percent over the last five years (even after a disastrous 2008), 15 percent over the last 10 years and 18 percent over the last 30 years.

Government bonds, on the other hand, have given investors lower returns of seven percent over the last five years, 16 percent over the last 10 years and 14 percent over the last 30 years.

If you had put your money in cash, your returns over the past 30 years would have beaten the returns you would have earned from residential property.

Latter points out that listed property (in the form of property unit trusts on the JSE or property companies with retail and commercial space) is a different animal entirely from residential property. It has out-performed all other asset classes over the five- and 10-year periods and has closely matched Alsi returns over the full 30-year period.

"It comes as no surprise that these two asset classes are equally regarded as 'growth assets'," Latter says.

As with any investment you make, when you are deciding on whether or not to invest in property for your retirement, there are three factors you have to consider: risk, taxation and liquidity, he says.

Risk
Residential property has a very low volatility and can potentially earn you very high returns. If you invest on the stock market, you can get good returns, but you are exposed to more volatility. This does not mean residential property doesn't have other risks.

"What most people don't consider is concentration risk. One of the golden rules of investing is that you should always diversify your investments instead of putting all your eggs in one basket," Latter says.

He says there are about 400 stocks listed on the JSE. Faced with such a choice, you are unlikely to choose and invest in only one company.

"If you look at residential property - and just consider the website www.myproperty.co.za - there are about 75 000 properties up for sale.

"You are going to invest in one property, one street, one suburb, one city. Why would you pin all your retirement savings on just one property?" he says.

In addition to this, and remembering that residential property is more of an income asset, the 'returns' are highly dependent on the diligent rental payments of your tenant. According to the National Credit Regulator, only 41.2 percent of 18.1 million credit-active consumers are in good standing. This leaves the majority being denied credit by banks to buy properties, and being forced to rent. "In essence, you may be accepting risk that the banks deemed unpalatable. This, coupled with strengthened tenant rights when it comes to eviction, is a cash-flow risk that should definitely not be overlooked," Latter warns.
Taxation
You need to think about how the South African Revenue Service (SARS) will tax an asset in which you invest, Shaun Latter says.

When you buy property as an investment, SARS will treat you in one of two ways: as an investor or as a trader.

A property investor’s intention is to receive rental income, and the investor is likely to hold the property for a long period.

When a property investor sells the property, he will pay capital gains tax (CGT) at a maximum rate of 10 percent.

A property investor also pays income tax (at his marginal rate of tax) on the rental income he receives from the property.

A property trader, however, buys a property at what he or she regards as a low price, with the hope of selling it in the short term at a profit. The sale of the property in the case of the trader is regarded as a revenue receipt. In this case, the property trader will pay income tax on the sale at a maximum rate of 40 percent.

Both property traders and property investors can get tax concessions on costs associated with the purchase and sale of the property (such as the estate agent’s commission) and any capital or infrastructural improvements made to the property. This can include maintenance costs, such as fixing a burst geyser or painting the boundary walls. You can also write off the interest on your mortgage bond against any income you receive from the property.

"While there may be tax concessions when investing in a residential property, it still remains relatively "tax heavy". It does not compare well with, for example, retirement funds, where the premiums you pay are tax-deductible, there is no tax levied on the capital growth and the fund is excluded from your estate for estate duty purposes," Latter says.

With a residential property, on the other hand, when you die, your estate will have to pay estate duty on the property after your estate duty exemptions have been taken into account.

Liquidity
"Liquidity refers to how quickly or easily you can withdraw funds from an investment," Latter says.

He compared residential property with an endowment policy, a collective investment scheme (such as a unit trust) and retirement funds.

An endowment policy has limited liquidity, because in the first five years after taking out the policy, you may be limited to taking one loan and making one withdrawal. After the first five years, the funds become totally liquid and any withdrawals (in part or whole) become available within about eight days.

Latter says that a collective investment scheme is fully liquid. You can make withdrawals (in part or whole) at any stage, although you may have to wait up to five days to receive the funds.

Retirement funds have limited liquidity, and your money is generally tied up until you reach retirement age (usually 55), although you can opt to leave your money invested for a longer period.

"A residential property also has limited liquidity. If you want to get your money out of the property, you have to sell it. It's an all-or-nothing deal and the time constraints are unknown, as
the sale of your property is dependent on a 'willing buyer, willing seller' transaction. Your property could be on the market for anything from a few weeks to a year," Latter says.

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