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Chartered Accountants & Business Advisers

Alternatives to savings accounts

With cash ISAs offering low rates of return, how much risk is involved in making your cash grow?

It's well-known that returns from traditional cash ISAs have dropped dramatically over the past decade. The interest rates offered by savings account providers are dismal.

These days it's rare to find an ISA paying more than 2% a year, even on five-year fixed accounts. Rates on easy-access ISAs are even worse, with many paying little over 1% a year.

With cash ISAs now generating such measly returns, those who are interested in earning decent returns on their savings might now be wondering what other options are available.

What are the options? What kind of returns can you expect? And how much risk is involved compared to simply holding cash? This guide will explore the alternatives to savings accounts.

High-interest current accounts

There are several high-interest current accounts available from high street banks. Rather than your money in a 1% fixed-term ISA, you can receive rates of up to 5% a year by depositing into one of these current accounts. However, be prepared to pay monthly fees in return for access.

Most providers will place a minimum monthly deposit amount on high-interest accounts. This can range from £500 to over £1,000. These accounts will therefore only be suited to those who offer a guarantee of making the minimum monthly deposit.

Another condition to watch out for is the maximum balance upon which interest is payable. Many providers will only pay the high rate of interest on balances of up to £2,500. Exceeding this maximum threshold can cause the interest rate to drop significantly.

Be sure to check whether the advertised rate of interest is fixed. Many accounts pay a high rate as merely an introductory offer, before falling after 12 months.

Peer-to-peer lending

Peer-to-peer (P2P) lending activity has seen a marked increase over the past decade. Also known as crowdlending, this new and innovative form of capital investment can generate returns far exceeding those from your humble cash ISA.

Online P2P firms act as intermediaries between savers looking for a good return on their money and borrowers who are seeking capital for personal or business purposes.

These platforms enable people to borrow and lend outside of the traditional banking system, which works to both the creditor and the borrower's advantage. The borrower pays a lower rate of interest, while the creditor enjoys a higher return. The rate of return will be determined by risk: the lower the credit rating of the borrower, the more interest you will earn (and vice versa).

It's critical to know the company's policy on credit defaults. P2P lending is not covered by the Financial Services Compensation Scheme, so you cannot assume to be subsidised in the event of the borrower defaulting.

Some P2P firms provide compensation for defaults but some do not. These firms will offer higher rates of return for the additional risk involved. Should you choose one of these P2P firms, it is extra important that you carefully consider who you lend to.

Alternatives to savings accounts

Investment funds

If investing directly in the stock or bond markets isn't for you, open-ended investment companies (OEICs) and unit trusts may be an option.

These collective investment schemes operate by pooling the capital of multiple investors into a shared fund. This allows you to avoid the high level of risk associated with investing directly in the stock market by spreading it among a potentially unlimited number of investors.

Investment funds can own a variety of assets, the most common of which are stocks and shares, and corporate and government bonds. All investment funds carry a degree of risk and you will need to choose the level of risk that suits you.

An additional benefit of investment funds is they are administered by either a fund manager or an authorised corporate director. Having a professional at the helm removes the time and expertise that would otherwise be required for direct stock or bond investment.

Returns from unit trusts and OEICs come in two forms: **income** and **accumulation**. Accumulation will see your returns reinvested into the fund (thereby increasing your capital investment), while income will pay you any returns unless you opt to reinvest any income and dividends from the funds.

Unit trusts v OEICs

	Unit trusts	OEICs
Structure	Unit trusts sell units of a fund	OEICs sell shares of their investment company to investors
Price	Unit prices offer two prices (bid and offer) to buyers and sellers	OEIC share prices have a single price which will rise and fall in line with the assets in the fund
Management	Fund manager	Authorised corporate director

Buy-to-let

Those who are aiming to invest over the long term may consider becoming a buy-to-let landlord. Renting out a house can be profitable – both in terms of rental income and capital growth should you sell it at a profit.

You should take your time researching both the market and the property, thinking carefully about your target demographic and your budget. Additionally, drawing up financial forecasts and contacting letting agents will increase your chances of accessing a buy-to-let mortgage.

When thinking about your potential expenditure, make sure you factor in the following:

- survey fees
- solicitor fees
- mortgage costs
- maintenance costs
- refurbishments
- building insurance
- landlord insurance
- letting agent fees.

On top of this, investing in property has the capacity to produce large tax bills. The three most important taxes to account for are:

- income tax
- stamp duty land tax (or land and buildings transaction tax in Scotland)
- capital gains tax (when selling the property).

Recent changes to mortgage interest tax relief

The beginning of the 2017/18 tax year saw the introduction of a new restriction on mortgage interest tax relief for buy-to-let landlords.

Before 6 April 2017, landlords were able to offset all of their finance costs (such as mortgage interest) against their property income and pay tax at their marginal rate on the difference.

However, this tax relief is now being gradually phased out. For example, in the current tax year, landlords can now only offset 75% of their finance costs against their property income; the remaining 25% is charged the basic rate of tax. By 2020 all finance costs will become taxable at the basic rate.

Tax year	Proportion of finance costs deducted from property income	Proportion of finance costs taxed at the basic rate
2017/18	75%	25%
2018/19	50%	50%
2019/20	25%	75%
2020/21	0%	100%

Contact us to discuss your savings and investments.

Important Information

The way in which tax charges (or tax relief, as appropriate) are applied depends upon individual circumstances and may be subject to change in the future. ISA and pensions eligibility depend on personal circumstances.

This document is solely for information purposes and nothing in this document is intended to constitute advice or a recommendation. You should not make any investment decisions based upon its content. The value of investments can fall as well as rise and you may not get back the amount you invest.