

*Bentley Holmes*

Mortgage & Protection Advisers



Buy to Let Guide

It has now become common for a buy to let property to form part of an individual's investment portfolio. Property has always been easy to understand in that it is tangible and therefore has made it easier for an individual to see the value their asset holds.

In truth though buy to let property has become far more complicated with changes in legislation, there is greater variety of product available from the lenders and more investors in the market place.

This guide is aimed to help you consider the right choices before adding new or further buy to let property to your investment portfolio.

## Where to begin

When you purchase your first buy to let you are become a landlord and will be running your own business. You will require a Buy to Let mortgage which is used to purchase the property that is to be rented out as a source of income.

Finding the right property is key to the success of your long term investment strategy. You will need to research the size and type of property, having a comprehension of what is in demand and what rental income you can expect to obtain. It is worth getting advice from experienced letting agents who will know the local market and where such demand lies. 'Often I find my clients start with their first purchase in the area where they live as they now this market.' It is important to consider the source of your funding to have an indication of what you may be able to borrow which will enable you to focus your time on properties within your budget. In the current market since the Credit Crunch of September 2007 funding can dictate what is possible more than any other factor.

## Research

You can do this either yourself or by employing a specialist search agent to help you find the area and property type you require.

It is important to gather as much information from as many different sources, such as estate agents, letting agents, newspapers, internet, local authorities etc. to gain as much knowledge of the area and the possible demand of the property rental market.

This is even more important in an area away from your own routes and knowledge, for example living in London and buying in Leeds.

## Choosing Location

Good transport links and schools / universities may be important to tenants, so it is worth looking into properties with these services close by.

## Mortgage Options

It is imperative you seek Impartial Financial Advice to ensure you have the most suitable mortgage product for your purchase.

The term of a buy to let mortgage can be between 5 and 40 years, usually to a maximum age of 75.

Property and tenant type can affect the borrowing options and lenders available.

Limited Company buy to let mortgages are available, although since the Credit Crunch the number of lenders offering this type of loan is far fewer.

Buy to let mortgages, unlike residential mortgages, are generally not calculated as a multiple of income but based upon the achievable monthly rent against the interest only mortgage payment, taking into consideration potential rental voids.

Buy to let mortgages are available to first time buyer although a different criteria is often applied.

## Choosing a mortgage

- Consider what type of mortgage you would like to buy the property with
- Consider the impact of future rises in interest rates
- Consider how you would meet monthly mortgage payments if the rent was not paid or the property was empty.

We advise you to spend as much time necessary with us to ensure you choose the

## Lenders

Historically buy to let mortgages have been available up to 85% loan to value but since the Credit Crunch loan to values have been reduced by the lenders with 75% being the market average. Again the number of lenders offering buy to lets is far fewer in today's market.

The rental income you receive from your property is taken into account and the rental should be equal to between 100% - 130% of the monthly mortgage dependent upon each lenders criteria. It is sensible to use 125% as a benchmark. The usual increase in rental versus mortgage payments is to cover other associated expenses with your buy to let, such as letting agents fee, service charges for flats, potential rental voids.

Your lender will expect the tenant to hold an Assured Short Hold tenancy agreement with you and it is usually recommended that you use a letting agent for this although it is not a lending requirement.

## Loan types

All types of mortgage are available, from fixed rates and discounted rates to base rate tracker loans.

Highly competitive fixed rate mortgages tend to attract a high arrangement fee where higher rates would tend to have lower fees. Arrangement fees tend to range between £799 to as much as 3.5% of the loan amount.

Fixed rates are priced against swap rates not against Bank of England Base Rate, but against LIBOR. If LIBOR is considerably more expensive than Bank of England Base rate this can lead to much higher fixed rates than tracker.

Discount and Tracker rates are both variable rate types and are generally aligned to either the Lender's Standard Variable Rate (SVR) or Bank of England Base Rate. When considering these variable rates investors should factor in potential interest rate rises.

## Gearing or Refinancing

This is the process of remortgaging a property to release capital to make further purchases.

Historically property prices have risen and dependent upon values at any one given time there could be an opportunity to release equity from your property to help you grow your portfolio.

## Void Periods

This is a period of time when the property is not let and otherwise vacant, meaning that there is no rental income and therefore the mortgage payments need to be paid for from your own resources. It is sensible to have a contingency should you have any void periods.

## Type of property

- Flats – typically 1, 2 and 3 bedrooms.
- Houses

Some lenders may not lend on certain property and tenant types which could include:

- Bedsits
- Studio flats
- Flats above commercial premises
- High rise flats
- Ex local authority property
- Houses in multiple occupancy
- DSS tenants
- Corporate Lets
- New Build flats

Each lender has their own criteria and target market, we recommend you speak to us so you are aware which lenders will be able to lend on the property you want to purchase.

## Costs

There are various costs associated when you let a property and you should consider these to ensure that you are not making a loss against the rental income. These costs are in addition to any mortgage payment and can include:

- Letting agents fee (typically 15%)
- Insurance premiums
- Repairs / Maintenance
- Contingency for Void Periods
- Accountants Fee

Don't forget if you are purchasing a buy to let you also have the usual costs associated with purchasing the property:

- Lenders arrangement fee
- Survey fee
- Stamp duty
- Solicitors fees and associated conveyance fees
- New Build flats

Each lender has their own criteria and target market, we recommend you speak to us so you are aware which lenders will be able to lend on the property you want to purchase.

FCA does not regulate Solicitors or Surveyors.

## Letting agent

Your letting agent will usually offer you a menu of services and either will charge for finding the tenant or both finding the tenant and managing the property.

## Insurance premiums

These can include building and contents insurance, rental cover insurance if tenant defaults, legal expenses cover to ensure solicitor or barrister fees are paid if you have to take a tenant to court.

## Repairs / Maintenance

With safety standards today it is imperative that properties are maintained accordingly, safety certificates need to be in place. Unforeseen repairs may be required.

## Accountants Fee

As you are now running your own business and you are generating an income you will need to file a return to HMRC. To ensure that you receive the best advice you should use the services of a qualified accountant.

## Tax

Whether you are purchasing your first Buy to Let or you have a portfolio it is imperative you have an accountant who can advise you of the current legislation surrounding your tax affairs.

It is possible to offset certain costs against the rental income to help reduce your income tax liability.

After the budget of April 2016 it was confirmed that the tax treatment of Buy to Let properties will change.

Over a 4 year period the level of mortgage interest you can offset against the rental income will reduce by 25% per annum and therefore profits will be liable to income tax. It is now more important than ever to seek advice from a qualified Accountant.

Please note that Bentley Holmes Limited are not tax advisors and therefore we cannot give you tax advice. If you do not have an accountant, please go to our website and our Links page for a number of recommended firms.

## Capital Gains Tax

You may be liable to pay Capital Gains Tax (CGT) at a rate of 18% on any profit you make from the sale of your Buy to Let. Calculating CGT you can usually deduct from the gross proceeds the original purchase price of the property together with the associated costs of buying and selling the property. It is also possible to take into account capital improvements made to the property during the period of ownership.

Please ensure that you retain all receipts to help your accountant determine what CGT liability you may have.

CGT must be paid by 31st January after the end of the fiscal year to which the gain relates.

You do have an annual CGT free allowance which is £11,100 for the tax year April 2016 /2017.

## Tenants

Choosing the right tenant is important and this should have formed part of your consideration when researching the area in which you highlighted to purchase your property.

Are you looking to attract single people or families, professionals or Council tenants or even students?

Your lender will require you to have an Assured Short hold Tenancy agreement usually for 12 months with a 6 month break clause. The tenancy agreement will need to confirm the name of the landlord(s) and tenant(s), property address and rental amount.

The agreement must also include the conditions of use which are the basic rules that the tenant must adhere to, for example smoking, keeping of pets. This also outlines tenants' rights and responsibilities, who is responsible for insurance cover, damage and repair of utilities.

The tenancy agreement is signed by all parties.

Your letting agent will usually take care of the tenancy agreement for you but you can always ask your solicitor to ensure it is correct and legally binding.

## Tenancy Deposit Protection

This is mandatory in the UK for landlords from April 2007 and there are heavy penalties for non compliance.

## Tenancy Deposit Scheme

Regulated by letting agents, it is an insurance based deposit and dispute resolution scheme, open to all landlords and letting agents. A fee is payable to insure the scheme against any misappropriation of the deposit.

[www.tds.gb.com](http://www.tds.gb.com)

## Tenancy Deposit Solutions

Set up by the National Landlords Association, it is an insurance based scheme, open to all landlords and letting agents. A fee is payable to insure the scheme against any misappropriation of the deposit.

[www.mydeposits.co.uk](http://www.mydeposits.co.uk)

## Deposit Protection Service

This is an insurance based deposit and dispute resolution scheme. It is open to all landlords and letting agents. The service is funded from the interest earned from deposits held. [www.depositprotection.com](http://www.depositprotection.com)

## Houses of Multiple Occupancy (HMO's)

New regulations under the Housing Act 2004 have brought in changes and there are a number of criteria by which now your let property could fall into the category of a HMO. These criteria are as follows:

- An entire house or flat which is let to 3 or more tenants who form 2 or more households and who share a kitchen, bathroom or toilet.
- A house which has been converted entirely into bedsits or other non self contained accommodation and which is let to 3 or more tenants who form 2 or more households and who share a kitchen, bathroom or toilet.
- A converted house which contains 1 or more flats which are not wholly self contained and which is occupied by 3 or more tenants who form two or more households.
- A building which is converted entirely into self contained flats if the conversion did not meet the standards of the 1991 Building Regulations and more than one third of the flats are let on short term tenancies.
- In order to be a HMO the property must be used as the tenants' only or main residence and it should be used solely or mainly to house tenants. Properties let to students and migrant workers will be treated as their only main residence and the same will apply to properties which are as domestic refuges.

You may require a licence if you answer yes to any of the following questions:

- Do you rent out property?
- Does your property have 3 or more storeys (including habitable attics and basements??)
- Does your property have 5 or more unrelated tenants?
- Are any of your tenants unrelated to each other?

It is not unusual for each local authority to have their own interpretations and therefore it is essential you speak to the local authority in relation to where you pay the council tax for the let property to determine if you require a licence.

Currently failure to have a correct licence can result in a fine of up to £20,000 and is a criminal offence.

This information was taken from the Government website and for further information please refer to [www.communities.gov.uk/corporate](http://www.communities.gov.uk/corporate) or contact your local authority

## Legal Considerations

- Obligations to the tenant(s)
- Obligations to third parties

## Obligations to the tenant(s)

- Gas safety regulations 1998 (installation and use).
- Furniture and Fittings regulations 1988 under Fire Safety.
- Although there is no legal requirement all electrical appliances must be safe.
- Electrical works carried out in the property must comply with Building Regulations under Part P of the 2000 regulations.
- Housing Health & Safety Rating System (HHSRS) part of the Housing Act 2004.
- A general duty under Defective Premises Act 1972 to ensure that the tenant and their guests, including personal property are safe from harm.
- Protection from Eviction Act 1977.

## Obligations to third parties

- The landlord must inform the Inland Revenue in the first year of purchasing a property to rent, that it is for that purpose and no later than 5th October of that year.
- You must request a tax return and file this by 30th September for HMRC to calculate. For self assessment you must file your return by 30th September for paper based returns and 31st January if online.
- A licence is required if housing is 3 or more floors.



# Advantages and Disadvantages of buying a Buy to Let Property

## Advantages

- Long term investment which can lead to possible profit
- Low interest rates making rental yields higher
- Provides a potential income stream from rental income
- Potential to increase value in the property by renovating and extending
- Tangible asset which can give better sense of real asset value
- Diversification to stock and share portfolio investments
- Can reduce tax liability if correctly structured

## Disadvantages

- Fewer mortgage products available providing a limited choice
- Rental demand may be lower in low interest rate environment
- Cost of ongoing maintenance
- Bad tenants – failure to pay or damage to property

## Business Considerations

Remember as expressed at the start of this guide when you purchase a buy to let you are starting your own business.

You should consider if this is a long term or short term investment. Long term investments would be considered at least 5 years but more likely 10 years and more. A long term investment has a better chance of overcoming fluctuations in the market giving potential to capital growth. Short term investments should be where there is scope for adding value to the property increasing capital value and being able to overcome fluctuations in property prices.

Remember to consider all the costs involved, it is not as straight forward as deducting your monthly mortgage payment from the rental income to provide a profit, as explained already there are lots of costs associated with owning a buy to let property.

Try to avoid properties with huge maintenance considerations unless you are able to fully take these on board. Gardens can be considered as a huge maintenance, can you afford a gardener?

Make sure you have a legally binding tenancy agreement, avoid using 'off the shelf' agreements. Remember to have your solicitor look and the tenancy to ensure it is binding.

Before the tenant occupies the property ensure that all correct documents have been issued and signed by all parties including a condition report and precise inventory.

Before buying your property and arranging your mortgage speak to an accountant to confirm the best way of structuring your purchase, either in personal names or a limited company.

If you are not going to manage your property yourself ensure you have a managing agent, remember this service will cost more but the letting agent will be experienced at doing this and able to collect your rents on time.

Make sure all your insurances are valid and in place.

## Further reading material

There are many places where you can find further information about buy to let property but the following are considered sensible starting points:

- ARLA – The Association of Residential Letting Agents – this is the professional self regulating body solely concerned with residential lettings – [www.arla.co.uk](http://www.arla.co.uk)
- NAEA – The National Association of Estate Agents – [www.naea.co.uk](http://www.naea.co.uk)
- BPF – The British Property Foundation – [www.bpf.org.uk](http://www.bpf.org.uk)

## Disclaimer

The guide is for reference purposes and you should make your own research in addition to this guide. Bentley Holmes Limited cannot be held responsible for any purchase that you decide to make nor can it be held responsible for any of the ongoing considerations of your property. You are responsible to ensure that your property is adequately insured and that all legal considerations have been undertaken. You are also responsible for your own tax affairs.

**Your property may be repossessed if you do not keep up repayments on your mortgage.**

For mortgage advice we can be paid by commission from the lender or we can charge a fee of typically 0.5% of the loan amount.

The information and content of this guide is intended for UK consumers only, and is subject to the UK regulatory regime. The FCA do not regulate will writing services and some forms of mortgages.

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