GUIDE TO BUY TO LET

JOHN CHARCOL™
INDEPENDENT MORTGAGE EXPERTISE

BUY TO LET

Buy to let refers to the purchase of a property with the specific intention of renting it out. If you already own a property and you want to start renting it out, you should contact your mortgage broker as you may need to remortgage.

In this guide, you'll find all the information you need on financing your buy to let purchase, the tax implications, and your obligations as a landlord.

Once you've finished reading, we hope that you'll be able to manage your buy to let purchase with total confidence.

MAKING MONEY FROM BUY TO LET

Investing in the property market with a buy-to-let has sometimes been cast as a quick buck, but successful buy-to-let investing and turning a profit in today's environment can be anything but. There was a time when property investment was less risky, offered easier returns and was much less regulated. But increased taxes, greater regulation and higher costs mean anyone investing in a buy to let property has to have a plan.

Being a landlord requires a lot of time as well as money so it's important to find the right property, understand your long-term goals and have an understanding of your finances to ensure your investment not only suits your budget but your expectations as a landlord too.

When deciding to become a landlord and you acquire property for buy to let purposes, you should start by looking at what your investment goals are. As rental incomes are on the increase, if you find the right property buy-to-let it can be an excellent way to bring in a high rental yield (through the monthly payments you receive from your tenant), gain capital appreciation (through rising house prices), or even both!

Typically, when working out the expected return on investment for a buy-to-let property, as a landlord you will look at two things; the rental yield and the capital appreciation. Some landlords will focus on one and not the other, but it is definitely worth having an appreciation of both.

RENTAL YIELD: the term used to describe the return on a property investment from a rental perspective. When investors compare rental properties, they will calculate the rental yields to see which is the most lucrative. To do this, they will divide annual rent by the value of the property, and then multiply the result by 100 to get a percentage return on investment. Finding the right property and the right mortgage can return a rental yield of around 5 – 10% depending on where you're based.

Here's an example of how to calculate your rental yield:

Total investment = £210,000

Annual rent = £18,000

Annual costs = £10,000

Net annual income = £8,000

£8,000 / £210,000 = 0.038. 0.038 x 100% = Rental Yield of 3.8%

CAPITAL APPRECIATION: Capital growth, or capital appreciation, is the value by which the property goes up over time. The value of a property can also depreciate. The percentage of the original purchase by which the property has increased will represent the return on the investment from a capital growth point of view.

CHOOSING THE RIGHT BUY TO LET PROPERTY

When you're looking for an investment property it's important to remember that you won't be living there so you should be thinking about areas that are good to invest in rather than ones you'd like to live in.

Here are a few other things to consider when buying to let:

Talk to a local estate agent

They'll be able to tell you about the local rental market and point out some suitable areas and properties.

Look at the rental market in your chosen area

For example, a young professional may look for a smaller property with good transport links whereas a family may look for good schools and safe, green space. It is common for landlords to buy a property in an area they don't know too well then assuming that they will be able to charge a specific rent amount and have queue of people wanting to live in it. Many private landlords come unstuck or don't make the money they want to early in their buy-to-let investment career for this reason. Ensure you thoroughly research the demand for rental properties and the average rent in a particular area before you invest.

Consider how much time you have to be a landlord

It isn't always as easy as sitting back and watching the rent roll in. If you're doing a day job at the same time as being a landlord, you may want to consider using a letting agent to deal with the majority of tasks associated with your property.

How much effort and money do you want to put into decorating and furnishing your property?

While you want to make your property comfortable, homely and well finished for your tenants, you should also factor into your budget the fact that tenants often don't take such good care of a property simply because they have less invested in it themselves.

Can you afford the time and money to buy a 'fixer upper'?

It can be a good project and the end result can be fruitful but there's a balance between a 'buy to let' and a 'buy toi-let'! Bear in mind that if you buy a property that is uninhabitable (e.g. doesn't have a working bathroom or kitchen) you may be denied a mortgage. In this case, you'll need to use savings, if you have it, or you could apply for a bridging loan to secure the property and do it up before securing a mortgage.

Consider what you can afford

Sounds obvious but buy-to-let mortgages require you to be able to cover the mortgage repayments and other costs comfortably. To assess whether you're able to do this, lenders will look into the market rental value and your personal financial standing to see if you can cover repayments even during times when you may be stretched such as periods of no occupancy.

GETTING A MORTGAGE

Buy to let mortgages differ from residential mortgages. In addition to assessing your affordability, buy to let mortgage lenders will base your loan on the expected rental income of your property.

Lenders will need the rental income to be between 125% and 165% of the interest repayments (not the capital repayments) depending on the lender and your financial standing. Lenders will conduct a 'stress test' to establish if you'll be able to keep up with repayments, interest fluctuations and other expenses even when your property is vacant. Do bear in mind that interest rates on buy to let mortgages tend to be higher than residential mortgage rates (typically 3-5%).

The deposits also vary. Where on a residential mortgage, you can start with as little as a 5% deposit, buy to let mortgages typically require a minimum 25% deposit. Some lenders will give you a mortgage with a 15% deposit however, generally, the larger your deposit, the greater range of mortgage products you'll have to choose from.

You shouldn't rely on your rental income alone either. As part of the stress test we mentioned earlier, lenders will take a look at your income, expenditure and other existing debt to establish your affordability. Some lenders will require you to earn a minimum amount on top of your rental income.

As with any mortgage, seeking the advice of a broker will help you to understand what's required of you and which financial route suits your circumstances best.

OTHER BUY TO LET COSTS

When you decide to go down the buy to let route, there are some other costs involved in getting started and in being a landlord going forward. These include:

Mortgage fees – In order to set up your mortgage, lenders will often charge a product arrangement fee. Some will charge this up front whereas others will add it to the total borrowed. Bear in mind that if the charge is added to the borrowed amount, you will pay interest on this and it will cost you more in the long run.

Survey fees – The word 'survey' in the world of mortgages can mean anything from a simple valuation all the way up to a full structural survey. The required level of 'investigation' into your property will depend on your lender, the mortgage you're applying for and the property you're applying for a mortgage on.

Building insurance – When you come to exchange contracts, your mortgage lender will require you to have buildings insurance in place. If you think you'll extend your property portfolio in the future, you may want to consider taking out a policy that allows you to add properties to it at a later date. At John Charcol, we have a specialist team who can help you find the right policy.

Management fees – We've mentioned the advantages of using a letting agent to manage your property. However, you should be prepared to pay their fees. They normally charge a percentage of the rent (+ VAT) so make sure you factor this cost into your budget.

Repairs – When you draw up a rental agreement, you'll need to include what the landlord is responsible for fixing. Normally, this includes fixtures and fittings and items included in the property such as; the cooker, fridge, boiler and furnishings. You may not be able to predict when something will need fixing so it's best to have some cash in reserve as a contingency.

When your property is unoccupied – If your buy to let property is in a popular area and is well priced, it is unlikely to be unoccupied for long. However, even if your property is unoccupied for a couple of months, you'll still need to have the money to keep up your repayments and cover the utility bills and council tax. Some lenders refer to this as a 'rental void period'.

Stamp duty – As with buying a normal property, you will have to pay stamp duty upon purchase. However, stamp duty is 3% higher on buy to let properties than regular purchases. Read on to find out more about tax on buy to let properties.

BUY TO LET PROPERTY TAXES

There are a few taxes associated with buy to let properties. In April 2017, the government began to phase in new tax rules which mean landlords will be hit with a higher tax bill. Here's how it works:

Stamp Duty – The rate of stamp duty went up in April 2016 and is now set at 3% higher than stamp duty on a residential property. Stamp duty works in the same way as income tax in that a different tax rate is applied to different 'sections' of the value of the property. However, there is no tax free threshold on buy to let properties so you'll be paying tax all the way up to the top rate (15%) on the portion of a property over £1.5m. Stamp duty can be difficult to calculate so we've made it easier for you.

Visit charcol.co.uk/mortgage-calculators to work out the stamp duty on your buy to let property in seconds.

Tax relief – Before April 2017, landlords were only taxed on their net rental income i.e. the rental income minus the interest mortgage costs. Post April 2017 however, this 'tax relief' will be diminishing by 25% per year until 2020 whereupon landlords will have to pay tax on all of their rental income. Rental income is taxed at the same rates/bands as regular income.

There also used to be a 'wear and tear' allowance however, this was replaced in April 2016 by the replacement furniture relief. Where landlords used to be able to claim 10% tax relief irrespective of if they bought new furniture or not, landlords can now only claim for the total value of furniture bought that year.

Capital gains tax – If you sell your buy to let property for more than you bought it for, the profit you make may be subject to capital gains tax. As of the 2017/18 tax year, there is a tax free threshold of £11,300 and any profit made above this will be taxed at 18% and 28% depending on how much profit you make and your marginal rate of tax. If you've made a significant development to your property such as an extension, you may be able to offset the cost of those improvements. We can refer you to a tax specialist if you wish to find out more.

Inheritance tax – If you have inherited a buy to let property, inheritance tax applies. As an individual, there's a tax free threshold of £325,000 and you'll be taxed at 40% for any value above the threshold. If you inherit the property and you're married or in a civil partnership, you and your partner have individual thresholds meaning you only pay tax on the value over a £650,000 threshold.

Setting up as a limited company – There are some tax benefits to setting yourself up as a limited company.

USEFUL CONTACTS AND INFORMATION FOR LANDLORDS

ARLA:
www.arla.co.uk

Gas Safe Register:
www.gassaferegister.co.uk

GOV.UK:
www.gov.uk

HMRC:
www.hmrc.gov.uk

NICEIC:
www.niceic.com

The Deposit Protection Service:
www.depositprotection.com

WHY CHOOSE JOHN CHARCOL

We've been helping landlords buy property and protect their investments for over 40 years. Over this time, we've helped thousands of people get the best deal to maximise their property empires, both large and small. Here's how we've helped all those people and how we can help you too.

WE'RE INDEPENDENT
That means we're not tied down to a number of mortgage providers on a panel. Instead, we search a huge number of providers across the whole UK market to find a mortgage that's just right for you.

We're also not driven by commission. We're only driven by the desire to get you great deal on your mortgage.

WE'RE EXPERTS
When you're investing in the buy to let market, you'll probably experience the full spectrum of emotions. We aim to do our bit to take the stress out of arranging the mortgage and protecting your property.

That means:

- You'll speak directly to your own personal adviser and case handler. They'll stick with you until the job is done.
- Your adviser will speak to you in plain English, get to know you and your requirements and be totally transparent with regards to any fees and charges.

96%
OF OUR CLIENTS RECOMMEND US ON*
REVIEWS

*Correct as of Dec 2018

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Helping you get the mortgage you need to live in the home you love

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