Buy to Let Mortgage Guide

This guide will provide insightful information about the Buy to Let market, rental criteria, affordability and everything you need to know about purchasing an investment property and growing your portfolio.

What is a Buy to Let?

This is when a property is purchased for the sole purpose of being rented out to tenants as opposed to habitation by the purchaser. Buy to Lets are purchased for various reasons but the intention is generally in order to generate an income or to make a capital gain once the property is sold.

Deposit

The majority of lenders will require a minimum deposit of 25% for a Buy to Let mortgage but there are some lenders who will offer an exception to this and accept a 20% deposit providing you can meet their criteria.

Tenancy

The type of tenant you have can have a huge impact on the mortgage deals available to you and the lenders willing to consider you. For example, many lenders have alternative deals for landlords wishing to let out to students or on HMOs (houses in multiple occupation).

An HMO or House in Multiple Occupation is defined as a house occupied by 2 or more individuals who aren't related or bear no relationship to one another. These are typically classed as 'shared houses' and would normally include locks on bedroom doors and communal kitchen or bathroom facilities.

Stamp Duty

As of the 1st April 2016, there is now a 3% stamp duty surcharge on all Buy to Lets and second homes:

Brackets	Buy to Let/Second Home Rate
Up to £125,000	3%
£125,001 - £250,000	5%
£250,001 - £925,000	8%
£925,001 - £1,500,000	13%
£1,500,001	15%

First Time Buyer

The majority of lenders view first-time buyers buying a Buy to Let as a risky option and are therefore reluctant to lend. This has proved problematic but there are still lenders out there who are prepared lend on this basis.

It's also worth bearing in mind that even if you have owned a property in the past but are currently classed as owning no properties, this can also still deter a number of lenders.

Income

Buy to Let mortgages are assessed based on rental income. The higher the rent, the more a lender will be prepared to lend. Nevertheless, the majority of lenders (with a few exceptions) will require you to have a minimum personal annual income (either from employment or self-employment) of £20,000 or £25,000 in order to proceed with them.

Buy-to-Let Deals

The deals offered are similar to residential deals in that lenders offer fixed and variable rate options. However, due to the additional risk that Buy-to-Lets pose to a lender, it's not uncommon for rates to be 1% - 2% higher in interest. Similarly to residential mortgages, generally the higher the deposit, the better rate you can obtain; a 40% deposit would provide you with the best rates available on the market.

Buy-to-Let Fees

Fees to set up the mortgage are also similar to residential mortgages and can include valuation fees, admin fees or arrangement fees. Depending on the lender you choose, arrangement fees in particular tend to be higher than residential ones and can often be based on a percentage of the total loan amount.

Use of Letting Agents

The purchase of an investment property has many benefits but can have its drawbacks. Unless you have a tenant, you'll have another mortgage payment to pay out for if the property remains empty and once you do have a tenant, you are then responsible for managing the property effectively which can be time consuming and stressful. A letting agent would typically charge a fee/percentage of the monthly rent but in exchange for this, would normally find a tenant quicker than you going alone and would be in charge of the full management of the property, thus taking the stress away from you. If you are interested in this service, then please contact the Lettings Team of our sister company, Potter and Ford Ltd on 01494 778844.

Buy-to-Let Taxation

Recent tax changes have meant that by 2020, you will be charged interest on all rent received. Previous taxation rules allowed landlords to offset their mortgage interest payments (interest only element – not the capital) and various other expenses against the rent, thus resulting in tax being charged on a lower figure. This reduction in offset of mortgage interest is slowly being forced in at 25% intervals as followed:

In the tax year of 2018/19 you can offset 50% of the mortgage interest against the rental income. From 2019/20, this figure drops to 25% and by 2020, you can no longer offset interest against the rent at all.

The new changes nevertheless include tax relief of 20% on the mortgage interest payable which therefore means that this new change will have no implications on basic rate tax payers.

For higher rate tax payers, this will pose more of an issue due to their personal income being taxed at 40% and their tax relief on mortgage interest only being 20%.

As an example: House Value: £400,000
75% LTV Mortgage - £300,000
Annual Mortgage Interest - £9,000
Annual Rental Yield of 5% - £20,000.

	2018/19	2019/20	2020 & Beyond
Annual Rental Income	£20,000	£20,000	£20,000
Annual Mortgage Interest	£9,000	£9,000	£9,000
Reduction in Mortgage Allowance	(50%) £4,500	(75%) £6,750	(100%) £9,000
Tax at 40% for High Rate Taxpayer	£6,200	£7,100	£8,000
Tax Relief of 20% of Mortgage Interest Allowance	£5,300	£5,750	£6,200

Rental Calculations

As mentioned earlier within this guide, lenders will assess the plausibility of obtaining a mortgage based on the rental income. Generally, lenders will lend more if you decide to opt for a 5-year fixed or proceed with a like for like remortgage as opposed to capital raising. Lenders' most generous rental calculations for this are around 125% @ 5% and they can go up to 145% @ 5.5%. For example, if you have an outstanding mortgage of £300,000 and wish to remortgage on a 5-year deal, £300,000 x 5% = £15,000 / 12 (for monthly sum) = £1,800. £1,800 x £125% = Required rental income to be £2,250 per month.

Portfolio Lending

From the 30th September 2017, The PRA (Prudential Regulation Authority) introduced a new definition of 'portfolio landlords' as landlords with just 4 or more mortgaged rental properties and recommended a far greater rental yield requirement from this type of borrower. This has had a significant impact on landlords who had previously only really considered themselves amateurs. Lenders have adopted mixed approaches to this in terms of criteria, but some lenders now insist that all background properties meet their rental calculations and others will simply no longer lend to landlords with 4 or more properties at all.

Insurance

Depending on whether you have purchased the freehold, buildings insurance may need to be put into place upon exchange of contracts. Another important consideration is Landlord Insurance. Although it's not compulsory, this insurance provides useful cover for accidental damage and financial protection against loss of rent. Whilst it may be an extra outgoing, tenant damage and missed rent is all too common in the Buy-to-Let market which supports the importance of this cover.

Capital Gains Tax

If you decide to sell your Buy-to-Let or Second Home and the value of the property has increased past the price at which you purchased it, you may find yourself liable for Capital Gains Tax (CGT). Various fees including stamp duty, estate agent/legal fees can be offset against this gain to bring this liability down. In addition, there is an £11,300 allowance this year that can further reduce tax due. If after deducting fees and the allowance there is still a gain, you will pay either 18% or 28% on this depending on your tax position.

Rental Voids

The chances are, at some stage in ownership of an investment property there will be a period you are without tenants. This can be a short or long-term issue depending on how long it takes to find a new tenant. As a result, you'll often have outgoings on this property such as the mortgage, insurance bills etc which you will have to fund. Therefore, it is vital to have some emergency funds to cover this eventuality.