Thinking of becoming a Buy to Let Landlord?

Here is your 9 page ESSENTIAL guide

Buying your first buy to let property can be scary.

What do you need to do?

What legislation do you need to comply with?

As a new buy to let landlord you need to learn all the legislation you could fall foul of, as well as keeping your tenants safe.

To help you, please find a 12 page guide below highlighting the basics for a first-time Buy to Let

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What is Buy to let?

Buy-to-let is a property purchased with the intention of renting it out to tenants. It should not be viewed as a short-term get rich quick type of investment. You can make a hefty profit as an investor of a buy-to-let property, you can also make an eye watering loss if you don't get the basics right from the start. You need to make sure you plan appropriately, buy the right property in the right area, abide by the ever-changing Government regulations and most importantly ensure that the expected income will cover the costs. Always seek tax advice from an accountant and mortgage advice from a reputable broker **before** you start to ensure that your aims are realistic and you have the budget to bring your plans to fruition.

Successful buy to let investing is not without its issues, like all investments there are financial risks (property values could go down) and Government regulations associated with the property rental market are changing all the time.

Being a landlord requires, as with any sort of investment, a lot of time, planning and money. Buying the wrong property in the wrong area would be very costly in terms of rental voids and/or lack of capital appreciation. You need a comprehensive understanding of your aims and the rules and regulations governing this type of investment.

What type of Buy to Let property should you buy?

Location is key, especially when looking to get the most out of your Buy to Let investment.

Research the property market in your chosen area – look on the property portals such as Rightmove, Zoopla, On the Market and Primelocation to see what types and the cost of property are available, also check out what is being advertised to rent and get a handle on rental values.

Consider the type of tenant you will be targeting. A student will be looking for a very different property and location to a family. You need to decide whether you are looking to profit from the rental income, the increase in value over time or a combination of the two. For convenience a lot of landlords target the areas near where they live and look for properties that they can immediately add value to by updating or extending. There is nothing wrong with this approach as their local knowledge can be a great help deciding on which particular area to buy in. However, when working out the potential income/yield these costs must form part of the equation. When investing in other areas professional advice from Estate/Lettings Agents is key to finding property with the correct mix of yield/income.

Personal preference for a particular type of property is a good starting point when looking for an investment property but it's important to remember that you will not be living in it yourself. You should investigate potential demand for rental properties in the areas that you are thinking to buy. How large is the catchment area? What major employers are there?

Is the population mainly static or mobile? Age of the potential tenants? Working or mainly benefits? These are all pertinent facts that need to be taken into account. If the area contains a lot of young mobile workers then one bedroom properties close to transport links would be a good idea. When these people settle down they are looking for two bedroom accommodation (good for singles/couples/young families). As they grow older they may require three bedroom properties. If they have children they may want a garden area, parking or garages. If you are aiming at the student market then proximity to a university campus would be the best place to start looking – however, it should be borne in mind that normally these tenants pay for only ten months of the year leaving a void period when you can get in and prepare for the next academic year. It is imperative that you have a good understanding of the area and the potential tenants that you are aiming for.

Think with your head, not your heart; always view a property a few times and make sure you only make an offer that works with your projected figures – for this reason be very careful buying at auction – you could very easily get carried away!

What is a good Rental Yield / Rental Income?

Rental yield measures the ongoing return on investment for a property. You should always consider your potential rental yield before purchasing a buy-to-let. The yield is the income you make, calculated by what your tenant pays in rent, minus any maintenance or running costs.

It is what makes Buy to Let so attractive as a **long term** investment.

Typical rental yields to aim for are 5 – 7% which should give you sufficient scope to make an income from your property whilst taking into account the costs of routine maintenance. Yield can be higher for an HMO although these are subject to much greater Government Legislation as discussed later in this article. At the time of writing the Bank of England base rate is 0.1%!

To work out the rental yield you divide a year's total rent by the purchase price of the property and multiply by 100.

For example, if you bought a buy-to-let property for **£200,000** and receive £750 a month in rent, to give an annual rental income of **£9000** (12 x £750), the gross rental yield is:

(9,000 / 200,000) x 100 = 4.5 or **4.5%**.

Capital Appreciation/Depreciation explained

Capital appreciation, also known as capital growth, refers to the amount that a property either increases or decreases in value over time. This can be affected by several things – the changes in the overall property market, planning matters affecting the area or improvements to the property itself. Checking out the value of a property over previous years is a well worth pointer to the future value. It is also a good pointer as to whether it is cost effective to make improvements and a pointer as to when to consider selling.

Property purchase price: £200,000
Current market value: £250,000
Capital growth: £50,000.

Do you want Capital Growth or Rental Yield?

As a Buy to Let investor you will be relying on Capital Growth or Rental Yield or a combination of both. I know of an investor who has taken over his parents' portfolio made up exclusively of flats above shops. Capital appreciation has been minimal but over the 25 years we have been managing his properties the rental income on these (mostly now owned outright) properties has increased considerably. His income nowadays is mainly from the rents and he has no intention of selling. Conversely, I also know investors who buy in up and coming areas intending to use the rental income to cover the outgoings and making their profit from selling after the property prices have risen; they then use this profit to put down as deposits on further properties. Their intentions are to continue doing this for a number of years and then sell up and retire on the proceeds. It should be noted that both of these scenarios are predicated on a **long term** vision. Very few, lucky, people make their fortunes from property in the short term, if you have a cast iron way to do so, please tell me!

Personally, I would suggest that a combination of the two is a much more sensible approach, whereby the rental income covers your costs plus a small yearly profit based on a property with at least a 5% per annum potential increase in value. It should be taken into consideration that this possible 5% increase in value is subject to compound, not simple interest, hence why property investment should be viewed as a long term strategy.

Bear in mind that if your initial costs of purchasing and renovating the property are high, you are unlikely to reach high rental yields over time, you will be dependent upon house prices increasing.

If, however, you buy a cheaper property and rent it out to several students, your rental yield will probably come in quite high, however, the ongoing legislative and maintenance costs will be higher.

Beware of buying 'off-plan!' This is where a developer sells new build units before they are built. Their plans are professionally produced and offered for sale on a first come first served 'discount' with accompanying possible rentals that rarely stand up to professional scrutiny. Many years ago we had a landlord who had bought off plan and paid £150,000 for a top spec apartment in a prestigious development. When it was eventually completed two years later I was asked how much it was now worth, the answer - £150,000! The reason – they have very good accountants. The rentals didn't work because 50 units came onto the market at the same time through various agents and some landlords were prepared to take a lower rent just to have their property let out! Such property speculation is not for the small buy-to-let investor.

Investment return

Bear in mind that if you are buying with a mortgage the rent to property price yield will not be the return you get. In order to work out your actual return on investment subtract the annual mortgage cost from your annual rent and then work this sum out as a percentage of the deposit that you have put down:
Example:
For a £250,000 property that could rent for £1200 per calendar month you would need to find a deposit of £75,000 plus 3% stamp duty of £7500 and buying costs of around £2000 a total of £84,500.

A £175,000 mortgage @ 5% interest = £8750

£1200 pcm rent = £14,400

Difference: £5650

This equates to a **6.68%** return on the money that you have invested. However, you must remember that Tax, maintenance, agent's fees and landlords expenses will need to come out of that total.

If you had bought this property outright your total upfront costs would have been £259,500 and the yield would have worked out at **5.55%** before Tax, maintenance, agents fees and landlords expenses.

These examples show only the rental yield on the property, account should also be taken of the potential capital appreciation of the property. Taking market surges and drops into account, over the past 20 years average prices have increased by 306%! If this continues for another 20 years' then the property you bought for £250,000 will be worth £817,000 in 20 years' time! Bear in mind that the majority of buy to let mortgages are interest only so at the end of the mortgage you would still owe the initial mortgage amount of £175,000!

After the costs of the investment have been taken into account you should allow the rent to build up over time. It can then be used as a deposit for further properties or to pay off the mortgage at the end of its term.

The Purchase

Not everybody has the requisite funds set aside to purchase a property outright. That is not necessarily a problem as many lenders specialise in buy-to-let mortgages. These mortgages function pretty much the same as residential mortgages except that they generally require a larger deposit and the interest rates are usually higher. The deposit is typically around 25% of the value of the property. Your personal income will also be taken into account and you will need to confirm that you can cover the costs of purchase – survey fees, solicitors fees, Stamp Duty etc. A fuller explanation of these terms can be found below. Always bear in mind that interest rates could change, ensure that you have the spare capacity in order to account for an increase!
The requirements for these mortgages differ significantly between lenders and the offers available will vary according to the amount of deposit put down and your ability to service the loan.

All lenders will subject your application to their current affordability calculations. Most insist that the monthly rental income must be at least 125% of the proposed mortgage payments on an interest only basis using a nominal rate of around 5%. Some of them will take other income into account as well – like personal salary and income from existing let property.

Currently the Stamp Duty on property that is not your prime residence is subject to a 3% surcharge.

Proof of Buildings Insurance is usually demanded by mortgagees and this will typically need to be supplied to them on a yearly basis. You will need to source the insurance from specialist brokers as a normal residential policy will not be acceptable.
Survey fees can vary depending on which survey you/the mortgagee stipulate; it could range from a simple property valuation to a full structural survey depending on age/condition of the property. A simple valuation will simply confirm the value, the rental assessment and whether the property is suitable security to meet the basic lending requirements of the mortgage company. A full survey will report on the current state of the whole property and point out any areas of concern now or in the future.
In addition to the above, a full structural survey reports on the actual state of the property, whether there are any hidden issues and highlight any factors that could be taken into account whilst negotiating the purchase. If the property is high value, of a certain age or their obvious maintenance issues it is advisable to have a full survey carried out.

Decide on whether you should buy old property or new build. In theory new build should equate with fewer maintenance bills going forward. On the flip side new build could mean a higher initial outlay. Possibly you could get a better deal by buying an older property so long as you budget carefully for any initial and ongoing works that may be required. Bear in mind that you are in a strong negotiating position as you are coming into the market without an onward chain and should therefore be in a position to move the purchase on more quickly.
It pays to have a thorough knowledge of the market, particularly the area of the market that you are considering to buy in. If the market is not very busy and homes are taking longer to sell you will be better placed to negotiate on the price.

For full advice on mortgages please follow the link: https://www.futuresfinancial.co.uk/

Freehold/Leasehold/Commonhold

It is extremely important that potential investors, landlords and property owners understand the differences between these methods of property ownership and what these differences mean for them and the value of their investments.
There are three types of property ownership in England and Wales, we shall look at each in turn.
Freehold: When purchasing a freehold property you are buying the outright ownership of the property and the land on which it stands and the entitlement to permanent residency for as long as you wish. You are entitled to make alterations to the property within the restrictions of the law although you may need to seek planning permission if you wish to make structural changes. Most houses are freehold and some flats can be sold freehold. Historically most flats are leasehold, however legislation is making it easier for leaseholders to buy their freehold.
You may have heard of a 'Flying Freehold' – a common example of this is where a room is situated above a shared passageway or a balcony which extends over a neighbouring property. They are quite common but are a grey area in the eyes of the law as they typically don't have right of access to make repairs – for this reason mortgage lenders are loathe to loan on property that contains them.

Leasehold: If you buy a leasehold property you are not buying ownership of the property but rather leasing it for a period of time. A leaseholder has the right to occupy the internal space of the property but does not own the structural fabric of the building or the land on which it is built. Most flats in England and Wales are leasehold and are subject to ground rent which is payable to the freeholder. In addition, a service charge is levied from which services for the building, insurance and maintenance are paid. Most leases contain a clause whereby the ground rent can be increased over time. The lease should also stipulate how the service charge is worked out and how it is divided between the other leaseholders. When the specified period has expired the property reverts to the ownership of the freeholder. Most leases are written for 99 years however they can be extended by agreement with the freeholder at a specified cost. Leases of 999 years are becoming more and more common. If you are thinking of buying a leasehold property bear in mind that most mortgage companies will not offer a loan if less than 75 years! The shorter the period of time left on the lease the cost of extending is generally more expensive. Whatever the case, it is important to read the lease carefully – some actually preclude letting or have other onerous clauses! It is advisable to have someone qualified to look over the lease for you. Leaseholders can convert to Commonhold – however ALL leaseholders must agree! The question is – is there any advantage to owning a leasehold property, well yes – repairs, maintenance and insurance activities are often the responsibility of the freeholder so you have nothing to worry about – except paying the bills of course.

Commonhold: The freeholder in this case is a Commonhold Association. The owner of each flat is a member of the association and mutually responsible for maintaining the communal areas of the building.

Advantages are that there is no set period of time when you have to leave – you are one of the freeholders. All decisions regarding the building are made jointly by the individual owners. Your flat will not lose value unlike with leasehold properties that lose value as the period of the lease gets shorter.

Residents Management Company (RMC) – Protects the interests of the leaseholders. RMCs typically manage the common parts of the building – external doors, roofs, hallways, parking area etc all of which require maintenance, insurance, lighting etc. Monies for these are collected from the service charges, however, additional monies may be required for larger projects and it is always advisable to have a reserve fund to pay for these. RMCs are run by directors, who are usually unpaid and appointed from the residents themselves. The RMC will have a Memorandum and Articles of Association to allow it to own, manage and administer a leasehold or freehold property. Companies usually employ a professional managing agent, expert in technical aspects of managing multi-occupancy properties and who have a thorough understanding of the legislation and regulations required to effectively manage a block of flats.

Ongoing Maintenance

The fabric of the building and the decorations will naturally deteriorate over time, hence we recommend that the property is inspected regularly so that incremental maintenance can be carried out on a regular basis, this not only avoids larger, unexpected bills but keeps the property in tip top condition and the tenants happy. As a rule of thumb we recommend that the internal redecorations be refreshed every five years

Estimating the costs of this maintenance is pretty much a finger in the air exercise dependent upon the age and condition of the property when it was bought. If you have your own home then you will have a fair idea of what and how much it could cost. We have found over the years that a little but often approach is the best way to stay on top of these expenses as it will reduce the possibility of expensive emergency works. As a minimum we would suggest that you budget for £250 - £500 per year. You will be responsible for internal redecoration and you should budget for this every five years, we would suggest that a figure of £2000 would be about right to cover this. These costs will need to be included in the calculations when working out the potential profit from your investment. When preparing your financial forecast it is always wise to factor in an amount for unexpected outgoings, that said, there are many insurances out there that can mitigate these problems.

Legal obligations

Gas safety certificates – all gas appliances in the property must be inspected every year by a registered Gas Safe engineer, a certificate is then produced which must be copied to the tenant before they move in or within 28 of the check being done.

Electrical Safety certificates – All rented properties must have a current Electrical safety certificate – these last for five years and once again a copy must be given to the tenant.

Environmental Protection Certificate – Since 1st April 2018, all privately rented property in England and Wales has to comply with new Government rules with the catchy title – the Minimum energy Efficiency Standards (MEES), the EPC will give you recommendations for improving the energy efficiency. Under these rules, landlords cannot let a flat or house unless the property has an Energy Performance Certificate (EPC) rating of E or higher. As with all Government regulations if you don't have an EPC available for prospective tenants to inspect, you could risk a fine – in this case of up to £5000. It should be borne in mind that legislation changes over time and we fully expect this rating to be increased in the future.

Smoke Alarms/Carbon Monoxide Alarms - Since 2015 landlords have been required to install at least one smoke alarm on each storey of their property. Carbon monoxide detectors need to be installed in any room containing a solid fuel burning appliance (coal fire or wood burner). On change of tenancy the landlord must ensure all alarms are in working order.

Furniture and furnishing regulations – To be compliant with these regulations a display label must be fitted to every item of furniture in a tenanted property; this includes mattresses.

Right to Rent - Landlords are required to carry out Right to Rent checks when setting up a new tenancy agreement. You will need to check that your tenants have the legal right to live in the UK by inspecting and making copies of any immigration documents and their passport. Full details of the requirements can be found on the Government website.

Landlords repairing obligations - As a landlord you will be legally responsible for keeping in repair:

The structure and exterior of the property – the walls, roof, foundations, drains, guttering and external pipes, windows and external doors.

Basins, sinks, baths, toilets and their pipework

Water and gas pipes, electrical wiring, water tanks, boilers, radiators, gas/electric fire or fitted heaters.

These are statutory repairing obligations and cannot be devolved to the tenant through anything written in the tenancy agreement. None of the costs of adhering to these responsibilities can be passed onto the tenant. It should be noted that you only have to make such repairs when you have been informed by the tenant that there is a problem although it is good practice to regularly (three or six monthly) visit the property to keep an eye on things yourself.

HMO licenses.

There is an obvious attraction in letting a property out to sharers – the rental income can be much greater. However, the Housing Act 2004 laid out regulations regarding HMOs which basically boil down to any property which has three or more people from more than one household. Large HMOs – over three stories with five or more people from different households are 'mandatory HMOs' and automatically require a licence. The Act also had a provision whereby individual councils could introduce licensing to meet local needs; therefore many now stipulate that any property with three or more unrelated sharers must be licensed and some require licenses for any let property! You will need a license for each HMO you let. If you are required to have a license do not ignore it – the consequences and fines are eye watering: up to £20,000 fine, be ordered to repay Housing Benefit received, be deemed an unfit person to hold an HMO license and also be unable to use the Section 21 process to regain possession of the property. In the worst case scenario the council can take over running of the property for up to five years! Full details of these requirements can be found on the Government website.

Deposits

Any deposit received must be put into a Government approved deposit protection scheme. The tenancy deposit scheme is designed to protect the tenants from unscrupulous landlords by providing a mediation service if there is a difference of opinion regarding the state of the property at the end of tenancy. To protect both parties a full inventory, preferably with photos should be produced and agreed at the start of the tenancy. This inventory will be relied on by the mediator who also has to bear in mind both landlords and tenants responsibilities regarding the let property.

TAX

You will probably need to pay income tax at your nominal rate on any profit you earn from letting out your property. **Profit** is what you have left after deducting allowable expenses. These include: Letting agent fees, landlords insurance, maintenance and repair costs, legal fees and some of the interest on any buy to let mortgages. The amount of mortgage interest tax relief allowable against tax has been decreasing since 2017. As everyone's tax position is different for a full breakdown of what this means please visit this website: Buy-to-let mortgage interest tax relief explained - Which?
Prior to 2016 there was a tax relief for wear and tear – particularly useful when renting fully furnished. Unfortunately, this has also changed and you can now only claim the actual cost of replacing furnishings. HMRC sometimes categorise what you think is replacement as a capital improvement and therefore you would be unable to claim tax relief. When you come to sell the property you will be liable for Capital Gains Tax on any growth in value over your Capital Gains tax free allowance (£12,300 for 2020/2021) that the property has enjoyed over the period of your ownership. At the time of writing this is charged at 18% for basic rate taxpayers and 28% for higher rate taxpayers

We strongly urge that you take independent financial advice regarding your tax affairs before entering the property market, if you have inherited a property or portfolio of property or are considering selling.

Selling

At some point you will possibly decide to sell your investment property. When you have decided on this course of action it is important that you talk to your tenants, firstly they may be in a position to buy it themselves, if not it is better to come to some amicable agreement as to when it can be put on the market – they will, after all, have to eventually move out or, if you are selling to an investment buyer, they will be the ones in residence when prospective purchasers are looking round and you will therefore want them to present the property in as good a light as possible.
The choices between selling with vacant possession or with sitting tenants come with pros and cons, if you have to remove the tenants your property will not be earning rent whilst it is on the market and it could take many months to sell; you will also probably have to spruce up the property before it goes on the market. If you sell with sitting tenants there are many administrative hoops you will have to navigate. Whichever course you choose communication and goodwill with your tenants is paramount, if the tenants are staying they will need to agree to viewings and the state of the property during these viewings can have a big impact on a possible sale, also, If you have to serve an eviction notice it would, at the very least, delay your plans and possibly incur court fees.

Selling to an investment buyer is simpler as they will probably be more experienced in the process, will be much less emotional about the property and will probably not be dependent upon a chain. There will be extra admin where you have to provide the tenancy agreement, right to rent records, gas safety certificates and inventory to the other side's solicitor, the deposit will also need to be transferred into the buyer's protected deposit scheme.

Conclusion

The foregoing is a pretty comprehensive precis of Buy-to-Let and hopefully explains the major points of investing in residential property. There is a lot to take in but never forget that there are many property professionals that you can call upon – Accountants, Mortgage Brokers, Estate Agents, Lettings Agents and Block Management Companies who will all gladly point you in the right direction. If you feel confident that you can spare the time to self-manage it would be sensible to join a Landlords Association where you can find a wealth of information to help.

Bearing all the foregoing in mind, provided that you have bought the right property, in the right area and you use a good managing agent, the amount of time that you have to invest in the business is very little.

For further information on the rental market in the Portsmouth area please contact Belvoir Portsmouth. Manager Samantha Bateman will be happy to advise you on Portsmouth

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