

A GUIDE TO

BUY-TO-LET MORTGAGES



Part of **HOWDEN**

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Buy-to-let is a popular investment for those looking for an alternative to savings, investments or pensions. Many investors rely on property to supplement their income in retirement, alongside a traditional pension. Although the landlord environment has changed dramatically over the past decade with the introduction of a raft of tax and regulatory changes, there is no reason why buy-to-let shouldn't be a part of long-term investment planning, as long as you do your research, take professional advice and allow for periods of time when the property is unoccupied, therefore not bringing in any rental income.

It is important to consider how you own your investment, whether that be in your own name or via a limited company. We will look into these options in more detail in the following pages.

What is a buy-to-let mortgage and who can get one?

If you are buying a property to let out, you can't use a standard residential mortgage you will need a buy-to-let mortgage, which is very different. With buy-to-let, it is the

rental income of the property which dictates the size of the mortgage rather than your income.

Typically, lenders require the rental income to be anything between 25 and 45 per cent higher than the mortgage payments. So, if your mortgage is £1,000 per month, the lender would expect to see a rental income of between £1,250 to £1,450 per month. You can find out what the likely rent for the property will be by speaking to local letting agents or checking out listings of similar rental properties in your area.

First-time buyers can become landlords although not all buy-to-let lenders will lend to you if you don't already own a property.

Where to get a buy-to-let mortgage – broker or direct from the lender?

Most lenders and some specialist providers offer buy-to-let mortgages. There is a lot of choice available and sometimes it can feel overwhelming – how do you make sure you've chosen the best deal if you haven't sifted through all of those available? This is where a whole-of-market mortgage broker such as SPF

Private Clients comes in, scanning the market for the best mortgage for you. It is also worth noting that some buy-to-let lenders only lend via brokers so you may miss out if you don't use one.

The deposit

Typically, you will need a higher deposit for a buy-to-let property than you would for a standard residential mortgage. Most buy-to-let lenders will want at least a 25 per cent deposit, whereas you may be able to buy a residential property with only a 5 per cent deposit or less.

Generally speaking, as is the case with residential mortgages, the bigger the deposit, the lower the rate you pay. The best rates tend to be available to those with a 40 per cent deposit or more.

Interest only

Although some opt for repayment, most landlords opt for interest-only mortgages whereby you pay only the interest on the mortgage each month and at the end of the term still owe the original amount – the capital – that you borrowed. This means lower monthly payments, with the majority of landlords planning to sell the property (or another in their portfolio) at the end of the term to pay off the mortgage and (hopefully) make a profit. Alternatively, you may be able to refinance at that point.

There is a risk that if property prices fall considerably, you could end up with a property worth less than the amount you borrowed – but will still have to pay back the original balance. In this instance, you will need to cover the shortfall.

Fixed or variable?

Interest rates tend to be higher on buy-to-let mortgages than on residential loans as lenders regard them as being higher risk. As with residential mortgages, there is a choice of fixed or variable-rate mortgages.

Fixed-rate mortgages

A fixed-rate mortgage ensures you know exactly how much your monthly payments are for the duration of the fix. If the Bank of England raises interest rates, your mortgage payments don't increase but neither do you benefit from rate reductions.

There are mainly two and five-year fixes available, with some lenders offering ten-year fixes. How long you fix for will

depend on your circumstances and future plans as there are usually early repayment charges (ERCs) to pay if you need to exit the mortgage before the fixed period ends. In other words, try not to fix for longer than you are sure about.

Variable-rate mortgages

There are two main types of variable-rate buy-to-let mortgage – a base-rate tracker, which usually follows the Bank of England base rate plus a margin, and a discounted-variable rate, linked to the lender's standard variable rate (SVR).

Base-rate trackers are the most transparent option as they track the Bank of England base rate, plus a set margin, so you know where you stand. If interest rates go up by a quarter of a percentage point, you will know that the following month your mortgage payments will go up by the same amount. If interest rates fall, so do your mortgage payments because they are directly linked, although most lenders have a 'collar' in place when rates do drop so payments will only fall so far.

A discounted-variable rate offers a discount to the lender's SVR, which is set at its discretion, so your monthly mortgage payments will go up and down in line with this.

With a variable-rate mortgage you are not protected from base rate rises but if the Bank of England reduces the base rate, your mortgage payments will fall.

How much does it cost?

When choosing a buy-to-let mortgage, it is important to work out the total cost – rate plus arrangement fees – to ensure you compare deals on a like-for-like basis. Lenders may offset a larger fee against a lower interest rate or vice versa.

Most lenders charge an upfront arrangement fee ranging from a set fee of hundreds or thousands of pounds to a percentage of the loan amount borrowed. This fee is due on completion although most lenders will let you add it to the mortgage. If you do choose to add it to the mortgage, interest will be payable on that amount.

There will also be a mortgage valuation fee to reassure the lender that the property is worth what you wish to borrow, which usually costs a few hundred pounds. However, it is not a survey and will tell you nothing about the condition

of the property, so it is worth having a homebuyer's report or full building survey if the property is old.

There are also conveyancing and legal fees. Some mortgages come with free legal fees but these conveyancers can be inundated with work so progress may be slow.

It can be worth paying for a good solicitor who will respond to your queries in a timely manner.

Mortgage brokers are paid a commission by the lender for introducing your business to them. This is stated in the Mortgage Illustration. Some brokers, such as SPF, also charge a fee, which can be a fixed amount or a percentage of the mortgage amount, depending on the work involved. This is payable on completion and will be discussed with you upfront. Refer to page 6 of this document.

Stamp duty

There is a 5 per cent stamp duty surcharge on second homes and buy-to-let properties in England, Wales and Northern Ireland. Please find out more at www.gov.uk/stamp-duty-land-tax.

Own name or limited company?

An increasing number of landlords are buying property via a limited company rather than in their own name.

If you do this, all costs, including mortgage interest payments, can be deducted as business expenses. If you buy property through a limited company you pay corporation tax on profits and dividend tax rates, which are less than income tax for higher-rate taxpayers, so for many private landlords this can be a sensible option.

If a property is sold for a profit, you will also have to pay corporation tax on any gains. Then you have to pay income tax when you withdraw any money from the company. However, the advantage of a company is that you only have to take money out when you need it so this could be in a tax year when other income is low. A limited company can also help with inheritance tax planning if you intend to pass your property portfolio onto your children.

A company structure is not right for every landlord, particularly as mortgage rates tend to be higher if borrowing via a limited company than in your own name. This is mainly because there aren't so many limited company mortgages available, although choice is growing.

SPF are not authorised to give taxation advice therefore it is very important to seek specialist tax advice before setting up a limited company structure. This is particularly the case if you are considering moving existing buy-to-let properties into a limited company as there are various other costs to consider



as you are effectively 'selling' the properties to yourself. These could include capital gains tax, stamp duty, legal costs and potentially early repayment charges and higher mortgage rates. However, for some landlords the long-term tax savings outweigh these costs.

Portfolio landlords

Landlords with four or more properties are referred to as 'portfolio landlords' and may find it trickier to get additional finance. Portfolio landlords must provide mortgage details, cash flow projections and business models for every property they own when applying for finance.

Some lenders have a maximum number of properties you are allowed to have in your portfolio (usually up to ten), while others use different interest calculation ratios and representative interest rates depending on how many properties you own. Some lenders also have rules on the maximum loan-to-value ratios you can have across your portfolio.

A few lenders take the landlord's personal income into account when calculating affordability. This may be useful if there is a shortfall in your assessment and you have the income to cover it. It is worth using a broker if you are a portfolio landlord as they will know which lenders are best to approach for funding.

When should I apply for a mortgage?

It is wise finding out how much you can borrow before you make an offer on a property. Lenders will also look at your outgoings and credit history. Until you know what mortgage you can get you won't know what you can afford.

A 'decision in principle' from a lender will give a ballpark figure as to what mortgage you can achieve. You can then go house hunting armed with this information, giving vendors and estate agents comfort that you are a serious buyer. Once you have found a suitable property, you can make an offer safe in the knowledge that you can afford to buy it. When it has been accepted, you can proceed to a full mortgage application.

How SPF can help

Our mortgage advisers have years of experience in arranging buy-to-let finance for clients, whether they are first-time landlords, have significant property portfolios, are buying in their own name or via a limited company. We have access to a wide range of buy-to-let mortgage options, as well as many deals that are available only to brokers, so you can rest

assured that you will get the right loan for your circumstances. We manage the mortgage process from start to finish and can turn things around quickly if necessary. Please contact us to find out more about how we can help you with your buy-to-let requirements.

Paperwork: Getting mortgage ready

- ✔ Check your credit history.
- ✔ Proof of ID – a recent utility or council tax bill, as well as a driving licence or passport.
- ✔ Three months' worth of bank statements.
- ✔ Proof of income – payslips for the previous three months and your P60.
- ✔ If you are self-employed, lenders may want to see your last two or three years of accounts or SA302 year-end tax calculations, and possibly your business bank account statements.
- ✔ Proof of deposit.

How the mortgage process works

There are several stages to the mortgage process:

- ✔ Contact a mortgage adviser. They will discuss your income, plans for the future, your risk profile, and your needs and preferences.
- ✔ The adviser researches the market to find the best option for your circumstances. They obtain a 'decision in principle' whereby the lender broadly agrees to the mortgage.
- ✔ Once you have had an offer accepted on a property, tell your adviser and they will complete the application form and submit it to the lender.
- ✔ The lender will underwrite the mortgage and instruct a valuation to ensure the property is worth what you intend to borrow.
- ✔ Once the lender is satisfied with everything, a mortgage offer is issued.
- ✔ You exchange on the property and your solicitor finishes the paperwork.
- ✔ Completion. You have successfully taken out a mortgage and bought a new property.

CONTACT US

To find out more about how we can help you please contact:

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If you fail to keep up with payments on your mortgage a 'receiver of rent' may be appointed and/or your rental property may be repossessed.

We may charge a fee for the advice we provide; this fee will be dependent upon your personal circumstances and will be agreed with you after we have fully understood your requirements. Any fee is payable upon successful completion of your mortgage, unless agreed otherwise. We may also receive commission from the lender.

SPF Private Clients Limited is authorised and regulated by the Financial Conduct Authority (FCA).
The FCA does not regulate some forms of buy-to-let and commercial mortgages.

