Buy-to-let mortgages explained

Buy-to-let (BTL) mortgages are for landlords who want to buy property to rent it out. The rules around buy-to-let mortgages are similar to those around regular mortgages, but there are some key differences. Read on for more information about how they work, how to get one and what mistakes to avoid.

Who can get a buy-to-let mortgage?

You can get a buy-to-let mortgage under the following circumstances:

- You want to invest in houses or flats.
- You can afford to take and understand the risks of investing in property.
- You already own your own home, whether outright or with an outstanding mortgage.
- You have a good credit record and aren't stretched too much on your other borrowings, for example, credit cards.
- You earn £25,000+ a year. If you earn less than this you might struggle to get a lender to approve your buy-to-let mortgage
- You're under a certain age. Lenders have upper age limits, typically between 70 or 75. This is the oldest you can be when the mortgage ends not when it starts. For example, if you're 45 when you take out a 25-year mortgage it will finish when you're 70.

"Special Purpose Vehicle" Limited Companies can also obtain BTL mortgages.

How do buy-to-let mortgages work?

Buy-to-let mortgages are a lot like ordinary mortgages, but with some key differences:

- The fees tend to be much higher.
- Interest rates on buy-to-let mortgages are usually higher.
- The minimum deposit for a buy-to-let mortgage is usually 25% of the property's value (although it can vary between 20-40%).
- Most BTL mortgages are interest-only. This means you pay the interest each month, but not the capital amount. At the end of the mortgage term, you repay the original loan in full. BTL mortgages are also available on a repayment basis.
- Most BTL mortgage lending is not regulated by the Financial Conduct Authority (FCA). There are exceptions, for example, if you wish to let the property to a close family member (e.g. spouse, civil partner, child, grandparent, parent or sibling). These are often referred to as a consumer buy to let mortgages and are assessed according to the same strict affordability rules as a residential mortgage.

https://youtu.be/rVtMdDango4 (Please open the hyperlink to view)

Advising, arranging, lending and administering BTL mortgages for “consumers” is covered under the same laws as residential mortgages and is regulated by the Financial Conduct Authority (FCA).

How much you can you borrow for buy-to-let mortgages

The maximum you can borrow is linked to the amount of rental income you expect to receive.

Lenders typically need the rental income to be 25–30% higher than your mortgage payment.

To find out what your rent might be, talk to local letting agents, or check the local press and online to find out how much similar properties are rented for.

Where to get a buy-to-let mortgage

Most of the big banks and some specialist lenders offer BTL mortgages.

It’s a good idea to talk to a mortgage broker before you take out a buy-to-let mortgage, as they will help you choose the most suitable deal for you.

Plan for times when there’s no rent coming in

Don’t assume your property will always have tenants.

There will almost certainly be ‘voids’ when the property is unoccupied or rent isn’t paid and you’ll need to have a financial ‘cushion’ to meet your mortgage payments.

When you do have rent coming in, use some of it to top up your savings account.

You might also need savings for major repair bills. For example, the boiler might break down, or there might be a blocked drain.

Don’t rely on selling the property to repay the mortgage

Don’t fall into the trap of assuming you’ll be able to sell the property to repay the mortgage.

If house prices fall, you might not be able to sell for as much as you had hoped.

If this happens, you’ll be left to make up the difference on the mortgage.

Buy-to-let and tax

Capital Gains Tax

If you’re a basic rate tax payer, CGT on buy to let second property’s is charged at 18% and if you’re a higher or additional rate tax payer it’s charged at 28%. With other assets, the basic-rate of CGT is 10%, and the higher-rate is 20%.

If you sell your buy-to-let property for profit, you will usually pay CGT if your gain is higher than the annual threshold of £12,000 (for the 2020/21 tax year). Couples who jointly own assets can combine this allowance, potentially allowing a gain of £24,000 (2020/21) to be made in the current tax year.

You can reduce your CGT bill by offsetting costs like Stamp Duty, Solicitor and Estate agent fees or losses made on a sale of a buy to let property in a previous tax year by deducting these from any capital gain.

Any gain from the sale of your property, should be declared on your Self Assessment tax return for that tax year and will be included when working out your tax status for the year which push you into a higher bracket.

Income Tax

The oncome you receive as rent is liable for income tax. This should be declared on your Self Assessment tax return for the tax year it was earned in.

This might be taxed at 20%, 40% or 45%, depending on your income tax band.

You can offset your rental income against certain allowable expenses, for example, letting agent fees, property maintenance and Council Tax.

Mortgage Interest Tax Relief

The rules around mortgage interest tax relief are changing. This will mean relief for finance costs on residential properties will be restricted to the basic rate of Income Tax.

Finance costs includes mortgage interest, interest on loans to buy furnishings and fees incurred when taking out or repaying mortgages or loans. No relief is available for capital repayments of a mortgage or loan.

Previously, you were able to deduct all of this interest on your mortgage from your rental income before tax was paid.

Some Risks Associated with Buy to Let

Risk	**How it might affect your buy-to-let investment**	**Is there anything you can do about it?**
Costs rise unexpectedly	For example, the mortgage payment rises, you have to make major repairs to the property, you employ a property manager and his/her fees rise, and so on. As a result, your income and your profit are reduced.	▪ Consider a mortgage with a fixed rate. Your payments will not go up even if mortgage interest rates rise. ▪ Be realistic: when planning whether the project is feasible, build in a margin for extra costs and maintenance.
Property is empty for longer than you had expected	Your total rental income for that year is lower than you had expected. At the worst, you may receive no income for several months and have to cover your mortgage payments and other costs from your savings or other income.	▪ Factor this scenario into your planning and decide on a contingency plan. E.g. Do you have savings or is there sufficient 'headroom' in income from other sources to cover a void period.
House prices do not rise as much as you had expected, or fall	The after-tax gain you make when you sell the property is less than you had planned or you even make a loss. At the worst, the proceeds from the sale might be too low to repay the mortgage in full.	▪ Be aware from the outset that there is no guarantee you will make a profit when you sell the property. ▪ Be prepared to put off selling the property so you can ride out any slump in prices. ▪ Take a repayment mortgage, so that you are paying off the loan as well as paying interest.

Poor location	There is little or no demand from tenants in the area where you buy, so it stands empty for long periods or the only way to get tenants is to charge a lower rent than you had planned. Either way, your income is reduced.	▪ Do your research before you buy – for example, talk to estate agents, visit and check the distance to shops, local schools, public transport. ▪ Employ a letting agent to recommend suitable properties – tenants won't necessarily want the same type of property as owner occupiers.
Property is in poor condition	Tenants do not want to live there or you have to spend large amounts bringing the property up to an acceptable standard. Either way, your income (and so your profit) is reduced.	▪ Do your research before you buy – get a survey of the property – bear in mind older properties tend to have higher maintenance costs. ▪ Employ a letting agent to recommend suitable properties and give you an idea of the rent you might expect.
Bad tenants	Tenants may damage the property, fail to pay rent on time, or upset neighbours. This may increase your costs, reduce your rental income and lead to a need to evict the tenants.	▪ Vet potential tenants, including taking up references. If you do not have time to do this yourself, employ a letting agency. ▪ Let the property under an assured shorthold tenancy. This lets you evict tenants on two months' notice with a minimum of fuss. Most lenders will insist you use this type of tenancy agreement.

Further information about buy-to-let

Council of Mortgage Lenders
Tel: 0845 373 6771; www.cml.org.uk
Mortgage Guide: Buy-to-let
www.cml.org.uk/cml/consumers/guides/buytolet

GOV.UK
www.gov.uk/
Guide: Renting out your property (Scotland)
www.gov.uk/renting-out-your-property-scotland
Guide: Renting out your property (England and Wales)
www.gov.uk/renting-out-a-property

HMRC
Local tax offices (see Phone Book)
www.hmrc.gov.uk/
Property income manual
www.hmrc.gov.uk/manuals/pimmanual/index.htm
Capital Gains Tax reliefs on property that's not your main home
www.hmrc.gov.uk/cgt/property/reliefs.htm
GREIT04005 - Property rental income: general
www.hmrc.gov.uk/manuals/greitmanual/GREIT04005.htm

The Association of Residential Letting Agents
Tel: 0845 250 6001; www.arla.co.uk

Residential Landlords Association Ltd
Tel: 0845 666 5000; www.rla.org.uk
Documents & Guides
www.rla.org.uk/landlord/documents/landlord_document_centre.shtml

General information about mortgages Financial Conduct Authority (FCA)
Consumer Helpline Tel 0800 111 6768
consumer.queries@fca.org.uk

Money Advice Service
Tel: 0300 500 5000
Buy-to-let mortgages
www.moneyadviceservice.org.uk/en/articles/buy-to-let-mortgages
Buy-to-let property investments
www.moneyadviceservice.org.uk/en/articles/buy-to-let-property-investments