Derbyshire™
Mortgage Services

Buy To Let Mortgage Guide

Buying an investment property is a big decision that, if planned carefully, can be very rewarding. We've created this buy to let mortgage guide to ensure you understand exactly what's involved in property investing.

When searching for a property to invest in, there are many different things to consider. Firstly, you need a special type of mortgage designed for landlords known as a buy to let mortgage. While these mortgages are very similar to standard residential mortgages, there are key differences. We believe that purchasing any property, whether for your own home or as an investment, should be as stress free as possible, so we're here to help you understand exactly what is required in a buy to let mortgage, as well as what it takes to be a successful landlord. From differences in interest rates and tax, to arranging tenancy agreements and securing the right property in the right area, this guide will provide a handy source of information about your buy to let mortgage.

1. Buy To Let Mortgages: The Key Differences

1.1 What is a buy to let mortgage?

A buy to let mortgage is a special type of mortgage designed for landlords who are looking to rent out their property to tenants. Without such a mortgage, you will not be able to rent out your property as a landlord (unless you're a cash buyer and you don't need a mortgage at all). While a buy to let mortgage is similar in its structure to a standard residential mortgage, there are some key differences.

One of the first major differences is that the majority of buy to let mortgages are interest-only, rather than repayment. This means that you only pay back the interest on the mortgage each month, and at the end of the lending period you will need to pay back the capital in one lump sum. This could be from the sale of the property, savings or other investments. There are advantages to the interest-only mortgage, mainly that the monthly repayments are cheaper, giving you more flexibility. However, this type of mortgage doesn't reduce your overall debt, and the risk of house prices falling may not leave you enough money to repay the mortgage in the future. You can still, of course, choose a repayment buy to let mortgage from the outset.

Buy to let mortgages are also not based solely on your personal income, but rather on how much rent the property can generate. Lenders will use a rental income calculation to assess how much they will lend, and this calculation will vary from lender to lender. As a rough guide, the most common calculation is 140% of rental income at 5.5% interest – this interest figure is not the interest you will pay back on the mortgage, but merely a stress test used by the lender to calculate a loan that is affordable in the long term.

1.2 Interest Rates

Interest rates on buy to let mortgages are typically higher than residential rates. You might find that conveyancing costs and arrangement fees can also be higher for rental properties.

1.3 Deposit

Buy to let mortgages often require a much larger deposit than standard residential mortgages. The minimum deposit is usually 20%, although a deposit of 25% is the most common. In order to get the best buy to let mortgage rates, as with standard residential mortgage rates, you will need to put down a higher deposit, anywhere up to about 40%.

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1.4 Stamp Duty and Tax

You will still have to pay Stamp Duty Land Tax on a property investment, and if the property is additional to your main residence you will be charged different rates and must have paid this stamp duty within 30 days of completion. These rates were established on 1st April 2016 and are as follows:

- 3% on the first £125,000
- 5% on the portion up to £250,000
- 8% on the portion up to £925,000
- 13% on the portion up to £1.5 million
- 15% on everything over £1.5 million

As a landlord, any profit you make from renting out a property will also be liable for income tax. There are ways to reduce your tax bill by offsetting certain costs against the received rental income, including property repairs and maintenance, insurance and any letting, management or legal fees.

There are a variety of tax implications when purchasing an investment property, and it is advisable to seek the help of a specialist tax advisor who can explain the situation fully. We work closely with some highly skilled tax advisors, and we would be happy to recommend them to you.

1.5 Limited Company Buy To Let Mortgages

Due to recent tax changes affecting those who personally own buy to let properties, it is becoming more common to purchase investment properties through a limited company. This company must be a SPV (Specialist Purpose Vehicle) limited company and have the correct SIC (Standard Industrial Classification of economic activities) codes.

Limited company buy to let mortgages are generally more expensive than personal buy to let mortgages, but the tax benefits of buying through a limited company may make this the route most suitable for your circumstances. Getting expert advice in this field from a specialist tax advisor, however, is crucial.

1.5 Tenancy Agreements & HMO

If you are a private landlord and looking to rent a property to a tenant as their home, then you will need an Assured Shorthold Tenancy (AST). Mortgage lenders will often insist that you have an AST when applying for a buy to let mortgage and can ask to see a copy of the agreement. In England, you will also need to place your tenant's deposit within one of the 3 official government backed tenancy deposit protection schemes – if any dispute with the tenant arises, the scheme will protect the deposit until the dispute is settled.

If your property is going to be let to several tenants who aren't members of the same family (very common for rentals provided to students) then your property may need, or already have, an HMO (House in Multiple Occupation) licence. The local authority can provide further information on this license and whether it is required for that particular property. The choice of buy to let mortgage lenders for HMO properties is more limited, but one of our expert advisors will certainly be able to help you find a deal that's right for you.

2. Choosing a Buy to Let Property

2.1 Find the right area

When making a property investment, you have to make sure that you find a property you can make a profit from. One of the most important factors to consider is the area you purchase your new property in. Some landlords, especially private landlords, prefer to choose a property that is nearby, or within the same town or city, as it makes management easier. However, it is important to consider the profitability of the property as well as just how feasible it is for you to manage it.

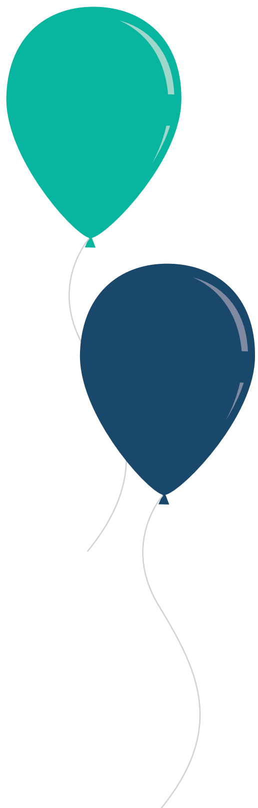
When choosing an area to purchase a new property in, there are certain things you should be asking. While a property doesn't need to tick all of these boxes, it's worth considering them to estimate just how desirable your property might be to a tenant:

- Is the area 'in demand'? Or is the demand for the area expected to grow in the long term?
- What demographic lives in the area currently (families, students, young professionals, households with housing allowances)? Will this demographic change any time soon?
- Does the area have good transport links?
- Does the area have local amenities, shops or good schools?

- Is there a benchmark level of rent for the properties in this area?
- Are there any major developments occurring in this area in the next decade?
- What is the crime rate in this area?

2.2 Find the right property

As with finding the right area for a property investment, you also need to consider the type of property itself. Certain types of properties will be better suited to different demographics, or might be rare for the area, so make sure you ask the following questions to ensure that your investment is well placed:



- What type of properties do most tenants in the area want to live in?
- Are the rental properties in this area furnished or unfurnished by landlords?
- Is there a certain property type that is expected to grow in the area? Will this property type grow to a point of oversupply?

Some properties can also be more difficult to find buy to let mortgages for, whether due to their age, type or location. There are restrictions on mortgages available for ex-local authority or high rise flats, where lenders might put limits on the number of floors within the block or on how many privately-owned flats are available within the block. Flats above commercial premises, such as restaurants, shops and offices, can also have restrictions. A buy to let mortgage will be secured against your property, some types of buy to let mortgages are not regulated by the financial conduct authority.

2.3 Find a good letting agent

Letting agents can be incredibly helpful when searching for the right property in the right location. With a shortlist of preferred cities and towns, the type of property and even the type of tenant (long term, short term, student) they can advise on which available properties will be best suited to you. By establishing the right kind of property in the right kind of area for a particular type of tenant, you can also develop the right knowledge to pitch your new property to future tenants.

Many landlords will also choose to use a letting agent to help manage their property after purchase. While you can still be a private landlord, it can be time consuming and a letting agent will also have plenty of experience in leasing properties to tenants. There are, however, costs to using a letting agent – typically they will take a 5-10% cut of the monthly rental fee, and will also charge fees for finding tenants to rent the property. For their expertise, however, paying for the services of a good letting agent can be worth it in the long run. We work closely with a number of letting agents who we can recommend should you wish to use their services.

2.4 Cash flow and Management

As a landlord you have many responsibilities, and before you make a commitment to purchasing an investment property you must understand them and be prepared to fulfil them. Your landlord responsibilities will impact your cash flow, but by being aware of and planning for them you can ensure that you still continue to profit from your investment. You should always try to have 3-6 months of reserve mortgage payments, just in case.

Your mortgage lender will require you to have landlord's building insurance to protect the building that the mortgage is secured on, and you must make sure that you renew this each year so as not to be in breach of your mortgage agreement. Tenants are not responsible for repairing the property (unless they have caused the damage or violated their tenancy agreement) and as landlord you are responsible for all maintenance and upgrades. This also includes completing an inventory and obtaining compulsory gas and electricity certificates, and keeping these updated.

You also need to factor any void periods into your cash flow. These void periods might be while you search for a new tenant or perform any necessary redecoration or repairs to the property. Regardless of whether you have a tenant or not, you will still need to make your mortgage repayments during these periods. Failure to make these repayments could lead to your mortgage lender repossessing your property to retrieve the money that you owe them. There are ways to insure against rental voids and other costs that you might not think of, but your letting agent should be able to advise you about this.

3. Buy to Let or Let to Buy?

If you're looking for a new home but want to keep your old home and transform it into a property to let out to tenants, this process is referred to as let to buy. You can ask your current lender for their permission to let out your current property, and they may switch your mortgage to a buy to let rate, but not all lenders will allow this to happen. Another option is to remortgage your property to a new lender on a buy to let deal. If you decided to remain with your current lender, however, you must inform them that you intend to rent out your home. If you fail to do this, you might be in serious breach of your mortgage agreement.

Whether you are purchasing an investment property with the intention of buy to let or let to buy, our fee free service will always ensure that you have all the time needed to consider your options and understand the commitment you are making. Our qualified buy to let mortgage advisors will be there from first meeting until the purchase of your new property is completed, completing your buy to let mortgage application on your behalf and making sure that your purchase runs smoothly.

4. What Next?

We hope that this guide has been useful for understanding buy to let mortgages. Our priority at Derbyshire Mortgage Services is always to find the best deal on a mortgage that is suited to you and your circumstances, and our dedicated team of expert advisors will be with you every step of the way, from first meeting until the day you move in.

We will never charge you for our services, so if you're ready to find another property, or if you have any queries, or even if you're just considering your options for the future, why not give us a call on 01332 554098 and let us help you start planning today.