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Buy-to-let mortgage guide

BUY-TO-LET MORTGAGE GUIDE

Buy-to-let mortgages can be confusing, particularly if you are a first-time landlord.

Using a broker like Firstxtra can help you understand how these mortgages work, get you the correct rate and help you find the right property.

They can also work out what how much you can afford to put down and what rental income you can expect to receive and what your monthly payments will be.

Having a team of experts on the other end of the phone can help reduce stress and give you peace of mind that the whole process is taken care of.

There is no guarantee that it will be possible to arrange continuous letting of the property, nor that rental income will be sufficient to meet the cost of the mortgage.

In this guide, we'll cover all the basics you need to know before making that all-important decision.

WHAT IS A BUY-TO-LET MORTGAGE?

A buy-to-let is a property purchased with the intention of renting it out to tenants, usually on a long-term tenancy basis (min of 6-12 months).

If you are purchasing a property as an investment, rather than to live in for yourself, you won't be able to take out a residential mortgage.

Instead, you will need a specialist buy-to-let mortgage, which allows you to borrow money to buy a property that you plan to let out.

While buy-to-let mortgages are in many ways similar to a normal mortgage, there are some key differences between the two.

WHAT IS THE DIFFERENCE?

The main differences are that buy-to-let mortgages usually require a minimum deposit of 20-25% and have slightly higher interest rates than a residential mortgage. Buy to let mortgages are taken out solely for the purpose of renting the property.

WHO IS ELIGIBLE?

You must meet certain eligibility criteria to successfully receive a buy-to-let mortgage.

A lot of lenders have a minimum personal income requirement, this may in the region of £25,000 per annum. Although, there are still many lenders who don't have a minimum income requirement.

In most cases lenders will work out how much you can borrow based on the rental income the property will generate.

Buy-to-let mortgages are for both seasoned investors and for new landlords looking to take their first steps into the rental property market.

Many lenders will require you to own your own residential property before taking out a buy-to-let mortgage. However, there are lenders that don't require this and can lend to you still but the criteria may be different.

To work out whether a buy-to-let property is a good investment, you should look at the rental yields and potential future capital growth.

Rental yield measures the ongoing return on investment for a property.

Capital growth, meanwhile, is the value that the property increases or decreases by over a set period of time.

WHAT SHOULD I DO FIRST?

Seek some advice

As with any mortgage and investment, getting professional, expert advice from a broker will help you find the best option for you.

You provide us with details about yourself, your financial circumstances and the property you are looking to purchase.

After that, we'll do all the hard work of finding the right mortgage lenders and products to meet your specific needs.

Once we've found the right provider, we can then proceed with your full application and take all the hassle away for you.

WHAT ARE THE DIFFERENT TYPES OF BUY-TO-LET MORTGAGE?

Fixed Rate

With a fixed rate mortgage, the interest rate stays the same (i.e is fixed) for the duration of the loan.

This means you know exactly what you are going to be paying and there are no nasty surprises.

Fixed rate mortgages are typically taken out over a period of 2, 3, 5 or 10 years before returning to a variable rate for the remainder of the mortgage.

Variable rate mortgage

Like a fixed term mortgage, you can choose to be tied in for 2, 3, 5 or 10 years.

But as the name suggests, the interest rate isn't fixed and can therefore go up and down throughout the duration of the loan depending on the rate of inflation.

Some variable rate mortgages have the added benefit of not have any early repayment charges but in most cases the rates tend to be higher.

Tracker rate mortgage

A tracker rate mortgage is very similar to a variable rate mortgage.

The main difference between the two is that a tracker mortgage follows the Bank of England base rate, rather than the lender's Standard Variable Rate (SVR).

Although lenders normally change their SVR as a result of The Bank of England Base Rate changing, they don't have to change them by the same amount.

With a tracker rate, the mortgage tracks, by a pre arranged amount, an independently set interest rate.

Some tracker rates will have the benefit of not having any early repayment charges and you can also normally have a tracker rate for 2, 3 or 5 years.

Interest-only mortgage

As the name suggests, with an interest-only mortgage you only pay the interest on the loan. At the end of the term, you'll still owe the original amount you borrowed.

Usually, the monthly payments are lower because you aren't paying off any of the capital.

This is usually the popular option for buy-to-let landlords as the rent they collect from tenants will pay off the interest.

When they are ready to sell, the money they make from the sale pays off the capital.

Part repayment and part interest only (Part and part)

As it says on the description, this a mixture of both a repayment mortgage and an interest only mortgage. The lenders criteria for this is normally the same as for interest only borrowing.

Repayment mortgage

A repayment mortgage is the most common type of residential mortgage, but is often not the preferred type for buy-to-let landlords.

It is where an individual makes a monthly repayment with some interest paid on top.

Once you have paid back all of the mortgage debt and interest, you will own 100% of your property.

WHAT ARE THE SPECIALIST AREAS OF THAT ARE ALSO COVERED UNDER BUY-TO-LET MORTGAGES?

Limited company buy-to-let mortgage

Holding buy-to-let property in a limited company may offer tax benefits for some landlords.

One big difference is you don't pay income tax on rental income with a buy-to-let limited company. Instead, any rental profits on properties that are held within a limited company are charged Corporation Tax, which currently stands at 19%.

When you own a buy-to-let property through a limited company, you can also deduct certain expenses as they are considered business expenses rather than personal.

It's always best to get some advice from a qualified accountant to weigh up the pros and cons and workout whether or not a limited company buy-to-let mortgage is the right option for you.

Holiday let mortgage

A holiday let mortgage is designed for people looking to borrow money to buy a property that will be let out on a short-term basis to tourists as a business.

It is also different from a buy-to-let mortgage, where you borrow money to buy a property that will be let-out on a long-term basis.

A holiday let income will usually vary, in peak months it could be much higher, but unlike a buy-to-let income, it isn't guaranteed for months at a time.

So, the amount a lender will loan you with a holiday let mortgage is based on an income projection figure rather than a simple multiple of potential rental income.

As a result, the lending criteria for holiday let mortgages is usually much stricter than with a residential or buy-to-let mortgage.

HMO mortgage

A house in multiple occupation –known by the abbreviated term HMO – is a property which is rented by three or more tenants who aren't part of the same household.

Many landlords find an HMO appealing as it provides an opportunity to collect rent from a higher number of tenants and therefore boost their rental income.

If you intend to rent the property as an HMO, then you will need an HMO mortgage rather than a residential mortgage.

If you're considering converting a property into an HMO, there are also several things you'll need to do, such as meeting legal requirements and making the property suitable for multiple tenants.

You'll have to ensure that there is enough space for everyone, rooms are habitable and shared facilities are of an acceptable standard.

Location is often an important consideration when going for an HMO. For example, a property close to a university or college is likely to be a popular choice for students looking to house share.

WHAT DEPOSIT WILL I NEED?

In order to be able to get a buy-to-let mortgage, you'll generally need a deposit of at least 20-25% of the value of the home.

As with standard residential mortgages, the bigger the deposit you put down, the better the rate you'll be able to get.

Many lenders will use a rental income affordability calculator which takes into account the potential rental income received against the amount of money you wish to borrow. Some lenders may also use your personal income in this calculation.

Most lenders will ask that the monthly rental income must be at least equal to 145% of the monthly mortgage payments on an interest-only basis.

For basic rate taxpayers and Limited companies this could be 125% rather than 145% but lenders can and do vary.

WHAT OTHER COSTS DO I NEED TO CONSIDER?

When it comes to purchasing a property, it is important to remember that it isn't just the deposit you need to pay for. There are also a number of additional costs to consider too.

Here are some of the main ones that you need to be aware of:

Extra Stamp Duty

If you are purchasing a property that's not your main residence, such as a second home or a buy-to-let, you will have to pay an additional surcharge on top of the standard Stamp Duty rates. These rates can be found in the Stamp Duty section on the Government website.

Paying tax on rental income

Any rent you receive from your tenants is classed as income, and therefore you'll need to declare this as income and complete an annual tax return. You may have to pay income tax on this extra income. We always recommend you speak with a qualified tax specialist to guide you on this.

Capital Gains Tax

Capital Gains Tax is a tax on a the profit when you sell something that's increased in value. It's the gain you make that's taxed not the amount of money you receive. You will have a tax-free allowance each year which changes along with Government guidelines. You can find this information on the Governments website or your accountant should be able to advise you further.

Letting agent fees

Sorting out paperwork, chasing rent and staying on top of everything can be difficult and time consuming, particularly if you have multiple properties you are renting out.

You might want to consider employing a letting agent to manage the property for you.

If you do, there are additional costs to consider. Most letting agents charge a percentage of the rental income, typically this can be anywhere from 8% to 15%, plus VAT.

However, you may feel like it's money well spent if it gives you time to focus on other things.

Legal fees

A solicitor or licensed conveyancer will carry out all the legal work when it comes to buying and selling your home. We can recommend you with quality firms that we work alongside and they will be able to price this for you once you have found a property.

Mortgage broker fees

Firstxtra (the mortgage broker) will manage your entire application, from start to finish. There are charges for the services we provide, we would disclose all our fees to you at the initial meeting.

Mortgage lender fees

The lender may also have fees that are associated with the mortgage, these may include an arrangement fee, valuation fee and telegraphic transfer fee. We would discuss all the fees with you before applying for a mortgage.

WHAT ARE MY RESPONSIBILITIES AS A LANDLORD?

Being a landlord comes with many responsibilities. As the owner of the property, you are the one responsible for any general repairs or building costs, not your tenants.

This may include fixing any problems with the boiler, heating or water supply, or any existing fitted electrical appliances the property has. You have a duty of care towards your tenants so you need to ensure the property is habitable and safe to live in.

Be prepared that there may be weeks or months when the property might be empty, such as when you're in-between tenants. During these periods, the responsibility will fall on you to continue to make your monthly repayments.

Any missed mortgage payments could result in the repossession of your property.

Therefore, it is vital that you make sure you have enough savings to cover these periods and we normally suggest that 3-6 months' worth of mortgage payments is a good starting place to have.

WHAT INSURANCE WILL I NEED?

Getting the right type of insurance is vital as it can help protect you – and your property – when things don't go to plan or when something serious happens.

Landlords Buildings insurance

While it's not a legal requirement, most mortgage lenders require you to have buildings insurance in place when you exchange contracts. It's the minimum level of insurance required by most lenders.

If you are purchasing a leasehold property then the buildings insurance is normally covered in the Service charge that you would pay.

Buildings insurance covers the cost of rebuilding your home if it's damaged or destroyed.

Garages, sheds and fences are also sometimes covered, as is the cost of replacing items such as pipes, cables and drains. These are all subject to the policy that you take out and at Firsxtra we will look after theses insurances for you and make sure that you are purchasing the correct policy for your needs.

Landlords Contents insurance

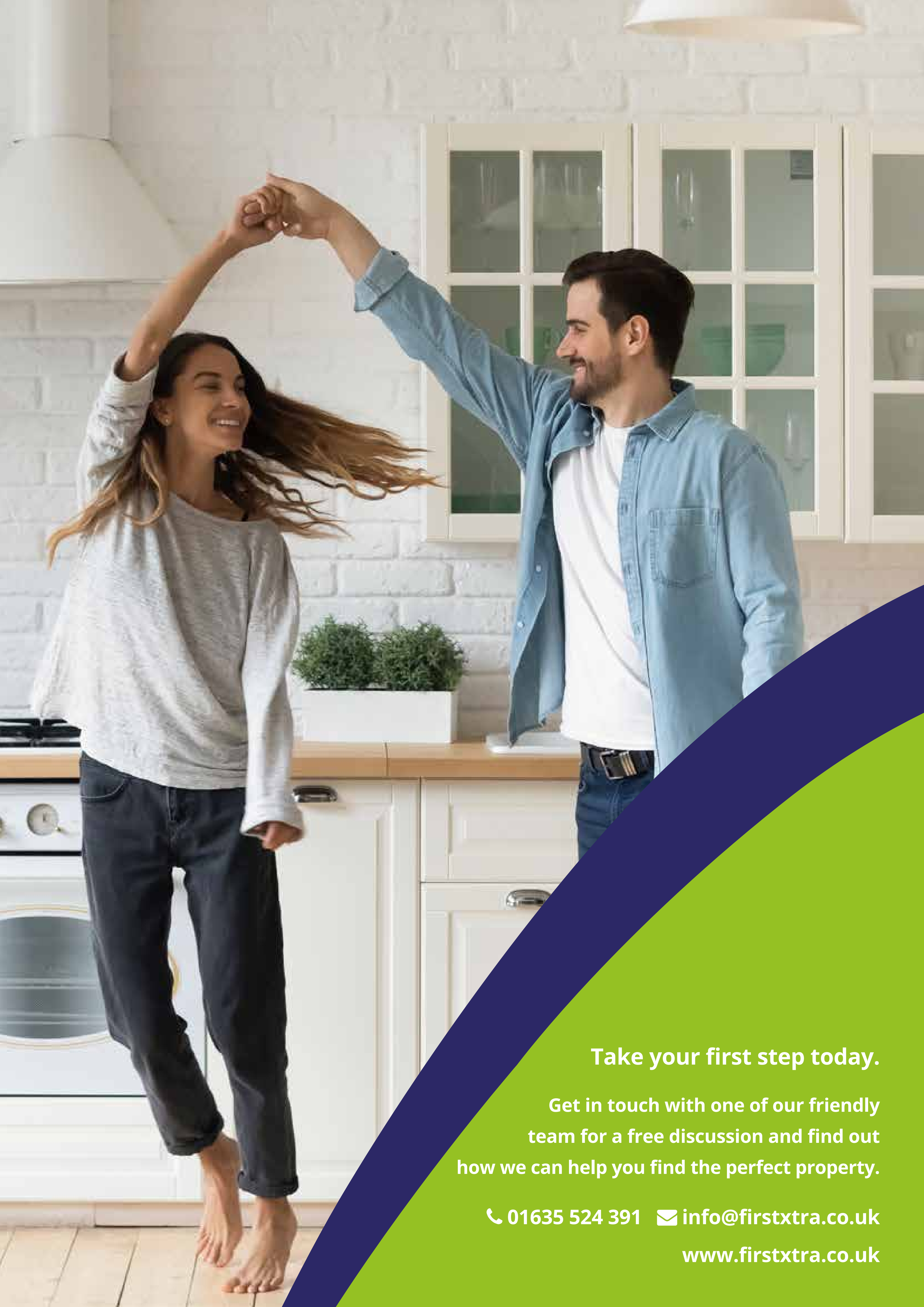
Your tenants will be responsible for insuring their own personal belongings.

However, if you want to insure against damage to carpets, furniture, decorative and electrical items that are already in the property, it's a good idea to get it. This can be purchased as an add on alongside your buildings insurance or separately if you do not require to get your own buildings insurance.

Rental Protection insurance

Occasionally, even the best tenants can find their circumstances suddenly changing, such as redundancy or long term sickness, meaning they're unable to pay the rent.

We can offer Rent Protection insurance that can give you peace of mind that you won't lose out if your tenant can't, or won't, pay the rent. We can also include legal expenses cover as standard to cover the legal fees needed to evict the tenant and regain vacant possession of the property.


Take your first step today.
Get in touch with one of our friendly team for a free discussion and find out how we can help you find the perfect property.
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