

## IFA Fact-Files

### "Buy to Let? "



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The greater availability of "buy to let" mortgages has encouraged more people to see renting residential property as an alternative investment or indeed pension. In this "Fact File" we have highlighted the main issues you should consider before purchasing a second home as an investment:

#### Cost

**Mortgage** - The interest rates charged for "buy to let" are often slightly higher than normal loans but the usual range of variable or fixed rates are available. You can expect to pay up to 2% above Base Rate for a standard variable rate. A valuation fee and/or arrangement fee of £300-£400 may be payable but with many lenders keen to grab a share of this market you should shop around.

**Stamp duty** - The Chancellor left Stamp Duty rates and thresholds unchanged in his latest Budget so, with the average house price hovering around £150,000 you can expect to add 1% to the purchase price as follows:

Purchase price	% of total transfer
£0 - £60,000	0
£60,001 - £250,000	1
£250,001 - £500,000	3
£500,001 +	4

**Legal fees** - A solicitor will typically charge £300 + VAT for conveyancing plus the cost of carrying out the necessary searches.

You will also need a legal Tenancy Agreement - you can purchase a standard Shorthold Tenancy Agreement from most stationers but if you do not intend to use a professional letting agent you should ask a solicitor to draft a contract for you.

**Letting agents' fees** - The main aim of a letting agent is to keep your property occupied with quality tenants. When it comes to repairs or disputes the legal responsibility is yours alone. That said it can be very wise to appoint a letting agent who will credit check prospective tenants and ensure that the rent is collected on time. Some firms offer a "let only" service where you pay a fixed fee per tenant. More commonly you will pay 10-15% of the rent for a "let & management" service.

**Repairs & disputes** - These are the unknowns of letting property. Many tenants rent houses precisely to avoid the cost and hassle of repairs. If you want to command the highest rent for your property you will need to give it a lick of paint each time someone moves out and ensure that repairs are carried out promptly. In the worst case scenario of tenants causing damage and refusing to pay it is hard to predict what you might spend trying to recover costs.

**Gas & electricity certificates** - Most appliances in the property (including the central heating) must be checked annually by a qualified professional who will issue a certificate of compliance.

**Fixtures & fittings** - For many of the reasons set out above it is ill-advised to let property furnished. With more of your possessions in the property there is more to be damaged and there are also strict guidelines about flame retardant materials so your old sofa may not be allowed.

**Accountant** - If you need an Accountant, they will probably charge at least £150 per annum plus VAT.

## Tax

**Income** - Profit from rental income is taxed at normal Income Tax rates. If you are employed full time this is likely to be 22% but if you already earn more than £35,000 all of the profit from your investment is liable to 40% Income Tax. Even if you are a Basic Rate taxpayer currently, the extra income from renting could push you into the 40% bracket.

**Growth** - When you come to sell your investment property you will almost certainly be liable for Capital Gains Tax. This is charged on the difference between the purchase price and the selling price which should (hopefully!) be substantial. CGT is charged at 10%, 20% or 40% depending on your normal Income Tax rate. Every individual has an annual CGT exemption – for the 04/05 tax year it is £8,200.

**Inheritance** - If you still own the property when you die it is very likely that your Estate will have to pay Inheritance Tax. Currently IHT is charged at 40% of the Estate value over £263,000 so owning at least 2 houses will almost certainly push you into that bracket. The main exemption is assets passed to your spouse on death but this only delays the inevitable when he/she dies and passes the assets onto the children. IHT planning is a complicated area covered in another "Fact File" and you should always take professional advice about your individual circumstances.

## Risks

As with any investment you should only part with your hard earned cash if you fully understand the risks involved. Believe it or not, investing in property is not "safe as houses":

**Interest rates** - We are just beginning to see interest rates rising after reaching a 40 year low. It is extremely difficult to pass on rising mortgage costs to tenants as quickly as the lender passes them onto you! If you are planning on someone else paying the mortgage for you, make sure you budget for such increases. A fixed rate mortgage can make sense here but this will usually involve being tied to that lender for a number of years.

**Negative equity** - A real fear is that house prices fall to a level where the mortgage is bigger than the value of the property. No one can accurately predict house prices but it is a fact that they are higher than they have ever been almost everywhere in the UK. Negative equity is not necessarily a problem for long term investors but note that when prices fell in the late 1980s, it took almost 10 years for them to return to previous levels. Our view is that house prices will fall over the short to medium term.

**No tenants** - A bigger risk is that you have to pay the mortgage while the property is empty. Buying good quality property in popular areas can reduce this risk and more people are renting than ever before but that should not be taken as a guarantee that you will always have tenants.

## Conclusion

Investing in property costs more than almost any alternative but thanks to "gearing" it is possible to build up a large portfolio quite quickly. Past experience suggests that there is good growth potential but residential property is a much more volatile market than most people realise. The longer you can afford to hold onto your property the more attractive the proposition becomes but investing is all about timing your purchases and your sales. Without a doubt, UK residential property is very expensive at its current level and many commentators are predicting a correction to allow more first time buyers onto the ladder. Investors who wait a couple of years could do much better than those who buy now.

The other great truism of investment is not putting all your eggs in one basket. Since most property investors already own one house this becomes even more relevant. We are concerned that the new breed of property investor is the same person who bought technology shares just before the bubble burst. If this is the case, be sure that you are not jumping out of the frying pan into the fire.

*If you have any questions or need an independent review of your investment arrangements, please contact Martin Andrews to discuss your situation further. Martin Andrews & Associates Ltd is an Independent Financial Adviser regulated by the Financial Services Authority.*

*Information given in this document should not be taken as advice as it is intended for guidance only. If you wish to have an assessment of your own situation, you should contact the office for advice.*