

Buy-to-let mortgages



FSA®

Financial Services
Authority

This factsheet is from the Financial Services Authority (FSA), the independent watchdog set up by the government to regulate financial services in the UK and protect the rights of consumers.

The FSA is responsible for regulating most mortgage sales from 31 October 2004. However, the FSA does not regulate mortgage sales if one or both of the following apply.

- The mortgage is a second charge on your home. 'Second charge' means you already have another loan secured against the home.
- Less than 40% of the property on which the loan is secured is used or will be used as a home by the borrower or a member of the borrower's immediate family.

Only very few 'buy-to-let' mortgages are regulated by the FSA. This means that you may not be able to take complaints about this type of mortgage to the Financial Ombudsman Service. You are also unlikely to be able to seek redress from the Financial Services Compensation Scheme if the firm against which you have a complaint becomes insolvent.

What is a buy-to-let mortgage?

A buy-to-let mortgage is a loan you take out to buy a property which you intend to rent to tenants. The mortgage might be a second charge on your own home or, more usually, it is secured against the property to be let.

It is a long-term investment which you hope will generate an income from rents and a capital gain when you sell the property. But there is no guarantee that you'll make a profit on your investment.

How much can you borrow?

The maximum you can borrow is usually linked to the amount of rental income you might expect to receive. For example, a lender might require the projected rental income to be 30% higher than your mortgage payment. Typically, you'll need to pay a deposit of around 20% of the value of the property.

What type of mortgage can you have?

You can have either a repayment or an interest-only mortgage.

If you choose an interest-only mortgage, you should think about making capital repayments when you can afford to do so to reduce the amount you'll need to repay at the end of the mortgage term.

You might feel this is unnecessary if you intend to sell the property to repay the mortgage. However, bear in mind that, if house prices fall, you might not be able to sell for as much as you had hoped. And you will have to make up the difference if the property sells for less than what you owe – a risk that increases, the higher the percentage you borrow. If you sell for a profit, you may have to pay capital gains tax.

Don't forget that with a variable rate mortgage, your costs will rise if interest rates go up, eating into – or even wiping out – your income and profit.

Some risks of 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.	<ul style="list-style-type: none"> ■ 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.	<ul style="list-style-type: none"> ■ Be realistic: when planning whether the project is feasible, build in an allowance for empty periods. ■ Consider employing a letting agent to find tenants. ■ Do not take on a bigger mortgage than you can afford.
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.	<ul style="list-style-type: none"> ■ 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.	<ul style="list-style-type: none"> ■ 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.	<ul style="list-style-type: none"> ■ Do your research before you buy – get a survey of the property – bear in mind older properties 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.	<ul style="list-style-type: none"> ■ 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: 020 7440 2255; www.cml.org.uk

Buying to let; Thinking of buying a residential property to let?

Office of the Deputy Prime Minister

Tel: 0870 122 6236; www.odpm.gov.uk
Booklet 97 HC 228 B *Assured and assured shorthold tenancies: a guide for landlords*

Inland Revenue

Local tax offices (see Phone Book)
www.inlandrevenue.gov.uk
IR150 *Taxation of rents – a guide to property income*
CGT1 *Capital gains tax – an introduction*

The Association of Residential Letting Agents

Tel: 0845 345 5752; www.arla.co.uk

Residential Landlords Association Ltd

Tel: 0845 666 5000; www.rla.org.uk
RLA Information Pack

General information about mortgages Financial Services Authority (FSA)

Leafletline: 0845 456 1555
www.fsa.gov.uk/consumer

FSA pack *Choosing a mortgage – Taking the right steps*

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