

INCREASING YOUR RETURNS BY USING FINANCE TO YOUR ADVANTAGE

Imagine you have £100,000 cash to invest into residential letting. How do you maximise your returns?

Mr & Mrs A don't believe in finance. They use their £100,000 to purchase a brand new property for cash. They let the property for £600 per month, i.e. £7,200 per annum. Due to inflation the rent increases and, eventually, after fluctuations in the property market, the house doubles in value.

Mr & Mrs B are clients of The Money Centre. They use their £100,000 as deposits to buy £500,000 of properties, just like the one Mr and Mrs A purchased. On this basis they also receive five times as much rental income, i.e. £3,000 per month or £36,000 per annum. The other £400,000 is borrowed and they pay interest on this amount of 5%. This works out to be £20,000 per annum. Therefore, net of interest, they receive £16,000 per annum. They are already **better off** than Mr & Mrs A..... but what happens in years to come? Well it is probably safe to say that Mr and Mrs B's rental income will rise with inflation as per Mr & Mrs A's. However, Mr & Mrs B's mortgage costs remain the same. Therefore, the gap between both couples rental income will continue to widen as time goes on. Then we need to look at the position when the properties have doubled in value. Mr & Mrs A have made a capital gain of £100,000 and have £200,000 worth of investment property. On the other hand, Mr and Mrs B have made £500,000, which is **five times as much capital gain**.

From day one

	Mr & Mrs A	Mr & Mrs B
Property value	£100,000	£500,000
Mortgage	Nil	£400,000
Capital invested	£100,000	£100,000
Rent	£7,200	£36,000
Interest @ 5%	Nil	£20,000
Rent net of interest	£7,200	£16,000

Projection for 15 years time assuming properties have doubled in value and that rents have increased with inflation at 3% per annum.

	Mr & Mrs A	Mr & Mrs B
Property value	£200,000	£1,000,000
Mortgage	Nil	£400,000
Rent	£10,890	£54,450
Interest @ 5%	Nil	£20,000
Rent net of interest	£10,890	£34,450

Accessing your profits

Assume your properties have increased in value by £100,000. You could realise your gains by selling, however, this would involve paying between 24% and 40% capital gains tax. The bottom line is that you will never end up with more than 76% of your gain if you decide to sell.

On the other hand, you could simply refinance and release up to 85% of your capital gain. The tax man will not get a penny. You are better off already. You have also retained the property so you also stand to gain from the effects of inflation on your rental income and any future growth in the property market.

MORTGAGES

There are many different types of mortgage to consider. The following are those we recommend:-

Base Rate Trackers

This is where a lender bases interest rates at a margin over the Bank of England minimum lending rate (otherwise known as bank base rate). Many lenders prefer not to offer mortgages on this basis as they are then tied to a fixed level of profitability. However, from a borrowers perspective, they are the best variable rate mortgages available. Be cautious of lenders who are offering low rates and ensure that the basis of calculating interest rates in the future are known.

L.I.B.O.R.

Some lenders are unable to lend against bank base rate for technical reasons. The alternative is LIBOR which stands for London Inter Bank Offered Rate. In simple terms, most lenders will fix their LIBOR rate every three months. LIBOR is typically within 0.25% either side of the Bank of England minimum lending rate. When measured over any reasonable period of time LIBOR and Bank of England minimum lending rate are similar but if anything LIBOR is marginally higher.

Capped Rates

By capping your interest rate you are effectively putting a ceiling on your interest rate, within a specified term, but without fixing. The main advantage of a capped rate is that your interest rate can fall but not rise above the capped rate. The disadvantage is that capped rates are often slightly higher than fixed rates.

Fixed Rates

The main advantage of fixing your interest rate is certainty of knowing what your repayments will be for a certain amount of time. Depending upon economic conditions you may also be able to secure funding at rates which are below variable rate pricing. The downsides are loss of flexibility, increased redemption penalties and/or extended redemption periods.

Flexible Mortgages

In an ever changing business environment, flexibility is crucial. The business of a residential property investor is no different. An investor might have an idea of when he wants to sell but can rarely predict when he will need or otherwise be tempted to sell. For this reason an investor should seriously consider the implications of redemption penalties. With a flexible mortgage many lenders will allow an investor to make overpayments. This facility can be used to plan the early repayment of a mortgage. Where the level of flexibility extends to re-drawing overpayments an investor can utilise the facility as a "sinking fund", say for refurbishment or so that payments can be missed in the event of rental income not being generated for a period.

WHAT TYPE OF PROPERTY?

Most lenders prefer to lend on properties worth in excess of £40,000. Additionally, many lenders offer their best deals on higher value mortgages. Accordingly, you need to strike a balance between value of property for mortgage purposes and the rental yield that can be attained. Look for properties with low maintenance costs and in an area with high demand for both rented and owner occupied properties. Your local newspaper on the main property day will be a good source of information. See the advertisements from the estate agents and also look at what the property managers are advertising. Many property managers will advertise to attract landlords with a certain type of property. This provides an indication of the types of property with the highest demand.

Please note that many lenders choose not to lend on ex local authority properties or flats above shops. Such properties can be mortgaged. However, as the competition between lenders that choose to lend on these types of property is low, they do not have to be quite so competitive.

Houses

The best returns come from shared houses, for example lettings to students. However, be prepared for extra maintenance and management problems if you choose to let on this basis.

You may also wish to consider letting to a company or housing association. However, you will need a different type of tenancy agreement for this type of letting and this could impede your borrowing ability. I will be happy to put you in touch with somebody who can provide you with further information about this if required.

Flats

The highest demand for lettings is usually for flats within walking distance of the city centre or railway station. Remember to budget for ground rent and service charges as these can have a significant effect on your cashflow. Before committing to the purchase of a flat, check with the freeholder that permission to let will be granted.

Blocks Of Flats

A small block of flats can be an ideal investment due to re-sale potential. Various options may be open to you when you decide to sell, including disposal of the whole block or the creation of leaseholds so that the flats can be sold separately. This means that the property can be sold either to owner occupiers or to another investor.

Another advantage of purchasing the whole freehold of a block of flats is control of the property in respect of ground rents and maintenance charges. You can also expect higher yields.

The main downside is that many (but not all) Buy-to-Let lenders shy away from lending on whole blocks of property.

Hmo's - Houses In Multiple Occupation

Here lies the trade off between capital growth and cheap mortgages against high yield and strong cashflow. HMO's will usually include flats and bedsits, often with some shared facilities. Rents are higher as they are usually charged per person and are often DSS funded.

Unfortunately, many lenders shy away from this type of property as they wish to disassociate themselves from what is normally the bottom end of the market. Additionally, re-sales can be slow and cumbersome as the only purchasers are other investors.

Lenders who do lend of this type on property often charge a premium on their lending or adopt very tight valuation policies. For example, they might value the property as if it were a private dwelling house and then deduct the cost to convert it back into a house.

HMO's can, however, be a good type of property to purchase if you need to generate an income and you are prepared to put in the work associated with regular tenant changeovers and refurbishment.

THE COSTS ASSOCIATED WITH BUYING TO LET?

Valuation Fees

The following application fee scale has been adopted by the majority of lenders we deal with. The application fee is inclusive of the cost of valuations, rental assessments and booking fees for exclusive products.

Property value	Fee
Up to £30,000	£199
£30,001 - £75,000	£224
£75,001 - £100,000	£249
£100,001 - £150,000	£268
£150,001 - £250,000	£330
£250,001 - £350,000	£393
£350,001 - £500,000	£500
Thereafter, (for guidance only)	£1.00 per £1,000 plus VAT

Payment may be made by cheque, credit card, Switch or Delta.

Stamp Duty

Stamp duty is paid on purchases in accordance with the following scale:-

PROPERTY PRICE	STAMP DUTY
Up to £ 60,000	Nil
Up to £250,000	1%
Up to £500,000	3%
Over £500,000	4%

Redecoration

Unless you are purchasing a brand new property, you should budget for re-decoration. No matter how tidy a property looks on first inspection, or when it was last decorated, once furnishings have been removed it will look untidy. Ignore your personal preferences in respect of colour and stick to magnolia or white. White is particularly useful in dark rooms.

If you are looking for somebody to do the work for you, your local landlords association will usually be able to refer you to a reputable and reasonably priced contractor.

Carpets and curtains need to be smart, hard wearing and neutral coloured. If they are not, change them! Beige is the best colour as it goes with anything. Go for a carpet with a fleck as it will not show dirt and marks as much.

Initial Void Period

It is reasonable to assume that you will not be able to let the property for up to a month. You will need at least a week to redecorate etc. The best way to reduce the void period is to seek permission of the vendor to show prospective tenants around in between exchange of contracts and completion. If the vendor has already moved out of the property you may even be able to negotiate access for re-decoration.

Ongoing Voids

On the basis that you have purchased the right property, in the right area, and it is in good decorative order, you should have very few problems attracting good tenants at market rent.

Be sure to budget for re-decoration every five years and an associated void period of say two weeks.

Make it a condition of your letting that outgoing tenants allow you to show prospective tenants around the property.

Fortunately, the lettings market and property booms are counter cyclical. At times when properties are slow to sell, more people will want to rent. In boom times, many small landlords will sell up for a quick profit. This often results in high tenant demand. In the event of tenant demand falling too low, due to the bulk of the market deciding to purchase for example, you should be in a position to sell for a handsome profit.

Lettings And Management

Other than finding the right tenant, the key to successful letting is getting the paperwork right. If you choose to self manage, join a landlords association. We will be happy to put you in touch with your nearest association who will be able to keep you abreast of the law and provide you with all the paperwork you will need. They are a useful source of information and for less than £100 a year membership, they provide superb value for money.

If you don't have the time to self manage you may wish to appoint a property manager. It is hard to know which one to choose so the best way is to go to at least one of your local landlord association meetings and ask other landlords. They will be quick to tell you who is best and to warn you of the crooks. It might cost you a few G&T's but could save you a fortune in the long run.

Furnished Or Unfurnished

If you are going to furnish then you must get it right. All furniture must be new and meet the latest fire and safety regulations. DO NOT, under any circumstances, furnish a property with second hand furniture. You could reduce rather than increase the rental value by putting in poor quality furniture.

If you are going to furnish, budget about £3,000 capital cost based on a two bed flat and bear in mind that you need to do this every five years.

As a general rule of thumb, we suggest that unless you can increase your rent by at least £60 per month you should let your property on an unfurnished basis. However, whether you furnish or not, you will be expected to provide white goods such as a cooker, fridge/freezer, washer/dryer etc. Talk to your local landlords association about suppliers that members have successfully negotiated discounts with.

Property & Landlords Insurance

Beware the fact that many insurance policies exclude risks on let properties. Additionally, a landlords insurance policy will need to cover additional risks, for example, payment of rent in the event of the property being uninhabitable due to fire, flooding, structural defect etc.

We have negotiated a heavily discounted block policy which is exclusive to clients of The Money Centre. I have enclosed a leaflet about this.

SERVICE

The main benefits for appointing THE MONEY CENTRE as your broker are as follows:-

- One to one service.
- You will never have to fill in an application form as we will complete them for you.
- We can offer you exclusive products with substantial discounts which are not ordinarily available to you.
- Until such time as your application is formally offered, we will telephone you at least every three days to let you know how your application is progressing.
- We will e-mail a Newsletter to you every month to keep you informed you of new deals and new ideas.
- THE MONEY CENTRE process applications in house. WE are in control of valuations and references. No matter how popular the product we offer you, YOU should NEVER be the victim of poor service from a lender.
- Such is our status with our lending partners, many of them have appointed specialist staff who care exclusively for clients of THE MONEY CENTRE

For this service we charge a brokerage fee of 1% of the loan amount, payable upon issue of the lenders formal mortgage offer(s) in accordance with terms which will be confirmed in writing prior to you making an application, or on amended terms which are subsequently accepted by you.

FURTHER CONSIDERATIONS

Other Brokers

Contrary to popular understanding, advice in respect of commercial finance is not regulated by statute (for the avoidance of doubt, commercial finance includes the financing of residential properties for letting). There is little, if any, recourse available for poor advice, misconduct or fraudulent practice unless the advisor is a member of the National Association of Commercial Finance Brokers.

NACFB

The Money Centre are corporate members of the National Association of Commercial Finance Brokers. The Association has its Code of Practice registered with the Office of Fair Trading and its grievance procedure is upheld in association with the Independent Institute of Arbitrators.

Recourse

The Money Centre holds £3 million of Professional Indemnity Insurance. Most Financial Advisors and Mortgage Brokers will have some insurance but these policies frequently do not insure against poor advice and associated losses in respect residential investment finance.

Repayment

You may choose either an interest only or repayment mortgage. Please note that if you chose the interest only option, the lender will presume that final repayment of the mortgage will be realised from the sale or refinance of the property within the chosen mortgage term. If you opt for an interest only flexible mortgage you will be in a position to control the repayment period yourself by making overpayments.

Life Insurance

The Buy-to-Let lenders recommended by The Money Centre do not insist on you taking out Life Insurance to protect the loan. This is considered by many professional investors and lenders as a completely unnecessary expense. Their view is that the property provides sufficient security, and in any event, rental income will continue to be paid by the tenant whether the mortgagee is living or not. Therefore sufficient income should be generated to service mortgage payments whilst the estate of the deceased borrower is settled.

Cashflow

Cashflow is the life-blood of any business. Investment into property must be treated as a business as provision must be made for periods when rent is not coming in and when property needs decorating or other forms of maintenance. To provide maximum cashflow, it is common practice for landlords to structure their funding on an interest only basis. You will appreciate that it is far easier to make overpayments than it is to renegotiate the level of mortgage repayments in the event of a cashflow shortfall.

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