Buy-to-let properties

At one time, investing in buy-to-let properties was seen as a sure fire way to achieve long term growth. Many investors, deterred by the ups and downs of the Stock Market turned to investing in property as a safer investment haven.

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The recession is having a significant impact on the buy to let market. With the buy to let stock increasing as a consequence of 'accidental' landlords - those who didn't want to sell property in a falling market. As a result rents have been pushed lower although according to research by findaproperty.com rents have levelled out at an average of £825 a month with stable yields of 4.55%. The exception to this is in London and Scotland where rents have fallen by as much as 1 per cent.

It is reported that some landlords have added to their buy to let portfolios with almost 10 per cent of landlords having purchased.

Loans on buy to let remain available although deposits of 40 per cent or more maybe required together with a few which again can be 3.5 per cent, or more.

Investing in property has resulted in more than one million buy-to-let mortgages as investors sought the seemingly safe haven of property investment. However, the credit crunch and the recession has changed the complexion of investing in property, not only for home owners, but also those who had sought to build up a property portfolio. For many investors 2008 was a difficult year as they faced the prospect of increasing interest rates as sub prime loans came up for renewal, coupled with the fall in property prices. For many, the reduction in interest rates has eased the immediate threat of negative cash flow, although the overall advantage of capital growth has, for the time being ebbed away.

The property market has always had its ups and downs, but the public perception is that these are less extreme than has been witnessed with the Stock Market. This perception spawned a significant expansion in the buy-to-let sector, especially during the ten years to 2008. Buy to let investors have invested in residential property in the expectation of capital growth, and in so doing earn rent which is applied to cover the costs of ownership.

The buy-to-let mortgage market declined throughout 2008 with only 37,000 new loans worth £3.9 billion in the fourth quarter of 2008, representing a reduction of 56 percent (65 percent in value) when compared to the same period in 2007. There are now more than one million mortgages with more than £130 billion outstanding.

Arrears have increased with more than 25,000 such mortgages in arrears. Reasons for arrears include:

- Fraud - some buy-to-let fraud involved over-valuation to achieve a larger loan than the sale price of the property, with no rent or mortgage ever being paid.
- Payment problems on the part of the landlords - landlords are not immune from wider economic problems, and some have diverted the rental income from tenants to servicing other commitments.
- Voids - there is an over-supply of rental property in some locations, so some landlords are not receiving a rental income on empty properties in current market conditions, and may be unable to pay their mortgage as a result.

However, in any down market there are always investors seeking opportunities and prepared to take risk and the housing supply remains inadequate as we continue to create more households than new homes. Investing in property remains an investment some will pursue, especially given the current market conditions. The cautious investor will make a deposit at least in excess of the 25-30 (some have increased their maximum loan to 40 percent) percent required by many buy-to-let mortgage provider and have a cash reserve to address any issues that may arise as a result of property voids.

Yields may look attractive given the current interest rates, but what will these look like if interest rates increase by two percent? There are still reasons why some may wish to invest in property, these include:

The student scene

One particular area where buy-to-let can make sense is in the provision of accommodation for student members of the family. Traditionally, this has involved paying out fairly high rents over a period of three or four years and seeing nothing in return (except perhaps a sizeable student loan).

By buying a house in the university area, your children can be assured of somewhere decent to live and should be able to cover most of the costs by renting rooms to other students.

The situation presents significant tax saving opportunities, but the correct formalities need to be observed. One of the most important is that the property should be bought by the student, not the parent. Lenders are normally happy to offer a mortgage to a student if the parents act as guarantors.

The property should then qualify as the student's principal private residence and so capital gains tax (CGT) exemption will be available on any profits from the eventual sale.

The rental income is potentially subject to income tax under the Schedule A business rules, which allow a proportion of the running costs (including mortgage interest) to be claimed against the rent. Alternatively, the provisions of the Rent a Room scheme allow the first £4,250 of rent in each tax year to escape tax, with any excess rent over £4,250 being taxed in full.

Furnished holiday lettings (Fhl)

The purchase of a dwelling with a view to short term letting for at least part of each year can give rise to some quite striking tax concessions.

The qualifying conditions are that the accommodation must be let on a commercial basis (i.e. not merely to offset the costs of ownership). It must be available as holiday accommodation for at least 140 days in the tax year and actually let as such for at least 70 of those days. It must not normally be in the same occupation for a continuous period of more than 31 days during at least seven months of the year, which need not be continuous but includes any months containing any of the 70 let days.

If these conditions are met, then the income is broadly treated as trading income, even though it is strictly a notional Schedule A business. Interest paid on a loan to purchase or improve the property is allowed as a trading expense (restricted if necessary by any private use proportion). Capital allowances and loss relief against other income sources may be claimed and the income qualifies as relevant earnings for personal pension purposes.

Properties used for qualifying furnished holiday lettings count as business assets for the purpose of CGT entrepreneurs' relief, and it is possible that they would also attract business property relief for inheritance tax. Such properties are eligible for CGT rollover relief and business gifts relief.

Budget 2009 included an announcement that Furnished Holiday letting status would be extended to lettings within the European Economic area, and that this treatment can be backdated. However, at the end of 2009/10 the furnished holiday letting scheme will be abolished in its entirety, and no further reliefs will be available.

If you have an appropriate property and letting activity outside the UK it is essential that you move quickly to capitalise on the retrospective relief. The deadline for claiming FHL treatment for income or corporation tax in 2006/07 is 31 July 2009. Later years can be claimed by amending the relevant tax returns. Do ask for advice as soon as possible.

Main residence

If a property has, at any time, been your main residence for CGT, it may also be possible to claim the residential lettings exemption as well as exemption for the period of occupation as your main residence and the final 36 months exemption

A significant CGT saving can result from occupying a property as your main residence for a relatively short time - consult us about this, and any queries you have about residential letting.