For intermediaries only

The broker's mini guide to

Portfolio landlords

In association with

Mortgage Solutions

Foundation Home Loans

Talking tax

How to help your clients

Limited company status

Is it the right move?

Welcome

The private rented sector is vital to the housing market, accounting for a fifth of households in England, having doubled in 20 years and overtaken the social rented sector.

Landlords range from those with one property to professional landlords with large portfolios, who make their living letting property to tenants.

You'll already be aware that, as of last year, the regulator defined portfolio landlords as those with four or more mortgaged properties, and lenders need a separate underwriting policy for these borrowers.

The practical impact of this has been a restriction in options for portfolio landlords, plus longer processing times with some lenders.

Luckily there are still specialists, including Foundation Home Loans, that focus on portfolio lending and work hard to keep the process as simple, quick and hassle-free as possible.

This concise guide looks at some of the key issues facing portfolio landlords, from tax changes that can impact their profits to the decision over whether or not to set up a limited company.

You don't need to have all the answers. In fact, when it comes to their personal tax position, you may need to signpost your clients to a tax adviser.

But by having a good overall knowledge of the sector, and relationships with trusted partners, your clients can have confidence in your ability to help them navigate the buy-to-let mortgage market.

We hope you enjoy reading this guide and find it useful.

Paula John, editor in chief, *Mortgage Solutions*

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You will find advertisements throughout the magazine carrying a warning:

YOUR HOME MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR MORTGAGE.

Remember, if at any time you face difficulty in making your mortgage payments, you must contact your lender as soon as possible in order to sort out the problem.

Taxed off

The lowdown on tax changes affecting landlords

Your clients should hopefully be aware by now of how tax changes are going to affect their portfolios.

If not, explain to them the importance of knowing what the changes mean for their portfolio – and their profits.

You can't give them tax advice, but you can brush up on your own knowledge of the changes. Here are the top takeaways for you to ensure you can confidently discuss them with your clients:

- The government is removing tax relief on mortgage interest payments and replacing it with a 20% tax credit. So effectively the relief is being capped at 20%.
- For most basic rate taxpayers, this is simply an accounting change, which might cost them more in professional fees but shouldn't impact their profits.
- Higher or additional rate taxpayers could lose out, because they will no longer be able to claim tax relief at their marginal rate – instead they'll get a tax credit of just 20%. For some, this can literally make the difference between profit and loss.
- Some basic rate taxpayers on the cusp of the higher tax rate bracket could find themselves pushed into it because of the changes, increasing their tax bill and denting their profits.
- Changes to the Wear and Tear Allowance will also impact your landlord clients. Instead of claiming relief on a nominal 10% of rental income, they can now only claim actual expenses.

These changes matter for two reasons. Firstly, they could reduce landlords' profits and lead them to reassess their entire strategy. Some will exit the market, others will sell part of their portfolio, increase rents, or refinance, and you need to be ready to assist them.

Secondly, last year's Prudential Regulatory Authority rule changes to loan-to-income ratios and stress-testing (see box, *Affordability rules*, below) specifically call for tax obligations to be factored into new affordability calculations. In other words, an increase in tax liability could impact your client's borrowing power and they will look to you to explain what this means.

How can you help?

Be very clear to your landlord clients how you can and can't help, because the last thing you should be doing is offering tax advice. It's too complex, too individual and beyond your scope, so refer them to their accountant or an independent tax adviser.

It could make sense to establish a referral relationship with a trusted tax expert who is experienced in buy to let. Ask other local brokers who they refer to and see if you can arrange a similar relationship.

Affordability rules

In January 2017 the PRA introduced new rules for lenders specifically around stress-testing and interest coverage ratios (ICR).

As a result, lenders have reassessed and published their criteria in relation to the new rules, making it clear how they determine affordability.

At Foundation, for example, the ICR ratio is a minimum of 125% across the landlord's portfolio, stressed at 5.5%.

Foundation Home Loans

Focus on Foundation

A firm footing for all your landlord clients

Foundation Home Loans only launched in 2015 but has already become a favourite of mortgage advisers and professional landlords.

That's because Foundation is a lender that is wise beyond its years, having been born out of a long-standing mortgage business and run by mortgage experts who understand landlords, brokers and buy-to-let mortgages.

We know that landlords want accessible mortgage finance, from a lender that will listen to their story, understand the bigger picture of their finances and find a solution that is fairly priced, simple to understand and completely transparent.

We also understand that a one-size-fits-all approach simply doesn't work in a complex sector and portfolio landlords come to us with a vast range of circumstances and finances. Whether it is the size of the portfolio, type of properties, equity position, other income or exit strategy, our landlord borrowers are all different and so are our broker partners.

But you share a similar desire for simple, clear mortgage products, consistent lending decisions, excellent customer service and expertise. And we'll give you that, because we believe in brokers and we want you to believe in us.

Portfolio landlords

New rules mean that portfolio landlord clients need to give a little more information to get a mortgage, so lenders can see the whole picture of their portfolio and wider finances.

While this can be time-consuming with some lenders, at Foundation we have made the process as straightforward as possible and will only ask for the essentials.

For example, we don't ask for business plans or asset and liability statements. We think the simplest solution is to look at the existing portfolio's leverage, loan-to-value (LTV) and rental coverage.

All we ask for is a spreadsheet, showing details of the portfolio – we'll accept an unlimited number of properties in a background portfolio, and will lend up to £3m.

We use this spreadsheet, along with automated valuation models (AVMs) and other background checks, to focus more on the concentration of the portfolio. We also stress test at 125% at 5.5% and ensure that the overall portfolio LTV is 75% or less.

You and your client need clear criteria and quick answers and we are proud of our service levels which are updated online daily.

Find out more

At Foundation we have always believed that professional mortgage advisers are best placed to help our clients find the right product for their needs.

For more information on what we offer and to see our current buy-to-let mortgage range visit *www.foundationforintermediaries.co.uk*

Limited company BTL explained

There are advantages to incorporating, but also drawbacks for some landlords

Limited company buy to let has soared in recent years, as landlords flock to this growing sector of the market because of the potential benefits.

Lenders have responded in kind with the number of limited company buy-to-let deals doubling between 2016 and 2017, according to Moneyfacts, and now accounting for one in five products.

Incorporating is right for many landlords, but not for all.

Potential benefits

Higher rate and additional rate taxpayers are particularly likely to see the benefits.

That's because, under a limited company, they don't pay income tax on their rental income – rather the limited company will pay corporation tax, which is currently 19%.

Crucially, they can also offset their mortgage interest, something that is being restricted for individual landlords (see page 4, *Taxed off*). Your client's tax burden could be reduced further through the use of tax-free dividends as a limited company and retained profits in the business (to expand their portfolio for example).

It's not all about tax though – there is more flexibility in a limited company structure, when it comes to changing ownership of properties, for example.

Possible drawbacks

However, limited companies don't enjoy the Capital Gains Tax personal allowance (currently £11,700), so your client could pay more when they sell.

More in-depth accounts are needed for a limited company, so their accountant's fees will probably rise. There's also the lack of privacy of having accounts published at Companies House.

Make sure your client is aware of the big difference between setting up a limited company to purchase another investment property and transferring existing properties into one. In the process of transferring a property your client effectively sells their property and the limited company buys it, triggering Stamp Duty liability again, and potentially Capital Gains Tax.

Despite a rise in limited company buy-to-let deals, there are still fewer mortgages available from a smaller pool of lenders, leading to higher average rates. Foundation, however, makes all its buy-to-let mortgage products available to limited companies and individuals.

Broker approach

Whether or not your client should buy through a limited company is their decision and they need to take personal advice from an independent tax expert or their accountant. The answer will depend on their finances, properties and mortgages, as well as their exit strategy.

One thing's for sure, advice involving your client's tax obligations is beyond your scope.

Advise them on the mortgages available to them if they incorporate. Show them you understand the key considerations of setting up a limited company.

But always refer them for independent tax advice if they are unsure.

Setting up a limited company

Before they get a mortgage, the lender will want to see that your client has a suitable company registered.

This is very quick and easy to do, either directly at *https://www.gov.uk/limited-company-formation/register-your-company* or their accountant will take care of it.

Facts and figures

Who are your typical landlord clients, why are they investing in property and how long do they expect to stay in the sector?

Foundation Home Loans recently carried out research with 1,000 buy-to-let landlords to find out more about them, their portfolios and their future plans.

The lender looked at landlord demographics, the number of properties they own and how long they expect to remain in the market, to get a picture of today's buy-to-let investor.

In focus

The majority of landlords – 66% – are men, with women accounting for a third.

Unsurprisingly, they are predominantly in the older age categories. Half (49%) of landlords are 55 and over, 40% are 35-54 and just 11% fall into the millennial category (18-34).

Nearly three-quarters (72%) own property in the region where they live, although a significant minority (28%) own some rental property in a different region.

Interesting, almost a third of landlords surveyed said they've been a landlord for between six and ten years, which puts their entry into the market squarely between the start of the credit crunch and the end of the recession - before the raft of government changes that have hit the sector in the last few years. Fewer than 5% entered the market in the last year.

Investment opportunity or accident?

Most chose to become a landlord because they thought it was an attractive investment but around a quarter of those surveyed are 'accidental landlords' – either inheriting a property or renting out a property previously owned for example.

The majority of landlords do it alongside a full-time job – 60% - while a fifth have a part-time job alongside their portfolio and a further fifth are a full-time landlord.

Long-term commitment

Landlords surveyed said they are committed to the sector in the medium term, typically expecting to remain a landlord for the next decade. Portfolio landlords are in it for the longer term, saying they will remain in the sector for an average 15 years.

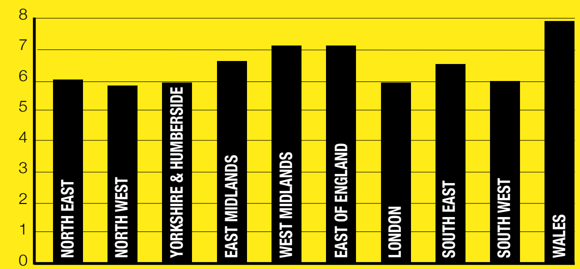
Indeed only 2% of portfolio landlords plan to leave the sector in the next two years, compared to 11% of landlords without a portfolio of properties.

And their exit plan?

Most landlords said they want to pass on their properties to their children (37%), while many intend to sell up (22%) and a fifth admitted they don't have a plan (22%).

Regional yields

Landlords in Wales and the Midlands are currently enjoying yields of 7%+, while returns are lower in London and the North West, as the chart here highlights:



Source: Foundation Home Loans, June 2018