PropertySolvers

Quick House Sale Experts

The Landlord's Report

Better Decision Making in the Modern Buy-to-Let Environment

2020 Edition

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The Property Ombudsman

GOV.UK Money laundering regulations

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Thank you for taking the time to read this report...

The content that follows complements our extended guide to **selling a rented property** and aims to provide UK landlords with a deeper insight into the current buy-to-let landscape.

Property Solvers is a quick homebuying company that prides itself in exploring all our clients options prior to discussing any form of sale. As accredited landlords with over 17 years experience, we have a solid understanding of the industry and believe that providing all the relevant information will help you make an informed decision regarding the future of your rental property.

Should You Sell Your Rented Property?

In recent years, the raft of legislative and regulatory changes has left many landlords questioning whether it is worth holding on to their properties.

Whilst such concerns are certainly valid, there appears to be a degree of scaremongering by the mainstream media and amongst online landlord communities.

This report focuses on the detail. We start by reflecting on the evolution of buy-to-let over the last 20 years or so, moving on to an exploration of Section 24 of the Finance (No. 2) Act, and the unprecedented impact on landlords this legislation will have. We also look at how to use Limited Company (Special Purpose Vehicle) in the buy-to-let context, the implications of the Prudential Regulation Authority stress-testing criteria and some information about our own services.

We welcome any questions or feedback. Please us a message 24/7 on **0800 044 3733**, email us at **info@propertysolvers.co.uk** or visit our home page at **www.propertysolvers.co.uk**.

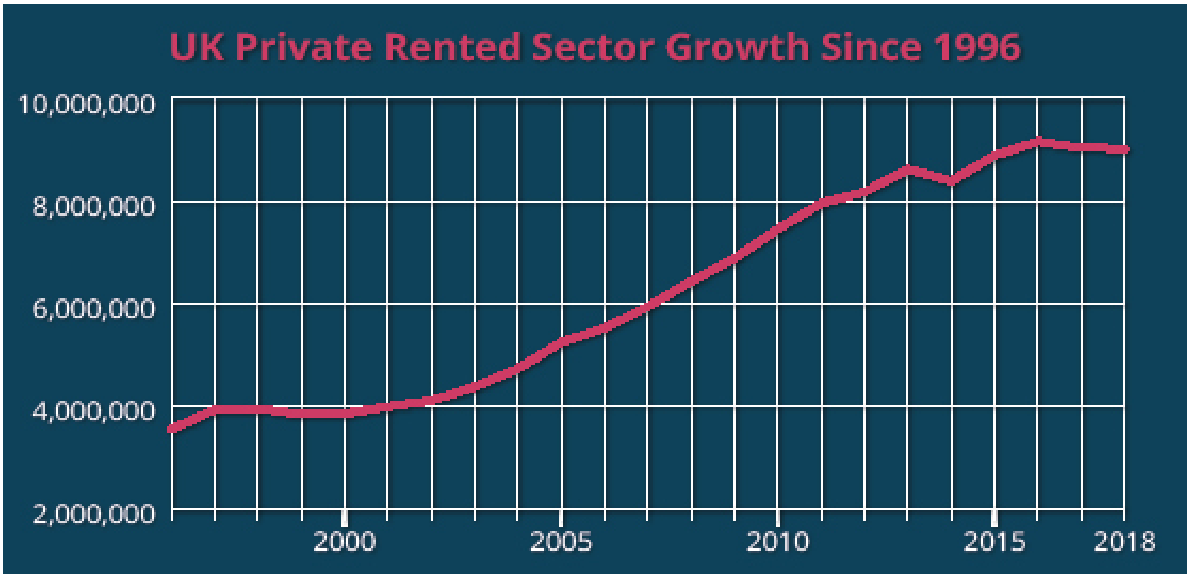
The Changing Face of Buy-to-Let Ownership

Doubling in size since 2002, the Private Rented Sector (PRS) is now the second largest tenure in England. Today, some 5.34 million (20%) of all households live in rented accommodation.

A Brief History

Many frame this massive growth to the introduction of the buy to let mortgage in 1996. Particularly in the early 2000s, secured lending against rental property reached massive highs. Prior to the credit crisis, it was even possible to finance close to 100% of a property's value as lenders increasingly became willing to accept very little collateral. The 'crunch' that then followed the property crash led to a sharp decline in buy-to-let borrowing between 2009 and 2010.

Nonetheless, the market recovered quicker than many were expecting. From 2010 to 2016, for example, new buy-to-let mortgage levels rose by almost 200%. This was arguably fuelled by the low interest rate borrowing environment offered by lenders in the space (even though deposit requirements have generally been higher). Despite what has been a tapering off in recent years, there are more landlords than ever before operating in the sector.



Top Down Controls on the Buy-to-Let Sector

In 2015, the government began implementing a series of measures aimed at decelerating the buy-to-let sector's growth.

Firstly, there was Section 24 of the Finance (No. 2) Act 2015 – perhaps the most punitive piece of legislation to ever hit the industry. These new rules look firmly set to limit the amount of mortgage interest that landlords can offset against gross rents. The legislation is expected to impact those who have borrowed heavily against their personally-owned properties.

Initiated in January 2017, the Prudential Regulation Authority (PRA) criteria is also likely to have an adverse effect on market dynamics – although debatably less so than Section 24. Aimed at preventing the 'loosening in current industry standards for buy-to-let underwriting', these stricter standards ultimately mean that investor landlords will need to commit additional sums of equity to secure financing.

Portfolio landlords (defined as those with 4 or more properties) in search of finance were also required to produce extra documentation including an asset / liability profile, business plan, current portfolio schedule and cashflow forecasts.

Throwing into the mix the Stamp Duty Surcharge initiated in April 2016 plus other compliance and regulatory reforms, it comes as no surprise that an increasing number of landlords are considering exiting the sector or restructuring their business.

Where Next for the Buy-to-Let Sector?

Most industry professionals have little objection to the PRA controls. The Stamp Duty surcharge was also understandable to a certain degree. However, the Section 24 certainly continues to leave many confounded.

Yet with government and policy makers continue to ignore criticisms by The Institute for Fiscal Studies, The Institute of Chartered Accountants, a broad spectrum of MPs and many other industry professionals, the chances of any kind of reversal seem slim at the time of writing.

Section 24 of the Finance (No.2) Act 2015

Disclaimer: Property Solvers are not qualified accountants, taxation or financial advisors. Whilst we endeavour to provide accurate up to date and complete content, all information provided should be regarded as an indicator and not to be relied on as a statement of recommendation or representation of fact.

Informally referred to as the ‘tenant’, ‘Alice in Wonderland’ and ‘revenue’ taxes, the former Chancellor´s summer 2015 budget set in motion an unprecedented process of tapered erosion of mortgage interest tax relief on individually-owned property.

Outlined in the table below, the first phase was rolled out in April 2017. Individual (non-corporate) landlords’ tax liabilities gradually worsen, culminating in 2020/21 (i.e. this tax year) when there will only be a 20% flat rate of relief on mortgage costs.

Most industry professionals believe that this new status quo will remain or, at best, that landlords may be granted retrospective exemption (for example, properties purchased prior to July 2015 when the legislation was announced would potentially be exempt from the restrictions).

The general advice to landlords is to genuinely understand one´s own specific financial position as a result of these tax changes in good timing so that the right preparations can be made.

Tax Year 2017/18

Mortgage interest on a personally owned property = 75% tax relief

Tax Year 2018/19

Mortgage interest on a personally owned property = 50% tax relief

Tax Year 2019/20

Mortgage interest on a personally owned property = 25% tax relief

Tax Year 2020/21

No relief will be allowed for mortgage interest

Note that, in most cases, mortgage interest relief deducted against rental income will be capped at 20% (even for higher rate and additional rate taxpayers). Restrictions will also apply to landlords that own properties in a partnership or a Limited Liability Partnership (LLP).

See the full legislation here:
http://www.legislation.gov.uk/ukpga/2015/33/section/24/enacted

Understand Your Tax Liability Post Section 24

The magnitude of the impact will entirely depend on what particular tax band you are operating in.

In the simplified examples below, we assume that Landlord A and Landlady B own very similar properties – valued at £100,000 and achieving a gross yield of 7.2% (£600 per calendar month in rent) at the point of the full effect of the legislation in 2020/21. Both are on the same personal buy-to-let mortgage terms and only differ by virtue of being within different tax thresholds:

Impacts of Section 24 of the Finance (No. 2) Act 2015 for Landlords	LANDLORD A IS IN THE 20% TAX BAND	LANDLORD B IS IN THE 40% TAX BAND
Before Section 24 Changes		
Annual Rental Income	£7,200	£7,200
Annual Tax Deductible Mortgage Interest (100%)	£3,600	£3,600
Annual Pre-Tax Profit	£3.600	£3,600
Tax on Profit	£720 (at 20%)	£1,440 (at 40%)
Net (Post-Tax) Profit	£2,880	£2,160
Effective (Post-Tax) Income Yield	2.88%	2.16%
Section 24 Changes Fully Phased in (2020/21)		
Annual Rental Income	£7,200	£7,200
Annual Tax Deductible Mortgage Interest (100%)	£0	£0
Annual Pre-Tax Profit	£7,200	£7,200
Tax on Profit	£1,440 (at 20%)	£2,880 (at 40%)
Mortgage Cost Relief	£720 (at 20%)	£720 (at 20%)
Tax Owed	£720	£2,160
Net (Post-Tax) Profit	£2,880	£1,440
Effective (Post-Tax) Income Yield	2.88%	1.44%

Landlord A, as a lower rate taxpayer, will not be impacted. Landlord B, however, as the higher rate tax payer, will incur net (post-tax) profit losses. Note that the above assumptions also do not factor non-mortgage interest costs such as voids, legitimate running expenses and other holding obligations – which will still remain fully deductible against gross rental income (revenue).

Irrespective of the position on the tax banding scale, there are a number of risks that all landlords should be aware of. Firstly, all it takes is a small increase in interest rates for some landlords to struggle to re-mortgage to competitive pay rates at the end of the term (and therefore be forced to remain on Standard Variable Rates). The higher monthly non-deductible mortgage payments could compromise cash flows.

Although re-mortgaging on a 'like-for-like' basis will not be subject to the Prudential Regulation Authorty (PRA) underwriting criteria (see page 20 onwards), aggressively geared landlords/ladies are likely to face challenges when looking for a suitable lender.

Secondly, as income tax will effectively be calculated on property-related earnings before mortgage interest payments (revenue effectively being classed as profit), individual landlords that are currently in the lower tax band may also find themselves inadvertently pushed into a higher tax threshold. This is because they will not be able to offset a significant majority of their interest payments after the financial year 2020/21.

Please Do Not Panic – There Are Solutions

If you find yourself in such circumstances, remember that many other landlords are in the same boat. Although there is a great deal of information in the public domain about potential solutions, be cautious about the steps you take.

Before making any kind of decision, understand that every landlord has different circumstances. Furthermore, many so-called 'tax mitigation schemes' are not backed up by an HM Revenues & Customs seal of approval.

Firstly, you should openly discuss your current and future tax position with a qualified accountant and/or tax advisor. You ideally want to work with someone that has demonstrable experience of working with landlord investors. As well as at Companies House, the necessary credentials can also be verified at the Institute of Chartered Accountants in England and Wales and the Chartered Institute of Taxation.

There are also a number of useful spreadsheets and tools in the public domain you can use to project and evaluate future tax liabilities (using your previous tax returns).

Deleverage Your Buy-to-Let Property / Portfolio

Make capital repayments or transferring lump sums from existing savings towards your mortgage account. In this scenario, it will be important to check with your lender that you will not incur any Early Repayment Charges (ERCs) for over-payments on your mortgage.

Transferring to a Spouse or Legal Partner

This may be an option if your spouse or partner is a low rate taxpayer. However, do make sure that any extra rental income will not push him/her into the higher tax bracket. Choosing this route could also have negative impacts on your finances in the future. Your tax bill may end up being excessively high say, for example, your spouse / partner wishes to gain extra income through employment, receive some kind of pay rise or other bonus.

Divest and Effectively Clear Personally-Owned Mortgages

You could sell your personally-held property and use the proceeds of sale to make further acquisitions within a more tax-efficient Limited Company structure (see page 13 onwards). Using this investment vehicle, you would be able to offset all of the mortgage interest against rental income (revenue). The aim here is to progressively 'drip feed' properties into an incorporated portfolio.

However, please remember to consider any impacts of Capital Gains Tax (CGT) when selling – although you will have certain allowances and other possible deductions such as rent relief and former principal private residency exemptions.

Such a strategy also needs careful thought with regards to ongoing tenancies and other cash-flow / management issues. Additionally, all second home purchases are also subject to the Stamp Duty surcharge. A good accountant will be able to advise you on the best way to efficiently and legally structure this process in line with your own circumstances.

Increasing Rents

There are some across the industry who believe that raising rent is the only option to deal with Section 24. However, taking such steps is not so simple in reality.

Much will naturally depend on local market dynamics. Landlords would have to be sure that price rises are correlated to the quality of housing provided and overall affordability. It is indeed our belief that the market dictates average rents, not landlords.

With inflation expected to rise in the coming years, tenants may struggle to keep up with extra financial commitments. You should also be wary of fuelling the already tense anti-landlord sentiment that exists in many parts of the UK.

Transferring Buy-to-Let Properties into a Limited Company

As this strategy is more technical, please read our disclaimer. We are not tax accountants / advisors and we strongly advise communicating with the HM Revenue & Customs.

Indeed, making a decision to incorporate personally-owned properties certainly deserves careful consideration. You may actually find it makes more sense to keep things as they are. For instance, there are ways to offset accumulated individual property losses over the years against future rental revenues. These losses are not transferable into the Limited company. In such a scenario, it can make financial sense to simply wait.

Furthermore, you may be unaware of the ability to use your spouse´s personal allowances to minimise overall tax liability. Another interesting angle is to use occupational pension contributions to reduce net employment income. It is for these reasons – and more – that discussing any plans with a suitably qualified professional is always a good idea.

Is It a Good Idea to Transfer Buy-to-Let Properties into a Limited Company?

Particularly for larger portfolio owners, transferring properties into a company is often advantageous over the long term:

- ✓ From a tax perspective, investors benefit from lower Corporation Tax and no restrictions on mortgage interest cost relief;
- ✓ There are also benefits when profits compound over an extended period within the Limited Company. For example, you can deploy larger amounts of capital for future investments compared to carrying funds forward in your own name;
- ✓ As a company Director, you can also pay money into a personal pension. This translates to a reduction in company profits so the amount of tax also decreases;
- ✓ As the company 'acquires' the portfolio at market value on the transfer date, there are notable tax savings when selling in the future.

Please remember that such plans would require an advanced cost-benefit analysis.

In most circumstances, you will be effectively 'selling' properties to a corporate structure and would therefore incur Capital Gains Tax and Stamp Duty at market value (not at the purchase price). Remember also, bar exceptional circumstances, refinancing with a new mortgage lender is also necessary.

Using Incorporation Relief When Transferring Buy-to-Let Property Into a Limited Company

Capital Gains Tax (CGT), however, can be eliminated by means of a qualifying business transfer in exchange for shares, triggering incorporation relief. In such a scenario, the investor must demonstrate the following:

(1) The business genuinely undertakes property-related business activities;

(2) There must be definitive proof of active full-time portfolio management. This, unfortunately, is probably an unsubstantiated argument for most small, medium, and even larger sole-trader landlords.

Each case has its own merits. However, the most common legal precedent cited at the time of writing is the *Ramsay* case (Elizabeth Moyne Ramsay v HMRC [2013]). The defendant[2] here was able to demonstrate 20 hours of working in the business for the purposes of s.162 of the 1992 Taxation of Chargeable Gains Act (TCGA). In short, the court based the decision on a qualitative analysis of 'hands-on' involvement in day-to-day management[3]. Activities such as attending courses, networking and property viewings are essentially not 'active' and, therefore, unjustifiable.

Minimising Stamp Duty When Transferring Buy-to-Let Properties into a Limited Company

In relation to Stamp Duty Land Tax (SDLT), one mitigation strategy is multiple dwellings relief where taxation is based on the average value of all the properties being transferred into the Limited company in exchange for shares.

As an example, if an investor has a residential portfolio of 15 properties valued at £2.1 million – each with an average value of £140,000 – the amount of SDLT owed per property would be £4,500 (£125,000 at 3% in addition to £15,000 at 5%), giving a total of £67,500.

Another option could be for the Limited company to opt for the transfer to be taxed at non-residential rates when six or more properties are transferred at the same time. In this scenario, the additional 3% residential investment surcharge would be exempt. However, note that multiple dwellings relief would not be available and Stamp Duty would be applied to the total value of the entire portfolio.

In most situations, therefore, property given away or transferred to another person or Limited company will involve 'chargeable consideration' (i.e. through cash or another type of payment including goods, works or services, release from debt or transfer of debt including the value of any outstanding secured loans). This essentially means that that Stamp Duty is, by and large, unavoidable.

However, by virtue of Schedule 15 of the 1890 Partnership Act, properties can potentially be moved into a partnership for a period of between 2 and 3 years, prior to setting up a Limited Company.

2 Mrs Elisabeth Moyne Ramsay who had a single property divided into 10 self-contained apartments with a large communal area, car parking, garages and a garden.
3 Spending at least 20 hours a week on property activity, Mrs Ramsay and her husband (both of who did not have any other occupation) engaged in the following activities: meeting with tenants to discuss rental disputes and payments; providing extra assistance to an elderly tenant; checking utility meters and making payments to utility providers; carrying out maintenance to unblock drains; fixing garage doors and refurbishing properties when tenants left; carrying out work to ensure that they were compliant with fire regulations as required with the local council; carrying out garden work and ongoing maintenance; cleaning communal areas and clearing rubbish; project managing the development of the property prior to the transfer.

In the same vein as incorporation relief, there needs to be two ‘connected’ people working together in a genuinely commercial business environment, providing significant additional services in return for payment, both with no other form of income. Note that whilst spouses, siblings, civil partners, parents and their adult children theoretically count as two partners, the use of this exemption has become open to some debate (there is no set test and the HMRC can remove the relief should it be deemed that the partnership has been established specifically for the purposes of avoiding SDLT).

However, assuming that the partnership is legitimate in the eyes of the tax authorities and not contrary to any anti-avoidance legislation, the following steps would need to be taken:

- ✓ The partnership will be created via the HMRC;
- ✓ The income / costs / profit from the property section of the Self-Assessment (SA) will be transferred to the partnership section and submitted in the most tax-efficient manner (normally by allocating the majority of the income to the lower-rate taxpayer for 2-3 years);
- ✓ At the end of the 2-3 year period, a lawyer should be used to draw up a partnership agreement to incorporate properties into the Limited Company. From this point onwards, annual accounts and corporation tax returns will need to be submitted by the partnership in addition to Self-Assessments as Directors of the business.

As mentioned previously, when attempting to mitigate both CGT and SDLT, bar exceptional circumstances, your current mortgage company will inevitably require you to refinance with a Special Purpose Vehicle (SPV) buy-to-let lender. This is likely to mean that you will lose any competitive rates you are benefitting from. It is also important to understand your real financial circumstances prior to moving ahead with such a plan. You may discover that following the above steps to reduce CGT and SDLT has actually not saved any costs (although this may change should interest rates rise in the coming years).

Note also that extracting profits is more difficult from a Limited Company and will be subject to income tax on dividends (on any amount over £2,000) which may also lead to a higher effective rate if you are a higher tax payer. Should the money be withdrawn as a salary, National Insurance will also be levied and landlords should also be mindful of the repercussions on the effective tax rate should you wish to dispose of properties in the future.

WARNING

Avoid Deed of Trust arrangements (also known as Beneficial Interest Company Trusts)

The idea of using an artificial structure to transfer the beneficial interest of a property into a Limited Company whilst retaining title and a mortgage in one´s own name (as a nominee) has generated extensive debate on social media and property forums.

However, the general advice from most experienced tax advisors is to avoid such schemes due to there being a number of wider legal questions involved that may result unexpected liabilities and even serious financial penalties down the line.

The principal issue from a tax perspective is a section of the Income Tax Act which prevents individuals from transferring an income stream into a company for tax reasons. Most (if not all) lenders terms and conditions will also not permit the mortgage of a personally-owned property to be transferred into a company in this way. In the best case scenario, the mortgage may be re-issued in the company´s name but under entirely different terms.

Moreover, borrowers may well be open to allegations of 'mortgage fraud' which, in a worst case scenario, could lead to the loan being called in or even more serious legal action.

Find a Good Accountant to Work With

Much of the content in this chapter merely scratches the surface and, reiterating that we are not accountants or tax advisors, it is strongly advised to have any decision reviewed in detail by a qualified professional. You may want to read a series of expert insights on Section 24 published on our property investor's blog, where you will also find their contact details.

In this regard, it should be noted that many accountants are not fully versed in the area and specific due diligence of the firm is strongly advisable. As well as Companies House (www.companieshouse.gov.uk), the necessary credentials can also be verified at the Institute of Chartered Accountants in England and Wales (www.icaew.com) and the Chartered Institute of Taxation (www.tax.org.uk).

Although some accountants are commenting that it's becoming increasingly difficult, we suggest obtaining a 'pre-transaction ruling' or a 'non-statutory clearance' (in writing) from the HMRC. You should make sure that there are no contraventions of General Anti-Abuse Rules (GAAR), Disclosure of Tax Avoidance Schemes (DOTAS) and other tax evasion legislation.

Corporate Buy-to-Let Acquisition

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Given the unavoidable repercussions of Section 24 of the Finance (No.2) Act 2015 on personally owned properties (see page 5 onwards), the wider consensus is that acquiring buy-to-let properties through Special Purpose Vehicles (SPVs) is the logical step forward.

A SPV for buy-to-let purposes is a company that is created to solely hold property and nothing else. From a lending perspective, such vehicles are preferred as they are easier to underwrite compared to trading Limited companies.

In addition to the obvious advantage of full mortgage interest relief, some of the broader advantages of building a 'corporatised' portfolio are outlined below:

- ✓ Although mortgage interest relief restrictions may not affect basic rate taxpayers, landlords intent on personal mortgaged portfolio expansion and/or other forms of income generation may face unexpected problems down the line. Here, the biggest risk is to be involuntarily 'pushed' into an onerous tax position. Buying properties in SPV structures, therefore, could be a more sustainable approach over the medium to long term;

- ✓ Albeit difficult to predict, the post-crisis low interest rate environment that many landlords have become accustomed to will eventually come to an end. Combined with the effects of the Section 24 legislation, higher non-deductible finance costs on individually owned buy-to-let properties could mean that cash flows come under strain. This could be particularly acute with excessively leveraged properties that have high debt servicing costs. Again, a Limited company structure potentially removes some of the risk;

- ✓ As highlighted from page 20 lenders are heavily scrutinising individual property purchases as part of the Prudential Regulation Authority (PRA) stress-testing criteria. Although 'like for like' re-mortgaging will be exempt, highly geared individual borrowers may find it difficult to find suitable products without injecting further capital or else be locked-in to more punitive standard variable or revert rates. From a lending perspective, some brokers argue that income cover ratios (ICRs) will be lower for properties acquired through SPVs as lenders in this space currently do not have to adhere to the stricter Prudential Regulation Authority (PRA) standards. However, although there may be some truth in this, it is highly questionable whether lenders will take a less conservative approach simply because a property is being acquired through a corporate entity;

- ✓ Albeit a politically and socially contentious issue, corporation tax looks set to be gradually reduced to 17% by 2020 (coincidentally when the full force of Section 24 will be felt across the buy-to-let sector);
- ✓ When profits are compounded over an extended period within a corporate vehicle, larger amounts of capital can be deployed for future investments than would be the case if the funds were carried forward in one´s own name. Therefore, 'mini-portfolios' can be built where an investor can stop buying in one company (SPV) and buy in another. Each will pay down all its debts and/or generate a cash positive surplus to reinvest in properties within new SPVs as the overall business grows and becomes more efficient;
- ✓ There is the potential to roll up excess finance costs that can be eventually offset against future Capital Gains Tax (CGT) liabilities (always speak to a qualified accountant / advisor with regards to your own tax structuring);
- ✓ Family members can be more involved through becoming shareholders and directors, resulting in future Inheritance Tax (IHT) and Capital Gains Tax (CGT) benefits. We strongly advise speaking with an estate planning specialist to ensure the most tax efficient structure in this regard;
- ✓ As a company Director, investors can also pay money into a personal pension. Here, the amount of profits that the company earns is reduced and therefore the amount of corporation tax owed also decreases. Funds in Self-Invested Personal Pensions (SIPPs) can also invest in commercial properties;

The downsides of using a company include the fact that profit extraction is restricted by means of dividends or salary-based payments, both of which will add a second layer of (income) tax – bar a £2,000 tax free dividends per Director.

SPV management also has extra administrative obligations. The company must produce annual accounts in a fixed, statutory format of which abbreviated versions will also have to be filed at Companies House and be publically viewable (apart from in certain circumstances).

Buy-to-Let SPV Property Purchasing Using Mortgage Finance

Although there is nothing stopping investors from approaching lenders directly, working with an experienced mortgage broker is usually recommended. A good intermediary will find the best products suited to your own financial circumstances and the property in question. Many also have direct relationships with underwriters and, from time to time, exclusive access to attractive deals.

As the corporate buy-to-let lending sector is relatively embryonic, new application processes are reportedly slow (up to 8 weeks at the time of writing) – which will be of little use when purchases are time-constrained.

In such situations, investors should position themselves to be able to transact quickly either through cash (vendors and professional sourcing companies would usually request proof of funds), some form of pre-existing and undrawn debt facility or reputable bridging finance. Most investors would then eventually refinance.

Here, it should be observed that bridging finance can be costly the 6-month rule[2] will normally apply and you should be prepared for delays.

At the time of writing, Limited company mortgage pay rates tend to be more expensive with 75% loan to value requirements largely being the norm. Anything higher is likely to come with a number of associated conditions.

As with individual buy to let mortgages, investors will also incur an arrangement fee (which are also slightly higher than personal buy-to-let mortgages) and be subject to early redemption charges (ERCs). The costs of the more advanced form underwriting, however, are not necessarily passed on to the borrower. It is also widely believed that a process of natural competition will encourage more competitive products to appear in the marketplace in the coming years.

To ensure there are no administrative hold ups, investors should have their company formally established with an associated bank account. Buy-to-let SPV lenders are reportedly tightening on income assessments and will typically require at least 2-years worth of SA302s from the HMRC, tax overviews, 3 months worth of bank statements and, if you are employed, your latest P60 and three of the most recent payslips.

Up-to-date detailed information on your existing property holdings will also be requested including full address(es), value(s), outstanding mortgage(s), lender names, monthly payments and a rental income schedule.

2 The vast majority of lenders, bar certain circumstances, will not refinance a property within the first 6 months of the original purchase date. However, readers can consult the following link to the Council of Mortgage Lenders (CML) to understand where lenders may apply specific exemptions: https://www.cml.org.uk/lenders-handbook/englandandwales/question-list/1813/

We also suggest having portfolio, cashflow forecast and income + expenditure spreadsheets in addition to the most recent tenancy agreements and a simple business plan which will outline your investment intentions and other key figures. Note that some or all of these details will need to be validated.

Prior to the lender undertaking any background checks, it is also advisable to verify both your personal (consumer) and business credit scores with a reference agency such as Experian. Any mortgage application will be classified as a ‘hard search’ and therefore leave a footprint on your credit file.

In the future, the ever rising use of technology within key financial processes is likely to mean that your creditworthiness as a buy-to-let mortgage borrower will be assessed on a more programmatic basis. Mortgage lenders are increasingly likely to adopt more sophisticated (and efficient) methods of analysing open market value, rental premiums and other key figures.

From the outset, the lender will want to know that the corporate structure is set up for the sole purpose of holding property. A Limited Company SPV therefore must have limited activities. The SPV will normally be created recently and registered under one of the following Standard Industrial Classification of Economic Activities (SIC) codes:

- ✓ Buying and selling of own real estate (68100); or
- ✓ Other letting and operating of own or leased real estate (68209)

Generally speaking, using ‘off the shelf’ Limited companies is not advisable – and it is always best to obtain the correct advice whilst ensuring that the company is clean (i.e. with no historical issues that could adversely affect any loan application).

Should it be a requirement to distribute dividends to other family members legitimately in the future, investors must also be certain that the structure of the company is formed in the correct manner. For example, the standardised online forms may not have the right clauses specific to your circumstances and plans.

Should a borrower already be a Director of an operational SPV for buy-to-let purposes and the annual revenue is less than £25,000, most lenders will request to see at least 2 years’ accounts as well as personal income, expenditure and other related evidence.

Note that it is only possible to alter the SIC code when filing the SPV´s Confirmation Statement (formerly referred to as the Annual Return) at Companies House. However, it is possible to file well in advance of the due date – meaning that the SIC code can be altered should the change be required to secure borrowing.

Background checks will be undertaken on the individual applicant(s) and director(s). Any evidence that a landlord would not be able to realistically surmount any ongoing buy to let holding challenges such as voids, impending refurbishments and other perceived risks will usually result in refusal.

The lender will want to see no signs of future revenue through the company of anything other than letting property and will normally also refuse mortgage finance should there be concerns over other trading activities. For instance, a branded Property Management Company (PMC) should generally not be used.

Some specialist lenders may not reject such applications – however investors should be mindful that there will typically be requests for further information such as demonstrable solid net profits after dividend and salary withdrawals with no unexplained losses. There are also likely to be funding limitations (higher downpayment requirements) as well as personal guarantees, fixed or floating charge debentures over the company to which they are lending (see below). The application period will also take longer as further checks are carried out on the company in addition to the individual and the property itself.

Should the SPV have the correct SIC code but has previously traded in another field, lenders may be willing to move forward providing that the Directors can formally confirm that the company will be used for letting purposes exclusively.

Loans between companies are entirely possible, but will invariably add to the already complex nature of the underwriting process. For example, in a scenario where a borrower would like to use an inter-company loan from his/her trading business to fund part or all of the deposit, the lender will want to ensure that there are no unexplained losses and, once the funds are extracted from the trading company, the business will remain suitably robust and well-capitalised.

In addition to confirmation of a clean credit rating, any capital being injected into the transaction will need to be readily transferable.

Whilst the criteria will vary from lender to lender, investors should also be aware of the following requirements:

Personal Guarantee or PG – in a situation of default and eventual repossession, the lender will normally 'fire sell' the property (usually via an auction or receivership disposal) with the proceeds being used to settle underlying mortgage liabilities. Should there be any balance, the directors and shareholders offering the PG will be fully liable. In most circumstances, however, lenders will usually not take a charge on the investor´s main residence.

Debenture – used to protect a lenders interest in a situation of default and eventual insolvency, this is a formal agreement that stipulates either fixed or floating charges alongside the terms and conditions.

To explain the difference between fixed and floating charges:

- ✓ A **fixed charge** is a 'hold' on property meaning that the borrower cannot dispose without explicit permission from the lender that has control of the asset(s);
- ✓ A **floating charge**, in general terms, is a security on an asset that has an alterable quantity or value (such as cash, unfactored debt, raw materials, fixtures, fittings or other company resources used to generate business and trade). Within the buy-to-let lending context, the borrower keeps control of the asset but in a repossession situation the floating charge effectively crystallises into a fixed charge. SPV lenders are less likely to use these charges as they generally rank behind preferential creditors, prescribed-part creditors and salary distributions;

Note that Debentures are typically 'all monies', in other words – existing, present and future loan advances will be secured.

Deed of Priority – this is an agreement that will be drawn up should there be one or more other lenders taking security over a SPV and will establish who will be 'first in line' to recover any net proceeds in an insolvency scenario.

The advance will be made against the security of a particular property and some lenders may agree to have recourse against the assets of an associated and/or parent company. However, most would normally prefer to operate exclusively on a 'ring-fenced' basis within each SPV.

Understanding Responsibilities as a Director of a Special Purpose Vehicle

On a final note, investors also need to know about their responsibilities as Directors of a Limited company. Annual accounts will need to be submitted to Companies House as well as HMRC tax returns – both after 9 months and 1 day of the year end.

Investors will also need to notify the banks and loan providers of the performance of the company and submit year-end financials. This will mean that bookkeeping and related administration should not be left to the last minute. Some lenders, for example, will want to see accounts before 3 months of the year end. However, much will depend on how choosy the lender is – some are satisfied with the information received during the initial due diligence process but several have become increasingly strict.

Buy-to-Let Limited Company (SPV) Mortgage Checklist

- [ ] Speak to your accountant, tax advisor and estate planner prior to making any investment decisions;
- [ ] Undertake a detailed cost-benefit analysis to establish whether Limited Company acquisition is the most tax efficient course of action. As long as the Section 24 legislation remains in place, this is likely to be the case (unless you are certain that you will remain in the low income tax bracket);
- [ ] Find a good mortgage broker with experience of Limited company lending and a solicitor that understands the additional paper work required;
- [ ] When purchasing with cash or bridging, ensure you understand what mortgage products and associated loan to values are available at the point of refinancing (observing the 6-month rule);
- [ ] Appreciate that buy-to-let mortgage financing through SPVs generally takes longer;
- [ ] Understand future tax obligation prior to acquisition (principally corporation and then a second layer of income tax on withdrawn dividends / salaries);
- [ ] When researching products, ensure that arrangement fees, higher BTL SPV mortgage finance costs and, where necessary, early redemption charges (ERCs) are incorporated into calculations;
- [ ] Ensure there will be no other forms of future revenue through the SPV other than for letting property. Note there may be exceptions in this scenario but lenders will request specific information relating to the existing company which will complicate the underwriting process;
- [ ] Note that intercompany loans to fund deposits will generally delay the application;
- [ ] Should you already be a Director of an operational SPV for buy to let purposes and the revenue is less than £25,000, most lenders will request to see at least 2 years' accounts. Lenders may also request an asset / liability profile, business plan, current portfolio schedule and cashflow forecast(s);
- [ ] Ensure both business and personal credit ratings are healthy;
- [ ] Ensure that current buy-to-let business operations are healthy (voids, unmanageable refurbishment costs and other perceived risks may ring alarm bells);
- [ ] Set up your Limited company (preferably not "off the shelf") using SIC codes 68100 (buying and selling of own real estate) or 68209 (other letting and operating of own or leased real estate);
- [ ] Set up a Limited Company bank account and understand extra administrative requirements with the HMRC and Companies House;
    - [ ] Have proof of income readily available (by means of SA302´s from the HMRC, tax overviews, bank statements and/or payslips);
    - [ ] Understand your obligations and responsibilities under Personal Guarantee (PG), Fixed / Floating Debentures and Deed of Priority contracts issued by the lender;
    - [ ] Having deposit funding firmly in place prior to exchange of contracts.

Prudential Regulation Authority (PRA) Stress-Testing Criteria

Disclaimer: Property Solvers are not qualified mortgage brokers or financial advisors. Whilst we endeavour to provide accurate up to date and complete content, all information provided should be regarded as an indicator and not to be relied on as a statement of recommendation or representation of fact.

Formally introduced in January 2017, the core aim of the Prudential Regulation Authority (PRA) revised criteria is to 'prevent loosening in current industry standards for buy-to-let underwriting, curtail inappropriate lending and reduce the potential for excessive credit losses'.

In essence, these stricter standards mean that, to meet the stress-tested debt servicing requirements, investor landlords will need to commit additional sums of equity to secure financing.

These new rules will not affect borrowing or refinancing in a Limited company capacity. However, we are advising buy-to-let property owners and investors to be mindful of the fact that the over-arching aim of the PRA is to control speculative lending (irrespective of how the property is acquired).

Therefore, it would be a reasonable expectation that similar affordability assessment criteria will be applied, if they are not already, by the majority of Limited company buy-to-let lenders in the short to medium term (the previous section of this guide approaches the question of purchasing residential property through Special Purpose Vehicles).

The policy shows clear signs that, alongside a feasibility analysis of the merits of the buy-to-let property being collateralised (i.e. confirmation that the deal 'stacks up'), affordability assessments will closely scrutinise your own personal financial circumstances. Referencing the policy documentation itself[1], we have summarised the prominent lending criteria below:

- ✓ Information regarding personal income through employment / self-employment will be required;
- ✓ Information regarding other income through pensions, savings, investments and company dividends (net of other tax liabilities and National Insurance contributions) will be required. Lenders will request at least 2 years of SA302 returns. Keeping up to date with personal and company accounts / submissions will therefore be fundamental;

1 Supervisory Statement (SS13/16) –
Underwriting standards for buy to let mortgage contracts (September 2016):
http://www.bankofengland.co.uk/pra/Documents/publications/ss/2016/ss1316.pdf

Policy Statement (PS28/16) –
Underwriting standards for buy-to-let mortgage contracts (September 2016):
http://www.bankofengland.co.uk/pra/Documents/publications/ps/2016/ps2816.pdf

- Lenders will require an understanding of the financial mechanics of existing portfolio holdings by means of requesting information on existing loan to value ratios, bank statements, Assured Shorthold Tenancy (AST) agreements and other relevant documentation;

- Lenders will want an understanding of present and future tax liabilities when financing the property, factoring in the impending tougher landlord 'Section 24' tax regime (see page 5 onwards). They will also look at whether any other personal income is being used to supplement rent (which will generally not be looked at favourably);

- The policy states that Capital Gains Tax (CGT) does not need to be included in the affordability assessments (as this tax only becomes liable when properties are sold);

- Lenders will want an understanding of other credit commitments (in addition to mortgage / secured borrowing) – including loans, motor finance and credit cards – that will continue after the buy-to-let mortgage contract is granted. These are typically verified through a credit reference agency. Borrowers should be wary of the effects of multiple credit application 'footprints'. A good broker will be able to direct you to the most appropriate loan, aligned with your own specific financial circumstances alongside the credentials of the investment proposition itself;

- Lenders will estimate future pay rates over a minimum horizon of five years from the expected start of the term of the buy-to-let mortgage contract, unless the interest rate is fixed or capped for a period of five years or more from that time, or for the duration of the buy-to-let mortgage contract if less than five years;

- Lenders can assume a reasonable level of future rental increases when assessing affordability that would mitigate interest rate rises. However, it is assumed that increases in rental income should not exceed 2%, in line with the Government's inflation target as measured by the 12-month increase in the Consumer Prices Index (CPI). The PRA will be monitoring the calibration of the stressed rate expectations to ensure 'ongoing appropriateness'.

The comparative worked examples below demonstrate how mortgages will be stressed at higher levels than the actual interest rate. At the time of writing, this is set at a notional default pay rate of 5.5% with a 145% Interest Coverage Ratio (ICR) affordability threshold.

Property achieving £400 per calendar month:

Pre PRA Stress-Testing Criteria

Annual rent	£4,800
Stress test	5%
Interest Coverage Ratio (ICR)	125%
£4,800 / 5%	£96,000
£96,000 / 125%	£76,800

Post PRA Stress-Testing Criteria

Annual rent	£4,800
Stress test	5.5%
ICR	145%
£4,800 / 5.5%	£87,273
£87,273 / 145%	£60,188
Extra borrowing required post-PRA	£16,612

Property achieving £450 per calendar month:

Pre PRA Stress-Testing Criteria

Annual rent	£5,400
Stress test	5%
Interest Coverage Ratio (ICR)	125%
£5,400 / 5%	£108,000
£108,000 / 125%	£86,400

Post PRA Stress-Testing Criteria

Annual rent	£5,400
Stress test	5.5%
ICR	145%
£5,400 / 5.5%	£98,182
£98,182 / 145%	£67,712
Extra borrowing required post-2017	£18,688

Property Achieving £500 per calendar month:

Pre PRA Stress-Testing Criteria

Annual rent	£6,000
Stress test	5%
Interest Coverage Ratio (ICR)	125%
£6,000 / 5%	£120,000
£120,000 / 125%	£96,000

Post PRA Stress-Testing Criteria

Annual rent	£6,000
Stress test	5.5%
ICR	145%
£6,000 / 5.5%	£109,091
£109,091 / 145%	£75,235
Extra borrowing required post-2017	£20,765

Below are some further considerations regarding extra borrowing requirements and lender obligations:

- ✓ As mentioned previously, larger deposits will be an explicit requirement to secure borrowing – particularly if investors are using shorter-term products. Lenders will essentially need assurance that the income derived from the property is sufficient to support the monthly mortgage interest (formally referred to as the ‘collateral risk profile’). The PRA has reviewed the prevailing standards in the industry and considered the impact of future interest rate increases, calibrating the stressed rate accordingly to ensure the loan will be adequately serviceable;
- ✓ Lenders do not want to create ‘mortgage prisoners’, therefore underwriting standards will not apply to borrowers looking to remortgage on a like-for-like basis (i.e. no additional borrowing);
- ✓ Equity and property price appreciation will not be factored into the loan decision making process (although lower gearing would be more likely to satisfy the stress-testing requirements outlined above);
- ✓ Rental income will be verified by a suitably qualified valuer, independent of the borrower, who will utilise automated valuation models or evidence of an existing Assured Shorthold Tenancy (AST) agreement (subject to appropriate policies, controls and risk management methodologies);
- ✓ When assessing affordability, mortgage companies can take into account the accumulated wealth of high net worth borrowers with an annual net income of no less than £300,000, or net assets of no less than £3,000,000;
- ✓ Lending to portfolio landlords (defined by the PRA as being those with four or more mortgage buy-to-let properties) will be assessed using a “specialist” (i.e. stricter) underwriting process. Such lending is now deemed to be inherently more complex given the ‘aggregated quantum of debt’, differentiated cash flows, costs arising from multiple tenancies and potential risks of property and/or geographical concentrations.

A proportionate approach will be adopted based on the borrower´s existing portfolio, alternative sources of income and other factors including:

(1) Experience in the buy-to-let market, the full portfolio of properties and outstanding mortgages;

(2) Total assets and liabilities (including any associated tax liabilities);

(3) Merits of any new lending in the context of an investor´s existing buy-to-let portfolio;

(4) Historical and future expected cash flows associated with all properties within the portfolio;

(5) Business plans and associated projections;

The PRA also expects firms to consider the borrower's refinancing risk at the end of the fixed or capped rate period. Due consideration will need to be taken of the following factors:

(1) Market expectations (using credible sources such as the Bank of England and not on the lenders´ own forecasts);

(2) A minimum increase of 2 percentage points in buy-to-let mortgage interest rates (this calculation can refer to either origination or reversionary rates[2]);

(3) Any prevailing Financial Policy Committee (FPC) recommendation or direction on the appropriate interest rate stress tests for buy-to-let lending;

The PRA will also expect mortgage companies to implement appropriate risk management and controls, including:

(1) Risk appetite limits on the flow and stock of buy-to-let lending, including Interest Coverage Ratio ICR and loan-to-value (LTV) limits;

(2) Appropriate oversight and monitoring of the risk profile of lending introduced by third-party intermediaries;

(3) Monitoring of portfolio concentrations and high risk segments. Controls are in place to ensure that any fraud risks associated with buy-to-let lending are effectively managed.

2 The origination rate (also known as the initial mortgage rate) is the level of interest set at the start of the original loan agreement. The reversionary rate, more commonly known as the Standard Variable Rate (or sometimes the 'Go To' rate), is the lender's 'default' rate without any limited-term deals or discounts attached. When a fixed, tracker or discount mortgage terms ends (usually between a period of 1-5 years), the borrower will usually be transferred automatically on to the lender's SVR (which may or may not track the Bank of England´s base rate).

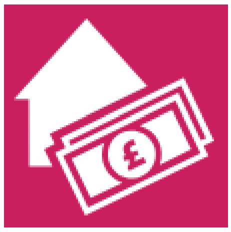
Property Solvers – Quick Sale Experts

We hope the contents of this report alongside our ‘how to’ guide on Selling a Tenanted Property have provided you with some clarity regarding your own position.

If you have decided to consolidate your buy-to-let holdings or exit completely by selling, Property Solvers would love to have to chat and explain how we could help.

We offer to main sales channels which will depend on your time and price objectives...

Quick Cash Sale



The Directors at Property Solvers have been professional landlords since 2003 and understand that sometimes a swift and efficient sale may be exactly what you are looking for.

With our Quick Cash Sale, we can complete on the sale between 7 and 28 days. We can also exchange on contracts in as little as 24-hours where required.

Below are some of the other benefits of using this service:

- ✓ We buy the property direct from you so there are no third parties;
- ✓ There are no estate agents or legal fees as we cover these as part of the service;
- ✓ We will buy problem properties with physical / structural problems (damp, Japanese Knot-weed including subsidence, serious damp, flooding history, Japanese Knotweed) and/or legal complications (restrictive covenants, negative easements, third-party consents, ransom strips);
- ✓ Even if you have issues with your tenants such as arrears or refusal to leave, we will buy and deal with the situation ourselves;
- ✓ There will be no price drops at survey (barring something majorly structural we have missed which is extremely rare), no pulling out of sales and no time delays;
- ✓ The sale 100% secure and confidential with none of the hassles of an open market sale;
- ✓ We are fully-regulated buyers with the appropriate insurances in place and proof of cash funds;
- ✓ We can offer cash advances should you need access to capital within short time-frames.

Quick Estate Agency Sale

With offers for our Quick Cash Sale service at up to 75% of the market value, many landlords are more interested in our Quick Estate Agency.

We employ a 'realistic pricing model' to sell and use our expertise developed over 15 years in the Quick Sale industry. This helps us generate a secure offer on your property in under 28 days at the full market value.

Below are some of the key benefits of using this service:

- ✓ We actively market your property on all the major property portals – including Rightmove, Zoopla, Prime Location and many others (see where we advertise);
- ✓ Floorplans, professional photos, interest-generating descriptions of your property;
- ✓ Bright and impactful FOR SALE board in front of your property;
- ✓ 24/7 freephone line / chat service so we don't miss any enquiries;
- ✓ Weekly reports direct from the property portals;
- ✓ Accompanied viewings (including evenings and weekends). We are happy to communicate with current tenants and work to their schedules without causing disruption;
- ✓ Complete sales progression (complete IT infrastructure / backend system);
- ✓ No sale, no fee;
- ✓ No tie-ins on the contract – if we do not generate an offer within 28 days you can leave and pay nothing. In short, you have nothing to lose by giving us a try!

However, it still comes with the risks of a normal sale. We are not in control of the process in the same we would be with our Quick Cash Sale option.

We do everything on our side to speed the process and guarantee a more efficient service than high street and online estate agents.

For more information about our competitive fees or to ask any questions regarding our services please visit our website **www.propertysolvers.co.uk** (our online live chat is open 24/7), call us anytime on **0800 044 3733** or email us via **info@propertysolvers.co.uk**.