NLA
NATIONAL LANDLORDS ASSOCIATION

Considerations before investment

Advice and guidance from the National Landlords Association

www.landlords.org.uk

PROFESSIONAL PRACTICE FOR PROFIT
IN THE PRIVATE-RENTED SECTOR

INVESTING
with knowledge

CALCULATING
your returns

CHOOSING
the mortgage

Considerations before investment

Thank you for requesting this National Landlords Association (NLA) guide to investing in residential property. For those who are not currently members of the NLA, or who may not have come across the Association previously, we exist to promote renting as a viable tenure, support landlords to make the most of their businesses and ensure that property investment remains sustainable by providing profitable returns.

Over the course of the last four decades the NLA has witnessed an enormous amount of change in housing, in particular attitudes towards renting and the proliferation of property investment as a means of providing income to a wide range of enterprising private landlords. However, one thing that has not changed in our time representing landlords is the importance of making good choices when it comes to buying property.

Property investment is far too often considered a game of chance, allowing those who happen to buy in the right place and at the right time to make a tidy profit. While it is certainly true that a little luck is never a bad thing, it is far from the only factor affecting profitability.

A wise investment will not only increase in value if the housing market rises, it will provide a steady and dependable income and provide a degree of protection from depreciation. A wise landlord will learn to recognise the signs of potential moneymakers and be alert to the warning signs often hidden behind the magnolia façade of a potential money-pit. This guide is one of a series of guides in which the NLA will help you to plan, execute and develop a sustainable lettings business.

Am I a landlord?

Landlords come in all shapes and sizes, and crucially all enter the market in subtly different ways.

Most come to the market in one of three ways:

1. **In search of a 'better' investment**

   Property is seen as a 'safe investment'. Houses and flats are tangible, you can see and touch a building in a way that you cannot for most other investments, making it much more approachable and understandable. Many who would otherwise have been content with conventional savings have recognised that historically low interest rates are bad news for bank accounts but a real opportunity for property investment.

   Many in this category are also mistrusting of traditional pension investments, having witnessed years of scandal and losses. Property, in particular its visible nature, can be an antidote to these misgivings.

2. **It's not worth selling**

   Particularly following an economic downturn like those in the early nineteen nineties and latter part of the last decade, many households find that it is simply not in their best financial interests to sell their home when they move. This is frequently due to negative equity concerns or simply a slow market. In these circumstances many become 'reluctant' landlords by moving on and letting their former home.

3. **Courtesy of a surplus property**

   The other type of 'accidental' or 'circumstantial' landlord tends to arise from the acquisition of a property by means of inheritance or following a couple's decision to cohabit leaving a former home unoccupied. Whatever the reason for the home surplus, this presents an opportunity to maximise your assets, if a few simple steps are taken.

continued overleaf...

Am I a landlord? cont.

However, the theme common to all landlords; ‘reluctant’ and would-be investors, is the desire for return on investment or ROI to make the most out of funds or assets available.

In order to achieve a positive ROI it is essential to plan your initial investment properly and realistically based on your assets, access to credit and potential for income generation. For most, the single largest financial decision to make will be how to finance a new purchase or to what extent you can re-mortgage an existing property, i.e. how much can, or should, I borrow?

Buy-to-let - What?

Buy-to-let (BTL) mortgages are the life-blood of the UK's private-rented sector. Forswearing the need for complex commercial lending arrangements, BTL products have changed the face of letting in the UK.
Whether you already own a property you plan to let or are interested in making that first acquisition, it is very likely that you will need to learn about BTL mortgages. Dealing with financial products can be daunting, particularly as the Financial Conduct Authority (FCA) classes BTL products as 'commercial' and therefore do not require the same degree of consumer protection as residential mortgages (the type you would use to buy your own home). However, there are lots of places a would-be investor can go for advice including independent financial advisors (IFAs), mortgage brokers, lenders themselves and of course landlord associations such as the NLA.

When shopping for a mortgage it is essential to understand the types of loan available. Broadly speaking, BTL loans can be broken down by the mechanism used to set repayments rates. Generally a mortgage will fall into one of the following categories:

1. **Fixed**

   The simplest type of mortgage, whereby the interest rate is set for a fixed period of time guaranteeing predictability.

2. **Capped**

   A capped product allows the loan's interest rate to fluctuate up to a pre-set ceiling above which it will not rise. This provides a degree of certainty, whilst also allowing borrowers to benefit from decreases in the lender's base rate.

3. **Tracker**

   Tracker mortgages allow the interest rate to fluctuate based on a pre-set relationship with either the Bank of England base rate, LIBOR or similar prescribed base rates. These loans do not offer the same degree of predictability, but allow borrowers to take advantage of decreases in interest rates.

4. **Discounted tracker**

   These are tracker mortgages which are discounted for a fixed period of time.

Buy-to-let - Why?

Borrowing against an asset, such as a rental property, is often referred to as leveraging which provides a very useful description of what is happening. A BTL mortgage allows a landlord to put a relatively small amount of money to much more efficient use, as a deposit, to allow the purchase and use of a much more valuable asset.

"Give me a lever long enough and a fulcrum on which to place it, and I shall move the world."

Archimedes of Syracuse

Understanding this principle can make it possible for landlords to diversify their portfolio and drastically improve their ROI without any additional capital investment. This is illustrated by the following case study.

The accidental landlord

Steve is an accidental landlord; following the death of his great aunt Ursula he inherited her house in Kent. The house is valued at £150,000 and a local letting agency has provided a rental valuation of £500 per calendar month.

Based on these valuations, he calculates that his £150,000 investment will produce an annual gross yield of 4%. *

However, Steve is keen to make sure that he puts his inheritance to good use and speaks with a financial advisor. The IFA points out that Steve could consider mortgaging his aunt's house in order to release £100,000 to invest elsewhere.

Steve decides to take the £100,000 released and use it to provide the deposits to buy two further houses priced £150,000. As a result he owns 3 investment properties, each worth £150,000 and providing a rental income of £500 per calendar month.

Based on this, Steve's £150,000 investment now yields 12% per year.

**Gross yield is calculated as income/investment value*100.*

The same principle can be applied to new acquisitions. Given the potential financial benefit of spreading investments and maximising the capital tied up in individual properties it is worth considering the optimum available loan to value and whether taking smaller equity stakes in more property would be advantageous.

As BTL mortgages are business loans, interest payments are tax deductible, improving the tax efficiency of property investment and reducing the cost of financing a portfolio.

Buy-to-let - How?

Of course understanding why BTL products can prove profitable is only part of the challenge. Accessing affordable and appropriate credit need not be difficult, but as anyone who has ever applied for a residential mortgage will confess, it can be challenging and frustrating at times.

Many landlords choose to take the stress out of selecting mortgage products by using a reputable mortgage broker, although lenders are increasingly keen to work with landlords directly.

The NLA provides an online comparison service for landlords trying to identify a good deal at www.landlords.org.uk/mortgages. This search facility is free to use and offers full NLA members cash back on completed transactions.

The mortgage product selected will depend on the type of property, target market and location as many lenders specialise or choose to restrict lending on niche investments. Once you have identified lenders active in your market place it is important to compare the various products on the market based on the cost and availability of individual products. Some of the common selling points to consider are:

- Interest rate (initial and reversion rates/SVR)
- Term of lending
- Repayment vehicles (repayment, interest only etc.)
- Applications fees
- Type of products (tracker, fixed etc.)
- Early repayment charges
- Special offers or discounts
- Cash back or loyalty offers
- Completion fees
- Restrictive terms and conditions (e.g. maximum tenancy length or restrictions on types of tenant).

Buy-to-let - How? cont.

Once you have identified a suitable product you will need to complete an application. In order to do so you will need to provide your personal details, details of your current financial status and any outstanding credit arrangements, your income and expectations of future rental income.

If successful you will receive an approval in principle and the verification process can begin, during which you will need to demonstrate that any information provided in your application is true and the property you wish to mortgage meets the lender's criteria for lending. It is at this stage that a valuation will be carried out to provide an overall value and estimate of an achievable rental income.

If all goes well a written offer will follow and you will be free to draw down the funds.

Application Timetable

Choosing the right property

Unlike many investment vehicles the choice of which investment to make is entirely yours. However, this is not to say that there is not advice out there to help you to select the right property to meet your investment needs. Local letting and estate agents can provide invaluable market intelligence, and a good relationship with an agent can help you to identify prospects before they become available to the wider market.

A trusted agent can advise about local demand, market characteristics and suggest viable investments – although it is important to bear in mind that even the most professional agent has a vested interest in your continued business.

The type of property you buy will depend on a myriad of factors and will hinge on the needs of the tenant market. For instance a large shared house close to nightlife could be a wise investment in a prominent university town, but may make little sense in commuter country where proximity to travel links and school catchment areas are key considerations.

Consider whom you want to attract to your property, of course there are no concrete categories of potential tenants but consider which of the following (or combination thereof) you may prefer to work with:

1. **Students**

   This group is largely dependent on geography and if you are looking to invest near a university it is a good idea to consider the needs of students by looking at similar property. Many universities have specific criteria or requirements which landlords must meet in order to work with their accommodation team.

2. **Sharers**

   Shared housing can offer a strong yield, but is often more complicated to manage and can require a different skill-set.

3. **Families**

   Families tend to want greater stability and may want to stay in the property for a longer period. This is usually good news for a landlord as it provides a long-term income. Proximity to amenities and schools is usually a high priority.

Choosing the right property cont.

4. **Older households**

   While not traditionally a mainstay of the private-rented sector, 'third-age' households make up an increasing proportion of the market. It is worth discussing the local demographics with relevant agents if you are interested in attracting this market.

5. **Commuters / professionals**

   Often seen as the most sought after tenants, 'young professionals' form a large part of the market. This is far from a uniform customer base, but proximity to transport and leisure facilities tend to figure high on their must-have list.

6. **Households in receipt of housing support**

   Households in receipt of housing benefit – currently called Local Housing Allowanc but soon to be replaced by Universal Credit – can fall into any of the above categories but are often viewed as a 'type' of customer in their own right. Information about the current rate of Local Housing Allowance or other applicable benefits and credits can be found online and will help to determine what rent levels are accessible by this part of the market. However, bear in mind most support recipients are also working households.

7. **Companies / commercial tenants**

   Companies often take on tenancies to allow employees to relocate or work in other areas temporarily. They can prove very good tenants. However it may be wise to seek the assistance of a professional agent or speak with a landlords association when agreeing terms. The type of agreement entered into will not be the same as those employed for individual tenants and can cause some confusion for the less experienced landlord.

Above all, it is essential to research potential locations and identify core criteria. It is possible to renovate and change almost any aspect of an investment property to meet customer demand, but if the location is wrong your valuable asset is unlikely to ever yield the kind of returns you would like.

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Choosing the right property cont.

When looking for a property it is important to take the following factors into consideration:

1. **Location**
   Even within a chosen area you cannot fix a bad location. Check the distance to local travel links and amenities and remember that those included in listing paperwork may be 'as the crow flies'.

2. **Condition**
   Are you prepared to renovate? What work is it likely to require? Remember you are responsible for the upkeep of your rental properties so look out for issues which are likely to require attention. Note the type of construction and how easy it will be to maintain and renovate as necessary.

3. **Status**
   Is the property freehold or leasehold? There are advantages and disadvantages to both depending on the property and personal opinion but it is essential to understand what is for sale, including the length and terms of the lease, if applicable. These factors can have a significant impact on the property's value and future saleability.

4. **Motivation of the seller**
   You're making an investment; this means that you have more flexibility and ability to proceed than 80 per cent of those in the market who are looking for a home. This flexibility has a value and can be used to good advantage with a motivated seller. Likewise, watch out for long chains with poorly motivated sellers. You don't want to wait months unnecessarily just because the vendor is in no hurry to move on.

5. **Potential income**
   This is crucial, just because you like a property does not mean it will make a lucrative investment. Remember, you are looking for your customer's ideal home – not yours. Assess the potential income by looking at other properties on the market and talking with local agents.

6. **Price vs. value**

   Every vendor wants to maximise his or her sale price. You are in a position to leverage your position as an investor, making decisions with a business brain and able to move fast. Check out recent sold prices - these are readily available online and can differ greatly from asking prices. Use this market intelligence to your advantage and make sure you only offer according to your valuation, not the vendor's. Getting a good price now will pay dividends in the long run.

When assessing different geographical areas think about the type of tenants you wish to attract and what type of properties they are likely to choose to live in – never forget an investment is most likely to prove successful if it is also a desirable home. The features and characteristics that will prove desirable will depend on the age profile, affluence, employment status and lifestyle of your target market so it pays to talk to landlords and businesses already in the market as well as looking around at the competition. If you are unsure where to start, why not attend a local NLA branch meeting to meet other landlord investors and share in their experience of the market.

Join the NLA

Being a landlord can be a rewarding business but it's not without challenges and as we've outlined above, there is risk. For further help and support with your lettings, join the NLA.

Membership benefits:

- Our range of resources will provide you with accurate information, practical guidance and legislative updates
- You can meet with fellow landlords and benefit from their experience
- Our membership promotional tools and accreditation scheme can help you gain a competitive edge
- Our wide range of services will help you deal with most aspects of letting property
- You can also enjoy substantial savings on our benefits and services
- Our on-going campaign activities and surveys will give you the opportunity to make yourself heard at a local, national and European level
- We offer a range of membership packages to suit your needs

For details visit: www.landlords.org.uk/membership

The NLA caters for all types of landlords:

I'm a Landlord working independently

Help with all aspects of letting property

I'm a Landlord working with my family

Extend the benefits of membership to your family

I'm a Landlord trading as a business

Manage your letting business more effectively

Glossary

LTV – loan to value

IFA – independent financial advisor

BTL – buy to let

Gearing – a measure of financial leverage or a ratio that compares equity to borrowed funds

Leverage – borrowing with the belief that income from the asset will more than cover the cost of borrowing

ROI – return on investment

Yield – return on investment expressed in percentage terms

ROE – return on equity

KFI – key facts illustration

SVR – Standard Variable Rate

LIBOR – London inter-bank offered rate

FCA – Financial Conduct Authority

Encouraging Renting

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NLAFGCBI v1 0514