

BUY TO LET PROPERTIES

At one time, investing in the Stock Market was looked upon as the sure-fire way to achieve long-term growth, but the recent performance of the Market has caused many people to look at alternative forms of investment.

The property market has also 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 has spawned a significant expansion in the *Buy to Let* sector. Basically this involves investing in property in the expectation of capital growth, and in the meantime earning rent which can be applied to cover the costs of ownership.

Many investors were encouraged by soaring house prices, but it must be recognised that prices cannot continue upwards at such a rate, nor can rent levels always be sustained, and there could well come a stage where it may not be possible to cover mortgage repayments out of rents

Typically a rental yield of about 6% is required to cover mortgage interest of about 5% and any additional costs such as letting agents' fees, but yields can be as low as 3% (and as high as 9%). Please remember that the greater the borrowing, the greater the risk.

However, experts believe that *Buy-to-Let* investors can expect a reasonable rate of return on their capital if they take a long term view of at least seven years. Properties should be chosen with care, in areas where tenant demand is high. The cautious investor will build up a cash reserve to be able to cut rents or go without a tenant for a couple of months, if necessary.

The Student Scene

One special area where *Buy to Let* makes very good 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, and good rates should be available to the student first time buyer.

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

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 (ie 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 may be claimed and the income qualifies as relevant earnings for personal pension purposes. This last point has become of less significance since the personal pension contribution regime was relaxed in April 2002.

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

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.

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