CITYRISE INVESTMENT GUIDE

The Definitive **Buy-to-Let Mortgage Guide**

CityRise

THE DEFINITIVE BUY-TO-LET MORTGAGE GUIDE

If you are reading this, you are more than likely considering purchasing a buy-to-let property. When investing in property there are ample considerations that must be made: where to invest, when to invest, how much to money invest. Of the many elements involved in buying an investment property one of the most daunting is the buy-to-let mortgage. You might not understand what they are, how they work, the interest rates you should expect or the different products available.

This article will untangle some of the complexities around buy-to-let mortgages so you can proceed safely with getting one.

WHAT IS A BUY-TO-LET MORTGAGE?

When you buy a property as an investment, you will not be able to fund your purchase with a normal residential mortgage. Instead, you will need a specialist buy-to-let mortgage. There are two main differences between a buy-to-let mortgage and a residential mortgage that must be considered.

Firstly, lenders see buy-to-let mortgages as higher risk because many buyers will use the rent to make their repayments. Should a landlord have issues with rent collections or suffer from periods of unoccupancy, lenders see a risk that they will default on repayments. This is not true for most landlords, who are generally financially secure people not solely dependent on rental income.

Nevertheless, because of the higher risk involved you will be required to pay a larger deposit. This is generally at least 25% of the total value of the property but depends on the lender in question. There are some lenders that might offer buy-to-let mortgages that only require a 20% deposit but expect to pay higher mortgage rates. To benefit from the best mortgage rates on the market some lenders might require a deposit as high as 40%. The table below highlights that most buy-to-let mortgages deals require at least 25% deposit.

DIFFERENT LTV PRODUCTS CURRENTLY ON THE MARKET

LTV PRODUCTS

MAX LOAN-TO-VALUE	NUMBER OF DEALS
60%	87
65%	46
70%	86
75%	173
80%	29

To put this into context, if you were to buy a £240,000 two-bedroom property with a 25% deposit, you would be required to pay £60,000 up front. If you wanted the better rates and decided to use a 60% Loan-to-Value (LTV) mortgage with a 40% deposit, you would pay £96,000.

Secondly, buy-to-let mortgages are mostly interest-only, whereas residential mortgages are primarily capital and interest loans. An interest-only mortgage requires the buyer to pay back monthly interest payments on the loan rather than the actual loan itself. Interest only repayments are much lower than capital and interest repayments, which allows for better landlord cashflow.

At the end of the term the mortgage must be repaid in its entirety. Most property investors will look to sell their property for more than they bought for, pay back the loan and take some profit. However, if the property's value has fallen over this period, then you will need to find the difference from somewhere. Therefore, it is crucial that you are buying a secure and profitable investment in an area with good yields but also strong capital appreciation. This way you will not be stung down the line.

CAN YOU GET A BUY-TO-LET MORTGAGE?

Now you understand the two main differences of a buy-to-let mortgage you might be wondering whether you would be accepted for one. Acceptance of a buy-to-let mortgage is remarkably similar to a residential mortgage and depends on a variety of circumstances, including:

- You are wishing to purchase the property
- You a familiar with the risks involved with investing in property and can afford to take them on.
- You have a good credit record and do not have excessive amounts of debt, for instance on credit cards.
- You should earn more than £25,000 a year. Lenders will be unlikely to approve a buy-to-let mortgage if you earn less than this.
- You are not over 70/75 years old. Lenders usually have an upper threshold of 70 to 75 and will usually not lend to people older than this.

AFFORDABILITY

INTEREST COVER RATIO'S

The above conditions are quite standard across all mortgage types. However, you should expect to be subject to a much more stringent affordability test when getting a buy-to-let mortgage. As part of the affordability assessments, lenders will use what are known as Interest Cover Ratios (ICR's).

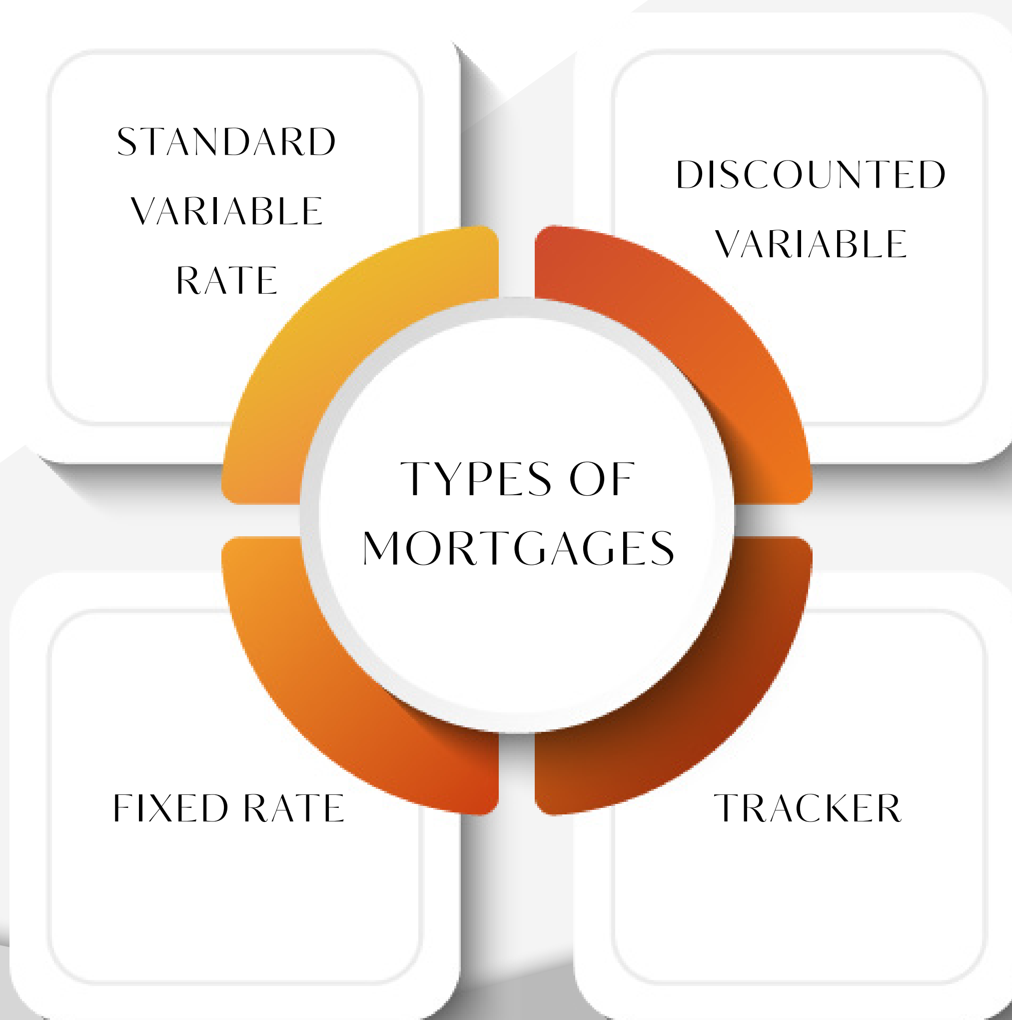
These are used to calculate how much profit a landlord is expected to make in relation to the monthly interest payments. In other words, the ratio of money the landlord will make in rent after making interest repayments. Banks usually use a representative value of 5.5% to determine the ICR.

Most lenders require that the projected rental income of the property be at least 125% of the landlord's mortgage payments. In some cases, this is much higher. You must therefore make sure the rent that is achievable for the property is at least 25% more than the interest repayments.

WHAT TYPE OF BUY-TO-LET MORTGAGE SHOULD YOU CHOOSE?

If after analysing your finances, you can afford to take on a buy-to-let mortgage then you will need to decide on the type of loan to take on. Again, there a many aspects that should be considered before choosing your product.

The amount of interest you pay back on a buy-to-let loan depends on many factors. Amongst others, these include the size of your initial loan, the rental value of your property and your own financial situation. However, it will also depend enormously on the type of mortgage you take on be it a fixed rate or variable rate loan. Each have specific advantages and disadvantages and we will dissect them here.



FIXED RATE

A fixed rate mortgage deal is a set interest rate that usually lasts for two to five years. If you choose this product your interest payments will remain the same for the duration of the fixed period.

Having a fixed interest rate gives you peace of mind knowing exactly what you will be paying each month. This allows you to budget better and ensure the rent you are charging will always cover the interest payments.

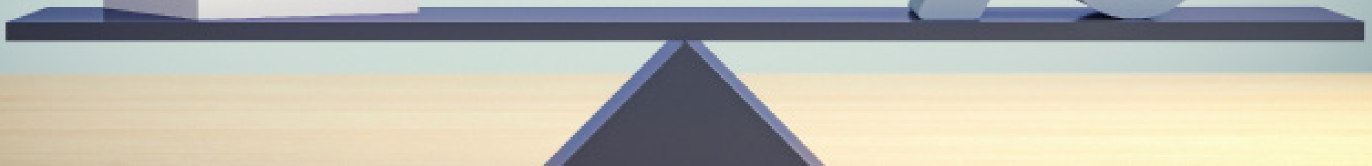
However, fixed rates are generally set higher than variable rate mortgages. Furthermore, you will not benefit from any fall in interest rates as your rate is fixed.

You will also be subject to early repayment charges if you want to get out of the mortgage before the end of the term.

One particularly important consideration is what you will do when the fixed rate term is over. Once the term ends lenders will automatically put you on their standard variable rate mortgage. These rates are some of the highest out there and it is therefore important you look for a new deal before your fixed term ends.

FIXED RATE

PROS	CONS
Your monthly repayments will always stay the same, regardless of whether interest rates increase.	Early repayment charges can be high. This makes moving home or remortgaging even more expensive.
With fixed rate mortgages you can budget far easier as you know what you are going to be paying.	After the fixed rate period you will be placed on the lenders SVR. You need to be aware of when this is to act appropriately.
Fixed rate mortgages can be the most affordable, especially if interest rates are low.	If interest rates improve during your fixed-rate period your payments will not benefit.



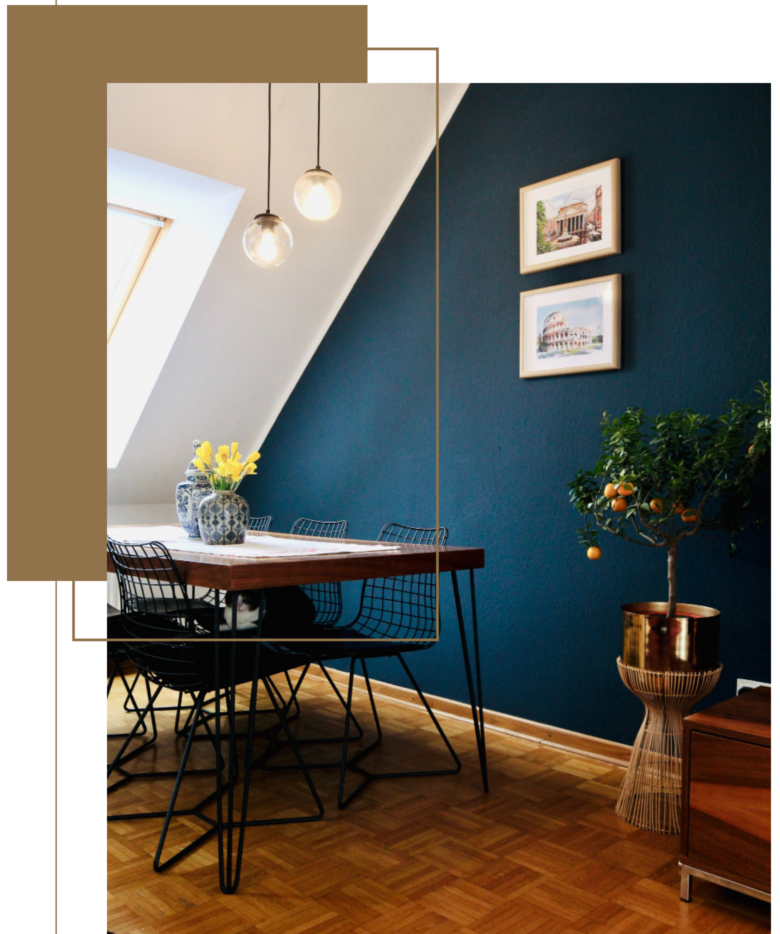
STANDARD VARIABLE RATE

These mortgages are the lenders default plan, and you will be moved onto this once your deal expires

As mentioned already, these plans can be the most expensive on the market, with the highest interest rates.

The lender can change the interest rate when they wish with little to no warning.

We would advise not to use an SVR mortgage and if you are currently using one, change it as soon as possible. The only advantage to SVR's in this sense is that you can change them without incurring exit fees.



DISCOUNTED VARIABLE

These mortgages have a fixed rate set below your lenders SRV. For instance, if your lenders SVR is 4% and the discounted rate is fixed at -1%, you will pay an interest rate of 3%.

However, the discounted rate will follow the SVR and you will therefore be subject to the same rises.

The discounted rate only lasts for a certain period, typically around 2 years. After this period has expired you will be moved back to the SVR.

TRACKER

A tracker mortgage is a type of variable-rate mortgage.

The interest rate 'tracks' (i.e. moves in relation to) an external interest rate. This is usually the Bank of England Base Rate, but others can be used. This makes it unlike an SVR mortgage, which has a rate set solely by your lender.

For example, if your tracker deal is described as 'Bank of England Base rate +1.5%', your rate will always be 1.5% more than the rate set by the Bank of England. Thus, if the Bank of England rate is 0.5%, your tracker interest rate will be set at 2%. If the base rate were to rise by half a percentage point, your tracker would rise to 2.5%.

Currently, the Bank of England base rate is set at a record low 0.1% and thus there could be some excellent tracker products. Make sure you understand the rate set above this by the lender before committing. Either way, the Bank of England base rate will not fluctuate as much as a lenders SVR and it is therefore generally safer.

TRACKER

PROS	CONS
Your lender is not able to change the interest. Only a change of the BoE base rate can do so.	If the BoE base rate rises, so will your monthly repayments.
If the BoE base rate falls, so will your monthly repayments	There may be early repayment charges if you switch before the deal ends.

STANDARD VARIABLE RATE

PROS	CONS
If BoE cuts the base rate, the SVR might follow it.	They are usually the most expensive product on the market. You are probably paying more than you should be.
There is usually no repayment charges and you can therefore pay back or remortgage when you want.	The lender is free to increase the SVR whenever they want. This can lead to large increases in your monthly repayments.
They tend to have lower arrangement fees than both fixed and tracker deals.	In a low-interest market, fixed rates are almost always better value.

DISCOUNTED VARIABLE RATE

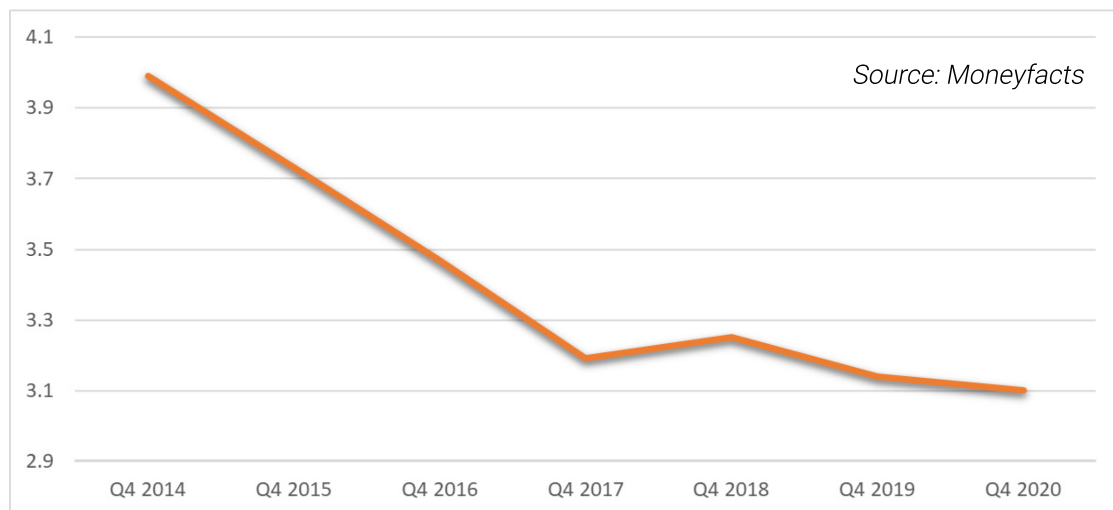
PROS	CONS
The rate will stay below the SVR for as long as the discount lasts for.	Discounted rate rises in line with SVR rises.
The rate will likely go down if the base rate falls.	The discount might not be attractive if the lenders base rate is high.
Lower early repayment charges than fixed rate mortgage.	It is still a variable rate and thus it is still difficult to budget.

Ultimately, it is your choice what product you would prefer to use. With respect to buy-to-lets we would most likely side with fixed rate as the additional risk of SVR's is not wise with a rental property. With a fixed rate mortgage, you can budget easily and will always be able to price rent in line with the interest repayments. This way, there is less chance of being caught out unexpectedly with rent not covering the interest repayments.

WHAT MORTGAGE RATES SHOULD YOU EXPECT?

Now we have a firm grasp of the different types of mortgage products available and the inherent advantages and disadvantages of each. You might be interested in what interest rates you should expect when choosing a mortgage product. Ultimately, you will need to shop around for the best rates, and we would always advise using a mortgage broker. The cost of using one will invariably save you money in the long term.

Nevertheless, we can have a look at the average fixed rate mortgages in the UK over the last 6 years. As you can see, In Q4 2020 during the Coronavirus pandemic, the average fixed-rate buy-to-let mortgage had an interest rate of 3.1%. This is down from 3.99% five years earlier, as shown in the graph below.



At the time of writing, interest rates are at record lows which is excellent news for landlords. Lower interest rates equals more money in your pocket each month. However, despite the low interest rates lenders have become increasingly cautious about who they lend to and what they lend on. When purchasing a buy to let do not be alarmed if some lenders will not lend on your property, you might need to shop around to find the right one.

HOW MUCH CAN YOU EXPECT TO BORROW?

The amount you can borrow depends on the Interest Cover Rate (ICR), discussed earlier. Essentially, this is based upon the amount of rent that you will realistically be able to earn from your investment property. You can estimate how much rent you can charge by looking into the rents of similar properties in your area. Your lender will also require verification of your property's rental value from an independent surveyor. Therefore, it is important to buy investment property with good yields or you might not be able to borrow enough.

As mentioned earlier, lenders will typically require you to receive 125% of your monthly interest payments in rental income but this can be as high as 145%. If your provider requires your rental value to be 125% of your interest payments, then you will need to charge your tenants at least £1000 a month if your monthly interest payments are £800. Essentially, the more you can charge in rent, the higher the loan you should be eligible for.

WHAT HAPPENS AT THE END OF YOUR BUY-TO-LET MORTGAGE?

Should you choose to sell your buy-to-let property or remortgage it you will be required to pay off the loan. If you are on an interest only mortgage, which is commonplace for buy-to-let properties, you will have no equity in the property. This is because over the period of owning the property you will have only paid the interest and not the actual loan.

In this situation you will expect the property value to have increased and you can therefore pay off the loan and take the capital appreciation for yourself. Traditionally, in the UK, property prices have doubled every 10-20 years. It is therefore safe to assume that over a longer period the property will go up in value. However, there are times like during the 2008 financial crash that property prices take a huge hit. If you were to sell the property during these downswings, then you might struggle to pay the loan back.

It is for this reason you should always invest in property sensibly. At CityRise we are here to offer you the best property investment advise and opportunities on the market. Please get in touch if you want to learn more about how property can work for you financially.

WHY INVEST WITH CITYRISE

Here at CityRise, we have successfully helped over 100 clients achieve their long-term property goals. We pride ourselves on adopting an authentic, personable approach whilst guiding you on your investment. Regardless of whether you're a first-time or seasoned investor, our experts will be with you from start to finish.

Our sector knowledge and expertise are well above average, having sold over £225 million worth of investment property across the UK. We've looked after over 500 tenants in a range of properties and managed the whole sales and lettings process for several new developments.

Whatever your motivation for investing in property, a CityRise consultant will take the time to get to know you before proposing the right strategy. This ensures that our property recommendations are always personalised to your unique circumstance and preferences.

All of our projects have been hand-picked for their general reputability, security, location, pricing, and prospective returns. Each investment goes through a thorough vetting procedure and is supported by a detailed due diligence report. You can rest assured that with CityRise, our thorough vetting procedure guarantees you will secure a profitable investment with little risk.

We are also proud members of ARLA Propertymark, the UK's leading professional and regulatory body for letting agents. If you choose to take a hands-off approach to property investment, you can leave your investment in our trusted hands. Our lettings and management services allow you to relax, knowing your investment is operating both successfully and legally in the buy-to-let sector. ARLA ensures that its members operate at a level of professionalism far above what the law requires, and advocates for more regulation in this rapidly growing sector of the property market. Therefore, if you choose to invest with us, you can feel confident lettings team will provide all the support you need for a smooth, enjoyable, and hands-off experience.

Secured my second investment property with CityRise and it was as smooth and uncomplicated as the first. The guys once again talked me through all potential opportunities in a simple, easy to understand manner without unnecessary jargon. I would honestly look no further than CityRise if you are interested in getting into property investment.

WILLIAM HARVEY

READ THE REVIEWS

Find out why we are rated excellent on TrustPilot

I have been investing in property for the last 15 years or so, buying many properties, both off-plan and existing. Dealing with the team at CityRise has been a joy. They are professional, communicative and inspire confidence every step of the way. I always feel I am in safe hands with them.

MORWENNA HALLEN

I have bought three off plan units from CityRise and with every purchase I felt that they advise me as if it was their own money they were investing. Honest and holistic and not just wanting to make a quick sale!

CHARLOTTE FISHER

Handed over my portfolio last year and the management has been sleek and efficient. I haven't been hit with hidden fees as I seem to with every other agent. Always a pleasure dealing with such great people.

CONNOR HANLEY-COLLINS