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Buy-to-Let Properties

The basic idea underpinning the *Buy-to-Let* sector is to invest 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 is now clear that prices could not continue upwards at such a rate, nor can rent levels always be sustained, and 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. Lenders may be happy to offer a mortgage to a student if the parents act as guarantors, and good rates could 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 (FHLs)

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 within the European Economic Are (EEA) and 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 (increasing to 210 from April 2012) days in the tax year and actually let for at least 70 (increasing to 105 from April 2012) of those days. It must not normally be in the same

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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 (105) 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 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.

Losses made in a qualifying UK or EEA FHL business may be set only against income from the same UK or EEA FHL business.

Properties used for qualifying FHLs are eligible for CGT entrepreneur's relief, rollover relief and business gifts relief, though it is very unlikely that they would attract business property relief for inheritance tax.

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.