

# What you need to know about...

## THE RISKS OF BUY TO LET

**Buy to let has been a real success story of recent years, especially given the rent rises in property prices. But behind the apparent success lies a number of investors with a cautionary tale to tell. Buy to let can be a great way to make money, but it can equally be an easy way to lose money for the unwary; the key is to carefully assess the property, and not be lured into the market.**

### What is buy to let?

Buy to let is a type of mortgage which allows you to invest in a property which is then rented for profit. Typically, a lender will require a 15% deposit, and will assess the suitability of the property against the rent which can realistically be achieved. Most lenders require that the rent is 125% of the mortgage payments. This means that if your mortgage is £500 per month, the rent needs to be at least £625 per month.

### What are the risks of buy to let?

We have set out below some of the main risks to investors in this market

#### Diversification

If your investment is in only one type of asset (such as property) and this type of asset starts to perform badly, then your whole investment goes with it; this can be compounded if all your investment is in one property. In theory you should try to diversify your assets to allow for peaks and troughs in the market; this will lower your exposure and risk.

The ideal is to spread your investment around different types of asset such as shares and cash. Remember that recently property has

done very well recently, but it has not always been like that. Property may go up in the long term, but does drop in value in some years.

#### Has the market peaked?

This is a difficult question since this has been predicted for some time; however, some lenders are reporting that new lending has been slowing recently, mainly due to the increase in interest rates, which have risen steadily for a year.

#### Gearing

This refers to borrowing against an asset, which can be a double-edged sword. If you buy your property for £100,000 you will need to put down a 15% deposit, costing you £15,000. If your property rises in value by 10% to £110,000, then your actual investment has increased from £15,000 to £25,000 - a rise of 66%! However, this works equally spectacularly in reverse: if your property was to drop in value by 10%, you would lose two thirds of your original investment.

#### Yield

This is also important, since this refers to the

Continued overleaf...

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annual return on your investment. In recent years, many investors have reported that rental yields have not increased very much, mainly due to over supply of rental properties. With house prices high, this makes affording a buy to let mortgage difficult. Also, given the risks associated with property investment, you should aim to achieve more than 6% returns as this can currently be found in an instant access cash account.

## Tenants

You will also have the hassle of dealing with your tenants. This can take up your time and money. You should plan for:

- **Void periods**  
Times when the property is not let, between tenants, or because they do not pay; your mortgage will still be due;
- **Maintenance**  
Either through wear and tear, or damage;
- **Management fees**  
Many landlords ask an agent to manage the process for them. This can cost up to 10% of the monthly rent.

## Taxation

You will have to pay:

- **Income tax on any profits**  
After allowable deductions, such as mortgage payments and maintenance;
- **Stamp duty**  
This starts at 1% of the purchase price, unless the property is below the threshold;
- **Capital gains tax**  
On any gains when you sell the property.

## Acquisition and disposal costs

You will need to use a solicitor for the conveyancing, and pay for other things such as a survey and property searches. This could cost £1,000. If you are selling a property, you will need to pay an estate agent, whose fees will range from 1-2% of the sale price.

## Mortgage fees

This is often overlooked, but you will probably pay application fees, and may have exit penalties. A loan may have an arrangement fee of up to 2% of the loan balance.

## Conclusion

The purpose of this factsheet is not to put you off buy to let investing, but to raise some of the pitfalls for the unwary investor. This remains a great way to invest your money, as long as you enter the market with your eyes open, and with a realistic view of what to expect.

If these issues have raised questions, then perhaps you should consider other types of investment, which may allow easier access and the chance to diversify your assets.

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