

# Breaking the chain

Let-to-buy mortgages enable borrowers to move upwards on the property ladder without having to embark on the lengthy process of selling their existing property first. **Ramona Leavers** outlines the risks and rewards in taking such an option

**T**here are two ways in which your client can choose to approach this market.

Firstly, they can rent their existing property out and then take a new mortgage on their new property; this will involve using their financial resources to provide a deposit on the new property or seek 100 per cent finance. Alternatively, they can undertake a let-and-buy which would involve remortgaging their existing property (to raise security by way of a deposit) to a new lender, who will usually also arrange the mortgage on the new purchase.

Whatever the specified route, there are many reasons why more and more clients are seeking to undertake the let-to-buy option. A number of clients choose to do so because they have constraints with their existing lender which prevent them from selling their home without incurring hefty redemption penalties. Switching to a let-to-buy mortgage until such penalties expire is an option worth consideration as it will facilitate the house purchase going through. Other borrowers take this route because they do not wish to undertake a prolonged selling process in order to release the funds for a house purchase. This can be a popular choice for those clients who may be offered a discounted purchase price on a new-build property assuming there is a quick completion or if market conditions dictate that the sellers' market has taken a bit of a downturn compared to the rental market in their chosen area.

## Quicker move

It is because the let-to-buy option breaks the house-buying 'chain' and



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therefore puts potential purchasers back into the first-time buyer/cash buyer type category that makes it so popular. Because the former home does not need to be sold, the person looking to buy can move fairly straightforwardly while those who may be tied up into a complicated chain will not be able to progress as quickly as their counterparts. Another benefit of taking this direction is that the usual fees associated with selling a property

(for example agent's and solicitor's fees) can be avoided, enabling the client to move forward with their new purchase at a greatly reduced cost.

We all know that increasing house prices and fears about investments have all substantially contributed to the growth of the buy-to-let market and this has almost encouraged first-time buyers to acquire their first property in areas that are deemed to be 'ideal for



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the rental market' (i.e. within easy access to motorway links/train links, etc). The choice of location for these properties is made intentionally (with more individuals having to rent and student lets on the increase). When it's time to 'move on' for those already on the property ladder, rather than sell they choose to take out a let-to-buy. This gives them the opportunity to acquire a new property with the added advantage of becoming a landlord and retaining an asset that will hopefully deliver rental yields over and above their mortgage payments on that property.

### Relocating

Let-to-buy is also the favoured choice for those clients that may have to undergo relocation with work. The need to move around for work necessitates the need to find somewhere to live. Because of this clients who are already homeowners tend to be reluctant to rent for a while before they buy as they consider this option a waste of money. However, why struggle with trying to cope with the sale of a property and a career move all in one go when we all know that selling property coupled with career changes are among the most stressful experiences (aside from getting divorced)? This is where let-to-buy can come into its own as it not only provides a solution to the financial difficulties associated with selling but it diminishes the stress factor.

### Easy to accomplish?

So far we have talked about the reasons why clients may feel the need to take up this option; however how easy is it to put the wheels in motion? The first port of call for your clients would be to approach their existing lender in order to ascertain whether they can switch their residential mortgage to a let-to-buy.

If authorisation is granted from the lender to enable your clients to switch to a let-to-buy then they may impose a change in interest rate (usually with higher loadings). This is because the lender deems there to be greater risk to it. Your clients would also need to be mindful that as well as a change in interest rate



they may also be liable to pay a product/administration charge – this type of fee is usually applied by the lender to cover its costs associated with working on the case. In situations where your client's existing lender is unable to help them they will need to find a specialist let-to-buy lender to assist them.

Having taken the decision to let an existing property rather than sell, the existing property in effect becomes the equivalent of a buy-to-let. As with traditional buy-to-let mortgages your client's income is not used to support the loan, instead let-to-buys need to be supported through the rental income achieved. Therefore any lender considering a let-to-buy scenario would need to see proof that the rental income will be sufficient to maintain the mortgage. Verification of this is usually provided by the valuer whose job it is to confirm what the estimated rental value for a property of that type and in that area should be. As with buy-to-let mortgages the rental income on let-to-buys is normally expected to cover anything between 125-135 per cent of the mortgage interest payments.

### Weighing up the risks

But with supply and demand for let-to-buy mortgages come risks as well as rewards. A number of analysts believe the Bank of England Base Rate is likely to increase by the end of 2005 and while it is unlikely interest rates will double, any increase in rates could have an adverse affect on those wishing to

invest in property. Another consideration that should be taken into account by your clients is the tax implications of taking on an investment property. The basic position is that tax is payable on the net income received from rental properties at the investor's highest rate of tax. Capital Gains Tax may also be payable when the property is sold and is charged on any profit made. There are however a number of allowable deductions from the gain; these include enhancement costs such as those associated with refurbishments, repair and maintenance.

Those that wish to keep their let-to-buy as an investment may decide to incorporate a limited company to hold the property for them. This is already becoming a popular option for buy-to-let investors with the main incentive being to reduce tax liability. However, one downside of this is that not many lenders allow mortgages to limited companies – Mortgage Trust being one of the few that do.

Rental voids and interest rate rises are also inevitable during the life of a let-to-buy mortgage and advisers who have an increased knowledge of buy-to-let mortgages will know that flexibility should be a key consideration when choosing a let-to-buy product and a lender. By choosing a lender that can offer full flexibility, investors will have the ability to overpay and subsequently use their overpayments to fund the property when they are 'in-between' tenants or even to extend their existing property portfolio at a later date. By overpaying when the property is rented out and income plentiful underpayments or payment holidays can be accounted for should the need arise.

It is clear then that it is not always essential for a client to sell their property before they buy and there may be distinct advantages such as speed of completion and avoiding expense by proceeding with a let-to-buy scenario. But in any case, if your clients are looking to purchase another property but do not want the hassle and stress of having to sell their existing property then the let-to-buy option is clearly a wise path to take.