BUY-TO-LET LANDLORDS, IS IT TIME TO SELL UP?

From this April, private landlords face tougher tax rules so it is harder than ever to make a profit. We look at the options open for those who still want an attractive yield from property

BY STEPHEN LITTLE

The buy-to-let market has become increasingly challenging for landlords in recent years, with a raft of new rules and regulations introduced to help rebalance the property market.

Since 2016, private landlords have had to pay an extra 3% on stamp duty when they buy an additional property, while mortgage tax relief has gradually been phased out.

From this April, the rules are getting tougher still. Landlords' tax relief from mortgage payments will be withdrawn and new rules on capital gains tax (CGT) are also being introduced.

Property experts have warned that the latest changes could be a step too far for landlords and result in some leaving the sector.

A quarter of private landlords in the UK planned to sell at least one property over the year to June 2020, largely due tax increases and government reform, a survey last May by the Residential Landlords Association (RLA) found.

Michael Adair, 66, from Bedford, is one of the many landlords who are disillusioned with the constant interference from the Government.

He says: "I am planning on selling my rental properties over the next three years. There is too much red tape and not enough protection for landlords. I have been a landlord for 30 years, but It is just not worth it anymore."

New regulations

Until April 2017, landlords could claim tax relief on mortgage interest on their rental income.

However, the Government has been gradually phasing out this out. From April, landlords will only be able to claim tax relief at the basic rate of income tax, which is 20%. Previously, they could claim at their marginal tax rate, which is 40% for higher- and 45% for additional-rate taxpayers.

The changes mean landlords will no longer be able to deduct mortgage interest payments or any other costs from their turnover before declaring their taxable income.

This is bad news for landlords who could find themselves paying more tax on rental income.

Some could even find themselves moving up to a higher tax bracket as they now have to declare the income used to pay the mortgage on their tax return.

Richard Lambert, chief executive of the National Landlords Association, says the changes have effectively rewritten the economics of renting for landlords.

He says: "Tax relief changes have had a huge impact, and we are now seeing an increasing number of people saying they are looking to sell up. Some landlords have effectively gone from making a tidy profit to a tax loss.

"By removing relief, the Government has increased the amount landlords have to pay in tax, reducing profit margins and squeezing the return from the investment."

If you are selling a buy to let or a second home, you have to pay CGT on any gains you make.

This is charged at 28% for higher-rate taxpayers and 18% for basic-rate taxpayers. As the tax-free CGT allowance is £12,000 you only have to pay CGT on profits above this limit.

At the time of writing, if you previously lived in a property and rented it out you can claim an exemption from CGT – known as private residence relief (PRR).

Landlords can claim PPR on property sales for the amount of time they lived in the home plus 18 months after moving out.

From 6 April, this will be reduced to just nine months, potentially costing landlords thousands of pounds more.

When landlords rent a property that they have previously lived in, they are entitled to lettings relief of up to £40,000 from any profit made from the sale.

But, from 6 April, this will only apply to landlords who live in a shared property with their tenant.

Landlords will also have to pay CGT sooner, with the date landlords having to pay the tax moving from January each tax year to within 30 days of completion of the sale of the property.

Richard Rowntree, managing director of mortgages at specialist banking group Paragon, believes the rule changes are making things less viable for landlords with smaller portfolios.

He says: "Changes to regulations have certainly had an impact on non-portfolio landlords and those coming to market.

"Professional landlords who run a portfolio and see it as a business are in it for the long run. They are not looking at it to support their pension or make a short-term profit, so rule changes have had less impact."

What are the options for landlords?

The tax changes were introduced to discourage investment in the property market and help free up homes for buyers.

By making buy to let less attractive through higher taxes, the Government hoped landlords would move out of the market allowing first-time buyers to get a foot on the property ladder.

However, the measures have had a knock-on effect on the property market.

Critics say that to help mitigate their losses, some landlords have had to raise rents or sell up.

Since the Government decided to remove tax relief and increase regulation, 222,570 landlords have left the sector, according to estate agency Hamptons International.

To counteract the losses, some landlords have remortgaged their residential property in order to pay off the mortgage on their buy to let. This is because buy-to-let mortgages are often more expensive than residential ones because banks view tenants as higher risk than owner-occupiers.

Other landlords are setting up limited companies, which allow them to pay corporation tax at 19% (17% from 1 April 2020). By doing this, landlords can avoid paying CGT or income tax.

Lambert says that landlords are mainly using limited companies when they buy new properties, rather than to move existing buy to lets into a company structure.

He says: "Landlords will raise rents where they can, but this will largely depend on what the market is like in that area.

"Most people are not moving their existing portfolios to a limited company as you have to pay CGT and stamp duty, and there are very few cases where that actually makes financial sense. However, people who are staying in are using limited companies to buy new properties."

Meanwhile, more and more landlords are switching to short-term holiday lets to make up for their losses

The Residential Landlords Association argues that this is partly because the tax system favours short-term holiday lets over long-term rented properties.

A report from ARLA Propertymark suggests that 230,000 UK landlords are likely to switch to short-term lets.

Paragon's Rowntree says the tax breaks for holiday lets mean the sector is likely to grow.

He says: "Yields are generally attractive and simple to maintain holiday lets, because there is a high turnover of tenants.

"IF I WAS STARTING OUT NOW, I WOULDN'T BE A LANDLORD"

James Fraser, 51, is one of the many landlords to have been hit by the Government's changes to the buy-to-let sector.

The phasing out of mortgage tax relief has hit him hard and he has considered selling up.

James, who lives in Stevenage and rents out 26 properties, says: "The changes to mortgage tax relief are ruining the industry, and landlords will have no other choice but to put rents up or quit.

He says the higher rate of capital gains tax that landlords have to pay will make it expensive for him if he decides to sell.

"Because of CGT, if I want to sell, I will lose 28% of profit to the Government. If you are trying to get out of the market, the Government takes an extra slice off you for doing so.

"While I don't mind paying tax, why should I be penalised by an extra 8% over everybody else? That's discriminatory."

James says to cover the cost of all the changes he has had to put up the rent.

He says: "I have tried to keep rents down and I have had some tenants for longer than 10 years, but I can't be charitable anymore."

James says the idea that landlords are raking in a fortune every month is a fallacy.

He says: "I have considered selling but I am not going to as I don't want to leave my long-term tenants in the lurch.

"Since 2015 the stress has been unbearable and if I was starting out now, I would not be a landlord."

"The 3% extra stamp duty needs to be dropped"

"However, if there continues to be growth in this area it could have a significant impact on the private rental sector."

Call for reform

The RLA and the NLA are both calling for a review of tax policy in the private rented sector to ensure the provision of long-term housing.

Dave Smith, policy director at the Residential Landlords Association, says the Government's tax policies in the rental sector are at odds with providing long-term affordable accommodation.

He says: "The 3% stamp duty charge is slowing down investment in new rented property and needs to be dropped to encourage growth in the sector.

"The tax system for rented housing is also leading to the provision of holiday homes over long-term rented properties.

"The Government needs to align its tax policies with the wider market to stop the decline in rental housing."

Lambert says: "We need to have long-term investment that encourages longer tenancies, not one that creates a system where there is a tax incentive for people who own second properties to let them out short term.

"It has become much harder in the past five years to run a business in this sector and the direction of government policy and regulation means that the challenges are going to continue and possibly increase." mw