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## Twenty Traps IGNORE

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It is hard to find anything positive to say about the state of the housing market. House prices, transaction levels and rates of mortgage approvals have all plummeted. But one of the few statistics to show an inexorable rise is the enormous increase in residential landlords.

Unable or unwilling to sell their homes in the current market maelstrom, so-called "reluctant landlords" are forced to let out their properties to make ends meet. Research published this week [WEEK BEG 8TH DEC] from the Association of Residential Letting Agents (ARLA) shows that 95 per cent of members report increased business from those who have become landlords by accident, rather than choice. This is backed up by November's RICS data on the housing market, which shows new lettings instructions have risen to a record high.

Renting out a property you can't sell may be a solution to financial problems, but it is not an easy answer. A myriad of traps await the reluctant landlord – many of which could result in severe financial penalties, as our feature shows.

Most property owners in this situation rely solely on their estate agents for advice and guidance. However, the residential lettings industry is unregulated, meaning many agents are poorly informed, or worse, out to take advantage of their clients' naivety.

The huge increase in properties available to let may be pushing down rental values, but it is also encouraging opportunists. Internet outfits have sprouted up offering "Become a letting agent in a day" courses for less than £150, demonstrating exactly why new landlords should do their homework before handing over their house keys.

"Reluctant landlords should recognise that they're going into business as soon as they start letting a property – even if it is their own home," advises Malcolm Harrison, spokesman for ARLA. "There are a lot of details to observe, but these are generally common sense."

### **TRAP ONE: Inform your mortgage company**

You must tell your mortgage company that you intend to rent out your property. "Most mortgage companies have this in the small print as a legal requirement," says property lawyer Tessa Shepperson of Landlord Law. "Normally, they won't have any issue, but it could affect your level of interest, or even invalidate your insurance."

## **TRAP TWO: Choose your letting agent wisely...**

Would-be landlords may be surprised to learn that there is no legal requirement for estate agents to be regulated. "Estate agents who used to only do sales have now switched to letting property, but it's not the same thing, and often they're not giving the right advice to landlords," says Neil Young, chief executive of portfolio manager the Young Group.

For accidental landlords, it is imperative that you have the right advice. Choose an agent who has opted to be regulated by the National Association of Estate Agents (NAEA), or the Association of Residential Letting Agents (ARLA). Both have strict codes of conduct, can address complaints and even impose penalties on offending members.

Shop around, don't be afraid to ask questions, and check out levels of service by phoning up and posing as a tenant.

## **TRAP THREE: ...but watch out for their fees**

"Estate agents who previously didn't do lettings at all now find they have to, or else they won't survive," says David Lawrenson of buy-to-let consultancy Letting Focus. "However, there is little margin in it, and I suspect many green accidental landlords coming in are taken advantage of, and end up paying quite large fees."

The landlord of more than 100 properties himself, Mr Lawrenson believes 10 per cent of the annual rent plus VAT is the norm for a letting fee. However, new landlords should be aware that this fee is charged up front at the start of the tenancy, and not spread over a year's rental payments. Worse, if the tenant decides to stay on at the end of their standard 12-month tenancy, the agent will repeat the original fee.

"Cartel is too strong a word, but every agent on the high street is doing it," agrees Simon Gordon, spokesman for the National Landlords Association.

"I really don't like the idea of renewal fees, as the agent hasn't done any work for it," Mr Lawrenson adds. He personally insists on striking such clauses out of contracts before he signs, but accepts that for landlords with only one property, this may be harder to achieve. "It is always worth querying these details," he insists. "The problem is that people are going in with their eyes wide shut, not reading contracts properly, and not shopping around."

## **TRAP FOUR : Do you really need a managing agent?**

If the thought of getting a phonecall from a tenant in the middle of the night moaning about a bust boiler fills you with dread, the majority of letting agencies will offer management services on top, and you should expect to pay a further 5 per cent (plus VAT) of the rent for this. However, make sure you know what is and what isn't included, and be very wary of quotes for repairs.

"Anyone paid to manage a property on your behalf won't control costs as effectively as you can," warns Mr Lawrenson. "Some are a little bit too cosy with their tradespeople, and get backhanders or kickbacks for carrying out repairs."

## **TRAP FIVE: Tenancy agreements**

If you choose to let your property without using a letting agent you will still need a proper tenancy agreement. These can be purchased online, or drawn up by a lawyer. "Landlords think of tenancy agreements as something they just need to have, and often do not bother reading them," says Landlord Law's Ms Shepperson, who offers bespoke agreements for clients "written in plain English, with no legal gobbledeygook. If the tenant can understand it, they are more likely to adhere to it."

## **TRAP SIX: Avoid the tenants from hell**

"A good tenant is the most important thing, but amazingly, a large number of landlords don't conduct any checks," says Landlord Law's Ms Shepperson. "Be warned - it can take up to eight months to evict a tenant who stops paying the rent, and you will still have to pay the mortgage."

The government's recent pledge on mortgage support does not apply to properties that are leased out. Agents typically obtain references as part of their service from an employer and a previous landlord, but seldom call to check them out.

"It's the landlord that suffers if the tenant is bad, not the agent, as they get their fee as a lump sum at the outset," Mr Lawrenson says, suggesting landlords pick up the phone. You could also try Experian's on-line service Check my Tenant. "I called to check out one employer's reference, and it turned out that the guy didn't even have a job," he adds.

Although letting agents will perform a standard credit check, the greater danger is that tenants will lose their job and be unable to pay the rent. "Wherever possible, I try to meet prospective tenants, or at least see the application form they've filled in," says Mr Lawrenson. "If they are bright, they will quickly get another job if they're made redundant."

## **TRAP SEVEN: Deposit protection schemes**

A recent survey revealed that 62 per cent of landlords are risking large fines by not registering tenant deposits. It became a legal requirement last November for tenants' deposits to be held in one of the three government authorised third-party schemes. The landlord has 14 days from the start of the tenancy to do so, and risks a fine equivalent to 3 months rent for non-compliance - not to mention losing eviction rights in the event of a tenancy dispute.

"Landlords still see deposit money as working capital for them to fund their property activities, and pay for repairs," says Kevin Firth, director of Deposit Protection Scheme, which holds deposits for free.

The two other providers offer insured schemes, where landlords keep deposits, but pay a fee to cover them in the event of a dispute.

Watch out for letting agents who offer to register deposits for you - a quick check on-line will reveal if they are members of either body - and obtain proof they have done so. "We have heard of unscrupulous agents sitting on deposits and not registering them," says Mr Firth. "If the agent goes under, your money is gone."

### **TRAP EIGHT: Is your inventory up to scratch?**

A thorough inventory of everything contained within the property is a necessity for entering a tenancy deposit scheme. In the event that a dispute arises, recourse is made to the inventory to solve it. "You should take photos of rooms and contents," advises the NLA's Mr Gordon. To the inexperienced landlord, this seems like a lot of hassle, but you will find any disputes can be settled quickly as a result."

"Be warned that there is a great deal of variation in the inventories provided by letting agents," advises Letting Focus's Mr Lawrenson. "Ask to see a sample before you sign the contract. They vary enormously in levels of detail, and you must have photographs in this day and age."

### **TRAP NINE: Is your property ready to let?**

Landlords have a legal obligation to ensure properties are in good condition, and comply with a growing amount of health and safety legislation. "The problem is, landlords hand over the keys to the letting agent in the belief that they will do it all for them, but sadly that does not always happen," says Landlord Law's Ms Shepperson.

For example, gas appliances must be checked annually by a Corgi-registered tradesman. Landlords will be held liable if a tenant is harmed by any electrical appliance provided in the property, although there is no legal obligation to check them. There are laws on fire safety, including the fact that all furniture and furnishings must be fire-safety compliant.

Anyone tempted to cut corners should remember that in October, a London landlord received a 4-month prison sentence and £21,000 fine after a fatal fire at one of his properties.

### **TRAP TEN: Insurance**

Rising unemployment means there is a greater risk of tenants defaulting on rental payments, but this can be insured against for 1-3 per cent of the annual rent. This is expensive, given the fact that rents are falling, but could prove invaluable for 'reluctant landlords' with only one property, where a lengthy void could be financially crippling.

"Most people – including letting agents – are not aware of this type of insurance, but we have seen a big increase in demand as the economy worsens," says Michael Portman, managing director of landlord insurance specialist Let Insurance Services.

Specialist buildings insurance which covers damage caused by tenants typically costs at least 20 per cent more than standard policies. "Be warned - insurers can easily get out of a claim on an owner-occupier policy if they hadn't been told the property was let," adds Mr Portman.

### **TRAP ELEVEN: Pitfalls of letting large houses**

If you are letting a large house to five tenants or more, your property will almost certainly qualify as a House of Multiple Occupation (HMO). You cannot legally let them out without a licence issued from your local council, and will be subject to more stringent regulation.

### **TRAP TWELVE: Energy Performance Certificates**

Few landlords are aware of the new EU certificate to measure the energy efficiency of leased properties, which costs about £100 to obtain. However, there is a £200 fine for every property that hasn't got one, and in Scotland, landlords will be liable for a fine of £5,000 plus a criminal record come January. On the plus side, install insulation and landlords can offset up to £1,500 against tax.

### **TRAP THIRTEEN: Help! My tenant has stopped paying the rent**

It is every landlord's worst nightmare, but sadly, Landlord Law's Ms Shepperson reports a substantial rise in instructions for possession.

"A lot of landlords get very upset about serving possession proceedings on a tenant who has lost their job, for example, but it is imperative to start proceedings as quickly as possible," she says, adding it can take 8 months to get a property back. "There is a shortage of properties for local authorities to house people in if they fall on hard times, particularly if they are families. Often, they won't rehouse them until the point that bailiffs are at the door. However, the tenants have to stay put to get re-housed, if they leave, they will have made themselves voluntarily homeless."

### **TRAP FOURTEEN: Income tax**

Surprisingly, many new landlords are unaware that they have to pay income tax on the rent they collect, after deducting expenses.

"HMRC are currently doing a trawl to find precisely this sort of person," reports buy-to-let tax specialist Helen Demuth of Smith & Williamson. "They find details of new landlords from advertisements for tenants, or through Land Registry records, and write to them asking if they're sure they pay enough tax."

### **TRAP FIFTEEN: Offsetting mortgage interest**

One of the biggest tax deductible expenses against rental income is mortgage interest. Ms Demuth warns of novice landlords incorrectly claiming both interest AND capital repayments on tax returns, and incurring the wrath of the Revenue. "Your mortgage company will break down the two payments in a letter if asked, but will probably charge £25," she says.

If you have a lot of equity in the property you intend to let, it could be advantageous to remortgage it and use the cash to buy your main home, and set off the increased interest payments against rent. However, buy-to-let mortgages are harder to come by and charge higher rates of interest.

### **TRAP SIXTEEN : What you can offset against tax...**

Aside from mortgage interest, landlords of furnished flats can also offset 10% of the annual rent if the property is furnished. "However, it has to be properly furnished, you can't just sling a bed in there," warns Ms Demuth. "You will need a full inventory, as the Revenue may well ask to see a copy." Other deductible expenses include water rates, service charges, agency fees, insurance, and professional charges.

### **TRAP SEVENTEEN: ...and what you can't**

If your property is in need of major refurbishment before letting, don't expect to count this against tax. "Replacing something that's there with something of an equivalent standard constitutes a repair, and is fully deductible," explains Ms Demuth. "However, if you fit a top-of-the-range kitchen or bathroom, the likelihood is none of it will be deductible. The thinking is that you've improved the value of your property by doing so."

### **TRAP EIGHTEEN: Capital gains liability**

If you sell a property that's your main residence, there is no capital gains tax to pay. But sell a property that you've been renting out as an investment, and you could get stung with an 18 per cent charge. "If you live in the property as your main home, then let it out, you have a window of three years when main residence relief covers the whole gain," advises Ms Demuth. "After three years, capital gains will be charged on a pro-rata basis, although it is possible to then claim a letting exemption of up to £40,000 per joint owner."

### **TRAP NINETEEN: Stamp duty**

If you're a higher rate tax payer, transferring a property ownership to your spouse may seem a neat way of reducing the tax liability. Transfers between spouses do not incur capital gains tax, but they do attract stamp duty (between 1-4 per cent) on the value of the mortgage transferred.

### **TRAP TWENTY: Selling the property to your tenant**

If a tenant wants to buy your property, the small print of your letting agency agreement may demand a percentage cut of the sale. This has resulted in a high profile legal battle (Foxtons vs Pelkey Bicknell) which also challenges renewal fees. The Office of Fair Trading ruling is pending, but the expectation is that Foxtons will lose, which could have huge repercussions. "If they lose, all agents will probably increase their upfront fee to compensate," predicts Mr Lawrenson.