A GUIDE TO HMOs

A Report by MFS

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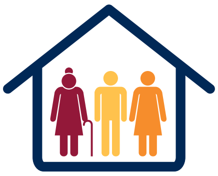
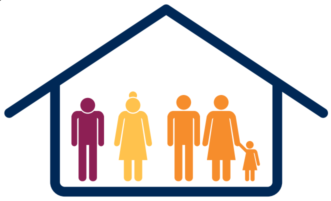
GUIDE TO HMOs: A REPORT FROM MFS

Since the 2020 pandemic, we're living in a time where house prices are rising, mainstream lender's criteria are tightening and finding a mortgage offer with a 10% deposit is near to impossible. Yet renting has never been so popular and Houses of Multiple Occupancy (HMO) are becoming well sought after. With demand for rental property on the rise, HMOs are becoming an attractive opportunity. Landlords can benefit from a regular income, but also potentially enjoy growth in the value of the property.

For England and Wales, an HMO property means there are three+ people living together who are from two or more different households. They must also be sharing facilities such as bathrooms, living rooms and kitchens. They're more commonly known as house or flat shares.



HMO
(**3 people** from more than one household living together)



Licensed HMO
(**5+ tenants** from more than one household living together)

But being a landlord is more than just renting out a room. There are many factors you need to consider before investing in UK property.

- Tenant safety.
- Meeting property requirement.
- Registering.
- Upholding the correct license (should you require one).
- You will need to be declared 'fit and proper' (no criminal record or a breach of landlord code of practice or laws).

Typically rented by young adults or students, but they are by no means limited to these brackets. Earlier this year, The Guardian released figures showing that people in their mid-30s and 40s are now three times more likely to be renting compared to 20 years ago. It's no surprise to the see the demand from tenants soaring.

Why are they becoming such a desirable opportunity for those looking for new residential investments?

We see three key reasons:

1

The stamp duty holiday
This relief is in place until the end of March 2021. Meaning landlords won't pay tax on the first £500,000 of a residential purchase.

2

Changes to planning laws
The government has announced new planning laws for commercial property. This means these properties can be converted into housing without full planning permission. As a result, HMOs are more accessible to commercial property owners.

3

HMOs can deliver substantial returns
Rental yields are higher when compared to traditional buy-to-let investments and are currently in high demand among renters. Including students, young professionals and families.

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WHAT TYPES OF PROPERTIES COUNT AS HMO?

One of the many great aspects of having an HMO, is that it can be used for a variety of reasons.
Examples of popular HMOs are:

- Bedsits
- Hostel
- House / flat share
- Student share accommodation (*accommodation owned by the university is not counted as HMOs)

License to let

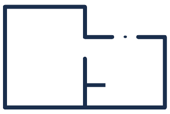
The most common aspect that will affect whether you need a HMO license is the amount of people you're looking to have under one roof.

Whilst a standard HMO does not usually require a license, you should always check with your local council for any additional requirements, as this can differ depending on location. Another aspect that may change the need for a license are the number of floors in the property.

Licenses can take a while to be granted, so apply well in advance to ensure you receive it in time. Once passed, an HMO license is only valid for one HMO property and a maximum of 5 years.

If you're housing a large HMO, you may need to convert your property to ensure you're in line with government guidelines. In this situation, **a refurbishment loan** may best suit your needs. You might need to install additional bathrooms, increase living space or adhere to specific bedroom sizes.

Landlords who renewed or applied for an HMO licence had to ensure bedrooms met the new minmum size requirements below:



6.1m²
for a person aged 10>

4.64m²
for a child aged 10<

10.22m²
for 2 people aged 10>

Different councils have different definitions of standard of living, meaning the sizes can vary dependent on district. Be sure to measure potential properties carefully, and always check with the local council guidelines before converting. If the size isn't met, then you will not be permitted to rent the room.

ADVANTAGES OF HMO

There can be many advantages to owning a HMO investment property:

Rental income

The yield from an HMO can be almost **three times higher** than a single let property, making it a favourable property investment for experienced landlords.

In demand

Housing with direct transport links to London are always more expensive than the UK average. HMOs in these areas are usually highly desired by commuters, as they often cannot afford to purchase these properties.

Conduct your own research on an area before purchasing or converting your property. It provides you with an understanding of how much renters are willing to pay for their accommodation, and to what level of specification. You can also see how your property will fair when compared against other HMOs in the area. You can always start by looking into:

- How many HMO / BTL properties currently in the area
- Average overall renting cost
- Rent on properties a similar standard and size to your own

Lower risks

With multiple tenants generating income, not only do you receive a higher yield, you also spread the risk should a tenant become suddenly be unable to pay rent.

This provides time for you to find another tenant, something a BTL properties cannot provide as revenue only comes from one source.

Tax matters

A high proportion of spending on an HMO property is revenue cost, which is income tax-deductible. You will need a clear and concise record of all works, to provide evidence when supporting the tax deduction claim. This will need to include details of expenditures, type of work and receipts.

You should be able to receive a template from your accountant, as well as any official advice they may have.

DISADVANTAGES OF HMO

Initial costs

House shares are commonly expected (by renters) to include furnishings: containing sofas, dining tables, white goods etc. Although itemised on the inventory list for the property, which protects them against theft and damage from tenants, it's still an initial outlay which will need to be covered **before** tenants are able to move in.

You must also consider continuous maintenance costs and ensuring all aspects of the property are up to date and at a decent standard for your tenants. For example, the electrics, fire extinguishers and living conditions. This can be included in the rental charge.

Wear and tear

Wear-and-tear is inevitable with any property letting and should be considered when evaluating the cost of your rental charge. It will fall to the landlord to ensure these standards are maintained to an acceptable level, ready for new tenants. Other damage caused by tenants, such as broken doors, damaged walls, or missing item, should be noted in the tenancy agreement.

Resale value

Once converted, reselling often becomes limited to finding other HMO landlords, with many traditional buyers avoiding them altogether. Whilst local estate agents are a good way to get the property viewings high, picking a specialist HMO agent will highly increase your chances of selling.

Finding a mortgage

This can be incredibly difficult and time consuming, as there is still a reduced number of high street lenders offering HMO mortgages.

RULES AND RESPONSIBILITIES

Of course, being a landlord includes accepting certain responsibilities.

Living standards

Properties will be expected to meet certain living conditions as a requirement of government regulations and to uphold the HMO license. This is to protect a tenant's health and safety. It can include elements such as:

- Amount of natural light
- Number of windows
- Correct heating & plumbing facilities
- Electrical safety
- Air Circulation

Tenancy agreements

The length of a tenancy can vary between 6 months and 7 years, but it will have to be agreed upon with the landlord.

To guarantee potential tenants are aware of their responsibilities, they should receive a copy of the HMO Code of Practice. Allow time for the potential occupiers to read this before signing the tenancy agreement. Clauses stated in the agreement are law binding. It is therefore very important that all parties understand the agreement in full before signing:

- Any damage to items supplied, maintained, or repaired by the manager that are labelled on the inventory list, will need to be replaced or its charge will be deducted from the security deposit
- Storing and disposing of rubbish as per the manager's arrangements
- Keeping the property grounds clear of any litter
- Fire safety measures, including the use of any fire equipment

Managing tenants

Landlords may also be called to resolve any disputes between tenants or fix issues that may suddenly arise, such as a burst pipe. It can be time consuming, particularly if you have another job. This is when estate agent management might be considered.

Should a tenant need to exit their agreement early, instructions and charges need to be clearly stated in the tenancy agreement. In most cases, landlords will ask for a notice period, to allow time for them to find a new tenant; often one-or-two-months' notice.

Health & Safety

Tenants safety and wellbeing should be of the utmost importance, a HMO landlord must therefore ensure the property has the following:

- An EPC
- A gas safety certificate – Gas must be checked annually
- Electrical installation condition report - All electrics must be checked every 5 years
- Correct fire safety measures
  - Fire doors
  - Minimum one smoke alarm per floor
  - Fire extinguisher
  - CO detectors in any room containing a fuel burning appliance
- Making sure there are no hazards on the property grounds
  - Including: damp, exposed asbestos and excessive heat

RECENT LAW CHANGES

Planning Permission for HMO Projects

Once upon a time, landlords could convert a property into a small HMO without planning permission. In today's world, those interested in converting, must research the planning rules and regulations beforehand, by checking with their local council.

Whilst you generally don't need planning permission when converting from a dwelling house or flat to an HMO property, you need to contact your local council to check with their specific regulation.

This may require a change of use (for example, from residential to commercial) As this will depend on location, you need to check with your local authority for their regulations on these matters.

Minimum Energy Efficiency Standard (MEES)

The minimum rating required on the Energy Performance Certificate (EPC) is rising. In April 2018, HMO landlords had to meet a rating of E for new tenancies and renewals. Now, all rented properties must meet this minimum standard. If not, the property will be deemed 'un-rentable' and the landlord can be fined up to £5,000 per property.

If you haven't received a EPC for your potential or current property, it's important to do this before letting it out, as if the level if below E, you will conduct works to increase the properties energy efficient level.

A good EPC level can be a huge selling point for potential tenants. There is no legal obligation to present the property's EPC, but it must be made available (free of charge) for those looking to seriously rent the property.

**Some properties are exempt, such as grade listed buildings, due to their nature and inability to change structure and add insulation.*

No DSS

The No-DSS ban came into effect in 2020. It was set into place to protect those receiving housing benefits from discrimination. It's a safeguarding measure ensuring they cannot be removed from their rented accommodation, resulting in homelessness.

Right to rent checks

This scheme allows landlords to check their tenant's legal status in the UK. This is to help clamp down on people trying to live illegally within the UK. It also provides a legal protection for landlords, as it provides evidence that they are checking their tenants and are in keeping with UK law.

Mortgage Interest Costs

From April 2020, landlords can no longer deduct their mortgage expenses from their rental income as a way of reducing their tax bill. Instead they receive a 20% tax reduction on whichever is the lowest of the following:

- Financial costs
- Property profits (accounting any losses from the previous year)
- Total income minus savings income, dividends, and personal allowance

If the finance costs are not their lowest, the difference can be carried forwards to future tax years.

HELP AND ADVICE

Funding throughout

Whilst mainstream finance may be your first point of call, it can be difficult to find the correct lenders that offer the right criteria to suit your needs. However, alternative finance can be specifically tailored to your property investment. For first-time landlords in particular, it can be incredibly difficult to find a lender at all. This is where bridging can step in, to support your investment.

When it comes to construction projects, timing is everything. Homeowners must ensure deadlines are met. Failing this, the project is at risk of being delayed, or worst – left abandoned. When refurbishing HMO properties, it is often much easier for works to be completed in one go, in a gap between tenants.

If you are converting your property into an HMO, a **bridging loan** can also provide the funds for this, under permitted or light development. As funds can be released in days, works can start almost instantly, decreasing the time that the property stays empty. We regularly work with landlords to arrange **bridging loans** for these projects.

As the age of first-time buyers rises, landlords are looking to welcome a whole new bracket of tenants. The "middle-aged renters". Which is why we're ready for the surge in demand of tenants. Our **conversion bridging loans** are here to support your HMO projects when you need it most.

COVID Conversions

Looking ahead, we could see new regulations being introduced to prevent COVID-19 outbreaks. Coronavirus cases are rising among students. The government might review current HMO rules to prevent overcrowding and the potential for virus outbreaks. For now, we must wait and see.

The other long-term impact of the pandemic could be the amount of time people spend in their homes. As lockdown measures persist, it is likely that socialising will remain infrequent. For students, this means more time spent in their house or flat. In turn, they might seek properties with more space or a higher quality of finish. Landlords ought to consider this trend.

If your HMO property purchase has been affected by Covid-19, you could be eligible for our **Covid-19 bridging loan funding**. Contact our underwriters today on **0207 060 1234**, to find out how we can help you through these trying times.

Alternative, this maybe a good time to update and modernise your HMO, so why not consider our **refurbishment bridging loan**.

HELPING HAND

Starting out can be a scary process, so we've collected a few resourceful websites to help guide you through your life as a landlord:

National Residential Landlords Association (NRLA)

This is an organisation and a community made specifically for residential landlords in the UK. It also admits letting agents, who can assist you in renting out your property. They aim to assist and represent all their members.

They also provide documents for experienced landlords, as well as a starter pack for those looking to enter the trade. Membership costs start from £155.

British Landlord Association (BLA)

This is a free national association that provides help and support for residential and commercial landlords alike. They assist both landlords with a singular BTL property, and multiple. They will help provide a lawyer, should you need one, as well as a list of documents that landlords can download in their own time.

Government Support

You will always be able to find government advice via the Gov website. This can be for Covid-19 updates, as well as rules & regulations and tenancy laws.

For more information, check out the MFS website on **www.mfsuk.com**.

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