



Buy to Let Mortgage Rates: The Real Costs

April 2013

Buy to let product numbers

In Q1 2013 there was an average of 434 buy to let mortgage products from 27 active lenders on the market. This figure is down 10 products on the previous quarter but we believe the decrease to offer no cause for concern and can be put down to trimming by lenders as they drop less popular products in favour of ones that have greater appeal. The average number of products over the last year stands at a healthy 450.

Buy to let product pricing

Overview

During the first quarter of 2013 buy to let rates fell by an average of 0.33% when factoring in fees. Two year fixed rate products at 65% LTV fell the most by 0.69% over the quarter and now stand at an average of 5.27% including fees.

Headline rates (excluding fees and other costs) fell by an average of 0.27% across the same period which, when compared to average rates including fees, demonstrates that overall fees have decreased slightly which is good news for borrowers.

Interestingly the gap between three and five year rates narrowed over the quarter and in many instances five year rates are similarly priced to their three year counterparts. As there are more "specialist" products available in the three year sector, the average cost of three year products can be higher than the average for the five year products.

Bank Rate, LIBOR and Swaps

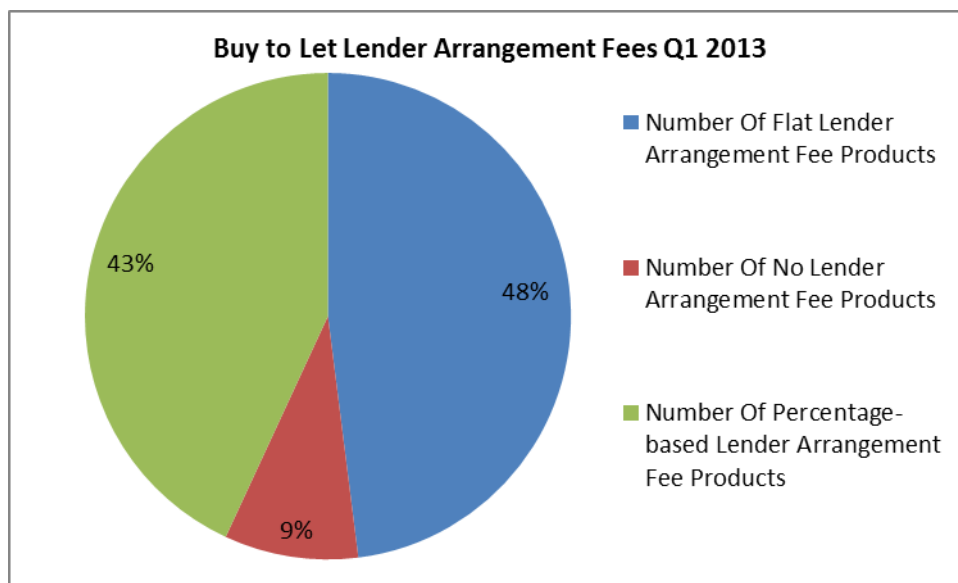
3 month LIBOR has been virtually static throughout 2013 – although in mid-April it finally fell down to 0.50% - matching Bank Rate for the first time in recent years. Swaps rates for 2 years have fallen 0.20%, 3 years by 0.25% and 5 years by 0.30% - all reflecting the effect on medium term rates of general expectations that interest rates will remain low for the foreseeable future.

Equally significant for borrowers has been the reduction in the average cost of borrowing over the related benchmark rate. The margin over LIBOR of all of the trackers has fallen by around 0.3% to 0.4%; the margin on fixed rate products has fallen much less (typically less than 0.20%) but with the margin on low loan to value 2 year fixes falling by as much as 0.56% in the period. These reductions in the margins must be to some degree attributable to the effects of the Funding for Lending Scheme.

Arrangement fees and other costs

In Q1 2013 lender arrangement fees, valuation fees and legal costs added an average of 0.52% onto the headline cost of a buy to let mortgage. This has dropped slightly since the beginning of the year when the figure stood at 0.57%. Costs were at a peak in 2010 when across all product types they added an average 0.66% pa to the average cost. Unsurprisingly they have a greater impact on short term (2 year) mortgages where in 2010 they added an average of over 1.1% to annual costs whereas this is now around 0.82%.

Of the buy to let mortgage products available in Q1 2013, 9% had no lender arrangement fee. This figure is up 1% on the previous quarter. 43% of products had percentage-based lender arrangement fees of between 1-3% compared to Q4 2012 when 46% of buy to let mortgage products carried a percentage-based fee. Nearly half (48%) of all buy to let products had a flat lender arrangement fee, up 2% on the previous quarter. The average flat fee is now £1,534, down £24 on Q4 2013. Overall these figures are good news for borrowers and demonstrate that competition between lenders has intensified.



Methodology

In order to track buy to let interest rates, 12 “standard” product ranges have selected. These are two, three and five year fixed rate and discounted/tracker mortgage products at 65% and 75% loan to value. Life time tracker products have also been incorporated into the results for each of the above periods for the discount/tracker products.

Fees inclusive graphs

The total cost of the mortgage (including lender arrangement fees, valuation fees and legal fees) have been calculated over the period of the discount or fixed rate and this has been used to generate an annualised cost over that period. Calculations have been based on a “standard” mortgage of £150,000. NB this result can be markedly different from the APR measurement legislated by the FSA; the APR fails to recognise the effect on borrowing costs of borrowers re-mortgaging once the period of the discount or fix have expired.

If individual mortgage products offered “free” arrangement fees, valuations or legal fees this has been recognised in the calculations of costs for those products.

By including these costs we have produced indices that more accurately reflect the costs of taking on a buy to let mortgage without distortions caused by the way that lenders have structured fees on their products to meet marketing requirements.



Costs have been calculated from our database of over 16,000 buy to let products held within our mortgage products sourcing system – Mortgage Flow. The results shown reflect the average cost calculated based on products available on each day since January 2008.

Where short term (< 1 week) withdrawals of products have occurred, the results have been adjusted to eliminate anomalous peaks and troughs in the average rates shown. At any time when there were no products available from lenders in a given category this shows as an average cost of nil for the period.

The resultant interest rates for discount and tracker products have been compared to the daily 3 month sterling LIBOR cost generated by the British Bankers Association.

The resultant interest rates for fixed rate products have been compared to the sterling interest rate swap costs for the related period.

Headline rates graphs

These graphs follow the traditional method of tracking only the average headline rate of buy to let mortgage products over time which belies the true costs involved. This data has been produced to demonstrate the effects of set up costs.

In all graphs, at any time when there were no products available from lenders in a given category this shows as an average cost of nil for the period.

Understanding interest rate swaps

Interest rate swaps help companies, portfolio managers and banks to manage cash flows by fixing interest payments over time. An interest rate swap is a contract to exchange floating payments linked to an interest rate for fixed payments, and is generally used to manage exposure to fluctuations in interest rates.

In an interest rate swap transaction, the parties to the transaction exchange or “swap” two types of interest payments – one a fixed rate, the other a floating rate – over the lifetime of the deal. The swap rate is the cost of switching from a floating rate to a fixed rate. The floating rate is typically determined by the three-month London Interbank Offered Rate used as a benchmark for floating rate mortgages and loans.

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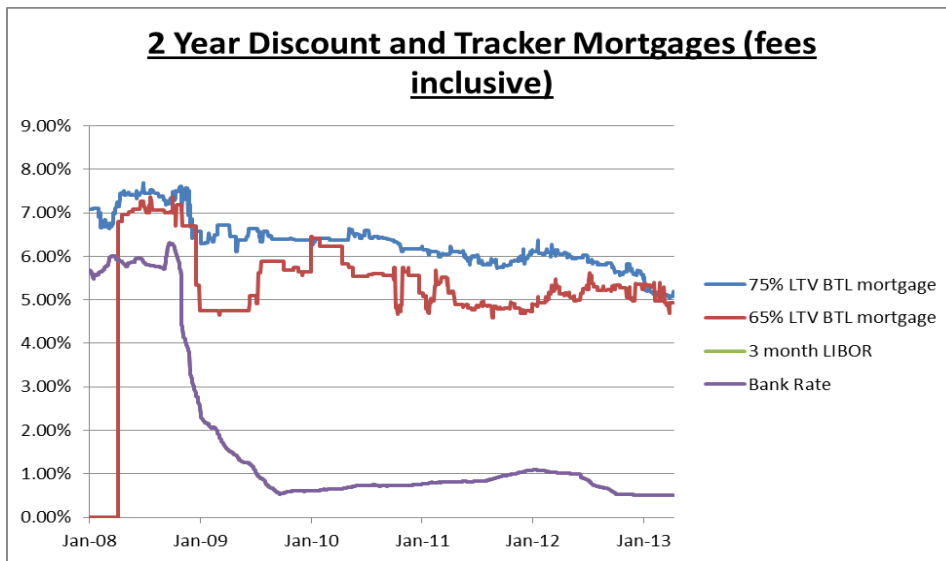


Table 1a

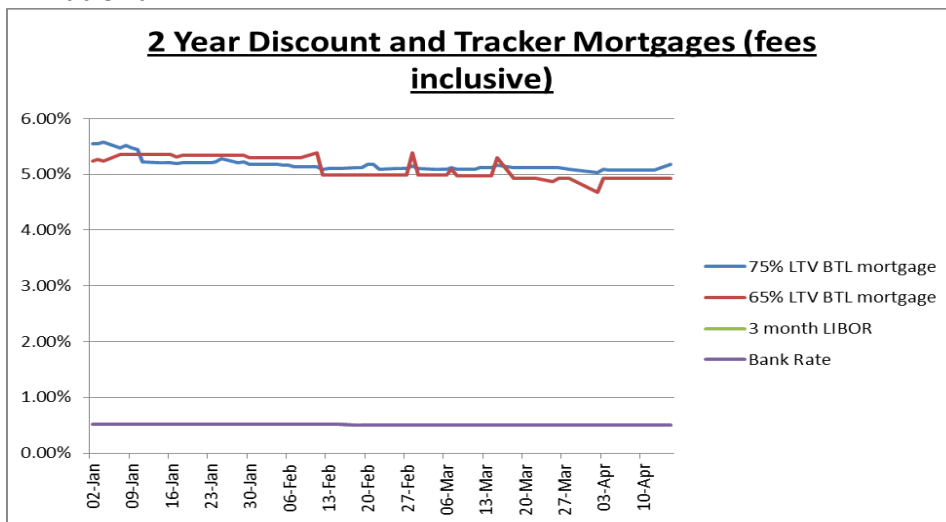


Table 1b

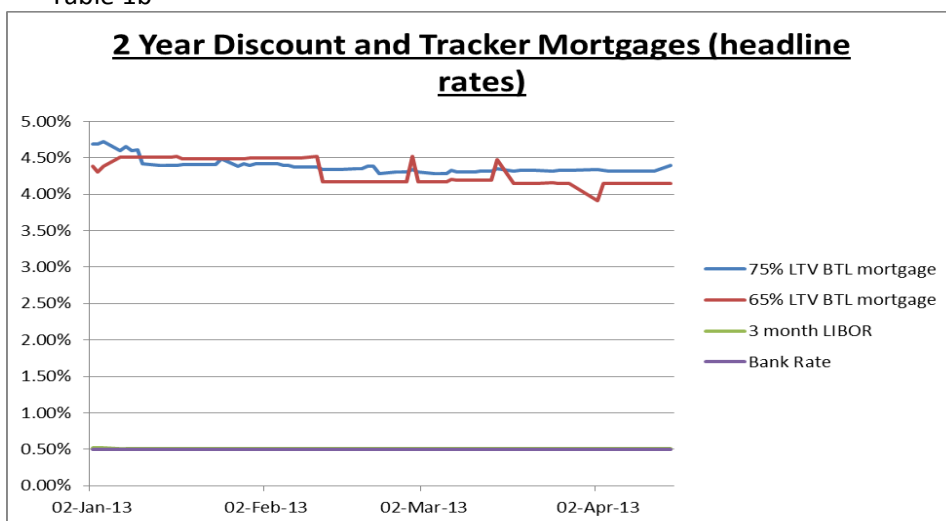


Table 1c

NB: 3 month LIBOR has been only marginally above 0.5% throughout 2013 and so cannot be split from the line for Bank Rate.

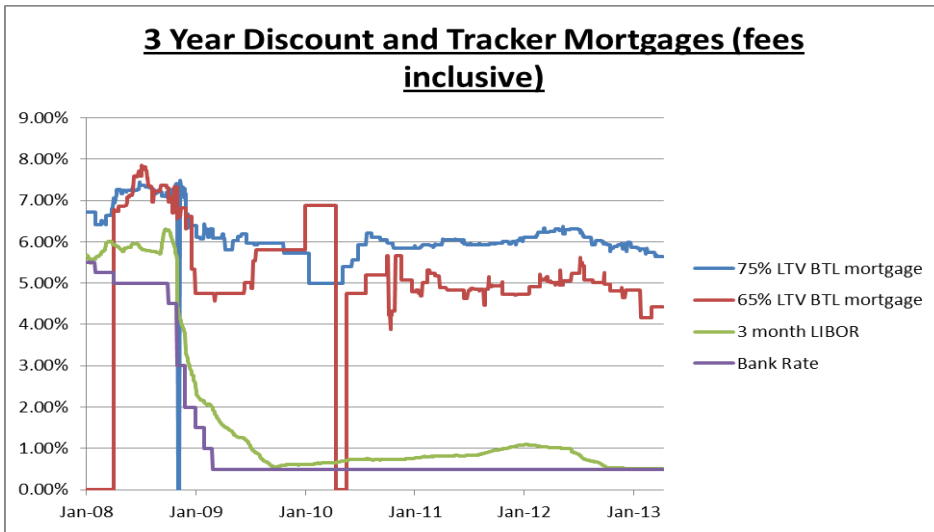


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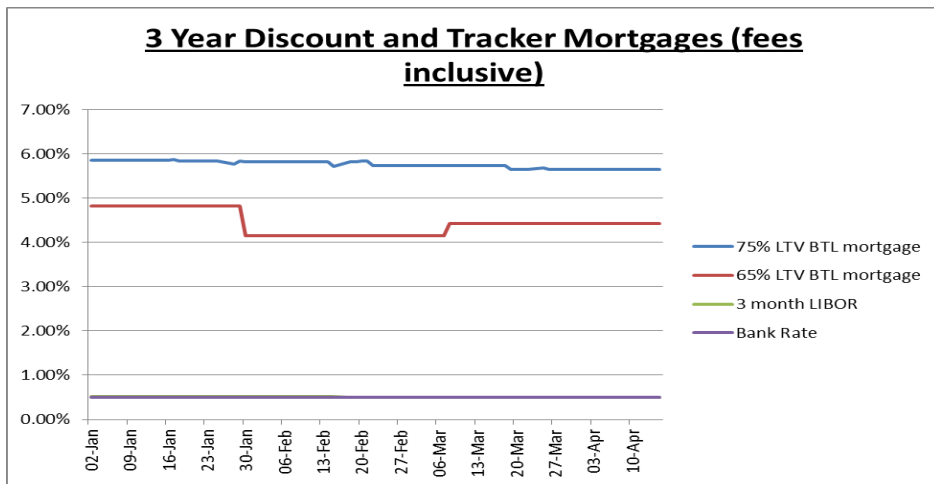


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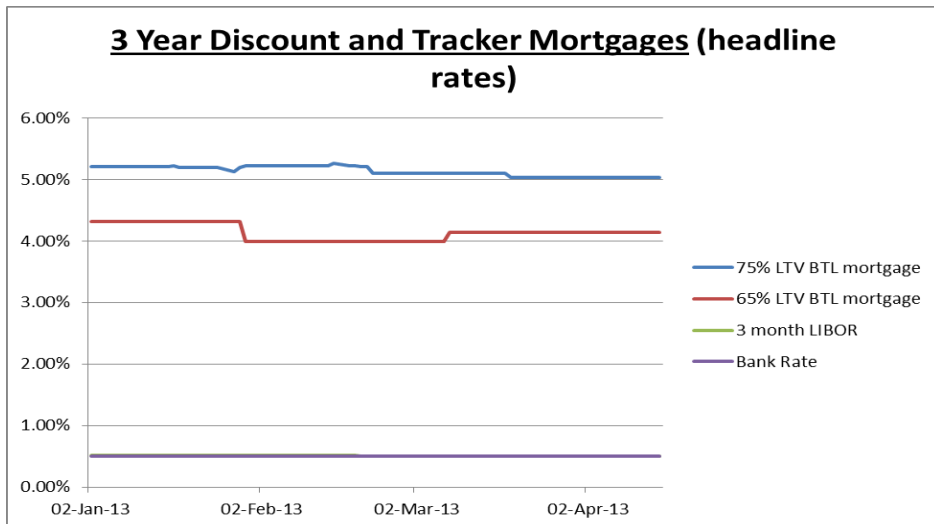


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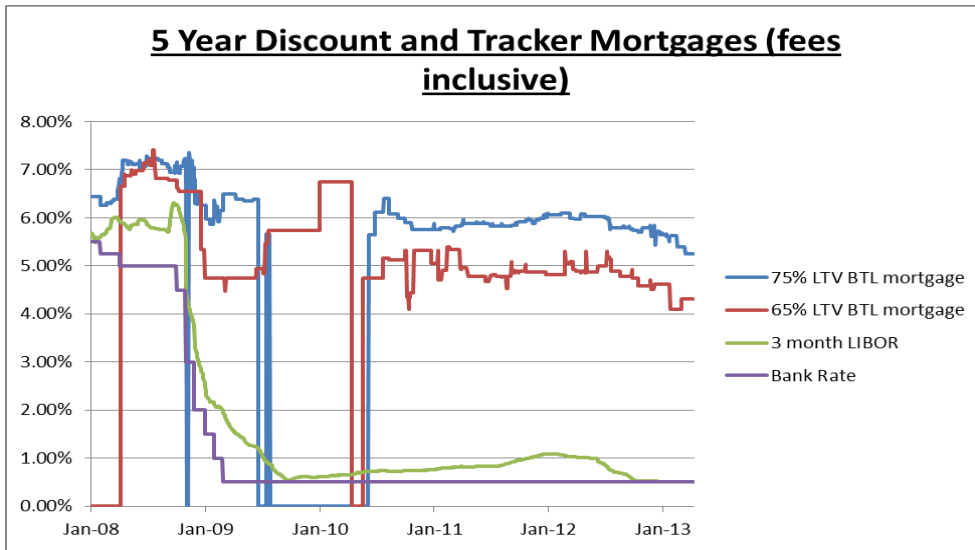


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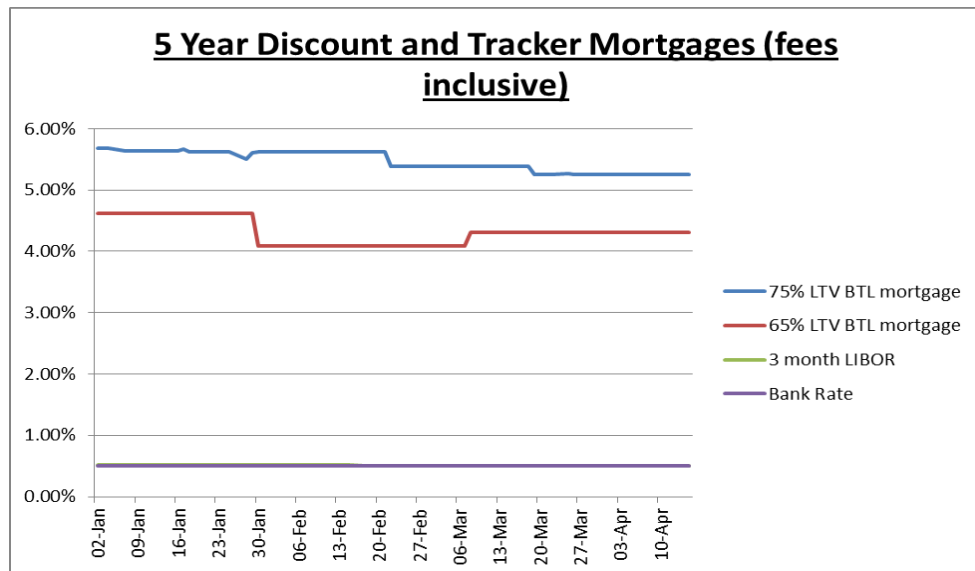


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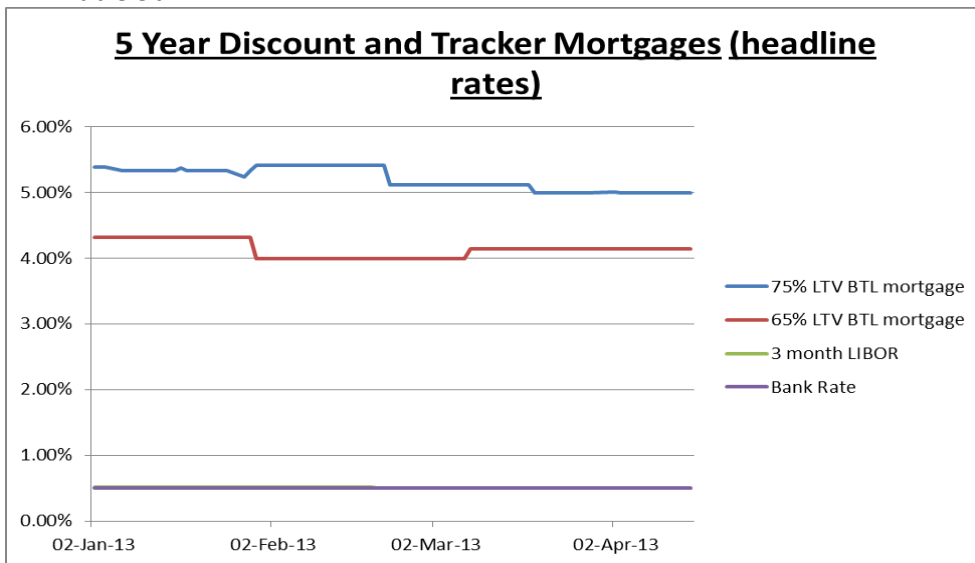


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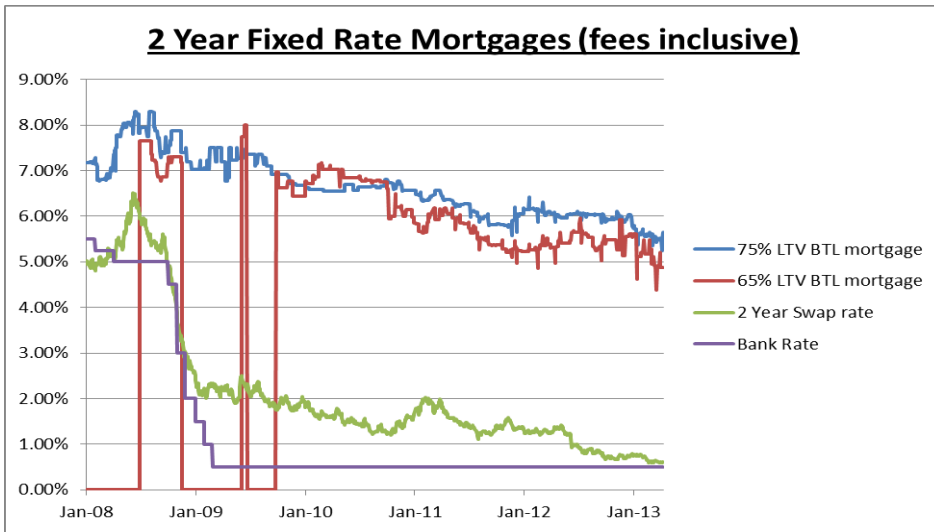


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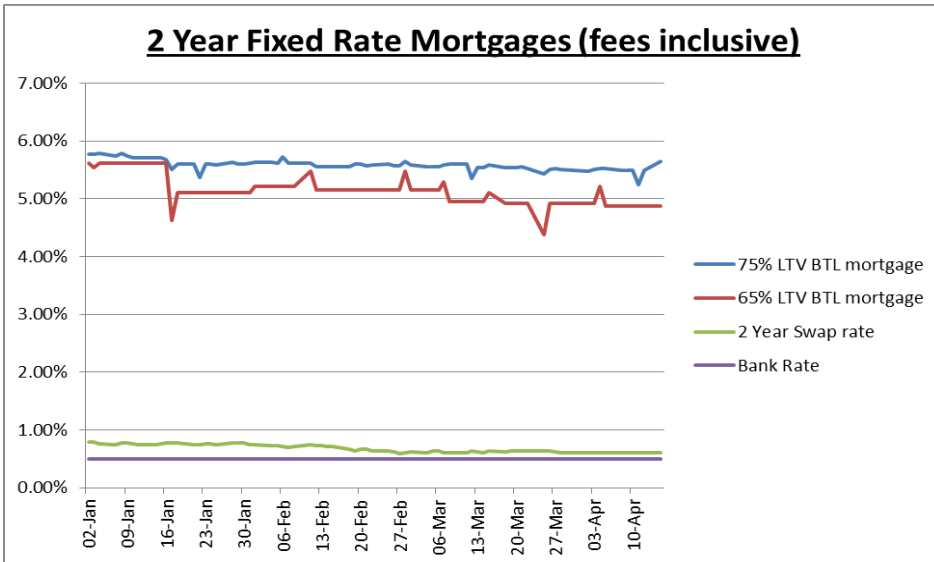


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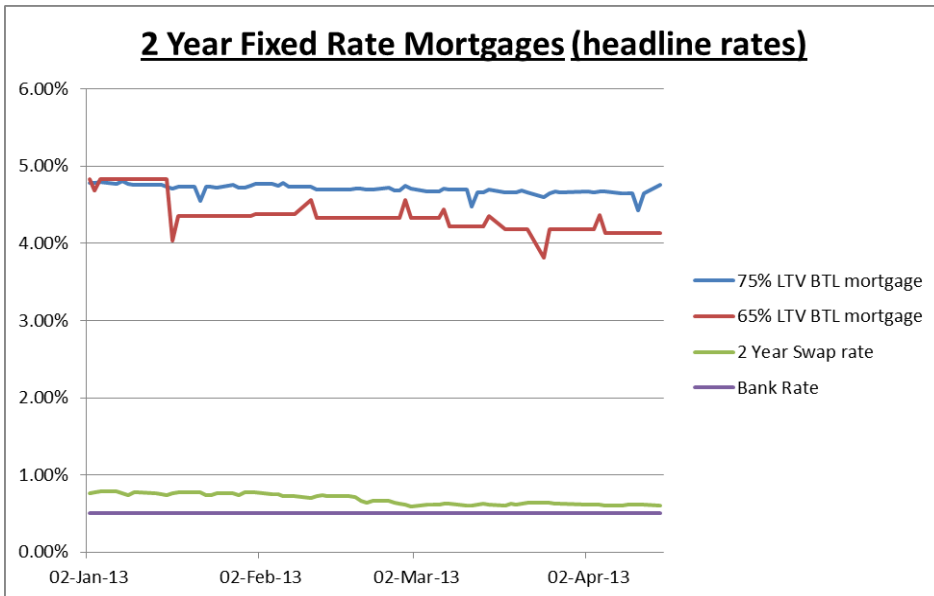


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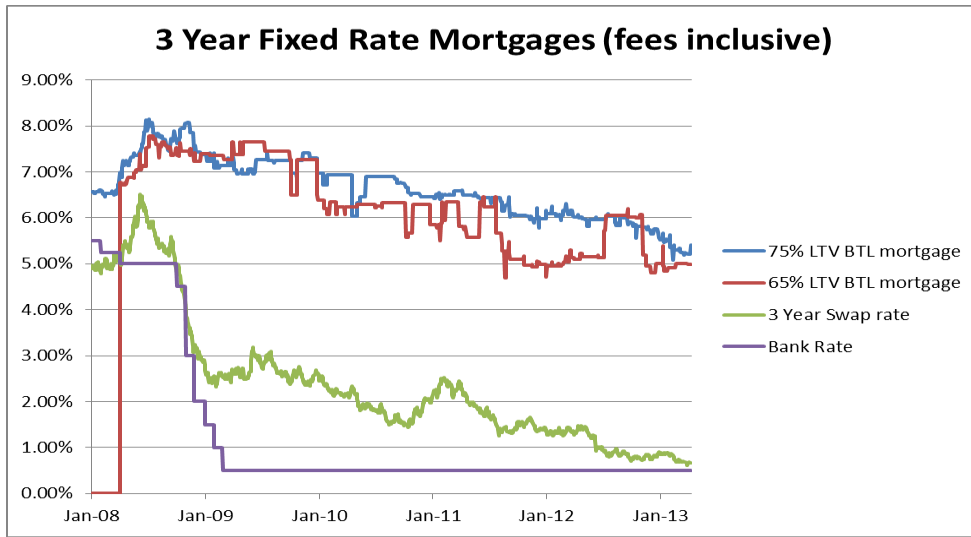


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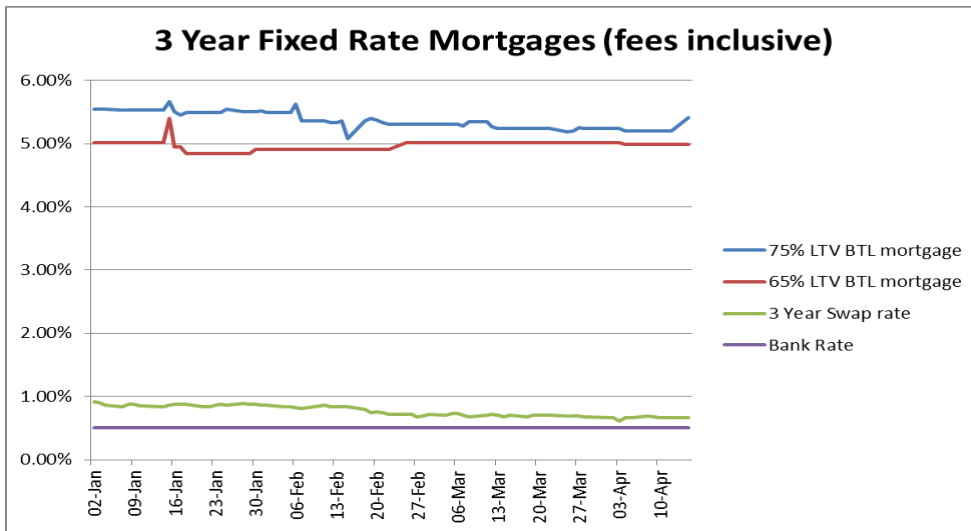


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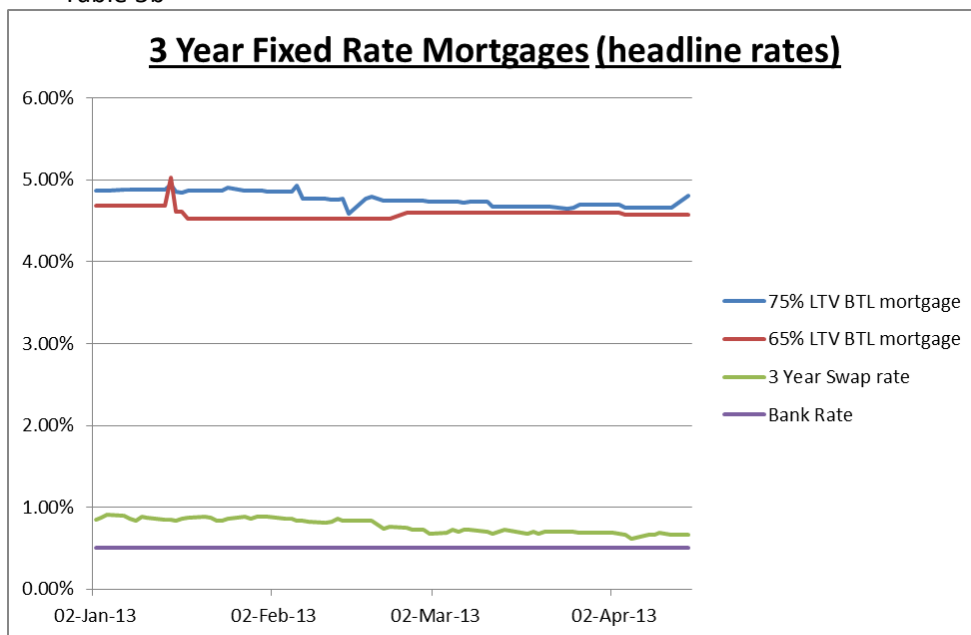


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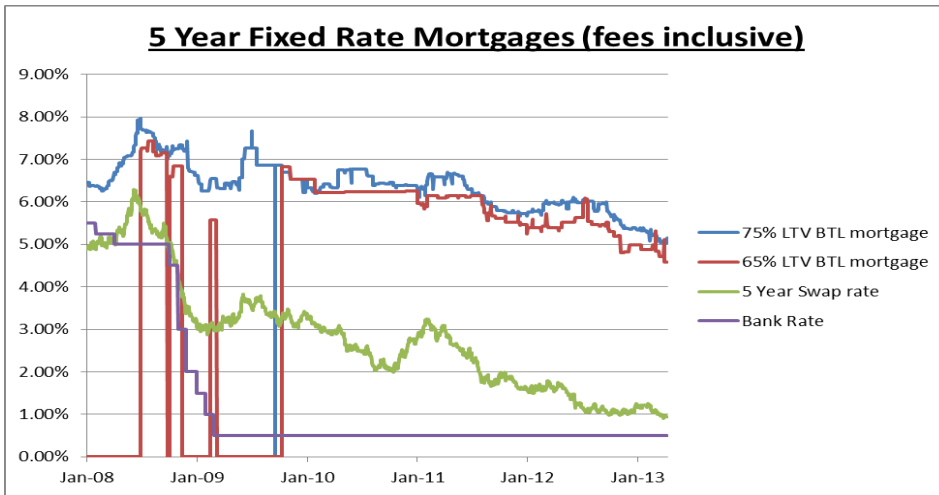


Table 6a

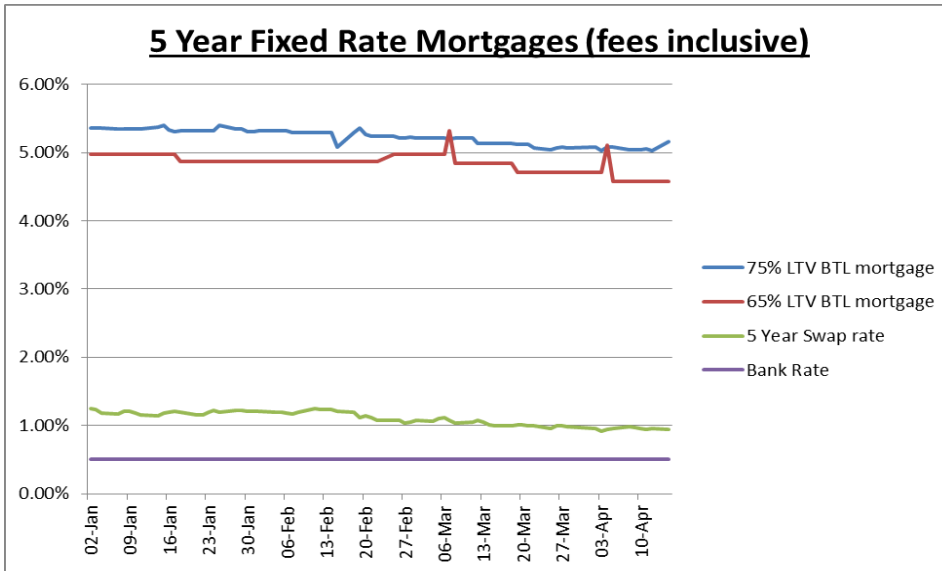


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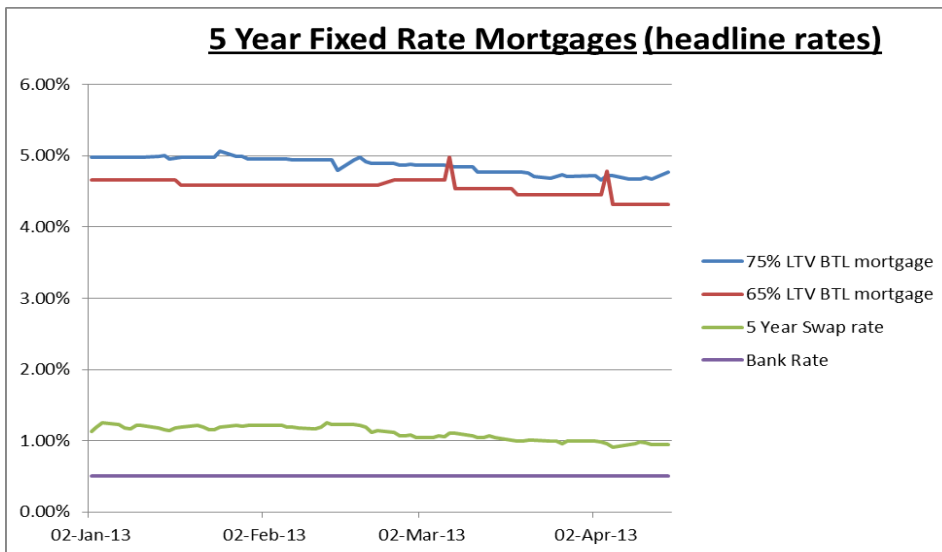


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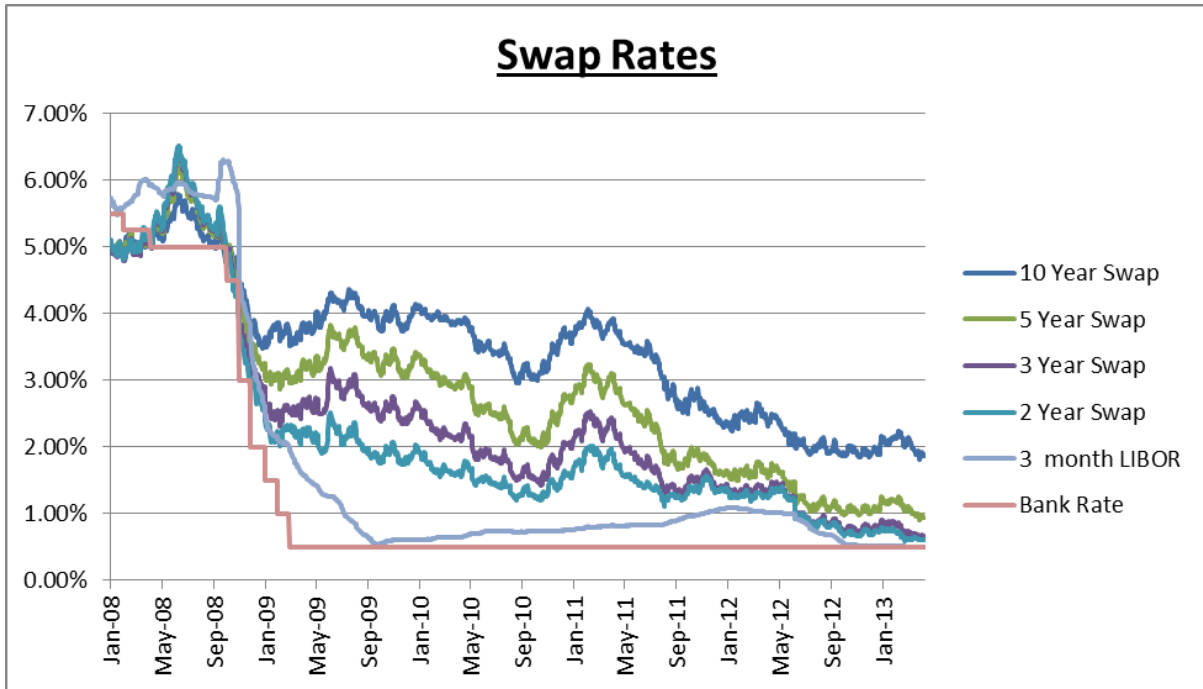


Table 7



April 2013

Effect of Costs on Buy to Let Mortgage Rates

	2 Yr Disc 65% LTV	2 Yr Disc 75% LTV	2 Yr Fix 65% LTV	2 Yr Fix 75% LTV	3 Yr Disc 65% LTV	3 Yr Disc 75% LTV	3 Yr Fix 65% LTV	3 Yr Fix 75% LTV	5 Yr Disc 65% LTV	5 Yr Disc 75% LTV	5 Yr Fix 65% LTV	5 Yr Fix 75% LTV	
Average	0.73%	0.84%	1.01%	0.99%	0.35%	0.53%	0.37%	0.67%	0.21%	0.29%	0.25%	0.39%	
Max	2.02%	1.64%	1.93%	1.45%	0.81%	0.96%	0.78%	1.00%	0.49%	0.50%	0.55%	0.67%	
Min	0.13%	0.10%	0.27%	0.52%	0.03%	0.15%	0.12%	0.18%	0.05%	0.04%	0.06%	0.16%	
Averages													Total Average
2008	0.44%	0.56%	1.02%	0.96%	0.40%	0.42%	0.38%	0.47%	0.11%	0.20%	0.32%	0.34%	0.47%
2009	0.35%	0.80%	1.35%	1.01%	0.16%	0.55%	0.21%	0.53%	0.10%	0.16%	0.22%	0.49%	0.50%
2010	1.10%	1.01%	1.44%	1.00%	0.27%	0.51%	0.43%	0.91%	0.20%	0.36%	0.27%	0.37%	0.66%
2011	0.68%	0.91%	0.83%	1.00%	0.34%	0.52%	0.45%	0.73%	0.26%	0.37%	0.20%	0.40%	0.56%
2012	0.79%	0.91%	0.74%	1.01%	0.49%	0.61%	0.40%	0.75%	0.31%	0.33%	0.24%	0.38%	0.58%
2013	0.81%	0.79%	0.78%	0.89%	0.31%	0.63%	0.38%	0.59%	0.18%	0.26%	0.29%	0.36%	0.52%
Combined	0.73%	0.84%	1.01%	0.99%	0.35%	0.53%	0.37%	0.67%	0.21%	0.29%	0.25%	0.39%	0.55%

Table 8

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