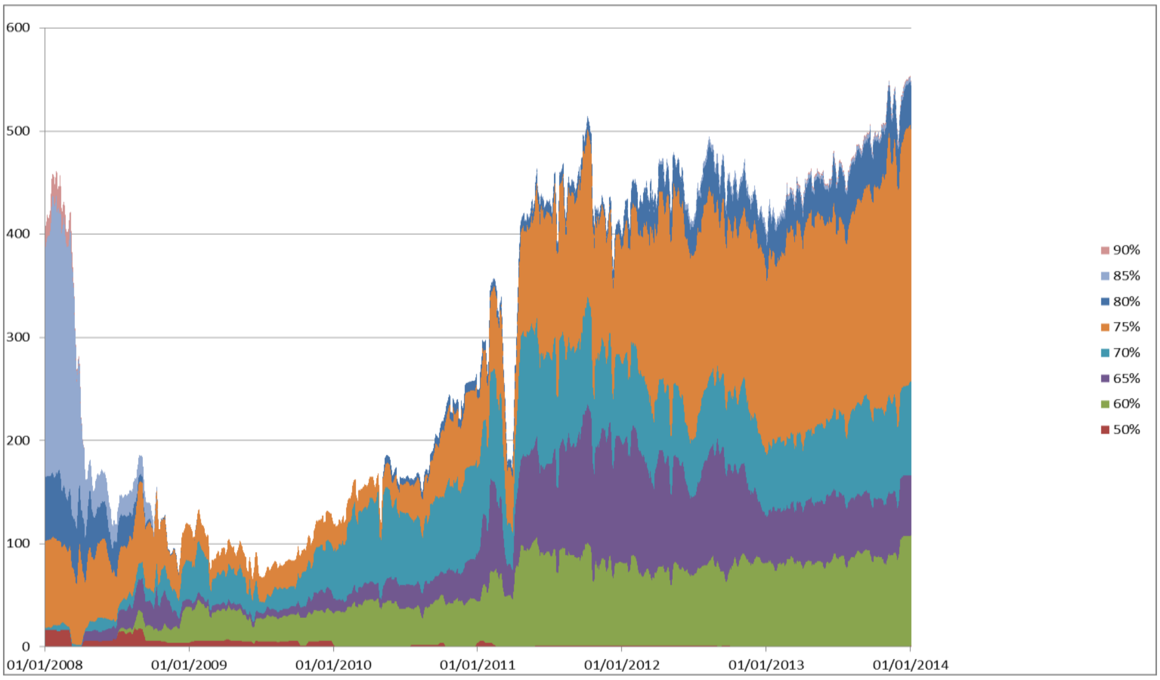
Mortgages for Business

Buy to Let Mortgage Rates: The Real Costs Q4 2013

January 2014

Buy to let product numbers

In Q4 2013 there was an average of 521 buy to let mortgage products from 27 active lenders on the market and at the end of the year there were over 550 products available to borrowers. This average in Q4 is 42 products up on the previous quarter and is now consistently above the number of products in early 2008 just before the financial crash. However, the difference between then and now is the loan to value availability. In early 2008 over half of the products were at 85% LTV and the rest were almost entirely 75%, 80% and 90% products. Today, the dominant product range is now 75% with significant product ranges available at 60%, 65% and 80%. In other words, the product ranges are at 10% lower LTV points now compared to six years ago. This change in the mix of products is shown in the graph below:



The range of products currently available is indicative of a healthy market with a wide range of products and a plentiful supply of funds available for lending without any of the unhealthy scrabbling for market share by lenders as happened in early 2008 demonstrated by the predominant availability of high LTV products.

Buy to let product pricing

Interest Rate Overview

Back in August the newly installed Governor of the Bank of England. Mark Carney, gave "forward guidance" that Bank Rate would be unlikely to increase until such time the official unemployment rate had fallen below 7%. With the announcement on 21st January that the unemployment rate had fallen by 0.3% to 7.1% in January questions have been asked as to whether that means that an increase in interest rates is now imminent. The 7% figure was never intended by the Governor as a "trigger" for a rate rise – purely as an indication of a metric that might indicate that inflationary pressures were likely to be building within the economy. The general feeling is that the Governor will lower the unemployment "target" to 6.5% - but may at the same time introduce another "trip-wire" related to increases in UK wage rates. We should find out more about the Bank's thoughts on future guidance when it publishes its Inflation Report in February. But so long as underlying inflation is under 2.5% there is probably not too much danger of <u>any</u> rise in Bank Rate.

Longer term, in the words of the Governor, "In the jargon, the equilibrium real interest rate, which has been negative for much of the period since the crisis, will eventually turn positive again, but it is likely to remain well below historical norms" – so even when rates rise we can reasonably expect that they will not revert to a real rate above 2 ½% for the foreseeable future.

Despite the fact that logically we are not much closer to the time when a rise will be warranted by a rise in inflation, the swap markets have responded with a surge in swap rates – particularly at the short end with little change in forecast rates after five years.

Whilst Bank Rate is set independently of Government there is undoubtedly some degree of pressure even if not actual influence exerted on the Bank of England by the occupants of Downing Street. Clearly the Government would love to keep rates down so the economy can readily achieve "escape velocity" as the Governor put it during his speech in Davos – but would it be such a disaster politically if there were to be a rate rise just before the election serving as a warning to borrowers about what they should expect if the "wrong" people ended up in Downing Street?

Buy to Let Mortgage Products

Increased competitive pressure during the course of 2013 have held down the true cost of three and five fixed rate mortgages – three year costs are virtually the same as when swap rates bottomed out in April and five year costs are around 0.1% p.a. higher than then. Yet swap rates have risen by over 0.75% for three years and 1% for five years since April – so how long can this last?

Competition is set to intensify further still in 2014 – but ultimately lenders will have to recognise increasing cost of funds. So whilst lenders' margins are likely to fall during 2014, it is highly likely that interest rates will rise on medium term fixed rate mortgages reflecting the impending rise in Bank Rate. We maintain our advice to investors to consider taking out five year fixed rate mortgages.

Buy to Let Mortgage Charges

After considerable fluctuation in charges from 2008 to 2012, there has been no significant change in the average charges for setting up a mortgage in the last quarter. On average across all products charges amount to around 1.5% which when added in to a 2 year loan adds 0.75% p.a. to the cost over the initial period, 0.5% on a three year product and 0.3% on a five year product.

However, the number of products with no lender arrangement fee crept up to 10.8% in Q4, up from 7% in the previous two quarters which highlights the increased competition between lenders at the end of the year. This is good news, particularly for investors who dislike the idea of arrangement fees and shows that lenders are beginning to take on board borrowers' preferences, (that's not to say that the lenders won't build in this lost margin elsewhere in the product). It is encouraging too that the majority of the increase was made at the expense of percentage based fees which now account for 40.2% of arrangement fees, down from 43% in Q3. Flat fees made up the remaining 49% down from 50% in Q3.

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