Mortgages for Business

Buy to Let Mortgage Costs Index
Q3 2014

Buy to Let Product Numbers

In Q3 2014 there was an average of 707 buy to let mortgage products from 28 active lenders on the market, up 70 products on the previous quarter. Most of this increase has occurred in the fixed rate product ranges and in particular within the five year fixes.

In the two years since we first started producing this analysis, the range of 5 year fixed rate buy to let mortgages has increased over threefold – so that there are currently around 150 different mortgages in this range. Similarly the number of mortgages available at 80% Loan to Value and above has more than doubled and as a result we have decided that, instead of displaying results just for 65% LTV and 75% LTV, we should show data split between Low LTV (50%, 60% and 65% LTV), Medium LTV (70% and 75% LTV) and High LTV (80% and 85% LTV).

Buy to Let Product Pricing

Interest Rate Overview

The first part of the quarter saw steady declines in Swap rates across the board before a modest rise in the first part of September. However, since late September there has been a spectacular fall in Swap rates with drops of 0.35% in 2 year Swaps, 0.5% in 3 year Swaps and 0.6% in 5 year Swaps. These drops have taken Swap rates back to the levels of summer 2013 but it is too soon for this to have filtered through into the pricing of products that are currently available.

Product Ranges – Fixed Rates and Discounted/Tracker Products

In our last report covering Q2 2014 we highlighted our belief that that fixed rate products currently represent far better value than trackers. This quarter I want to reinforce this message by showing two graphs (see page 2) comparing average costs of fixed rate and of tracker products over the last 21 months.

Looking at the average cost of Low LTV products (grey line) in the first graph of 2 year fixed rate mortgages, it is apparent that the margin between the cost of the average (fees inclusive) mortgages and the swap rate cost (orange line) has narrowed from around 4.25% in early 2013 to around 2.5% now, whereas the margin between Low LTV trackers and Bank Rate has narrowed from 4.25% to just 3.75%. This pattern is similar but less pronounced for the Medium LTV products (yellow line) – but interestingly is far less pronounced when examining the High LTV products (blue line). There are similar patterns for three and five year fixed rate products.

These results confirm our belief that fixed rate products are offering far better value (in relation to money market rates) than tracker products – certainly at anything below 75% LTV.

Conclusion

There is no “one size fits all” recommendation for the best product type for an individual investor but it certainly appears to be true that fixed rate mortgages at two, three and five years are offering considerably better value than trackers.

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Comparison of Average Costs: Fixed vs Tracker Buy to Let Products January 2013-October 2014

Table 1: Fixed Rates

Term: Fixed rate for 2 years initial term Costs including fees

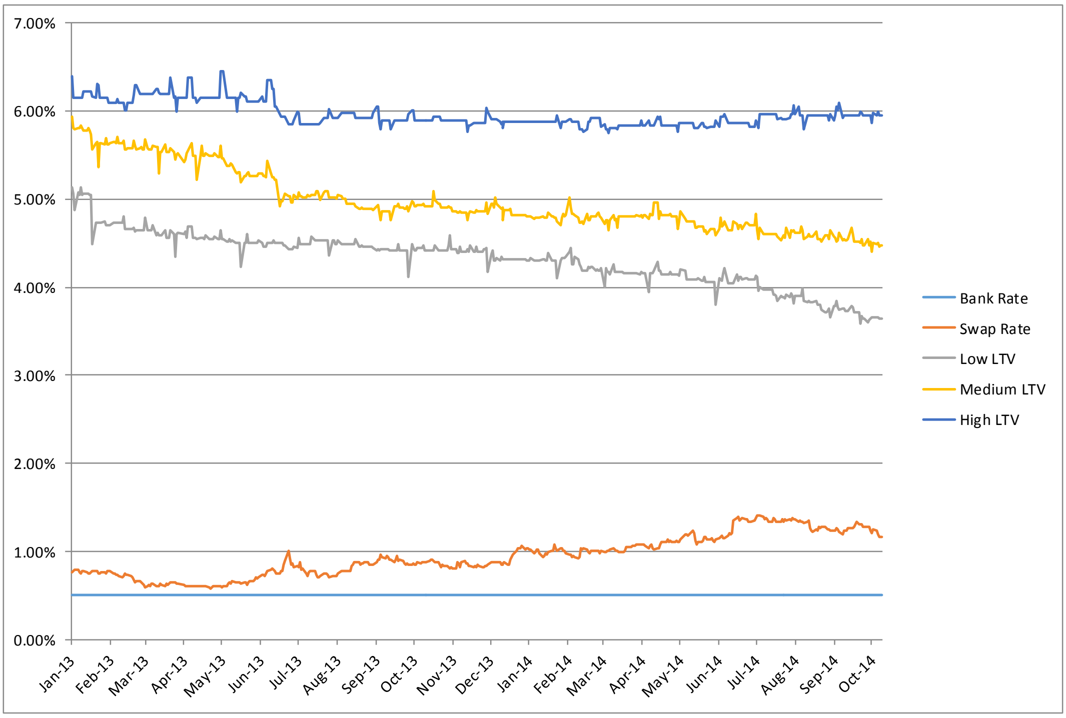
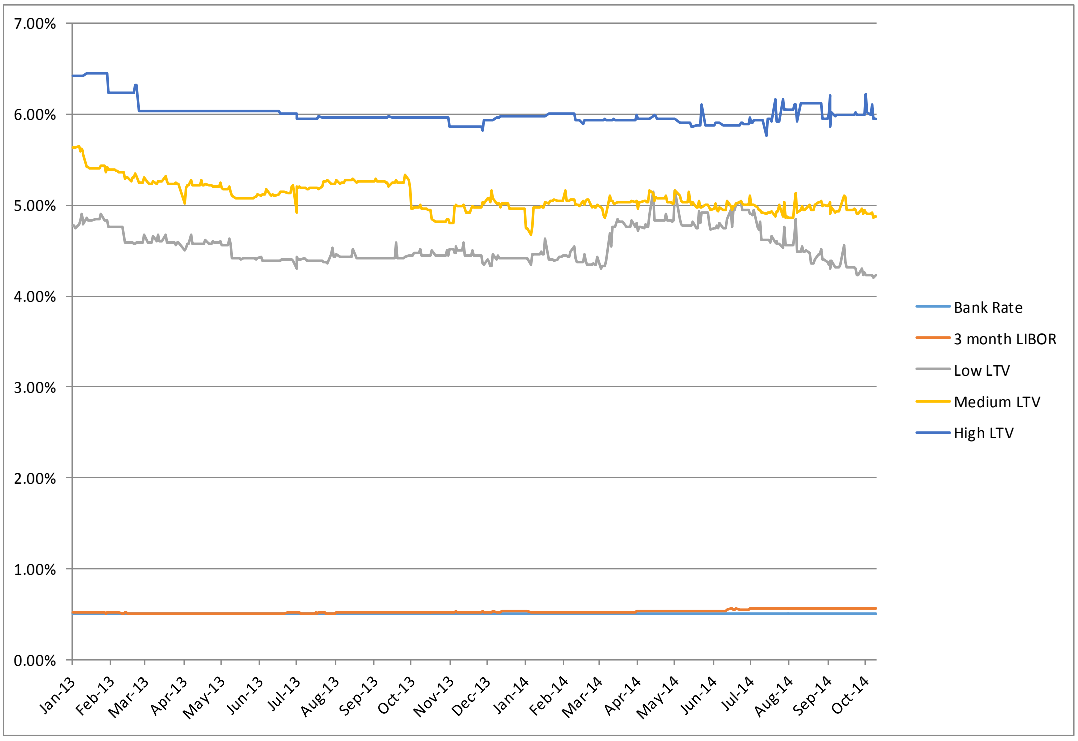


Table 2: Tracker Rates

Term: Trackers (All) Costs including fees



The main exception to this would appear to be in the higher loan to value category where it may make better sense to take out a short term tracker product – particularly if you are confident that rising prices will enable you to re-mortgage at a lower LTV in say, 2 years' time.

Number of Buy to Let Mortgage Products by Initial Term

Number of Buy to Let Mortgage Products		
Product	**Q2 2014**	**Q3 2014**
1 year	1%	1%
2 year	57%	54%
3 year	19%	17%
5 year	15%	19%
Loan term	8%	9%

The split of products sorted by their initial rate term is largely unchanged quarter-on-quarter; but with a further increase in the number of 5 year fixed rate products and the virtual demise of the one year product which had represented 14% of the products as recently as 2011.

Buy to Let Mortgage Charges

Having re-analysed the overall pricing data into Low, Medium and High LTV categories, we have also re-analysed the impact of charges into the same groupings. In doing this we have gone back to the start of 2013 to cover the period during which the "Challenger Banks" have had the most impact on buy to let products and their pricing.

Quarter on quarter there has been a very small reduction in charges – and they are now markedly lower overall than at the start of 2013 adding on average 0.54% p.a. to the cost of mortgages compared with 0.67% in the first quarter of 2013. This re-analysis has revealed that most categories of mortgages now have lower charges – but that High LTV mortgages now have higher charges than at the start of 2013. (See table below). This has contributed to the previous observation that the margin on High LTV mortgages has been held up whilst other mortgages have become noticeably cheaper over the period.

Effect of Charges on Buy to Let Mortgages				
	Low LTV	**Medium LTV**	**High LTV**	**Average**
2013 Q1	0.62%	0.70%	0.71%	0.67%
2013 Q2	0.59%	0.64%	0.77%	0.64%
2013 Q3	0.58%	0.65%	0.73%	0.64%
2013 Q4	0.56%	0.61%	0.75%	0.61%
2014 Q1	0.54%	0.59%	0.75%	0.60%
2014 Q2	0.50%	0.59%	0.76%	0.58%
2014 Q3	0.41%	0.56%	0.84%	0.54%

There has been very little change in spread of fee types, although there continues to be an incremental movement away from percentage based fees in favour of flat fees. The average cost of a flat fee has reduced again and now stands at £1,346, down from an average £1,498 in Q1 2014 and £1421 in Q2 2014.

Buy to Let Mortgage Charges		
Fee type	Q2 2014	Q3 2014
Flat fee	50%	54%
No fee	11%	12%
%-based fee	39%	34%

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