Buy to Let Mortgage Costs Index
Q4 2015

Buy to Let Product Numbers

In Q4 2015 although no new lenders entered the market, the average product count rose by around 100 to a total of 1,068, driven in part by an increasing number of products for limited companies.

Buy to Let Product Pricing

Limited Company Mortgages
Since the "bombshell" on interest tax relief for individual borrowers in July, the number of mainstream BTL lenders offering BTL mortgages to limited companies has risen from seven to eleven – thus reinforcing the competition in what is going to become a key sector of the market.

A simple comparison of all buy to let mortgages currently on the market reveals the following average "headline" rates:

Average Buy to Let Mortgage Rates				
	Trackers	Fixed Rates		
		2 years	**3 years**	**5 years**
Individuals	4.31%	3.19%	3.84%	4.01%
SPV Ltd Co's	4.63%	4.56%	4.47%	4.85%

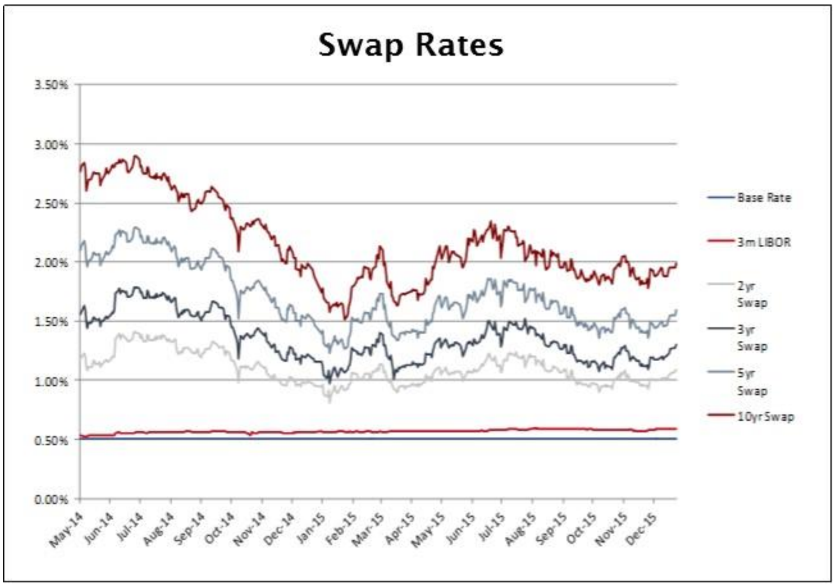
This apparently dramatic increased cost for limited companies has arisen because some of the "vanilla" buy to let lenders have some extremely cheap mortgages available for individual borrowers who meet tight criteria. Since there is some extra expertise and work involved in lending to limited companies, these lenders are not (currently) geared up to lend to companies – and thus there are few "bargain basement" buy to let mortgages for limited companies. Generally speaking lenders that offer mortgages to SPV limited companies are charging only a modest premium of up to 0.25% for these borrowers compared with products available for individuals.

With the impending Stamp Duty surcharge on buy to let properties effective from 1 April 2016, anybody intending to incorporate their BTL business in order to protect their interest cost tax relief needs to act now in order to get the transaction completed before April. The reality is that a modest amount of additional interest now (and many other associated costs) is likely to be a sound investment when compared with the additional tax that could be payable further down the road if action is delayed. As always I would caveat this by saying that every landlord's circumstances are different and they should take professional tax advice to determine the best course of action going forwards.

Interest Rate Overview - The path of uber-gradualism
Imagine a drunkard walking randomly in an idealised city. The city is effectively infinite and arranged in a square grid, and at every intersection, the drunkard chooses one of the four possible routes (including the one he came from) with equal probability.

Will the drunkard ever get back to his home from the bar?

It turns out that he almost surely will – and similarly it is almost certain that interest rates will at some point revert to "normality" – but there will doubtless be much staggering around in all directions on the way there. Q4 saw a modest reversal of the downward trends in Q3 - but already in Q1 2016 we have seen a lurch back downwards in all swap rates.



I have to admit that I have copied the term "The path of uber-gradualism" – but this does describe very nicely the likely changes in Bank Rate over the coming years. Whilst the US authorities imposed an increase in rates late last year, there is a feeling that they may already be regretting this move and that, whilst they won't reverse it, the rate of any future increases is likely to be extremely slow. Combined with decelerating growth in the UK economy this is likely to mean that we can forget any rises in Bank Rate for the time being.

Another factor that is relevant to the future costs of buy to let borrowing is the stance of the Financial Policy Committee of the Bank of England. To help understand the background to this I have extracted the relevant section from the minutes of 25th and 30th November 2015.

> ***UK property markets***
>
> *18. Activity and credit growth in the housing market had been gradually picking up over recent months. Mortgage approvals for house purchase had been 69,000 in September 2015, higher than the 62,000 level six months earlier, but well below the 1994-2007 monthly average of 99,000. Mortgage lending growth had been 2.2% in the twelve months to September 2015. House price inflation had risen to 7.8% on a three month on three month annualised basis in October and forward-looking indicators suggested growth would remain strong in the period ahead.*
>
> *19. The limited growth in mortgage lending had continued to be driven by the buy-to-let sector. In the year to 2015 Q3, the stock of buy-to-let lending had risen by 10%, compared to 0.4% for owner-occupiers.*
>
> *20. Some of the strength in buy-to-let lending was consistent with an increase in demand for accommodation in the private rental sector. Since 2008 this had appeared to be driven largely by the reduced availability of high loan to value (LTV) mortgage lending to owner-occupiers, which had increased the age at which many potential first-time buyers were leaving the private rental sector. Population dynamics were also likely to have played a role. These increases in rental demand,*

alongside low interest rates and low returns on alternative assets in the post-crisis period, had boosted the attractiveness of borrowing for buy-to-let investment.

21. Increased competition among lenders in the buy-to-let sector had not to date led to a widespread deterioration in underwriting standards of UK banks. But some smaller lenders had loosened their lending policies, for example by raising their maximum LTV thresholds. The Committee noted that new loans to buy-to-let investors were often subject to less stringent affordability tests than loans to owner-occupiers.

22. Assessed against relevant affordability metrics, buy-to-let borrowers appeared more vulnerable to an unexpected rise in interest rates or a fall in income. The Committee considered there to be a risk that during an upswing in house prices, investors seeking capital gains would be able to increase leverage through the purchase of multiple properties. The resulting boost in demand could add further pressure to house prices, prompting both buy-to-let and owner-occupier borrowers to take on larger loans, thereby increasing indebtedness. Since 2010, rates of credit loss on buy-to-let loans in the United Kingdom had been around twice those incurred on lending to owner-occupiers.

23. The FPC was alert to financial stability risks arising from rapid growth in buy-to-let mortgage lending and supported the programme of work initiated by the Prudential Regulation Authority (PRA) to review lenders' underwriting standards. The Committee also agreed that it would need to monitor developments in buy-to-let activity closely following the tax changes to the buy-to-let market announced by the Chancellor in the Budget and Autumn Statement.

24. HM Treasury would consult on powers of Direction for the FPC on buy-to-let mortgage lending before the end of the year. Ahead of these powers being finalised, the FPC stood ready to take action if necessary to protect and enhance financial stability, using its powers of Recommendation.

I have highlighted para. 22 above since this demonstrates only too clearly that the Bank of England is inclined to get involved in this market – and crucially it appears to be either singularly ill-informed or else it is choosing wilfully to exaggerate the rates of credit loss on buy to let mortgages.

Write-offs on buy to let mortgages since 2009 have averaged less than 0.2% p.a. and are currently 0.1% p.a. having peaked in 2011/12 at around 0.3% p.a. Any rational person would realise that when lenders typically operate on a Net Interest Margin (for BTL lending) of at least 2% p.a. this represents a loss that should be readily affordable. The reality is that only in two quarters in 2009 were arrears higher on buy to let than on residential mortgages – and thus by that measure buy to let is less risky than normal residential lending.

The danger is that the Bank of England may seek to impose constraints on buy to let lending which could simultaneously reduce the supply of mortgages and push up the cost of them. I am sure that the lenders will be lobbying hard to correct the misunderstandings in the Bank and it is to be hoped that the Bank will see the wisdom of waiting for the effects of the various tax changes to wash through the system before acting precipitously.

Conclusion

The Governor of the Bank of England has effectively given up on "forward guidance" regarding interest rates – but we do know that he is hell bent on trying to rein-in the buy to let market. Whilst the industry will doubtless resist the more extreme elements of his proposals, it is at least possible that at some point in the future there will be more restrictions on buy to let mortgages and/or they could become more expensive as additional (and objectively unwarranted) capital requirements are imposed on buy to let lenders.

Once again I re-iterate that time is now very short if you want to avoid the Stamp Duty surcharge that is coming in on 1st April.

Buy to Let Mortgage Products by Initial Term

Buy to Let Mortgage Products							
Product	**Q2 2014**	**Q3 2014**	**Q4 2014**	**Q1 2015**	**Q2 2015**	**Q3 2015**	**Q4 2015**
1 year	1%	1%	1%	1%	1%	1%	1%
2 year	57%	54%	52%	49%	46%	43%	43%
3 year	19%	17%	19%	18%	18%	22%	20%
5 year	15%	19%	18%	22%	24%	23%	24%
Loan term	8%	9%	10%	10%	11%	11%	12%

The absolute numbers of products available in each category are still rising – with all product ranges increases in number similarly.

Buy to Let Mortgage Charges

The overall trend of the last three years has been maintained as charges have continued to have a declining impact on total costs. There is now even a trend downwards to be seen in the High LTV category where costs had risen during 2014.

Effect of Charges on Buy to Let Mortgages				
Quarter	**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%
2014 Q4	0.39%	0.53%	0.90%	0.52%
2015 Q1	0.39%	0.53%	0.84%	0.51%
2015 Q2	0.39%	0.54%	0.77%	0.52%
2015 Q3	0.38%	0.50%	0.67%	0.48%
2015 Q4	**0.40%**	**0.50%**	**0.62%**	**0.48%**

There has been a significant shift in the proportion of products with percentage-based fees which has climbed steadily in the quarter. Indeed, currently (27th January 2016) there are more percentage-based fee products than there are flat fees.

This shift could be due to lenders looking for ways to claw back some of their margins which have been lost over time to competition. In general terms percentage based fees are likely to be worth more than flat fees which are not affected by the ongoing rise in property prices. Also, as the number of products for SPVs grows, our data tells us that the majority of these products have percentage-based fees.

The fees charged on flat fee products have remained static at around £1,500 – the same level has it has been since late 2010.

Buy to Let Mortgage Charges							
Fee type	**Q2 2014**	**Q3 2014**	**Q4 2014**	**Q1 2015**	**Q2 2015**	**Q3 2015**	**Q4 2015**
Flat	50%	54%	53%	51%	47%	46%	42%
None	11%	12%	15%	15%	13%	17%	18%
%-based	39%	34%	32%	34%	40%	37%	40%

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