Mortgages for Business

Q1 2018

Buy to Let Mortgage Index

Q1 2018

- Buy to let mortgage lending trends
- Product pricing
- Effect of underlying cost of funds
- How fees & charges affect pricing
- Borrowing by property type
- Personal versus Ltd Company borrowing

WINNER SEVEN TIMES Business Moneyfacts Award 2012-2018

Buy-to-Let Mortgage Broker of the Year

Introduction

Here at Mortgages for Business we track and analyse developments in the buy to let mortgage market to help landlords and property investors make informed investment finance decisions.

Up until the end of 2017, we have produced four separate indices:

- **Buy to Let Mortgage Product Index**
  Tracks product numbers, lenders, average pricing and loans to values (LTV).

- **Buy to Let Mortgage Costs Index**
  Outlines the real cost of taking out a buy to let mortgage including the impact of both the underlying cost of funds, fees and charges.

- **Complex Buy to Let Index**
  Tracks buy to let mortgage transactions at Mortgages for Business by property type, specifically, vanilla buy to let, houses in multiple occupation (HMO), multi-unit freehold blocks (MUFB) and semi-commercial property (also known as mixed use property). Data tracked includes purchases versus remortgages, average property values, loan sizes, LTVs and yields.

- **Limited Company Buy to Let Index**
  Tracks lending activity in this niche but growing sector of the buy to let mortgage market. Data tracked compares lenders and product numbers, and the split of buy to let mortgage transactions at Mortgages for Business between personal and Ltd Company borrowers. Transactions include both applications and completions.

The Buy to Let Mortgage Index combines all four of the indices listed above, plus additional research, allowing for greater analysis and comparison.

To see the previous results of any of the four indices, please visit the news and insight section of our website.

Buy to Let Mortgage Lending

The rise and fall

In 1999, the Council of Mortgage Lenders began tracking buy to let mortgage lending and the first seven years witnessed exponential growth within the sector from both the high street banks and specialist lenders. At its peak in 2007, total gross buy to let lending advances totalled nearly £45 billion – an increase of 70% in just seven years.

At this time buy to let accounted for approximately 12% of all mortgage lending advances in the UK with arrears less than half that of residential home-owner mortgages. There were c40 lenders (15 operating in the mainstream arena) offering between them an average of 600 products, some up to 90% loan to value (LTV). Lending criteria were relatively relaxed and providers were happy to consider all sorts of properties including new build houses and flats, houses in multiple occupation, flats above offices/shops and properties in need of refurbishment as well as lending to professional landlords with large portfolios and borrowers operating via limited companies.

In 2008 the credit crunch hit and it became clear that the banks were in crisis. Towards the end of the year the majority of lenders pulled out of the market, leaving just two mainstream providers, The Mortgage Works (part of Nationwide) and BM Solutions (part of Lloyds Banking Group), offering an average of just 80 products between them.

Lending criteria tightened, rates rose and appetite focused on vanilla properties. By 2009, buy to let lending had fallen to a mere £8.5 billion. Market share dipped to just 6% of overall mortgage lending. The hatches were well and truly battened down.

BUY TO LET MORTGAGE LENDING

After a couple of years in the doldrums, the buy to let sector began to recover. The turning point came in 2010, when in the April, two new lenders - Aldermore Mortgages and Precise Mortgages - launched onto the market. More lenders followed that year but perhaps most significantly, in the September, former leading specialist buy to let lender, Paragon Mortgages, returned.

Unbalanced market

The next few years buy to let mortgage lending continued its upward trajectory, fuelled by low interest rates, a chronic housing shortage and demand for privately rented property outstripping supply in many regions. By July 2015, buy to let accounted for more than 18% of all mortgage lending— well over the 15% nominal threshold agreed by industry professionals as a comfortable proportion.

Intervention

At this point the Government stepped in. In his Summer Budget, George Osborne announced his intention to create a more level playing field between those buying a home to let, and those buying a home to live in. He said that landlords had an advantage over homebuyers because not only could they offset their mortgage interest against their income, but the better off the landlord, the more tax relief they got.

The Chancellor believed that this situation had led to the rapid growth of buy to let which, if left unchecked, could pose a risk to the financial stability of the British economy. The leveller came in the form of taxation and regulation.

Section 24 of the Finance (No. 2) Act 2015, gradually reduces a landlord's ability to offset finance costs—including mortgage interest—against rental profits before calculating the amount of tax payable to HM Revenue & Customs.

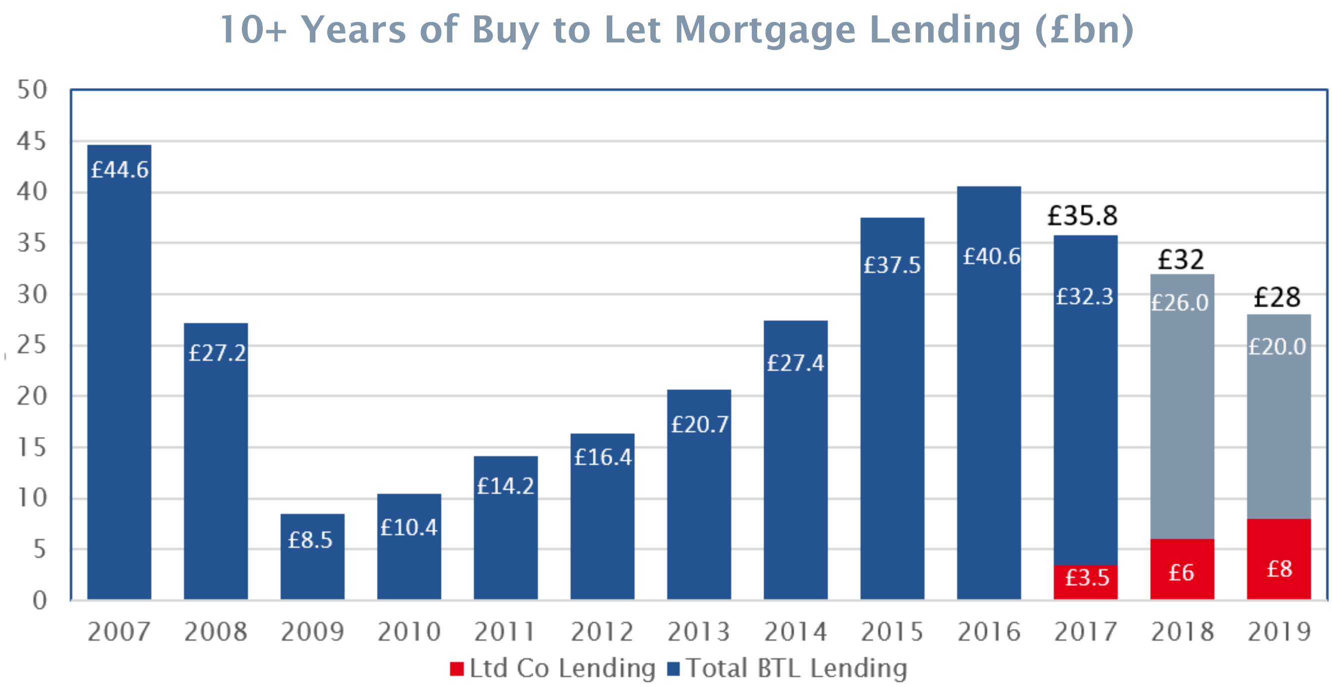
By 2020/21, the relief will have been replaced by a basic rate (currently 20%) income tax deduction.

The tax changes could tip some landlords into the next tax bracket, or even from profit to loss. Landlords who have traditionally been basic rate income tax payers shouldn't assume they won't be affected. Crucially, landlords borrowing in a corporate capacity were not affected.

But the government didn't stop there. In April 2016 a higher rate of stamp duty was introduced on all purchases of additional property including buy to let and second homes.

The buy to lenders were also targeted in the form of new guidelines issued by the Prudential Regulation Authority which set out stricter underwriting standards for buy to let mortgage contracts.

In essence this meant tougher income cover ratios and rental stress tests, plus more comprehensive affordability checks and a new class of 'Portfolio Landlord'. Those borrowing personally were more harshly affected than landlords using corporate structures as borrowing vehicles.



Source: **Blue bars** Data provided by UK Finance (and formerly by the Council of Mortgage Lenders, CML). **Light blue and red bars** Predictions provided by Mortgages for Business.

The lending dynamic changes

Change and yet more change in the fiscal and regulatory environment has, so far, had four noticeable effects on the buy to let mortgage market:

1. **Reduced buy to let mortgage lending**
2. **Restored the mortgage borrowing 'balance' between homeowners and landlords**
3. **Pushed an increasing number of landlords towards incorporation**
4. **Made the market more 'specialist' than 'mainstream'.**

Lending reached its second highest ever peak in 2016, the last year before the tax changes would begin their bite. The peak was fuelled in the first quarter of the year by landlords rushing to make purchases ahead of the new stamp duty regime. According to UK Finance, buy to let now represents 14% of all residential lending—proportionally back in the safe zone.

However, whilst overall buy to let lending is expected to continue to reduce, we predict that lending to landlords using limited companies will increase, as the above graph demonstrates. It should be noted that these predictions are our own, and based on scaling up our own transactional data, as to date, UK Finance has not released any comment on how it expects the market to develop.

It will be interesting to track how both landlords and lenders continue to adapt to the changing environment. And interesting to see if the government leaves the BTL market to bed in the changes or if it will introduce more measures which would be unwelcome at this juncture.

Lenders & Product Numbers

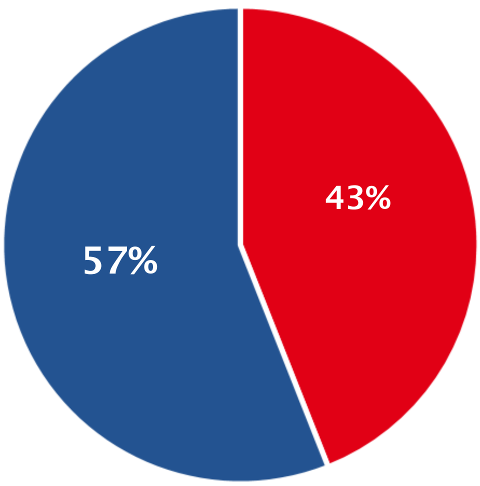
No. of buy to let mortgage lenders: 37

Average No. buy to let products: 1,466

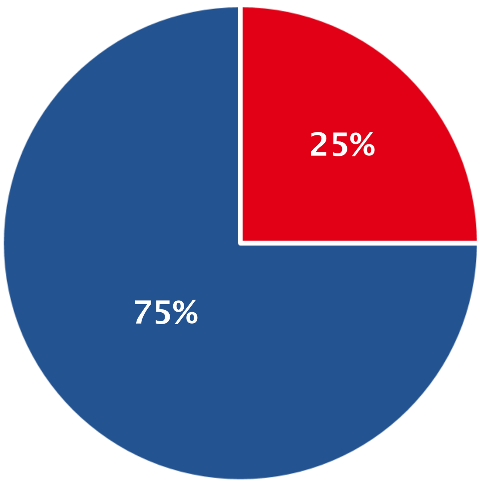
The number of buy to let lenders tracked increased by one in the first quarter of 2018 when Furness Building Society was included in the data set.

Buy to let mortgage availability also increased by an average of 132 products, up from 1,332 in Q4 2017.

The number of lenders offering products to landlords borrowing via a limited company remained unchanged at 16, although the total number of buy to let mortgage products available to limited company borrowers increased by 1%.



Lenders offering products to Ltd Co borrowers
Lenders with no Ltd Co products



Products available to Ltd Co borrowers
Products available to individuals

Pricing

Fixed Rate Buy to Let Mortgages		
Term	**Q4 2017**	**Q1 2018**
Average 5 year	3.55% (-0.02)	3.52% (-0.03)
Average 3 year	3.33% (-0.05)	3.34% (+0.01)
Average 2 year	2.93% (+0.10)	3.01% (+0.08)

Tracker Rate Buy to Let Mortgages		
Term	**Q4 2017**	**Q1 2018**
Average 5 year	2.94% (+ 0.13)	2.88% (-0.06)
Average 3 year	3.49% (+ 0.07)	3.54% (+0.05)
Average 2 year	3.01% (+ 0.07)	3.11% (+0.10)
Average Term Tracker	4.65% (+ 0.09)	4.59% (-0.06)

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PRICING

Overall pricing

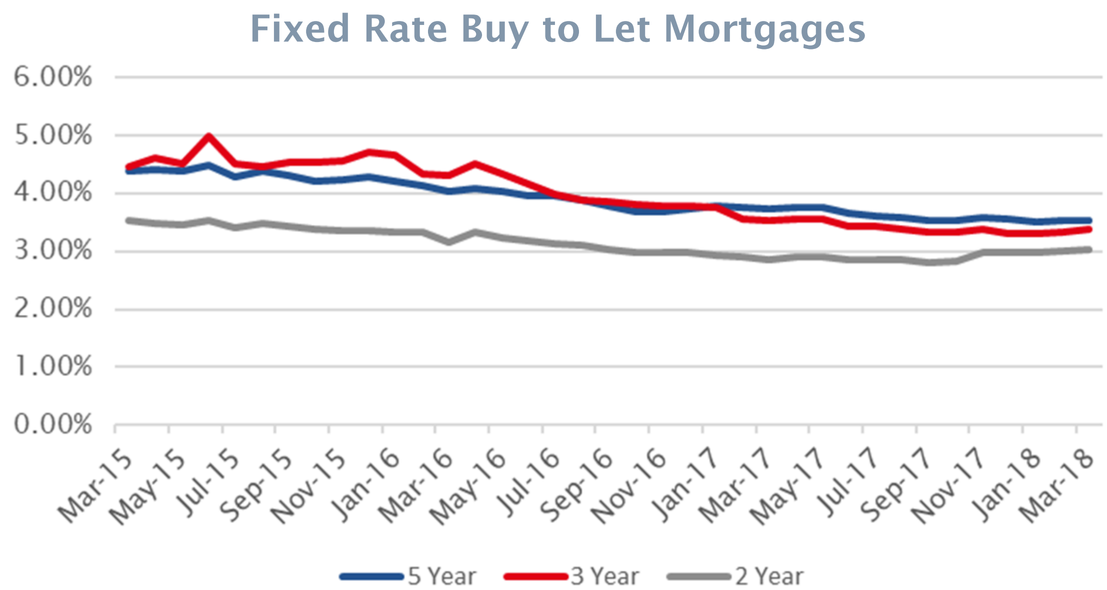
The start of the year brought new products with a number of incentives including cash back, free valuations and reduced early repayment charges.

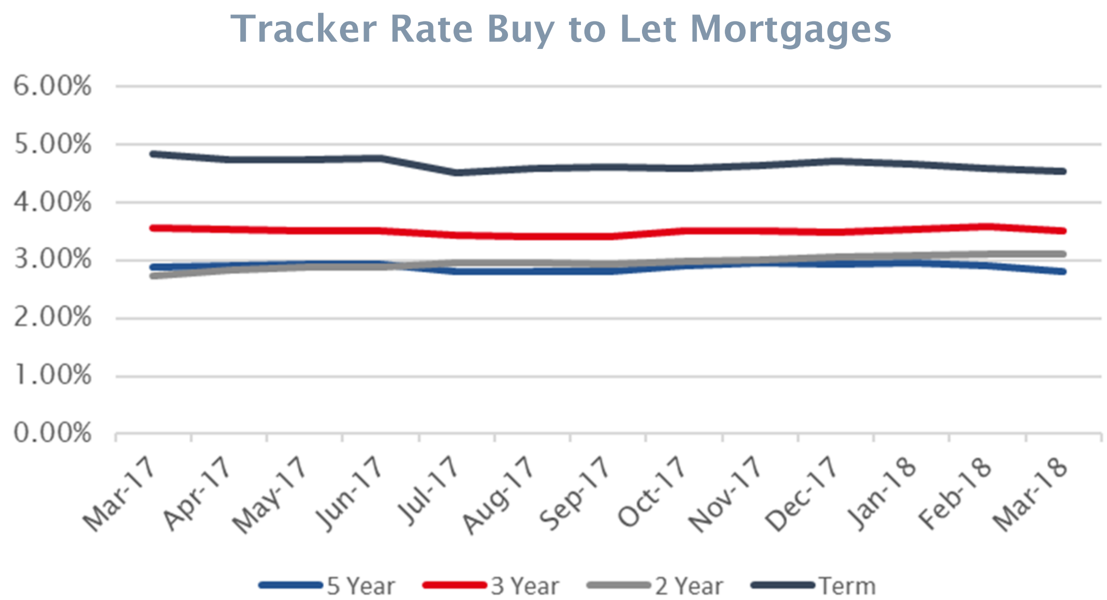
Fixed rates

On average, two and three year fixed rates increased marginally. This is unsurprising given the comments made in February by Mark Carney, Governor of the Bank of England, who indicated that Bank Rate would have to increase this year to bring inflation back on target.

On average, pricing of five year rates continued to decline, likely due to the increased competition between lenders, reducing their margins within the contracting buy to let market.

Tracker rates were more changeable during the quarter; however, they were still lower than the equivalent rates for Q1 2017 with the exception of the two year tracker which increased from 2.77% to 3.11%.





Limited company pricing

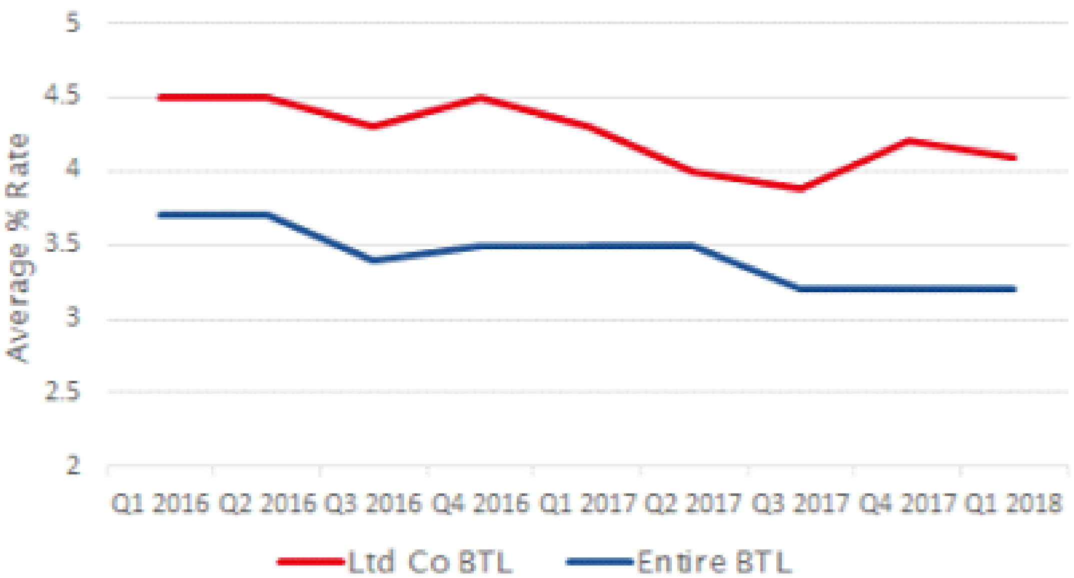
Average pricing for rates available to limited companies reduced in Q1 2018, with the exception of five year fixed rate products which saw a 10bp increase from 4.2% in Q4 2017. The table below incudes one and ten year fixed rates in the total row.

Products	Limited Company	
	No.	Av. Rate
Variable	111	4.4% ↓
2 Year Fix	108	3.8% ↓
3 Year Fix	39	3.9% ↓
5 Year Fix	110	4.3% ↑
Total	**368**	**4.1%↓**

Why rates to limited companies seem higher

Rates available to limited companies were generally higher than the market average. This is because the cheapest products are typically offered by lenders without the systems or underwriting skills in place to offer products to limited companies.

Average Rates BTL Mortgages Available to Ltd Companies



Underlying Costs

Bank Rate & Swaps

The first three months of 2018 have seen a marked increase in the swap rates. Speculation over a potential Bank Rate hike will have played its part in the increase. The majority decision by the Bank of England's Monetary Policy Committee to maintain Bank Rate at 0.5% in March of this year will have done little to allay the fears of a rate rise in the future. Q1 of 2018 has seen an increase in rates for all swap terms, with the two and three year rates breaking the one per cent mark for the first time since January 2016 (see graph overleaf).

Fixed rate buy to let mortgages

Fixed rate mortgage products are typically based on the current swap rate of the same term, with the addition of the lender's operating margin.

Since the beginning of the year there has been a steady increase in the cost of swaps (all terms) which peaked mid-February 2018. Since this time there have been dips and peaks but the overall trend is for a higher rate. This has not been entirely reflected in the fixed rate products available, suggesting that once again, lenders are continuing to absorb at least some of the costs within their profit margins.

One reason for this may be due to the fact that the growth rate of the buy to let market has contracted and therefore the competition is greater in this area. The reason for this contraction as reported by UK Finance in March 2018, is the ongoing impact of recent tax and regulatory changes.

Interestingly, the largest cuts in lenders margins have been on five year fixed term loans. As landlords seek to have some certainty over their costs, many will be looking to fix their mortgage over the longest term possible, making the five year fixed option an attractive choice. This is true for high, medium and low loan to value products.

Tracker rate buy to let mortgages

There has been little movement in the buy to let mortgage tracker rates for Q1 2018.

The high and medium loan to value tracker rates have dipped slightly from 4.4% to 4.3% and 4.1% to 4.0% from December 2017 to March 2018 respectively. As usual, the low LTV rates have been more erratic averaging at 3.7% in the first quarter of this year compared to 3.8% in the last quarter of 2017.

Conclusion

All indications from the Bank of England lead us to believe that another Bank Rate rise is likely in the near future. Savvy landlords will be reviewing their portfolios and looking for opportunities to reduce or fix costs, by refinancing their properties before rates increase further.

UNDERLYING COSTS

BTL Fixed Rate Margins Over Swaps			
Terms	**High LTV**	**Medium LTV**	**Low LTV**
5 Years	2.7% ↓ (3.3%)	1.8% ↓ (2.7%)	1.2% ↓ (1.9%)
3 Years	3.2% ↓ (3.3%)	2.5% ↓ (2.6%)	1.6% = (1.6%)
2 Years	3.0% ↓ (3.2%)	2.1% ↓ (2.3%)	1.5% ↓ (1.6%)

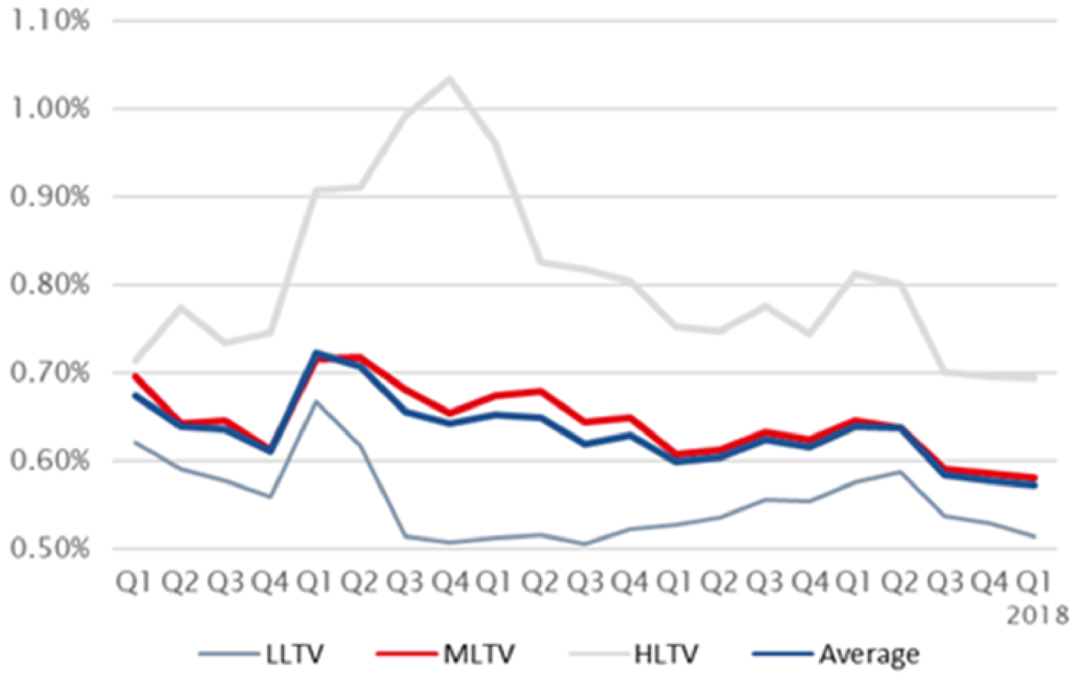
Swap Rates, Bank Rate & 3 Month LIBOR

Fees & Charges

Effect of fees & charges on headline rates

On average, the effect that fees and charges have on buy to let mortgages reduced slightly in Q1 2018 adding 0.57% to the headline rate from the 0.58% in Q4 2017. This is the lowest recorded effect since Mortgages for Business started tracking in 2013. Overall, there were reductions in fees and charges in low, medium and high loan to value options, the largest drop being from 0.53% to 0.51% in the low LTV range.

Effect of Fees & Charges on Buy to Let Mortgages

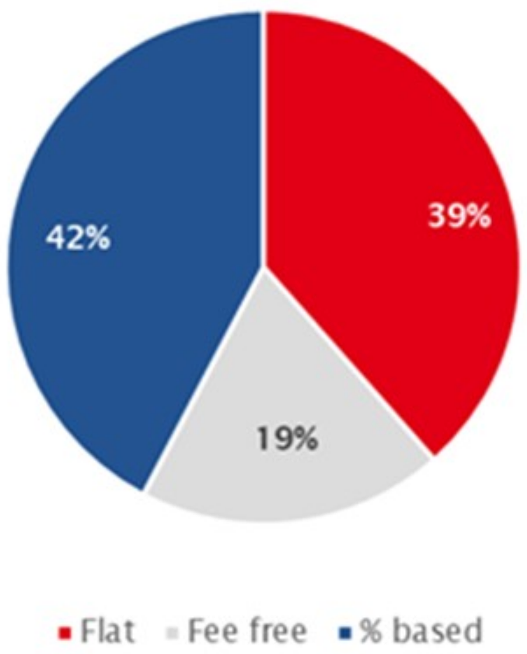


Lender arrangement fees

Lenders chose to increase the number of fee free products from 16% in Q4 2017 to 19% in Q1 2018, with a corresponding reduction in flat fee based products. This could be a result of the ever challenging and competitive market currently in operation.

The average flat fee increased again slightly on the last quarter in price, but remains less than £1,500.

Lender Arrangement Fees on Buy to Let Mortgage Products in Q1 2018

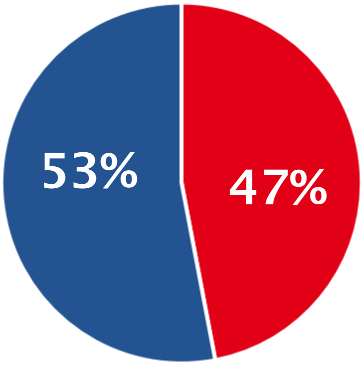


Lender Arrangement Fees on BTL Mortgages				
Fee Type	**Q2 2017**	**Q3 2017**	**Q4 2017**	**Q1 2018**
Fee-free	11%	14%	16%	19%
% based	48%	44%	42%	42%
Flat	41%	42%	42%	39%
Av. Flat	£1,446	£1,370	£1,423	£1,441

Ltd Company BTL Transactions

Limited company transactions as a proportion of all buy to let mortgage transactions (transacted at Mortgages for Business)

Since progressively reducing Income Tax relief on finance costs was announced in July 2015, we have seen an increasing number of landlords using limited companies (trading and SPV) as borrowing vehicles because for many, they afford greater tax and financial efficiencies. In H1 2015, we calculated that corporate borrowers accounted for c20% by volume and case count of transactions. In the space of less that three years, the situation has changed radically.

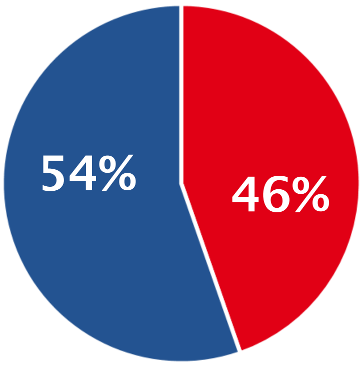


Ltd Co **CASES** completed

Individual **CASES** completed

Completed buy to let mortgage transactions

For the second quarter in a row, 47% of all buy to let mortgage cases which completed in Q1 2018 were for landlords borrowing via a limited company. However, by value, the proportion dipped from 49% in the previous quarter to 46% which means that less expensive properties were being financed.



Ltd Co completions by **VALUE**

Individual completions by **VALUE**

Newly submitted buy to let mortgage applications

The picture was somewhat different for buy to let mortgage applications submitted (not completed) in the quarter. By case count, 48% of applications were made by landlords using corporate structures, down from 51% in Q4.

However, by value, limited company applications accounted for 48% of all loans, up from 44% in the previous quarter.

Purchases vs Remortgages

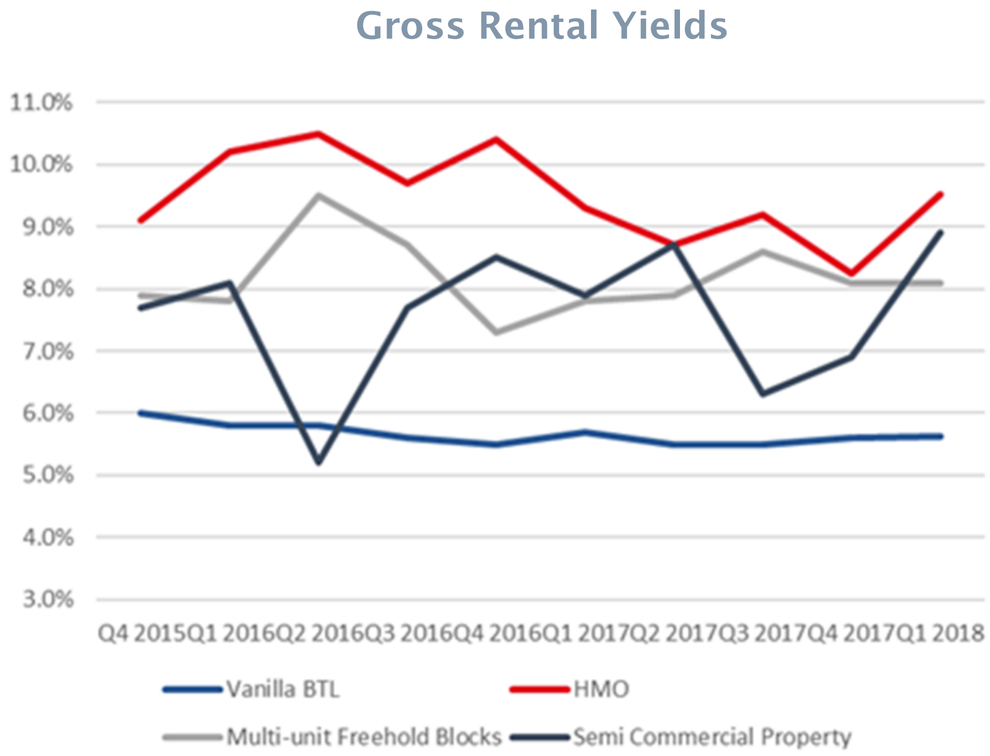
All transactions

As predicted in the Q4 2017 Complex Buy to Let Index, the proportion of BTL properties being remortgaged rather than purchased grew in Q1 2018 because of the knock-on effect of the introduction of the higher rate of stamp duty back in April 2016. Two years on, some borrowers will have come to the end of Early Redemption Charge periods on two-year rates, leaving them free to refinance onto other products.

This prediction is supported by recent UK Finance statistics showing a nine-year BTL remortgaging high in January 2018 followed in February by a 9.7% increase in remortgaging by number and value compared to February 2017.

Ltd company transactions

Although there were still more purchase transactions by landlords using limited companies, in Q1 the number of remortgages also increased as borrowing on two-year products rolled off ERC tie-ins.



Property Types

In Q1 2018, HMOs continued to provide the highest yields, while vanilla buy to let property was typically the most reliable investment.

Vanilla properties

The average value of a vanilla property being financed continued to decline and is now in the region of £282,500, the lowest it has been since mid-2013. Despite this, the average loan to value has remained consistently between 63-69% with a dependable yield of over 5.5% since the end of 2015. Vanilla property generated yields on average of 5.6% in Q1 of this year. All these factors continue to make vanilla properties the most popular and stable investment.

HMO property

HMOs produce consistently higher yields than other types of buy to let property. In Q1, they averaged a return of 9.5%, the highest it has been since the final quarter of 2016 when HMO yields hit an average of 10.4%.

Average property values

Average property values continue to fluctuate for all non-vanilla property types as do the average loans to values for a number of reasons:

- Fewer landlords in the market for these properties
- Fewer units available
- Regional price differences

PROPERTY TYPES

Transactions by property type

Vanilla Buy to Let				
	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Purchases	39%	41%	49%	39%
Remortgages	61%	59%	51%	61%
Average loan size	£204,147	£211,517	£183,202	£178,735
Average property value	£310,918	£326,611	£284,529	£282,492
Average loan to value	69%	69%	67%	66%
Average yield	5.5%	5.5%	5.6%	5.6%

Houses in Multiple Occupation (HMO)				
	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Purchases	29%	27%	33%	40%
Remortgages	71%	73%	67%	60%
Average loan size	£241,286	£234,217	£285,138	£233,957
Average property value	£307,171	£331,296	£434,643	£353,989
Average loan to value	70%	72%	68%	71%
Average yield	8.7%	9.2%	8.2%	9.5%

Multi-unit Freehold Blocks (MUFB)				
	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Purchases	21%	47%	29%	25%
Remortgages	79%	53%	71%	75%
Average loan size	£441,065	£273,558	£305,672	£328,868
Average property value	£742,836	£424,919	£439,750	£503,326
Average loan to value	67%	69%	70%	65%
Average yield	7.9%	8.6%	8.1%	8.1%

Semi-commercial Property (SCP)				
	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Purchases	67%	67%	40%	0%
Remortgages	33%	33%	60%	100%
Average loan size	£268,000	£694,375	£191,159	£950,000
Average property value	£373,333	£1,124,167	£483,000	£2,000,000
Average loan to value	72%	66%	42%	47.5%
Average yield	8.7%	6.3%	6.9%	8.9%

Data & Methodology

Lenders and products

Data is obtained from Mortgage Flow, our proprietary buy to let mortgage product sourcing system. Lenders tracked in the index are chosen for their active contribution to the market and include market-leading, mainstream providers, the challenger banks and the specialists which cater to full-time, portfolio landlords with complex borrowing requirements. Some lenders and products have been excluded including bespoke offerings and products only available on properties in smaller, regional areas.

Interest rates

In order to track buy to let interest rates, 12 “standard” product ranges have been 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.

Effect of fees & charges on headline rates

The total cost of the mortgage (including lender arrangement fees, valuation fees and legal fees) has 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. This result can be markedly different from the APR measurement which fails to recognise the effect on borrowing costs of borrowers remortgaging once the period of the discount or fix has 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. Including these costs 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.

Transactions

Transaction data is based on buy to let mortgage applications and completions submitted via Mortgages for Business. This proprietary data is held within our CRM database and includes information on purchases, remortgages, property type, property value, loan amounts, loan to value, rental income and gross annual yields.

Industry Jargon

Applications
Full buy to let mortgage applications that have been submitted to the lender but not yet completed, i.e. in progress.

Case count
The number of buy to let mortgages being transacted via Mortgages for Business, i.e. application and/or completion.

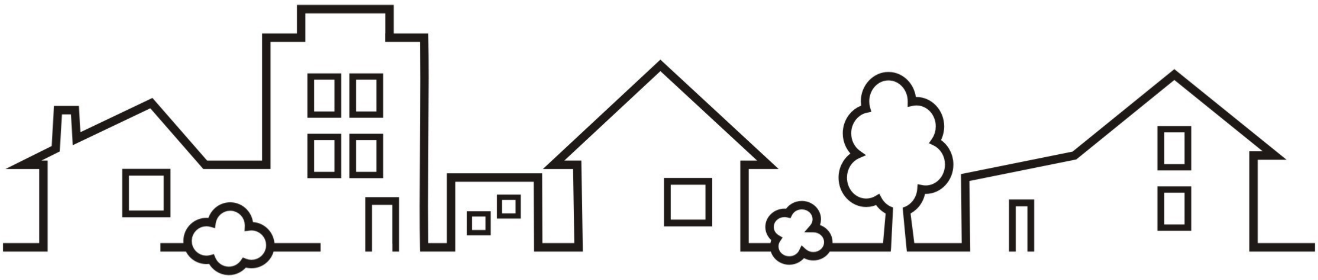
Completions
Buy to let mortgage applications that have been formally offered and drawn down. This includes remortgages.

Houses in Multiple Occupation (HMO)
An HMO is when unrelated tenants have exclusive access to their rooms and share part of the accommodation, such as the kitchen or the bathroom. An HMO may require a licence based on the number of storeys and/or the number of tenants, depending on the local authority.

Multi-Unit Freehold Blocks (MUFB)
This is a single building with multiple, separate, independent residential units owned under a single freehold title. Examples include purpose-built blocks of flats or Victorian houses converted into flats.

Semi-Commercial Property
Also known as mixed use investments, as both names suggest these properties are made up of part commercial and part residential elements, typically shops or offices with flat above.

Vanilla Buy to Let
These are standard buy to let transactions. Properties in this category tend to be normal 2-3 bed houses and flats. Both borrowers and properties fit the general lending criteria for off-the-shelf products offered by the mainstream buy to let lenders.



Further Research

We publish a variety of papers designed to help landlords, businesses and home-buyers make informed property investment decisions.

For more information

Please visit the **News & Insight** section of our website.

To discuss both the current and previous results of the Buy to Let Mortgage Index, in the first instance, please contact:

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Mortgages for Business