



SNAPSHOT

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The Buy-to-Let market – play or pass? *Is the party over for buy-to-let investors?*

With house prices plummeting, funding having dried up dramatically and amateur landlords wondering why they ever got into the lettings game in the first place, it would be easy to dismiss the BTL market as a definite no-go area for many investors currently.

But is this an entirely fair picture? Reports reveal that, with numbers on the up, the student lettings arena continues to perform well enough suggesting that not all is bleak on every BTL front.

With the market towards the bottom, is now the ideal time for savvy investors to reconsider the sector and gain some exposure at knockdown prices?

For our latest snapshot, headlinemoney has asked subscribing companies to address some of the issues facing the BTL sector.

Headlinemoney: *No one would say the BTL sector has been an easy one in which to participate in recent times. But is it really as terrible as many commentators suggest?*

Birmingham Midshires/Bank of Scotland:

The private rented market in general, and the Buy To Let market in particular, continues to play an important role in the UK's housing market by meeting demand, which still outstrips supply. BTL also remains a small but important part of our business, and across our brands which operate in this space – BM, Bank of Scotland and Halifax – we remain committed to the sector's long term, sustainable, future.

It is important to remember that the BTL sector grew at a remarkable rate in its first decade. Even under normal market conditions, this level of growth would not have been maintained. With the added stresses on lenders and investors of falling house-prices and squeezed household incomes, the sector has certainly been under some pressure. The Council of Mortgage Lenders has released its latest figures (20 Feb) into the BTL market and these indeed indicate a decline in overall lending volumes. However, in terms of loan performance, only 0.11% of buy-to-let mortgages were taken into possession in the fourth quarter of 2008, a rate broadly in line with the wider market.

National Landlords Association (NLA):

Experienced landlords are still making the best of low interest rate deals in the buy-to-let market as base rates make mortgages cheaper. But in tougher economic conditions, with a greater threat of rent arrears, those who hadn't really done their homework on how their local PRS market was coping, or are just not putting in the time to manage their letting business professionally are going to find times difficult.

Paragon Mortgages:

A fundamental prerequisite to understanding what is going on in buy-to-let is to separate out speculative property investment from genuine buy-to-let. Once this is understood the picture looks very different. Speculators that invested in property to 'flip' and make a quick profit, typically city centre flats, have been hit by an over-supply in that market and falling property prices. This is the area of the market that has suffered from chronic arrears.

'Traditional' buy-to-let, where the investor takes a long-term view and bases their purchase decision on proven levels of tenant demand, is not only proving resilient, but prospering in the current climate. Tenant demand levels have hit record highs as the housing market has stalled, leading to strong levels of rental income. Those investors with cash to spend are finding they can pick up properties at bargain prices and achieve very attractive yields.

Smartlandlord.co.uk:

'Buy-to-let' is a term coined in the 90s to describe the sector of the mortgage market which lent to people who let out their property, but the term is now commonly used to describe about the private rented sector in the UK.

The buy-to-let sector, in its original meaning, has unsurprisingly been heavily impacted by turmoil in the financial markets. Providers of buy-to-let loans are either nationalised and throwing landlords off their books, or sitting on their loan books waiting for the securitisation markets to open again. Buy-to-let loans are hard to come by and this is limiting the growth of the rental sector, which would otherwise be expanding in the current environment of high tenant demand and low house prices.

But the private rented sector is in much better health. As highlighted in the Rugg report released last year, the private rented sector is far bigger than buy to let and hence pure focus on buy to let will lead to incorrect conclusions about the investment and return potential from this sector. That is not to say that there aren't challenges for landlords in the current environment – there are. But behind the press hysteria is a more complex and less Armageddon-like story. There are even some great opportunities for experienced landlords in the current market.

A recent report from BDRC suggests 96% of landlords with more than 20 properties are still making a profit, and many of these are looking at ways to grow their portfolios while property prices are low. They do face challenges in getting loans, but the majority of these investors have a very low gearing across their portfolio, and are therefore able to redistribute equity to make purchases possible. The number of landlords attending auctions has shot up since the start of this year – indicating that many investors feel we're near the bottom of the market.

For landlords with fewer properties, the picture is mixed. Only 63% of those with one property are making a profit – showing that experience and informed investment is the key to success in this market. Some ‘forced landlords’ – people renting out property that they are unable to sell – and amateur landlords – those with one or two properties and high loan-to-value mortgages – are finding themselves in a difficult position.

But the biggest threats to the sector currently are rental and mortgage arrears as a result of job losses and the credit crunch. We advise landlords to take a proactive, DIY approach to managing their portfolio in order to save money and protect rental yields. Rent guarantee insurance is an absolute must-have, in our view, but unfortunately many buy to let landlords are still unaware that it exists.

Young Group:

It may not be as easy as it once was but opportunities do still exist and tenants are still renting quality property in convenient locations. Many investors are seeing positive monthly cashflow as a result of the reductions in base rate and Young Group clients who we advised more than 12 months ago to move onto tracker products in anticipation of the cuts are seeing positive cashflow in excess of £15,000 per year per property.

Headlinemoney: If it isn't, what evidence can you point to that sheds a glimmer of hope on the sector? What regions or sectors exist which have bucked the downward trend?

Birmingham Midlands/Bank of Scotland:

Buy To Let is always best approached as a long term investment. Despite the undoubtedly challenging times ahead, we continue to be confident in the sector's long term future because for the most part investors in BTL are professionals who have done their homework, understand the market, and generally hold on to their investments for at least 10-15 years.

Undeniably in the short-to-medium term the outlook remains testing, but certain recent trends and indicators are promising for BTL landlords. For example, we are seeing a significant number of would-be borrowers who are struggling to get onto the housing market choosing to rent rather than buy. This is increasing the demand for rental properties which is currently not matched by supply, thus increasing landlords' ability to demand a higher rent. In addition, thanks to successive base rate reductions, many buy-to-let borrowers will now be benefiting from significantly lower mortgage costs than when they initially took out their loan. They may well be experiencing an improvement in their net income as a result.

National Landlords Association (NLA):

Demand for rented accommodation is still high and we are hearing from members that tenants are staying in properties for longer. This bodes well for landlords with dependable tenants, it also means a more stable rental market for long-term professional landlords.

Paragon Mortgages:

The buy-to-let loans written today and into the foreseeable future will be the best quality business being written for years because the "froth" has gone out of the product and pricing. Indeed, the market today looks just like the market that Paragon launched buy-to-let into in 1995 - sensible loan-to-values with the landlord expected to put at least 25% equity into a deal. Pricing that reflects the risk and the cost of funds, but pricing that is still workable at the low levels of base rate. All we need now is some easing in capital markets, which will surely come.

Smartlandlord.co.uk:

On average, buy-to-let landlords own a property for 15 - 17 years. Property is a long term investment and landlords are less concerned about short-term house price fluctuations than consistently good rental yields - something we have found when working with landlords across the country. They tend not to make snap decisions and generally don't panic over market instability. Buy-to-let is countercyclical and landlords are usually the first to tell you that they resent the doom and gloom in the media's buy to let coverage, referring to it as a "self-fulfilling prophecy".

As we said, landlords with larger portfolios are still achieving healthy yields. There are opportunities and bargains for cash buyers and those who can find funding.

Terraced homes in student areas were always a good sector and student landlords are benefiting from even higher tenant demand – enrolments in higher education have rocketed since the credit crunch – and therefore stronger rental yields. In contrast, corporate lets are suffering in the current environment. Investors need to look at where the highest tenant demand is coming from, and make sure they are targeting the right groups of people.

Although property prices have dropped in the past year, they are on average still up by 20% on five years ago. Property is, therefore, on the whole still an appealing investment option compared to other investments.

Young Group:

The base rate cuts, reflected in lenders new products and standard variable rates, are now having a wider impact, particularly as the number of people coming to the end of fixed rate deals grows. A typical two year fixed rate currently coming to an end was around 5% when taken out. As these come to an end, lenders' standard variable rates are now much more attractive, typically representing a saving of around 40% in monthly mortgage costs.

Headlinemoney: With many lenders pulling the plug on BTL lending in recent months, how much more difficult is it for would-be investors to gain access to finance at the present time?

Birmingham Midshires/Bank of Scotland:

A number of players have left the market over the past twelve months, including some that previously accounted for a significant market share. As responsible lenders our primary concern is ensuring that we are writing a proportionate

amount of business. We cannot expect those lenders who remain in the market to simply absorb all of the business that those exiting the market have left behind.

That said, even in the current market there are opportunities for conscientious investors who react deftly to the prevailing conditions, and we certainly seek to support those with sound borrowing requests. Ultimately those who choose to invest for rental purposes rather than simply capital growth, and whose loan-to-value provide them with breathing room, will be in much better shape when looking for financing.

National Landlords Association (NLA):

Compared with residential mortgages, landlords on buy-to-let mortgages deal with much lower LTVs. Lenders have less capital to lend on mortgages and are being more risk adverse with the money that they are lending. That means that landlords need to show that they aren't looking for mortgages based on a risky lettings business and they have to also show that they can cope with 65-75 per cent LTV rates.

Paragon Mortgages:

A problem for genuine landlords at present is the absence of mortgage funding, which is not just a problem for landlords but for UK housing. In the early 1990's the private rented sector expanded rapidly to accommodate those not buying, losing their homes or choosing to rent. It is going to be harder for this to happen today because of the shortage of funding for buy-to-let mortgages.

How long this situation remains largely depends on the success of the Government's attempts to open up the wholesale funding markets. It has announced several initiatives to stimulate new lending, but it is important that it includes the non-bank lending sector in these initiatives as well as high street banks and building societies.

Smartlandlord.co.uk:

There is no denying that it is very difficult at present. Although property prices have fallen, would-be investors realistically need at least a 30 per cent deposit to have access to half-decent mortgage deals.

The number of buy to let mortgage options fell by almost 90 per cent in the past year. New products are only very slowly introduced and are often very expensive. That is why we continue to call for the Government to take action to help the buy-to-let sector, which provides a vital role in the UK housing market in the absence of sufficient social housing.

It is no surprise that the number of people taking out buy to let loans has shrunk - there are not many lenders or products left in the market to provide them. Providers of buy to let loans do not seem keen to build their books, quite the same attitude one sees on the homeowners market today. Landlords, like the next generation of aspiring homeowners, can't get mortgages. And with only a negligible social sector to pick up the slack, this begs the question, 'where are people going to live?' Unless the Government puts pressure on banks to lend, the UK will find itself in a housing crisis. Northern Rock's promise to increase lending is a good start, but a lot more is needed to make a real difference to the private rented sector.

Young Group:

There's a much narrower choice of products available to buy-to-let investors and a larger deposit is now required, but for those with investments that 'add up' lenders are still willing to lend. It comes down to the fundamentals of good investment; if the opportunity is valued at the level and is likely to generate positive cashflow from strong rental demand, lenders will provide funds, providing that as an investor you're willing to demonstrate your commitment (and share the risk) and put up a reasonable deposit of between 25 and 30%.

Headlinemoney: *What is the single-most important piece of advice you can offer to potential BTL investors thinking of gaining exposure to the market?*

Birmingham Midshires/Bank of Scotland:

Above all, take due care and consideration before entering the market, and take time in considering it, as it is a long term investment.

Prospective investors need to really do their homework – the cliché about "location location location" still rings true, and the market in London is not the same as in Newcastle. The labour market and rental demand can change dramatically from one place to the next, and landlords sticking to their local area may not always be the right decision. Having chosen a location, potential landlords must consider in detail the implications of regulation and tax,. They should also think about their target tenant when choosing a property. As a rule, young professionals look for modern properties, with easy upkeep and good transport links. Young families on the other hand need space, security, comfort and proximity to good amenities such as schools. A mortgage intermediary really is best placed to apply expert knowledge to each individual landlord's situation, both in terms of the right product, but also insight into the local area.

National Landlords Association (NLA):

Research, research, research your local PRS market. Make sure you aren't overextending yourself and that you have a back-up plan in case rent arrears become an issue. Last year 71 per cent of our members said they expected rent arrears to rise in 2009 and over a third were experiencing payment difficulties with current tenants.

Paragon Mortgages:

Do your homework and make sure that you only buy property with proven sustainable rental demand. A good quality property that will let through the cycle will always represent an attractive investment proposition.

Smartlandlord.co.uk:

Take a long-term view, do your homework and take control of managing your portfolio yourself. With an increase in supply of rented property, rents could fall for some months. Landlords need to be looking at ways to cut costs, manage their portfolios and their tenants carefully and insure themselves against the rising issue of rental arrears. The same applies to 'forced landlords', those who are letting property they are unable to sell in the currently climate. In fact, many will have to work harder to make a profit from their property, since the biggest

decision investors have to make – finding the right property with high tenant demand – is already taken.

We have developed a range of easy to use products and services – many of which have not been seen before -, specifically designed to give landlords more control and cut costs. Over a three year period, a typical landlord could save about £3,700 by using Smartlandlord.co.uk to find a tenant, manage their tenant's deposit, and guarantee their rent. The charges at Smartlandlord.co.uk are transparent. Landlords can pick and choose which services they use – they're in control. We only charge landlords for products and services they want to use. We don't just charge a big one-size-fits-all fee like lettings agents.

If landlords need their properties managed by a lettings agent, they'll have to pay an extra 3% on top their 12% fee. They'll pay that extra £250 every year even if nothing goes wrong with the property. If something does go wrong, lettings agents will mark-up to costs of getting workmen in. With Smartlandlord.co.uk, you only pay for maintenance services if you need them – and we don't mark up prices either.

Young Group:

Treat buy-to-let investment as a business. If you do this, you ensure that you carry out your research thoroughly. It's never been more important to ensure that investments 'stack up' and that can only be achieved by knowing the specifics of the opportunity – and also the wider property and mortgage market - inside out.