



Buy to Let Mortgage Rates: The Real Costs

July 2013

Buy to let product numbers

In Q2 2013 there was an average of 458 buy to let mortgage products from 27 active lenders on the market. This figure is 24 products up on the previous quarter thus confirming the healthy appetite for lenders to do business in this sector.

Buy to let product pricing

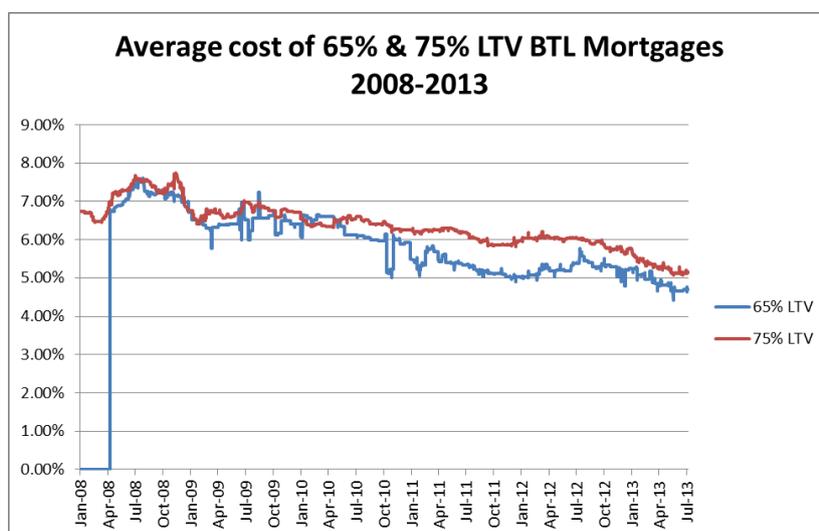
Overview

During the second quarter of 2013 buy to let rates fell by an average of 0.25% when factoring in fees. Whereas in Q1 the biggest fall was in the two year fixed rate products at 65% LTV which fell by 0.69% over the quarter, in Q2 the biggest drop was in the three and five year discounted rate products at 65% LTV – both of which fell by 0.40% - and the smallest drops occurred in the three and five year fixed rates. Both of these product ranges now average less than 4% inclusive of all costs – compared with their average over the last five years of around 5%. Buy to let mortgage rates excluding fees and other costs (headline rates) fell by an average of 0.23% across the same period indicating that there has been little change in typical fee structures attached to buy to let mortgages.

As happened in Q1, since there are more “specialist” products available in the three year sector, the average cost of three year products can be higher than the average for the five year products.

In what may turn out to be the most significant change for many months, the steady drop in rates appears to have halted and five year fixed rates are now around 0.2% higher than they were at the end of May. Looking at the swap rate graphs the reason for this is all too clear. Between 2nd May and 24th June, 5 year swap rates more than doubled from 0.91% to 1.85% in response to comments from Ben Bernanke (Chairman of the US Federal Reserve) and Sir Mervyn King (former Governor of the Bank of England). Whilst the 5 year swap rate has since retreated to 1.51% it seems unlikely that we will see the rate below 1% again and consequently this rise will ultimately be reflected in the rates payable on 5 year fixed rate mortgages.

Higher Loan to Value Mortgages

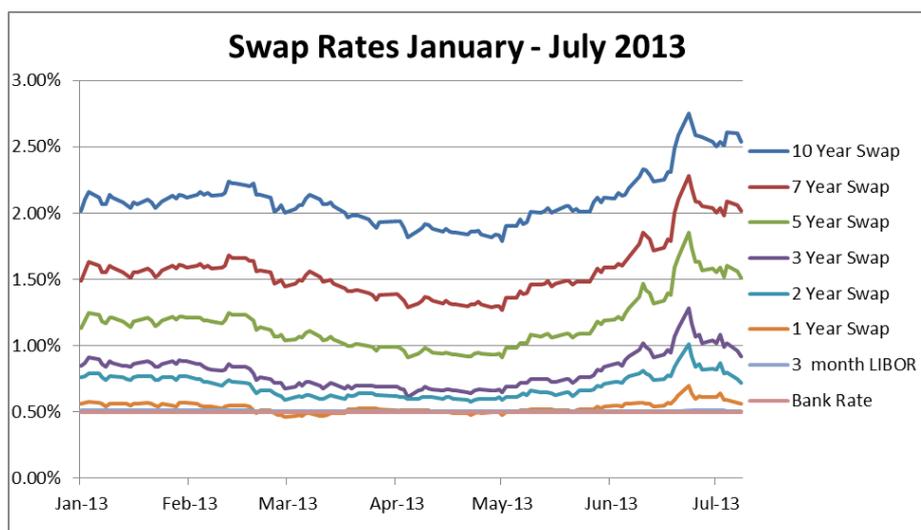




Intuitively it is to be expected that mortgages at a higher loan to value will cost more than those at a lower LTV. In the current market the two key LTV levels are 65% and 75% - although it can be seen in the chart below that before April 2008 the 65% price point did not exist – at that time the main price points were 75% and 85%!

As lenders started to return to the buy to let market in 2011 there was a clear preference for lower LTV mortgages such that in early 2012 65% LTV mortgages were around 1% cheaper than mortgages at 75% LTV. Since then the gap has narrowed so that in Q1 2013 the difference was just 0.39% although the gap widened in Q2 to around 0.46%.

Bank Rate, LIBOR and Swaps



Throughout 2013, 3 month LIBOR has been virtually static although in mid-April it finally fell to 0.50% - matching Bank Rate for the first time in recent years.

Comments by Mark Carney (the new Governor of the Bank of England) have served to calm the immediate concerns that had been stoked up in May / June by comments made by his predecessor and by Ben Bernanke (Chairman of the US Federal Reserve). As a result short term swap rates have subsided to levels only slightly higher than they were at the end of April. However swap rates for five years and longer have remained markedly higher than they were and this probably reflects a greater degree of realism about the long term future for interest rates.

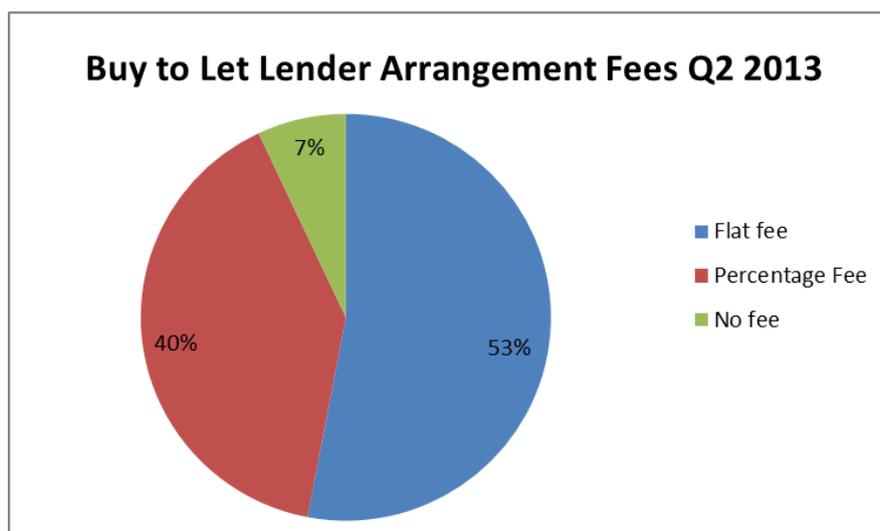
The increase in swap rates has not (yet) been matched by an equivalent increase in the cost of fixed rate mortgages and at the three and five year levels, margins over swap rates have declined by approaching 0.5%. Whilst this is doubtless being assisted by the effect of the Funding for Lending Scheme, it seems unlikely that lenders will not seek to re-establish some of this margin over the months ahead.

Arrangement fees and other costs

In Q2 2013 there was little change in the impact of lender arrangement fees, valuation fees and legal costs which added an average of 0.51% onto the headline cost of a buy to let mortgage. This has dropped slightly since the beginning of the year when the figure stood at 0.57%. Costs were at a peak in 2010 when across all product types they added an average 0.66% per annum to the average

cost. Unsurprisingly they have a greater impact on short term (2 year) mortgages where, in 2010, fees added an average of more than 1.1% to annual costs whereas this is now around 0.77%.

Of the buy to let mortgage products available in Q2 2013, 7% had no lender arrangement fee. This figure is down 2% on the previous quarter. 40% of products had percentage-based lender arrangement fees of between 1-3% compared to Q4 2012 when 46% of buy to let mortgage products carried a percentage-based fee. Over half (53%) of all buy to let products had a flat lender arrangement fee, up 5% on the previous quarter. This represents an interesting shift away from percentage based fees when between 2007 and June 2012, only 20-30% of products had flat fees.



The average flat fee is now £1,513, down £21 on Q1 2013 and down £45 on Q4 2013. This steady reduction in arrangement fees has led to a useful reduction in the overall level of up-front fees for arranging a buy to let mortgage.

Methodology

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

Fees inclusive graphs

The total cost of the mortgage (including lender arrangement fees, valuation fees and legal fees) have 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. NB this result can be markedly different from the APR measurement legislated by the FCA; the APR fails to recognise the effect on borrowing costs of borrowers re-mortgaging once the period of the discount or fix have 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.



By including these costs we have produced indices that 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.

Costs have been calculated from our database of over 17,000 buy to let products held within our mortgage products sourcing system – Mortgage Flow. The results shown reflect the average cost calculated based on products available on each day since January 2008.

Where short term (< 1 week) withdrawals of products have occurred, the results have been adjusted to eliminate anomalous peaks and troughs in the average rates shown. At any time when there were no products available from lenders in a given category this shows as an average cost of nil for the period.

The resultant interest rates for discount and tracker products have been compared to the daily 3 month sterling LIBOR cost generated by the British Bankers Association.

The resultant interest rates for fixed rate products have been compared to the sterling interest rate swap costs for the related period.

Headline rates graphs

These graphs follow the traditional method of tracking only the average headline rate of buy to let mortgage products over time which belies the true costs involved. This data has been produced to demonstrate the effects of set up costs.

In all graphs, at any time when there were no products available from lenders in a given category this shows as an average cost of nil for the period.

Understanding interest rate swaps

Interest rate swaps help companies, portfolio managers and banks to manage cash flows by fixing interest payments over time. An interest rate swap is a contract to exchange floating payments linked to an interest rate for fixed payments, and is generally used to manage exposure to fluctuations in interest rates.

In an interest rate swap transaction, the parties to the transaction exchange or “swap” two types of interest payments – one a fixed rate, the other a floating rate – over the lifetime of the deal. The swap rate is the cost of switching from a floating rate to a fixed rate. The floating rate is typically determined by the three-month London Interbank Offered Rate used as a benchmark for floating rate mortgages and loans.

Tables

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4a-c	2 year fixed rate (page 8)
5a-c	3 year fixed rate (page 9)
6a-c	5 year fixed rate (page 10)
7	Effect of costs on buy to let mortgage rates (page 11)

NB: When looking at the following tables please note that the 3 month LIBOR has been only marginally above 0.5% throughout 2013 and so cannot be split from the line for Bank Rate.

Comparison of 2 year discount & tracker buy to let mortgage rates

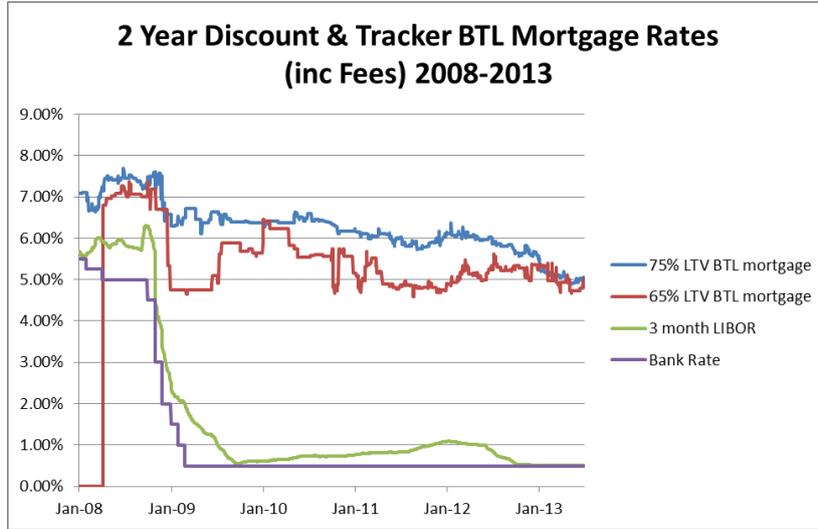


Table 1a

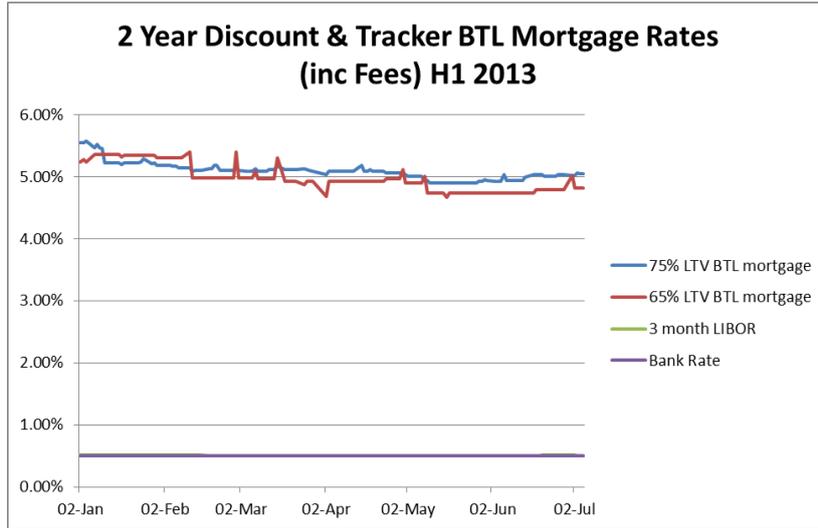


Table 1b

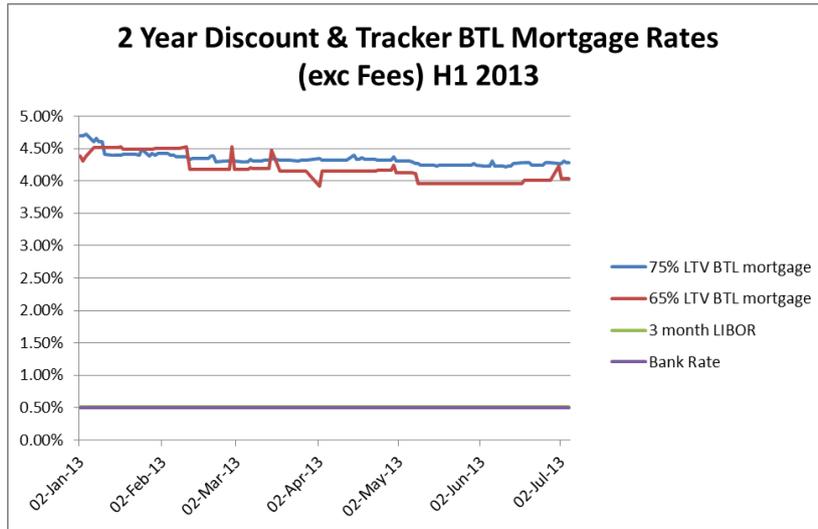


Table 1c



Comparison of 3 year discount & tracker buy to let mortgage rates

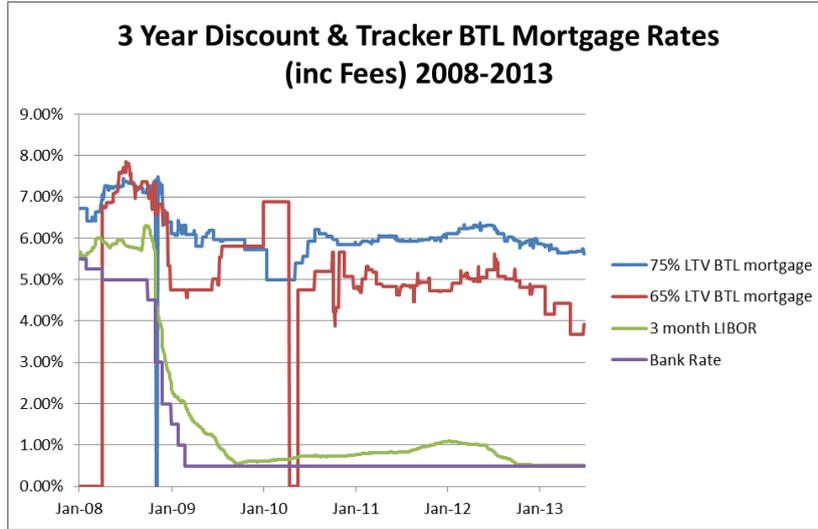


Table 2a

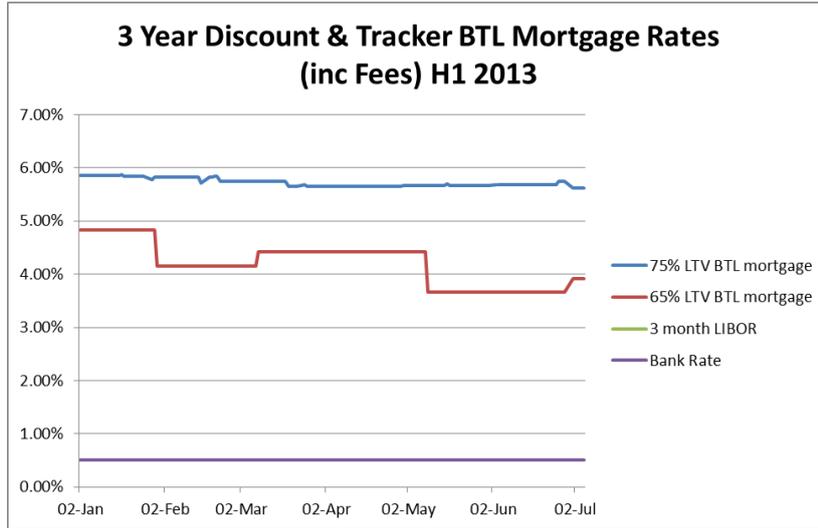


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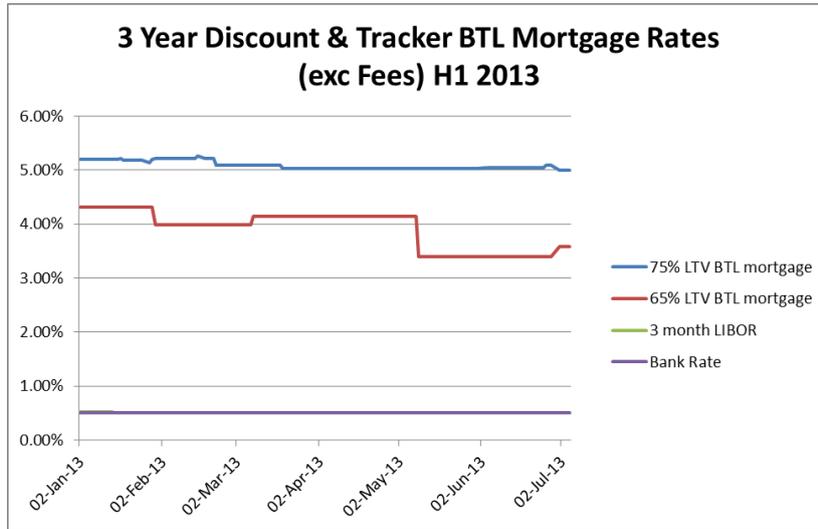


Table 2c



Comparison of 5 year discount & tracker buy to let mortgage rates

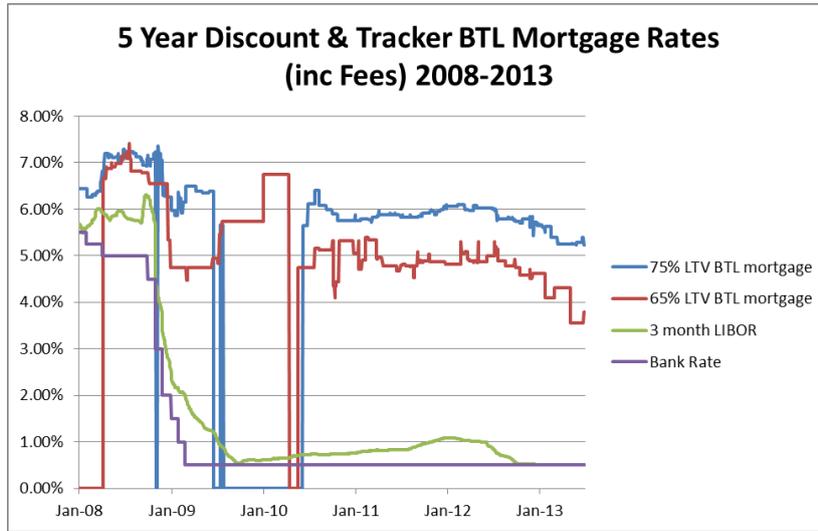


Table 3a

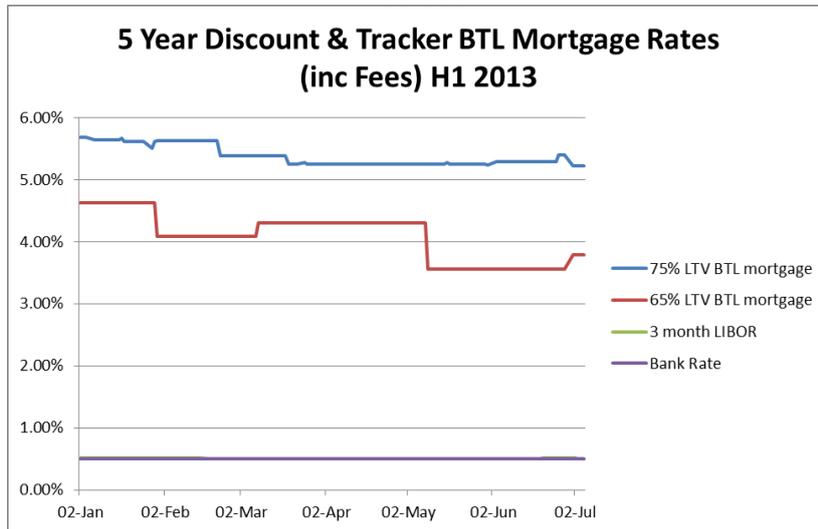


Table 3b

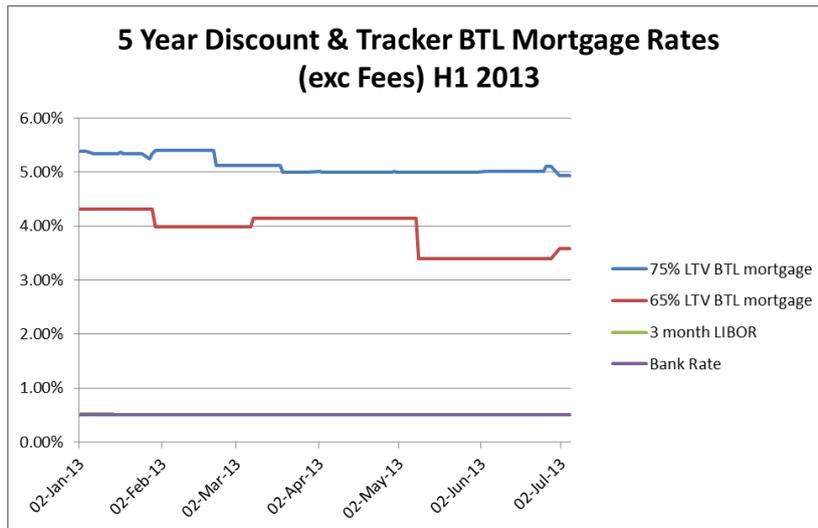


Table 3c

Comparison of 2 year fixed rate buy to let mortgages

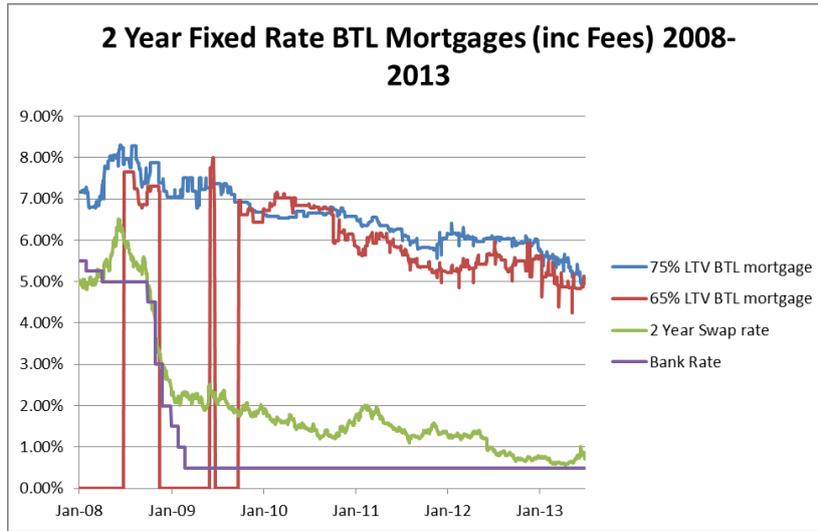


Table 4a

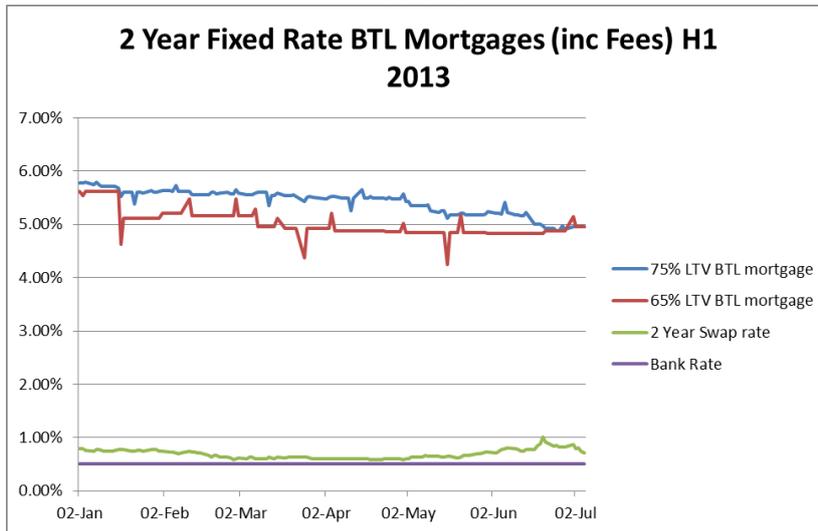


Table 4b

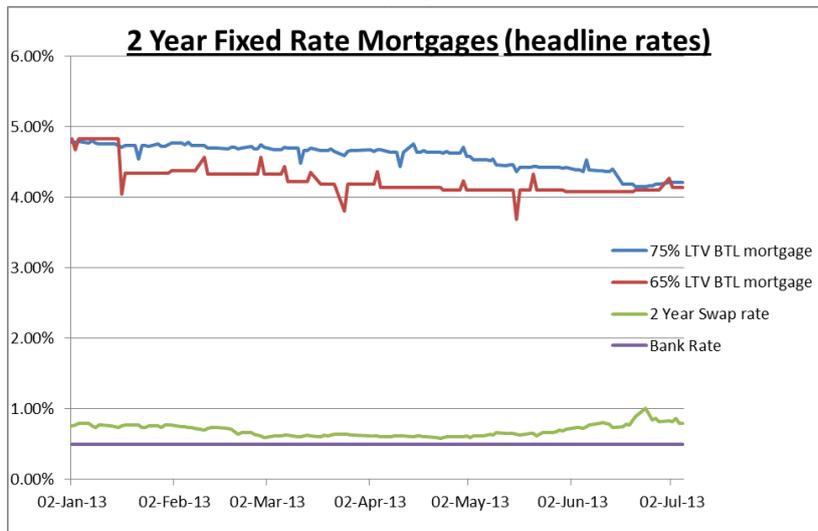


Table 4c

Comparison of 3 year fixed rate buy to let mortgages

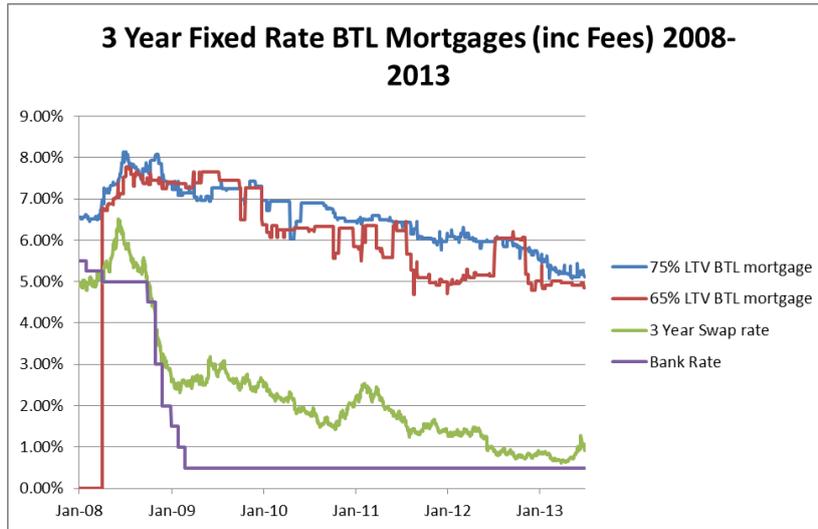


Table 5a

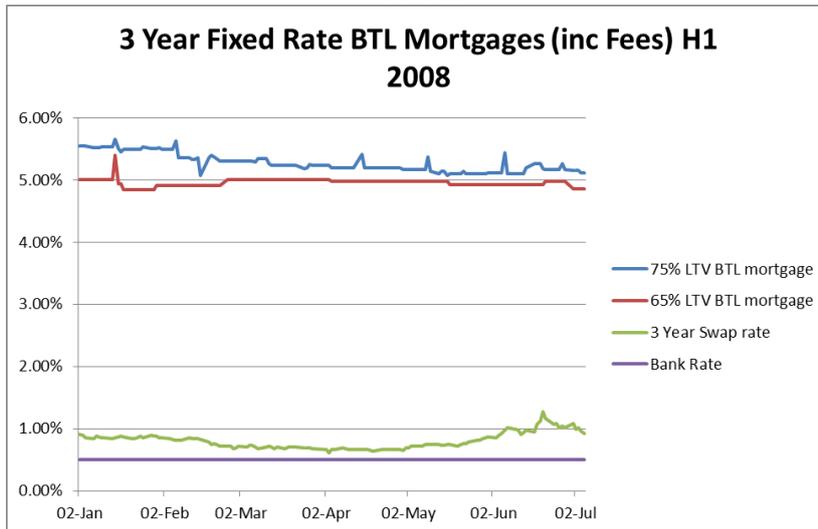


Table 5b

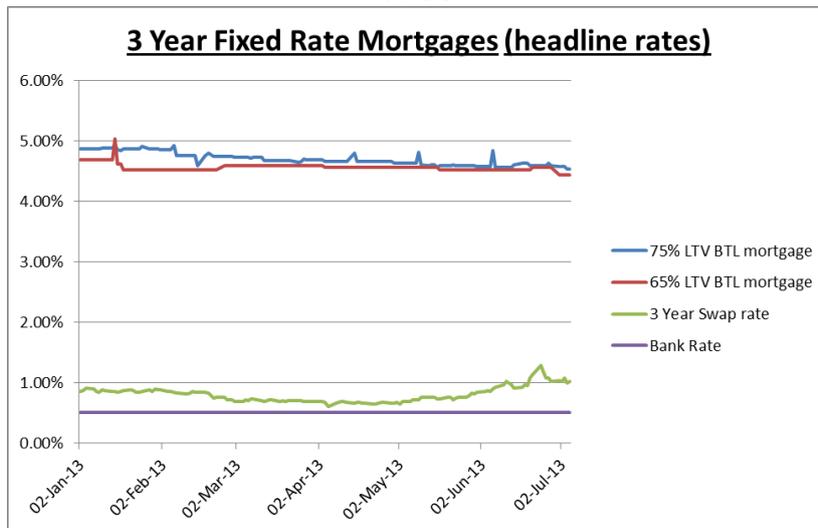


Table 5c

Comparison of 5 year fixed rate buy to let mortgages

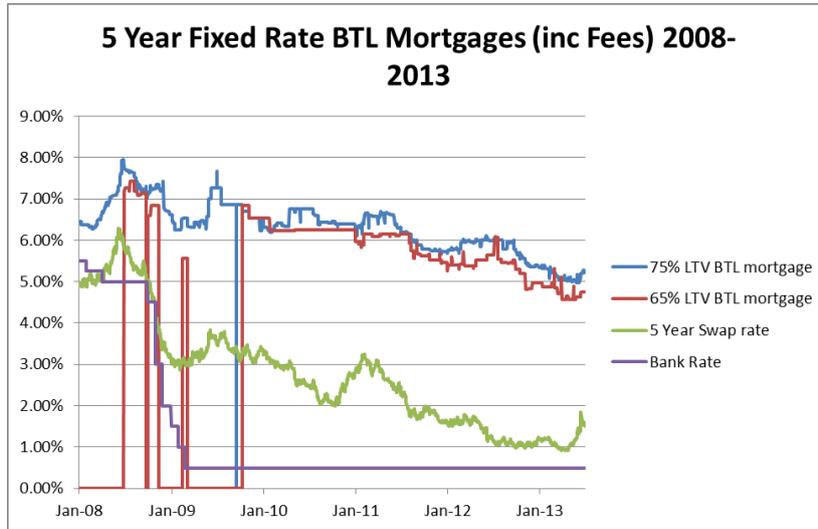


Table 6a

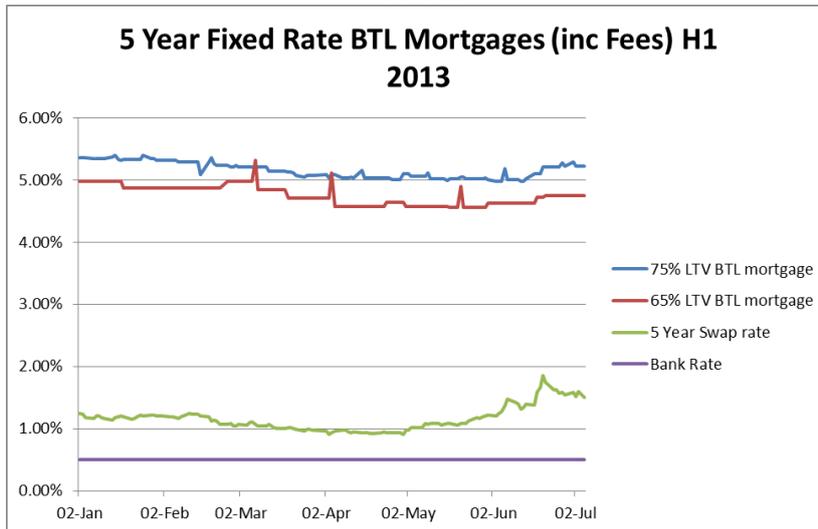


Table 6b

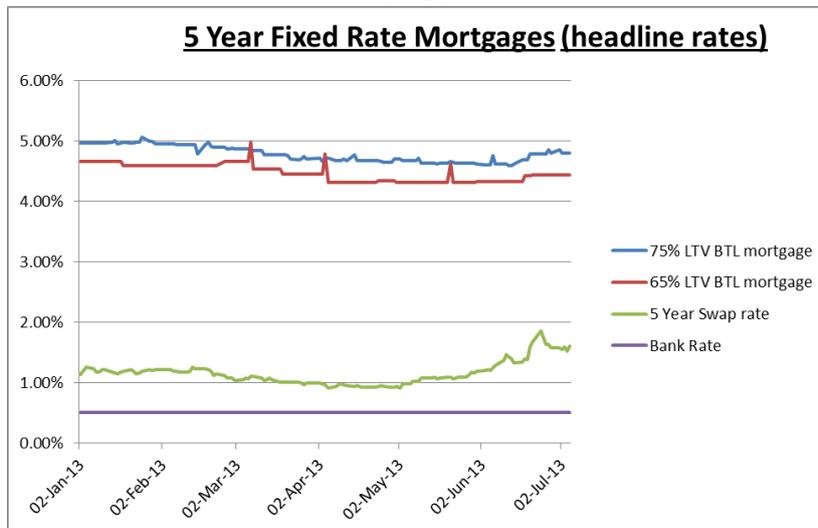


Table 6c



Effect of costs on buy to let mortgage rates July 2013

Effect of Costs on Buy to Let Mortgage Rates													
	2 Yr Disc 65% LTV	2 Yr Disc 75% LTV	2 Yr Fix 65% LTV	2 Yr Fix 75% LTV	3 Yr Disc 65% LTV	3 Yr Disc 75% LTV	3 Yr Fix 65% LTV	3 Yr Fix 75% LTV	5 Yr Disc 65% LTV	5 Yr Disc 75% LTV	5 Yr Fix 65% LTV	5 Yr Fix 75% LTV	
Average	0.73%	0.83%	1.00%	0.98%	0.34%	0.54%	0.38%	0.67%	0.21%	0.29%	0.25%	0.39%	
Max	2.02%	1.64%	1.93%	1.45%	0.81%	0.96%	0.78%	1.00%	0.49%	0.50%	0.55%	0.67%	
Min	0.13%	0.10%	0.27%	0.52%	0.03%	0.15%	0.12%	0.18%	0.05%	0.04%	0.06%	0.16%	
Averages													Total Average
2008	0.44%	0.56%	1.02%	0.96%	0.40%	0.42%	0.38%	0.47%	0.11%	0.20%	0.32%	0.34%	0.47%
2009	0.35%	0.80%	1.35%	1.01%	0.16%	0.55%	0.21%	0.53%	0.10%	0.16%	0.22%	0.49%	0.50%
2010	1.10%	1.01%	1.44%	1.00%	0.27%	0.51%	0.43%	0.91%	0.20%	0.36%	0.27%	0.37%	0.66%
2011	0.68%	0.91%	0.83%	1.00%	0.34%	0.52%	0.45%	0.73%	0.26%	0.37%	0.20%	0.40%	0.56%
2012	0.79%	0.91%	0.74%	1.01%	0.49%	0.61%	0.40%	0.75%	0.31%	0.33%	0.24%	0.38%	0.58%
2013	0.80%	0.76%	0.77%	0.85%	0.29%	0.63%	0.39%	0.57%	0.18%	0.27%	0.28%	0.37%	0.51%
Combined	0.73%	0.83%	1.00%	0.98%	0.34%	0.54%	0.38%	0.67%	0.21%	0.29%	0.25%	0.39%	0.54%

Table 7

For more information please contact:

Jenny Barrett
 Head of Marketing
 Tel: 01732 471615
 Email: jennyb@mortgagesforbusiness.co.uk

Simon Whittaker
 Finance Director
 Tel: 01732 471622
 Email: simonw@mortgagesforbusiness.co.uk