



Buy to Let Mortgage Costs Index

Q2 2014

Buy to Let Product Numbers

In Q2 2014 there was an average of 637 buy to let mortgage products from 27 active lenders on the market, up 51 products on the previous quarter. At the end of June there the figure topped the 700 mark meaning that product availability has increased by 116 since the end of 2013.

Most of this increase has occurred in the fixed rate product ranges and in particular within the five year fixes. Two years ago there were only 50 five year fixed rate products, at the start of April there were 89 and currently there are 128 – so lenders are finally creating the five year products that seem to be favoured by the FCA and which we have been recommending for the past year. Doubtless this competition in medium term fixed rate products is contributing to the pricing effects that we consider below.

Buy to Let Product Pricing

Interest Rate Overview

Two and three year money market swap rates have moved 0.2% higher over the quarter, five year rates have increased by 0.1% and ten year rates have scarcely moved. These factors have not been sufficient to dictate movement in the cost of buy to let mortgages where changes have been largely determined by competitive factors with a general reduction of 0.1% across most product ranges in the highly competitive 75% LTV sector.

Product Ranges – Fixed rates and Discounted/Tracker products

You might expect that, at a time when everybody is expecting a steady increase in interest rates over the next five years, fixed interest rate products would cost more than tracker products. However, examining our graphs of average interest rates it was noticed that this was not the case – so we decided to check this in detail by looking at comparable products to see if this was true at an individual product level.

We have compared the initial pay rate on comparable fixed rate and tracker products and compared the actual extra interest payable at outset on the fixed rate products with an expected premium (see below for explanation) calculated by reference to money market rates. The results are set out below. The comparison is based on how the structure of the products and does not take into account the lenders' funding mechanism:

Product Term	Lender	Tracker	Fix rate	Premium for Fixed rate	Expected premium	Discrepancy
2 Year	TMW	2.89% (BR +2.39%)	2.99%	0.10%	0.8%	0.7%
3 Year	BM Solutions	5.39% (BR +4.89%)	4.99%*	-0.40%	1.2%	1.6%
	Keystone	4.79% (LIBOR + 4.24%)	4.99%	0.20%	1.1%	0.9%
5 Year	Paragon	4.85% (LIBOR +4.25%)	5.54%*	0.69%	1.6%	0.9%

*Adjusted for different application fees

Expected premium for Fixed Rate

This has been calculated by comparing the cost of a term swap rate with the short term cost of funds – e.g. 5 year swap costs 2.2% and LIBOR is currently 0.6% so the expected premium for a 5 year product is 1.6%.



Conclusion

Fixed rate products offer considerably better value than tracker/discount products – being typically 1% p.a. cheaper than would be expected based on comparable tracker products and current money market rates.

Buy to Let Mortgage Products by Initial Term

Buy to Let Mortgage Products		
Product	Q1 2014	Q2 2014
1 year	2%	1%
2 year	59%	57%
3 year	19%	19%
5 year	14%	15%
Loan term	6%	8%

The split of products sorted by their initial rate term is largely unchanged quarter-on-quarter; however, one and two year rates have lost a total of 3% market share to five year and loan term rates. This suggests that lenders have taken some heed to industry surveys which indicate an increasing appetite from borrowers for longer term products.

Buy to Let Mortgage Products				
Product	2010	2011	2012	2013
1 year	18%	14%	5%	2%
2 year	49%	55%	58%	61%
3 year	16%	13%	17%	18%
5 year	9%	9%	13%	14%
Loan term	8%	9%	7%	5%

Looking at the data from an annual perspective, it is clear to see that one year products continue to lose market share, reducing in leaps, from 18% in 2010 to just 2% last year. In Q2 2014 the number of one year products had fallen further and currently only account for 1% of the entire buy to let mortgage market. From our perspective, borrowers are simply not interested in this type of rate because the initial period is too short.

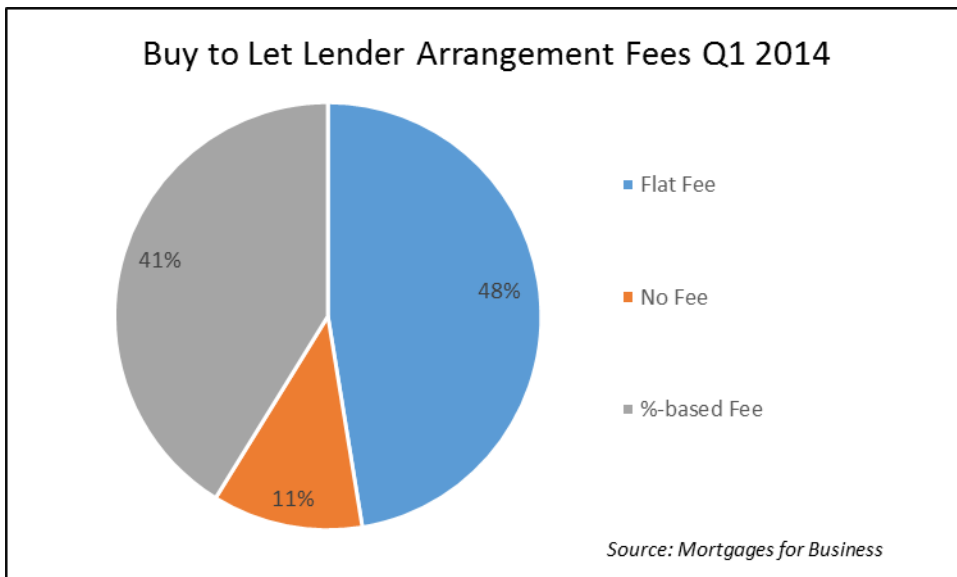
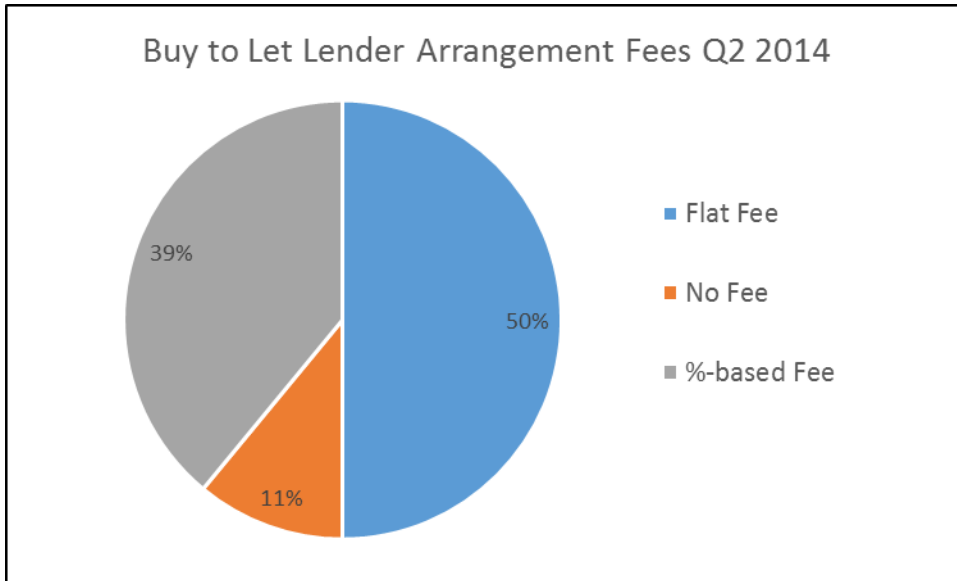
Buy to Let Mortgage Charges

Quarter on quarter there has been little change in the cost of arrangement fees. However, the costs applied to lower LTV mortgages continues to increase, and we continue to conclude that whilst lenders are competing strongly in the 75% LTV space, they are also taking the opportunity to significantly increase their margins on the lower LTV products in order to recoup some of their lost margins. (See table on page 5).

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 which now stands at £1,421, down from an average £1,498 in Q1 2014.



Buy to Let Mortgage Charges		
Fee type	Q1 2014	Q2 2014
Flat fee	48%	50%
No fee	11%	11%
%-based fee	41%	39%





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	Total
2008-2013													
Average	0.74%	0.81%	0.96%	0.94%	0.35%	0.55%	0.42%	0.65%	0.21%	0.29%	0.24%	0.39%	
Max	2.02%	1.64%	1.93%	1.45%	0.81%	0.96%	0.97%	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%	
Yearly Averages													
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	0.76%	0.74%	0.79%	0.79%	0.28%	0.66%	0.43%	0.58%	0.17%	0.29%	0.27%	0.38%	0.51%
2014	0.84%	0.68%	0.74%	0.67%	0.48%	0.62%	0.78%	0.53%	0.31%	0.31%	0.21%	0.35%	0.54%
Combined	0.74%	0.81%	0.96%	0.94%	0.35%	0.55%	0.42%	0.65%	0.21%	0.29%	0.24%	0.39%	0.54%
2013/4 Quarterly Averages													
2013 Q1	0.82%	0.80%	0.78%	0.89%	0.31%	0.63%	0.38%	0.60%	0.19%	0.26%	0.29%	0.36%	0.53%
2013 Q2	0.78%	0.72%	0.74%	0.81%	0.28%	0.63%	0.41%	0.54%	0.17%	0.27%	0.27%	0.38%	0.50%
2013 Q3	0.72%	0.74%	0.83%	0.76%	0.25%	0.68%	0.48%	0.61%	0.15%	0.32%	0.25%	0.41%	0.52%
2013 Q4	0.73%	0.71%	0.81%	0.69%	0.28%	0.69%	0.47%	0.56%	0.19%	0.32%	0.26%	0.37%	0.51%
2014 Q1	0.82%	0.66%	0.79%	0.65%	0.42%	0.63%	0.71%	0.53%	0.28%	0.29%	0.24%	0.38%	0.53%
2014 Q2	0.86%	0.69%	0.70%	0.68%	0.55%	0.60%	0.85%	0.52%	0.35%	0.33%	0.17%	0.31%	0.54%

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