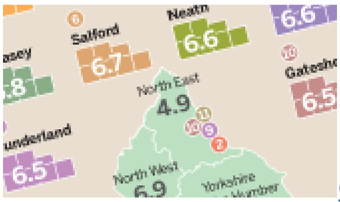
Rental yields are key in buy-to-let equation

By Tanya Powley

Banks and building societies are making it easier for landlords to borrow more, by making higher loan-to-value mortgages available – but many of the latest offers are not as competitive as they first appear.

Last week, Leeds Building Society and Aldermore increased their maximum loan-to-value ratio to 80 per cent – taking the number of lenders currently offering these deals to three, alongside The Mortgage Works (TMW), part of the Nationwide Building Society.



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However, while rental yields are increasing, there are still few areas of the country where they are high enough to enable landlords to meet the criteria for borrowing at 80 per cent loan-to-value.

According to Nigel Bedford of Largemortgageloans.com, all of the best deals at 80 per cent are two-year fixed rates and require a landlord to be receiving rent that is at least 125 per cent of the interest-only mortgage payment.
As 125 per cent of the interest on an 80 per cent mortgage is equivalent to the interest on 100 per cent of the property value, the rental yield must therefore match or exceed the mortgage rate.

For example, Leeds Building Society now offers a market-leading two-year fixed rate of 5.69 per cent, for up to 80 per cent loan to value. If a property is valued at £300,000, an 80 per cent mortgage of £240,000 would charge interest of £13,656 a year, or £1,138 a month. Rental income of 125 per cent of this amount would be £1,423 a month, or £17,070 a year. To earn this much rent on a £300,000 property requires a yield of 5.69 per cent.

For the same reason, a landlord would need a minimum monthly rent of £1,470 to qualify for Aldermore's two-year fix at 5.88 per cent, or £1,548 for TMW's rate of 6.19 per cent.

However, the latest LSL Buy-to-Let Property Index, published this week, shows that the average rental yield across England and Wales in December stood at 5.2 per cent, up from 5 per cent a year ago. In comparison, average yields in the South West are lower at 3.8 per cent, while properties in the South East and the North East are yielding, on average, 4.9 per cent.

But there are significant local variations. An analysis of buy-to-let investment yields for FT Money by Zoopla, the property portal, shows that properties in some towns yield nearly 8 per cent – mostly in the north of England.
It found that properties in Burnley, in Lancashire, can achieve the highest average yield: 7.6 per cent. Hartlepool has the next highest yield at 7.2 per cent, followed by Accrington and Blackpool at 6.9 per cent and 6.8 per cent respectively.

Yorkshire expands BTL offering

Two new entrants to the buy-to-let lending market are making their mortgages more attractive to property investors.
From Monday, Yorkshire Building Society is expanding its buy-to-let offering across England and Wales. Since its launch last August, it has only offered its buy-to-let deals to landlords with properties in certain postcodes in London and the South East.
Yorkshire also removes its requirement that the investment property must be within a 40-mile radius of the landlord's home, and reduces the minimum property value from £150,000 to £100,000.
Meanwhile, Santander has made its rates more attractive, following its uncompetitive foray into the market before Christmas. It has cut rates by 0.2 percentage points and launched a range of two-year tracker deals at 60 per cent and 75 per cent loan-to-value.
"The new Abbey deals are far better, particularly those with a fixed £1,495 fee," says Nigel Bedford. "All are for two years and their 60 per cent loan-to-value deals – a 3.49 per cent tracker and 4.09 per cent – are in the top ten. Their 75 per cent deals – a 4.09 per cent tracker and 4.99 per cent fixed – are in the top three."

But property experts say investors must look beyond headline yields. Other crucial factors include the level of tenant demand – to minimise "void" (unrented) periods and arrears – and the potential for capital growth.

"You need to do your homework if you want a buy-to-let property," says Aaron Strutt of Trinity Financial. "There are certain regions of the country that are struggling at the moment, so you need to be wary about where you invest."

Peter Williams of the Intermediary Mortgage Lenders Association agrees. "Anyone who thinks buy-to-let is a guaranteed winner should think again. It's not necessarily a one-way bet."

There are already some signs that tenant demand is beginning to deteriorate. In December, rents fell for the second successive month, according to LSL, and rent arrears rose to 10.7 per cent, compared to 9.3 per cent in November. David Newnes of LSL said this was partly due to the seasonal lull and money pressures around Christmas.

“The influx of financially sound, frustrated buyers has helped prevent higher general arrears so far but, as the labour market weakens and wage growth remains lethargic, we expect a steady rise in arrears as the year progresses,” noted Newnes.
Others argue that this is unlikely to cause significant problems for professional landlords while interest rates remain low. Bedford notes that a large number of landlords still have low mortgage costs, as lenders moved them to lifetime tracker rates when their fixed rates expired. “If they have a portfolio of properties, the low mortgage payments are easily covered – even if half the properties are producing no rent at all,” Bedford says.

This week also saw Barclays relaunch its 75 per cent loan-to-value mortgages. These were withdrawn last year, as higher than expected demand resulted in poor customer service levels.

However, while Barclays’ previous deals were attractively priced, its new offerings are not. It has a two-year fix at 5.29 per cent and a two-year tracker at 4.49 per cent – Bank of England base rate plus 3.99 percentage points – both with a £3,999 fee and available only through branches.