

The ARLA Review & Index

of Returns on Residential Investment

in association with the ARLA panel of Buy to Let mortgage lenders

FOURTH QUARTER 2003

The ARLA Panel of Mortgage Lenders



The ARLA Review and Index of Returns on Buy to Let Investment is compiled from the results of the quarterly survey of ARLA member letting agents. This is the largest survey of its kind and is undertaken with the support of the ARLA Panel of Buy to Let Mortgage Lenders.

The data, which covers yields, rents, void periods, types of rental property, regional differences etc, is drawn on average from more than 500 letting offices run by ARLA member firms. (Due to the postal strikes, the number of responding offices in the current quarter was lower than usual at 429. However, this still represents 31% of the corporate membership of the Association.)

The Review and Index takes account of capital appreciation so as to provide the data for total returns on Buy to Let Investment both for cash purchases and purchases with a mortgage (geared investment). The Index, which was set up in September 2002, is designed to provide a comparison with other types of investment over a period.

The figures for Buy to Let lending trends are drawn from the ARLA Panel. It does not attempt to give the total picture for all Buy to Let lending. It is designed to give current trends in amounts and values of investment mortgages and the types of interest rates preferred.

ARLA appreciates the high level of response to the survey given by the member firms of the Association. The research is carried out on behalf of ARLA by Owen Carey Jones, who is responsible for conducting independent research for a number of mortgage lenders and for their representative bodies.

NB. All these figures are national averages and there will be significant regional differences as well as significant differences between individual firms in the same area.

For the detailed results of the ARLA surveys visit www.arla.co.uk

Fourth Quarter 2003

The average values of both rented houses and rented flats have increased over the last three months, in the case of houses by 9.5% from an average of £303,700 to £332,600 and in the case of flats by 9.1% from £185,700 to £202,700.

The average weighted rental return on a rented house has increased from 5.3% to 5.4% since August, whilst the average rental return on a rented flat has risen a little more, from 5.3% to 5.6%.

The average void period is now 31 days, up from 29 days three months ago. The average number of purely investment properties which are managed by ARLA members' offices is now 83, up from 78 properties in August.

There remains an over supply of rented residential property. 64% of ARLA members' offices report that there are more properties than tenants. The position is most severe in Prime Central London.

ARLA members' offices find they are now showing an average of 5.6 prospective tenants round a property before it is let, a figure which is down from 5.9 three months ago.

The average proportion of ARLA members' offices' portfolios which are made up of investment property has risen from 46% to 49% over the last three months.

The average number of new tenancies signed up in the fourth quarter was 31.8, up from 29.0 in the third quarter and 27.5 in the second.

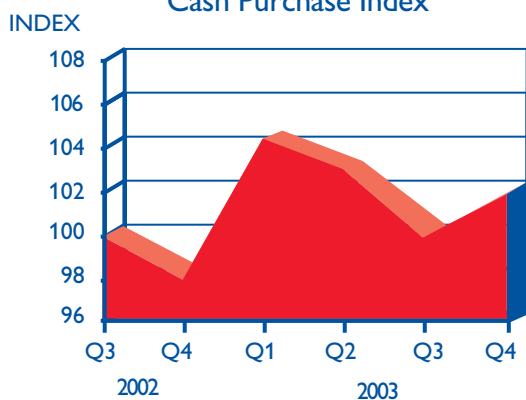
The ARLA Index

(Q3.2002 - 100.0)

Cash Purchase

102.0

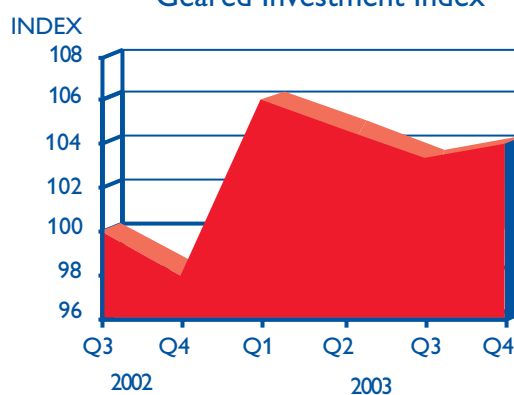
ARLA Buy to Let
Cash Purchase Index



Geared Investment

103.7

ARLA Buy to Let
Geared Investment Index



Annual Rates of Return on Buy to Let Investment

The tables below show the annual figures used in calculating the Rate of Return on Buy to Let Investment over a five year period. This result is shown in the last column of each table. Throughout this Review, Rates of Return include both Rental Yield and Capital Appreciation.

Annual Rates of Return on Buy to Let Investment (Cash Purchase)

Region	Gross Annual Rental Yield (%)	Average Void Period (days per year)	Net Annual Rental Yield (%)	Capital Appreciation (% per year)	Rate of Return on Inv. (over 5 years)
Prime Central London	4.85	40	4.32	8.55	10.81
Rest of London	6.20	34	5.62	8.55	11.68
Rest of South East	5.55	29	5.11	8.55	11.35
South West	5.55	25	5.17	8.55	11.38
Midlands	6.05	27	5.60	8.55	11.67
North West	6.95	30	6.39	8.55	12.19
North East	6.60	32	6.03	8.55	11.95
Scotland/Wales/NI	6.10	36	5.50	8.55	11.60
All Regions	5.65	31	5.18	8.55	<u>11.39</u>

Annual Rates of Return on Buy to Let Investment (Geared Investment)

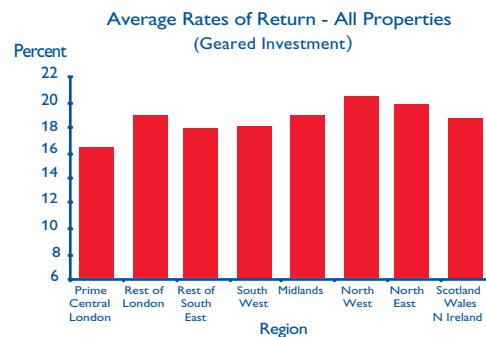
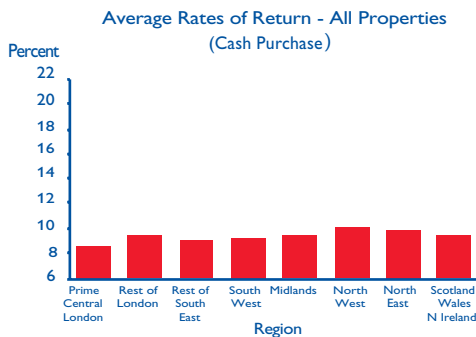
Region	Gross Annual Rental Yield (%)	Average Void Period (days per year)	Net Annual Rental Yield (%)	Capital Appreciation (% per year)	Rate of Return on Inv. (over 5 years)
Prime Central London	2.69	40	0.73	8.55	22.60
Rest of London	7.69	34	5.54	8.55	24.76
Rest of South East	5.28	29	3.67	8.55	23.94
South West	5.28	25	3.87	8.55	24.03
Midlands	7.13	27	5.45	8.55	24.72
North West	10.46	30	8.37	8.55	25.97
North East	9.17	32	7.05	8.55	25.41
Scotland/Wales/NI	7.31	36	5.10	8.55	24.57
All Regions	5.65	31	3.89	8.55	<u>24.04</u>

Effect on Annual Rates of Return of Different Rates of House Price Inflation

The following tables show the average net annual compound rates of return over five years for each region based upon the assumptions detailed below subject to variations in the anticipated average rate of house price inflation from the central figure which is based on the average annual rate of house price inflation over the last twenty years.

Annual Rates of Return for Different Rates of HPI (Cash Purchase)

Region	Average -2%	Average -1%	Average for last 20 years (8.55%)	Average +1%	Average +2%
Prime Central London	9.05	9.93	10.81	11.70	12.59
Rest of London	9.98	10.83	11.68	12.54	13.41
Rest of South East	9.62	10.48	11.35	12.22	13.09
South West	9.66	10.52	11.38	12.25	13.13
Midlands	9.96	10.81	11.67	12.53	13.39
North West	10.51	11.35	12.19	13.03	13.88
North East	10.26	11.11	11.95	12.80	13.66
Scotland/Wales/Ni	9.90	10.75	11.60	12.47	13.33
All Regions	9.66	10.52	11.39	12.26	13.13



Annual Rates of Return for Different Rates of HPI (Geared Investment)

Region	Average -2%	Average -1%	Average for last 20 years (8.55%)	Average +1%	Average +2%
Prime Central London	17.96	20.33	22.60	24.79	26.91
Rest of London	20.46	22.64	24.76	26.81	28.80
South East	19.51	21.76	23.94	26.04	28.08
South West	19.62	21.86	24.03	26.12	28.16
Midlands	20.42	22.61	24.72	26.78	28.77
North West	21.85	23.94	25.97	27.94	29.87
North East	21.21	23.34	25.41	27.42	29.38
Scotland/Wales/Ni	20.24	22.44	24.57	26.63	28.64
All Regions	19.63	21.87	24.04	26.13	28.17

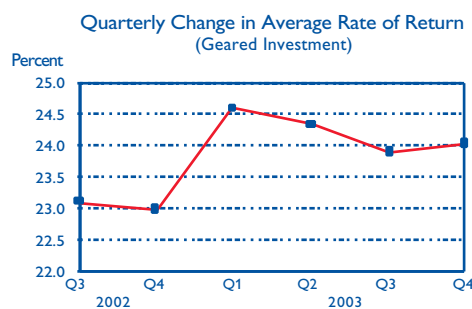
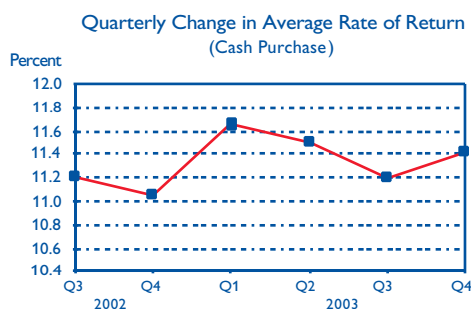
Quarterly Changes in Average Annual Rates of Return

The tables below show how the net annual compound rates of return over five years from this quarter have changed compared to the projection for the third quarter of 2003.

These figures are based on the average rate of house price inflation over the last 20 years which is 8.55% per year.

Quarterly Change in Average Annual Rate of Return (Cash Purchase)

Region	Q1 2003	Q2 2003	Q3 2003	Q4 2003	Change Q4/Q3
Prime Central London	11.08	11.22	10.83	10.81	-0.02
Rest of London	11.34	11.37	11.20	11.68	+0.48
Rest of South East	11.50	11.39	11.15	11.35	+0.20
South West	11.50	11.54	10.78	11.38	+0.60
Midlands	12.36	11.87	11.36	11.67	+0.31
North West	12.71	12.24	12.33	12.19	-0.14
North East	12.00	11.65	11.82	11.95	+0.13
Scotland/Wales/NI	12.36	11.79	11.79	11.60	-0.19
All Regions	11.63	11.49	11.18	11.39	+0.21



Quarterly Change in Average Annual Rate of Return (Geared Investment)

Region	Q1 2003	Q2 2003	Q3 2003	Q4 2003	Change Q4/Q3
Prime Central London	23.28	23.63	22.96	22.60	-0.36
Rest of London	23.92	23.98	23.87	24.76	+0.89
Rest of South East	24.32	24.05	23.74	23.94	+0.20
South West	24.30	24.40	22.83	24.03	+1.20
Midlands	26.37	25.22	24.27	24.72	+0.45
North West	27.21	26.10	26.57	25.97	-0.60
North East	25.53	24.68	25.38	25.41	+0.03
Scotland/Wales/NI	26.37	25.02	25.30	24.57	-0.73
All Regions	24.62	24.28	23.83	24.04	+0.21

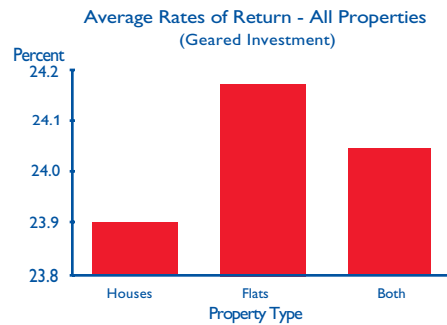
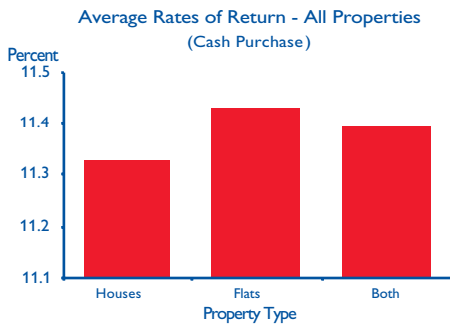
From these figures it is clear that, overall, average rates of return, which declined for most of 2003, have now turned upwards. With three exceptions, Prime Central London, the North West and Scotland, Wales & Northern Ireland, this improvement applies across the whole country.

Differences in Annual Rates of Return for Houses and Flats

There is not a huge difference in rates of return between houses and flats, although flats do command a slightly higher return than houses and this applies across the whole country with the exception of the North West and North East of England.

Differences in Annual Rates of Return for Houses and Flats (Cash Purchase)

Region	Average Annual Rate of Return (%)		
	Houses	Flats	Average
Prime Central London	10.68	10.97	10.81
Rest of London	11.54	11.78	11.68
Rest of South East	11.21	11.30	11.35
South West	11.30	11.47	11.38
Midlands	11.67	11.72	11.67
North West	12.24	12.15	12.19
North East	11.96	11.94	11.95
Scotland/Wales/NI	11.57	11.67	11.60
All Regions	11.33	11.44	11.39



Differences in Annual Rates of Return for Houses and Flats (Geared Investment)

Region	Average Annual Rate of Return (%)		
	Houses	Flats	Average
Prime Central London	22.27	23.00	22.60
Rest of London	24.42	24.99	24.76
Rest of South East	23.60	23.82	23.94
South West	23.83	24.24	24.03
Midlands	24.72	24.85	24.72
North West	26.09	25.87	25.97
North East	25.43	25.37	25.41
Scotland/Wales/NI	24.49	24.73	24.57
All Regions	23.90	24.17	24.04

Fourth Quarter Calculation Examples

Cash Purchase Example

(As used in projecting the Annual Compound Rate of return on a **Cash Purchase** for a five year period without a mortgage)

Description	Amount (£)	Notes
Investment Purchase		
Property purchase price	237,787	
Acquisition costs	4,756	2% of purchase price
Total investment cost	242,543	
Source of Funds		
Deposit 100% price plus costs	242,543	
Mortgage 0% purchase price	0	
Rental Yield		
Gross annual rent - year 1	13,435	5.7% of purchase price
Assumed rate of rent inflation		2% p.a.
Rent lost in voids	1,130p.a.	31 days per year
Net income after voids - year 1	12,305p.a.	
Mortgage interest	0p.a.	
Net income after voids and interest	12,305p.a.	
AFTER 5 YEARS		
Value of property after 5 years	358,375	8.55% per year growth on original value
Selling costs	7,168	2% of sale price
Value of investment	351,208	Value after 5 years less sale costs
Capital growth after 5 years		44.8%
Net income yield after 5 years	64,675	
Annual Compound Rate of Return		11.39% p.a.

Geared Investment Example

(As used in projecting the Annual Compound Rate of Return on a **Geared Investment** over a five year period assuming a 75% mortgage)

Description	Amount (£)	Notes
Investment Purchase		
Property purchase price	237,787	
Acquisition costs	4,756	2% of purchase price
Total investment cost	242,543	
Source of Funds		
Deposit 25% price plus costs	64,203	
Mortgage 75% purchase price	178,341	
Rental Yield		
Gross annual rent - year 1	13,435	5.7% of purchase price
Assumed rate of rent inflation		2% p.a.
Rent lost in voids	1,130p.a.	31 days per year
Net income after voids - year 1	12,305p.a.	
Mortgage interest	9,809p.a.	
Net income after voids and interest	2,496p.a.	
AFTER 5 YEARS		
Value of property after 5 years	358,375	8.55% per year growth on original value
Selling costs	7,168	2% of sale price
Value of investment	172,867	Value after 5 years less sale costs
Capital growth after 5 years		169%
Net income yield after 5 years	15,632	
Annual Compound Rate of Return		24.04% p.a.

Assumptions & Sources of Data

1. The average rate of return on a **Cash Purchase** is the return based on the purchase price of the property plus initial acquisition costs.
2. The average rate of return on a **Geared Investment** is the return based on the cash outlay in terms of cash deposit for the purchase (i.e. purchase price less mortgage loan) plus initial acquisition costs.
3. Initial property acquisition costs are assumed to be 2% of the property purchase price.
4. Average gross rental return as a percentage of the property value is taken from the latest survey of ARLA members.
5. The average number of weeks during which a property is not let (the void period) is taken from the latest survey of ARLA members.
6. These figures do not include agents' fees and charges nor any estimation of the costs of minor repairs and maintenance.
7. The average mortgage is assumed to be on an interest only basis and to be equal to 75% of the property purchase price.
8. The average mortgage interest rate is assumed to be Bank of England Base Rate + 1.75%, currently 3.75% + 1.75% = 5.50%.
9. The average annual rate of house price inflation is based on the average for the past 20 years which is 8.55% for 2003 and was 7.83% for 2002.
10. The average annual rate of rent inflation is assumed to be 2%.
11. Average selling costs are assumed to be 2% of the value of the property at the end of the period.
12. The average Net Return on Investment is based on the outcome after 5 years, before tax.
13. Average rented residential property prices are taken from the latest survey of ARLA members.
14. The figures shown for All Regions are unweighted overall average figures.

N.B. The five year projection period has been selected to reflect the likely minimum lifetime for a Buy to Let investment

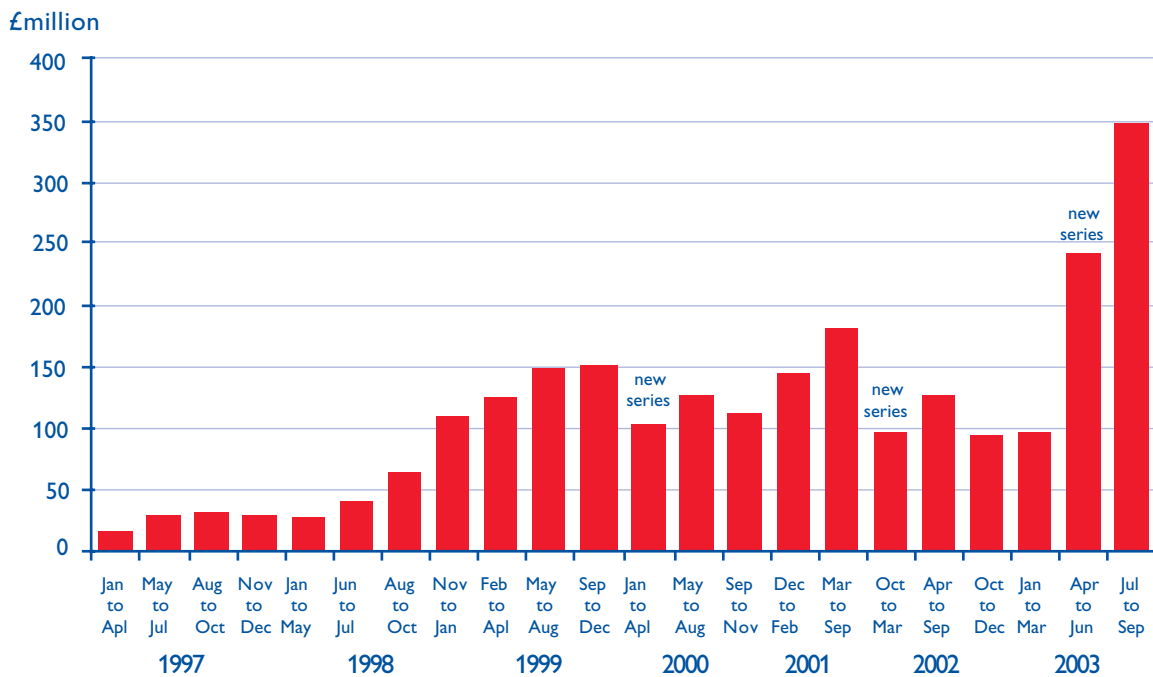
Lending Trends

The ARLA Buy to Let reports of lending trends are issued quarterly but are not concurrent with the survey of letting agents which provides the data for the Review and Index.

The table below shows the lending pattern since the launch of Buy to Let. However the constitution of the panel has changed from time to time and, although these figures are not conclusive overall lending figures, they are believed to represent a fair picture of the progress of the Buy to Let market and its current state, both regionally and nationally.

The trends shown below were published in November but have been included in the Review and Index so as to present a rounded picture of rents and returns together with the Lending Trends.

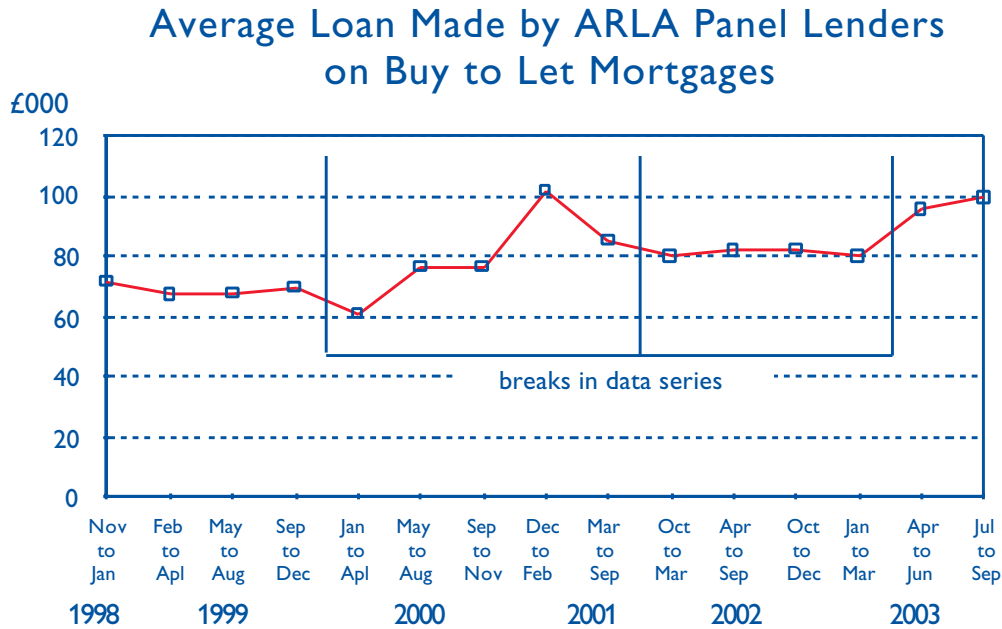
Average Monthly Lending by ARLA Panel Lenders on Buy to Let Mortgages



Source: ARLA

CHANGES IN AVERAGE LOAN AMOUNT

The average loan made on Buy to Let properties by ARLA panel lenders in the third quarter of 2003, at £99,464, was 3.8% higher than for the second quarter. The table and chart below show how the average amount lent on a Buy to Let property has changed over the last four years.



Source: ARLA

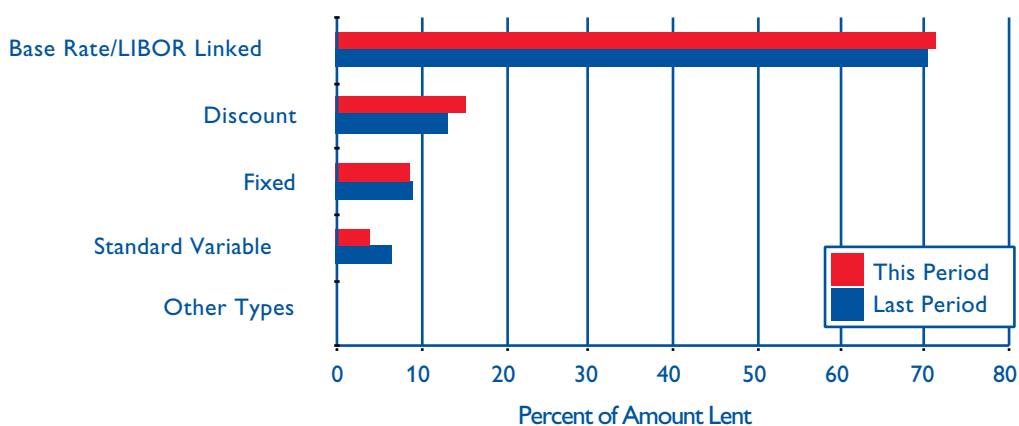
TYPES OF BUY TO LET LOANS

Interest Rate Type

The most popular interest rate type for Buy to Let loans made in the third quarter of 2003 was Base Rate/LIBOR linked rates with 71.4% of all Buy to Let lending by ARLA panel lenders being of this type. A further 15.6% was Discount rate and 8.9% was Fixed rate whilst only 4.0% was lent on Standard Variable rate loans.

Compared with the second quarter, the main change has been an increase in discount rate loans at the expense mainly of standard variable rate cases.

Distribution of Buy to Let Lending by Interest Rate Type



Source: ARLA

REGIONAL FIGURES

There was a sharp increase in both the number and amount of loans executed in all regions. Distribution of lending across the regions was little changed but the percentage increase in number of loans did vary region by region with the largest increase (49.9%) being seen in the South West and the smallest (21.3%) in Prime London.

The South West also posted the biggest increase in amount lent (55.4%) whilst the Rest of Central London saw the lowest (31.1%)

Regional Distribution of New Buy to Let Mortgages by Amount Lent

Region	Apr 03 to Jun 03 (%)	Jul 03 to Sep 03 (%)	Percentage Change in Amount Lent Per Month
Prime London	2.8	2.7	+41.5
Rest of Central London	20.4	18.7	+31.1
Rest of Greater London	12.4	12.1	+39.6
South East England	19.4	20.3	+50.0
South West England	9.1	9.9	+55.4
The Midlands	10.8	10.6	+40.7
North West England	9.6	9.8	+45.0
North East England	9.0	9.8	+55.0
Scotland, Wales & NI	6.5	6.2	+35.2
TOTAL for UK	100.0	100.0	+43.1

In terms of differences in the sizes of loans made on Buy to Let properties in each region, as expected, the average loan on a Prime London property was the largest at £310,500. This figure was more than four times the average figures for the North East of England, the North West of England and Scotland, Wales & Northern Ireland and more than three times the size of the overall average loan.

Regional Average Loan Size for New Buy to Let Mortgages (£000s)

Region	Apr 03 to Jun 03	Jul 03 to Sep 03	Percentage Change
Prime London	260.1	310.5	+19.4
Rest of Central London	150.3	161.5	+7.5
Rest of Greater London	136.3	142.6	+4.6
South East England	107.5	112.0	+4.2
South West England	98.9	103.6	+4.8
The Midlands	75.8	79.3	+4.6
North West England	65.9	68.2	+3.5
North East England	59.3	65.1	+9.8
Scotland, Wales & NI	67.0	66.9	-0.1

Compared with the second quarter of the year, the average loan sizes in the third quarter were all, with the sole exception of Scotland, Wales & Northern Ireland, higher than they were three months ago.

The biggest increase in average loan size was for properties in Prime London which increased by 19.4% from £260,100 to £310,500 whilst the smallest was for Scotland, Wales & Northern Ireland with a tiny fall of 0.1% from £67,000 to £66,900.



An Investor should

Plan to be a Buy to Let Landlord over the medium to long-term as it is an investment that produces a variable combination of rental yield and capital appreciation.

Make an objective business decision when purchasing a property based on research of the needs and requirements of the local market, not based on personal taste.

Be aware that the rental market is fast moving with fluctuating supply and demand. This can influence achievable rental levels and occupancy rates.

Take informed advice from both professional Letting Agents and specialised financial advisers from the beginning.

A Lender should

Conduct a thorough analysis of affordability and not lend more than you can afford to repay.

Undertake a professional assessment of the security and the reasonableness of the forecast rental income.

Provide clear information on Buy to Let products and services and on your obligations as a borrower.

Explain what to do if you get into difficulties with mortgage payments.

A Letting Agent should

Demonstrate a comprehensive understanding of the legalities, regulations and obligations that apply to Landlords, Tenants and Agents.

Provide realistic and up to date guidance on supply and demand based on a detailed local knowledge of the market.

Hold Professional Indemnity Insurance, separate Client Accounts, be a member of a compulsory Client Money Bonding scheme and employ trained, qualified staff.

Have access to a complaints process over the service standards of letting agents and procedures for resolving disputes over deposits between Landlords and Tenants.

For the detailed results of the ARLA surveys visit www.arla.co.uk



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The ARLA Panel of Mortgage Lenders

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