



The ARLA Review & Index

for Residential Investment

in association with the ARLA Group of Buy to Let Mortgage Lenders

FIRST QUARTER 2008



The ARLA Group of Buy to Let Mortgage Lenders

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First Quarter 2008

The overall average capital asset value of rented houses has fallen by 4.5% over the last three months as a result of a fall of 10.3% for those managing properties in Prime Central London. The average value of rented houses in the Rest of the South East was unchanged and in the Rest of the UK the average values of rented houses increased by 3.2%.

Over the same period the average value of rented flats throughout the country fell by 3.6% as a result of falls of 5.9% in Prime Central London and 5.2% in the Rest of the South East. Conversely, the average value of rented flats in the Rest of the UK rose by 5.0%.

Average weighted rental returns for houses are up from 4.8% to 5.0% compared with three months ago, reversing the change seen then, whilst the equivalent figure for flats is up from 4.9% to 5.0%, also reversing the earlier change.

On balance ARLA members report increased achievable rent levels over the last six months on all types of rented property but with a lower proportion saying this was the case in Prime Central London (65% compared with 72% three months ago) although in the Rest of the South East the proportion was up from 52% to 62% and in the Rest of the UK the figure was almost unchanged at 44%.

The demand for rented residential properties has continued to outstrip supply, particularly for members in the Rest of the South East with almost six out of ten of these (59%, up from 57% three months ago) now saying there are more tenants than there are properties available for them. Meanwhile, the proportion of members managing properties in Prime Central London who say there are more tenants than properties has fallen (from 64% to 52%) but the proportion of those in the Rest of the UK who say this has remained constant at 38%. Overall, despite the recent falls, the proportion saying there are more tenants than properties available for them is still at its third highest level since this question was first asked more than five years ago.

Less than one in thirteen ARLA members (7%) say that landlords are currently buying more properties, a figure which is down from 11% in the fourth quarter of 2007 and the proportion who now say landlords are currently selling properties has risen from 16% to 19%, with the result that the proportion saying landlords are marking time has dropped from 71% to 69%.

Compared with the fourth quarter of 2007, the average void period is unchanged at 3.4 weeks (24 days) and the average number of new tenancies signed up in the preceding three months was 32, down from 36 three months ago as a result of seasonal factors.

The average proportion of ARLA members' offices' portfolios which are made up of investment property has fallen slightly from 53% to 52% compared with the fourth quarter of 2007 but the average number of purely investment properties which are managed by ARLA members' offices has risen from 110 to 114 properties.

On average, ARLA members say that tenants remain in the same property for a period of 16.1 months, a figure which is unchanged compared with three months ago. Overall, respondents say that 20% of their lettings are to immigrants with 16% being to immigrants from EU countries and immigrant tenants are most likely to be encountered by those managing properties in Prime Central London and least likely to be encountered by those in the Rest of the UK.

Two thirds of ARLA members (66%) say that it is either impossible, very difficult or quite difficult to obtain references on immigrants from new EU member states although this is much less likely to be the case for those managing properties in Prime Central London.

N.B. All these figures are averages and there will be significant local differences as well as significant differences between individual firms in the same area.

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 and of investor landlords who subscribe to the ARLA Buy to Let website. This is the largest survey of its kind and is undertaken with the support of the ARLA Group of Buy to Let Mortgage Lenders.

The Index, which was set up in September 2002, is designed to provide a comparison with other types of investment over a period. However, it should be noted that the Index is a measure of percentage returns on investment and as such does not move in line with inflation whether this be house price inflation or changes in consumer prices. It should not, therefore, be expected to rise over time just because prices have risen. If the Index remains at the same level as it was when it began in 2002, i.e. at 100, this simply means that investment returns for buy to let have remained constant. Thus if returns on investment in buy to let were good in 2002, then an Index of 100 in 2008 means that returns are still good and vice versa.

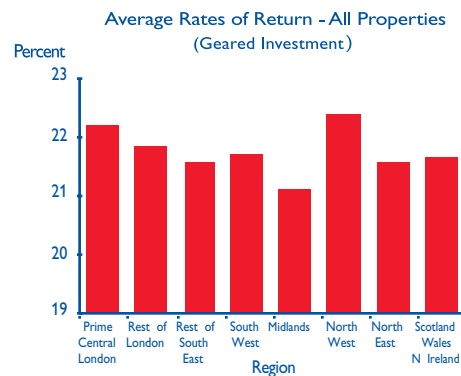
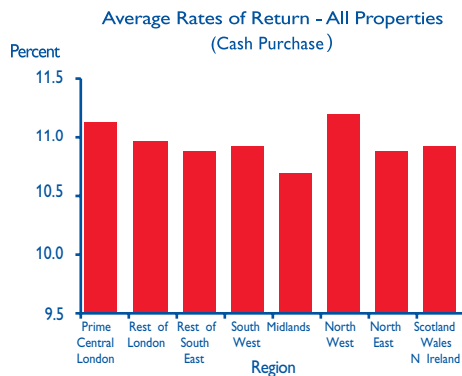
The data, which covers yields, rents, void periods, types of rental property, regional differences etc is drawn from 439 letting offices run by ARLA member firms and 288 investor landlords. The Review and Index takes account of capital appreciation so as to provide the data for total returns on Buy to Let Investment both for cash purchases and purchases with a mortgage (geared investment). ARLA appreciates the high level of response to these surveys from both member firms and individual investors. 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.

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

The following tables show variations in the average net annual compound rates of return over five years for each region, based upon variations in the anticipated average rate of house price inflation. The average rate of house price inflation 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 (8.21%)	Average +1%	Average +2%
Prime Central London	9.39	10.25	11.11	11.97	12.85
Rest of London	9.23	10.09	10.96	11.83	12.71
Rest of South East	9.11	9.98	10.85	11.72	12.60
South West	9.16	10.02	10.89	11.77	12.64
Midlands	8.93	9.80	10.68	11.56	12.44
North West	9.44	10.30	11.16	12.02	12.89
North East	9.11	9.98	10.85	11.72	12.60
Scotland/Wales/NI	9.16	10.02	10.89	11.76	12.64
All Regions	9.18	10.05	<u>10.91</u>	11.79	12.66



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

Region	Average -2%	Average -1%	Average for last 20 years (8.21%)	Average +1%	Average +2%
Prime Central London	17.55	19.92	22.20	24.39	26.51
Rest of London	17.10	19.50	21.81	24.03	26.17
South East	16.76	19.19	21.52	23.76	25.92
South West	16.90	19.32	21.64	23.87	26.03
Midlands	16.24	18.71	21.07	23.34	25.54
North West	17.70	20.06	22.32	24.51	26.62
North East	16.76	19.19	21.52	23.76	25.92
Scotland/Wales/NI	16.90	19.31	21.63	23.87	26.02
All Regions	16.97	19.38	<u>21.70</u>	23.92	26.08

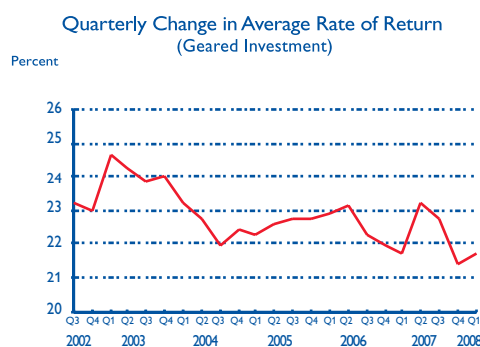
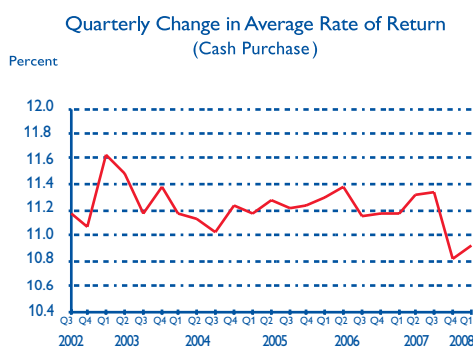
Quarterly Changes in Average Annual Rates of Return

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 last quarter.

These figures are based on the average rate of house price inflation over the last 20 years, which changed last quarter from 8.66% to 8.21% per year.

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

Region	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Change Q1/Q4
Prime Central London	11.31	11.33	10.59	11.11	+0.52
Rest of London	11.36	11.43	10.91	10.96	+0.05
Rest of South East	11.28	11.33	10.90	10.85	-0.05
South West	11.08	11.10	10.51	10.89	+0.38
Midlands	11.49	11.33	10.97	10.68	-0.29
North West	11.94	10.79	11.03	11.16	+0.13
North East	11.39	11.30	10.84	10.85	+0.01
Scotland/Wales/NI	11.22	12.08	11.07	10.89	-0.18
All Regions	11.32	11.34	10.81	10.91	+0.10



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

Region	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Change Q1/Q4
Prime Central London	23.25	22.71	20.86	22.20	+1.34
Rest of London	23.36	22.96	21.68	21.81	+0.13
Rest of South East	23.15	22.70	21.67	21.52	-0.15
South West	22.66	22.11	20.65	21.64	+0.99
Midlands	23.69	22.71	21.85	21.07	-0.78
North West	24.79	21.31	22.01	22.32	+0.31
North East	23.43	22.63	21.53	21.52	-0.01
Scotland/Wales/NI	23.00	24.60	22.12	21.63	-0.49
All Regions	23.25	22.73	21.43	21.70	+0.27

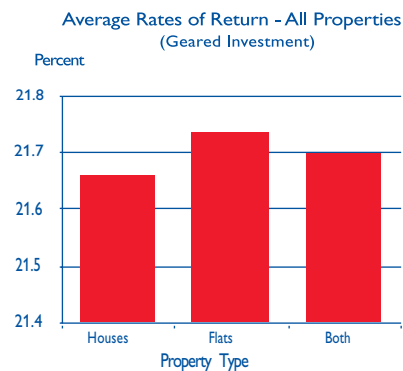
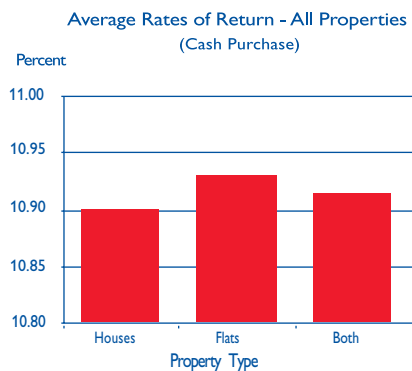
A change was made in the second quarter of 2007 to the assumptions used in calculating average annual rates of return which was that the mortgage interest rate started to be based on an average of two year fixed rates offered by the ARLA group of buy to let lenders at the time of preparing the Review & Index instead of a fairly arbitrary 1.75% above the Bank of England Base Rate.

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 tend to command a slightly higher return than houses except in the North of England, Scotland, Wales and Northern Ireland.

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

Region	Average annual rate of return (%)		
	Houses	Flats	Average
Prime Central London	11.07	11.15	11.11
Rest of London	10.81	11.11	10.96
Rest of South East	10.83	10.87	10.85
South West	10.86	10.92	10.89
Midlands	10.64	10.71	10.68
North West	11.25	11.06	11.16
North East	11.03	10.67	10.85
Scotland/Wales/NI	10.92	10.86	10.89
All Regions	10.90	10.93	10.91



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

Region	Average annual rate of return (%)		
	Houses	Flats	Average
Prime Central London	22.10	22.29	22.20
Rest of London	21.42	22.19	21.81
Rest of South East	21.46	21.57	21.52
South West	21.56	21.71	21.64
Midlands	20.98	21.17	21.07
North West	22.57	22.07	22.32
North East	21.98	21.05	21.52
Scotland/Wales/NI	21.71	21.55	21.63
All Regions	21.66	21.73	21.70

Fourth Quarter Calculation Examples

Cash Purchase Example

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

Description	Amount (£)	Notes
Investment Purchase		
Property purchase price	330,264	
Acquisition costs	6,605	2% of purchase price
Total investment cost	336,869	
Source of Funds		
Deposit 100% price plus costs	336,869	
Mortgage 0% purchase price	0	
Rental Yield		
Gross annual rent - year 1	16,462	4.98% of purchase price
Assumed rate of rent inflation		4.1% p.a.
Rent lost in voids	1,068p.a.	24 days per year
Net income after voids - year 1	15,395p.a.	
Mortgage interest	0p.a.	
Net income after voids and interest	15,395p.a.	
AFTER 5 YEARS		
Value of property after 5 years	490,002	8.21% per year growth on original value
Selling costs	9,800	2% of sale price
Value of investment	480,202	Value after 5 years less sale costs
Capital growth after 5 years		42.5%
Net income yield after 5 years	85,262	Allowing 4.1% rent inflation
Annual Compound Rate of Return		10.91% per year

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	330,264	
Acquisition costs	6,605	2% of purchase price
Total investment cost	336,869	
Source of Funds		
Deposit 25% price plus costs	89,171	
Mortgage 75% purchase price	247,698	
Rental Yield		
Gross annual rent - year 1	16,462	4.98% of purchase price
Assumed rate of rent inflation		4.1% p.a.
Rent lost in voids	1,068p.a.	24 days per year
Net income after voids - year 1	15,395p.a.	
Mortgage interest	15,952p.a.	
Net income after voids and interest	-557p.a.	
AFTER 5 YEARS		
Value of property after 5 years	490,002	8.21% per year growth on original value
Selling costs	9,800	2% of sale price
Value of investment	232,504	Value after 5 years less sale costs
Capital growth after 5 years		161%
Net income yield after 5 years	5,503	Allowing 4.1% rent inflation
Annual Compound Rate of Return		21.70% per year

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 taken as 6.44% which is the average two year fixed rate offered by the ARLA group of buy to let mortgage lenders at the time the Review & Index is prepared (in this case, the last week in February).
9. The average annual rate of house price inflation is based on the national average for the last 20 years which was 8.21% for 1986-2006, 8.66% for 1985-2005, 8.80 for 1984-2004, 8.70% for 1983-2003 and 8.55% for 1982-2002.
10. The average annual rate of rent inflation is assumed to be the same as the overall rate of inflation based on the Retail Prices Index (RPI). For this quarter, the figure was 4.1%.
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

Investor Profiles

Nine out of ten respondents do not intend to sell their investment properties if house prices should fall. This proportion is virtually unchanged from the previous quarter.

The average life expectancy of rental property investments is 16.7 years, unchanged on the last quarter.

Almost half of all investor landlords, 46%, expect to buy more Buy to Let properties in the next twelve months. This is a small increase of 2% over the previous quarter.

The average Loan to Value ratio of residential rental portfolios is 57%. The proportion of investment landlords with LTVs of more than 75% has dropped considerably since the autumn from nearly 30% to 23.9%.

There has been a substantial increase in the proportion of investment landlords who believe that immigration has had a significant impact on the private rented sector, up from 21% to 29% since the end of 2006.

ARLA surveys for the first quarter of 2008 was carried out during February. For reasons of space, this printed Review and Index does not contain all the results from the quarterly ARLA surveys on which the Review and Index is based. All results are obtainable on the Buy to Let section of the ARLA website, www.arla.co.uk

In the next 12 months, do you expect to sell some or all of your let residential properties?

More than three quarters of respondents to this survey (76%) said that they did NOT expect to sell any of their let residential properties in the next 12 months.

Nevertheless, a significant minority of nearly two out of ten respondents (18%) said they did have such expectations with more than another one in twenty (6%) being unsure whether they would be selling any properties or not in the next 12 months.

Response	Percent of Respondents (%)		
	Sep 07	Dec 07	Mar 08
Yes	15.0	13.8	18.1
No	77.5	76.7	75.9
Don't know	7.5	9.5	6.0
Base: All answering	(160)	(210)	(216)

Compared with three months ago, the proportion saying they do intend to sell some or all of their properties in the next 12 months has risen from 14% to 18%.

Do you expect/anticipate that you will acquire further (Buy to Let) investment properties during the next 12 months?

Getting on for half of all respondents (46%) said that they did expect to acquire further Buy to Let investment properties during the next 12 months but more than a third (34%) said that they did not. In addition, two out of ten landlords (20%) were unsure whether or not they would acquire further properties in the next year.

Response	Percent of Respondents (%)		
	Sep 07	Dec 07	Mar 08
Yes	54.2	43.9	45.5
No	29.4	32.1	34.2
Don't know	16.3	24.0	20.3
Base:All answering	(153)	(196)	(187)

Compared with three months ago, the proportion saying they will acquire further buy to let property in the next 12 months has risen a little from 44% to 46% as has the proportion saying

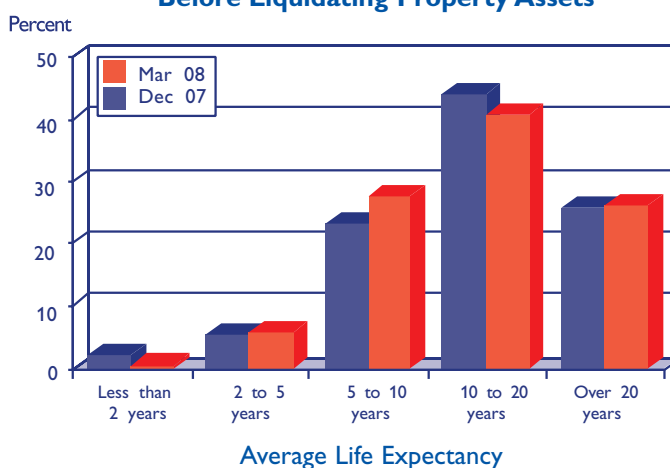
From original acquisition time, what do you expect to be the average life expectancy of your property investment, before you liquidate your property assets?

Clearly the vast majority of residential landlords are in the business for the long term with almost two thirds (66%) saying that the average life expectancy of their property investments is more than 10 years.

Average Life Expectancy	Percent of Respondents (%)		
	Sep 07	Dec 07	Mar 08
Less than 2 years	0.6	2.0	0.5
2 to 5 years	7.6	5.5	5.7
5 to 10 years	26.1	23.1	27.5
10 to 20 years	41.4	43.7	40.4
Over 20 years	24.2	25.6	25.9
Average (years)	16.5	16.7	16.7
Base:All answering	(157)	(199)	(193)

Simple analysis shows that the average life expectancy of these property investments is 16.7 years, which is unchanged since the last survey three months ago.

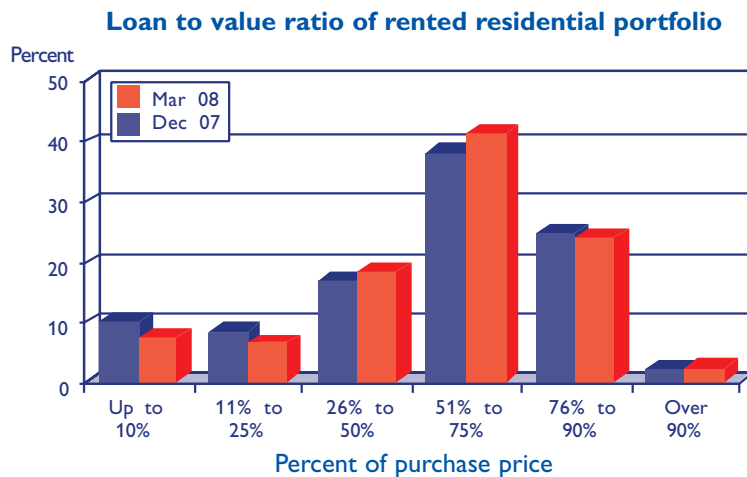
Average Life Expectancy of Property Investment Before Liquidating Property Assets



What is the approximate overall loan to value ratio of your rented residential portfolio?

More than four out of ten respondents (41%) said that the approximate overall loan to value ratio of their rented residential portfolio was between 51% and 75%.

Loan to Value Ratio	Percent of Respondents (%)		
	Sep 07	Dec 07	Mar 08
Up to 10%	2.7	10.0	7.6
11% to 25%	9.4	8.4	6.5
26% to 50%	18.8	16.8	18.5
51% to 75%	38.9	37.9	41.3
76% to 90%	28.9	24.7	23.9
Over 90%	1.3	2.1	2.2
Average (%)	58.7	54.8	56.5
Base: All answering	(149)	(190)	(184)

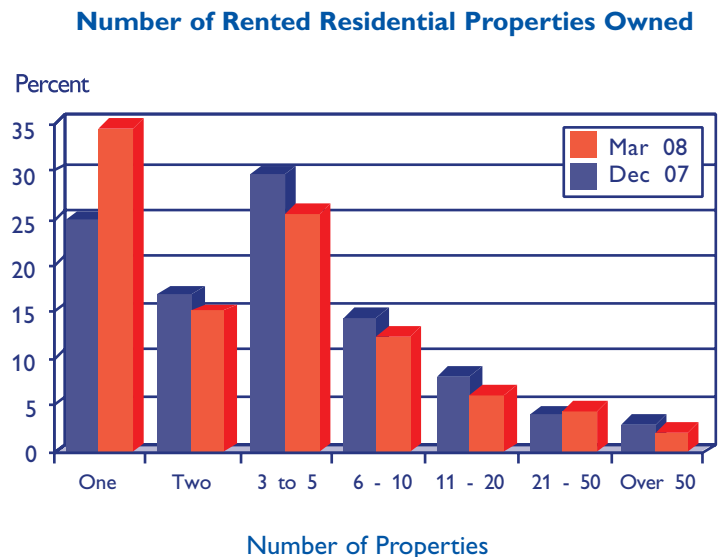


How many rented residential properties do you currently have in your portfolio?

Half of all respondents (50%) had only one or two properties in their portfolios whilst only one in eight (13%) had more than ten properties in theirs.

Number of Properties Percent of Respondents (%)

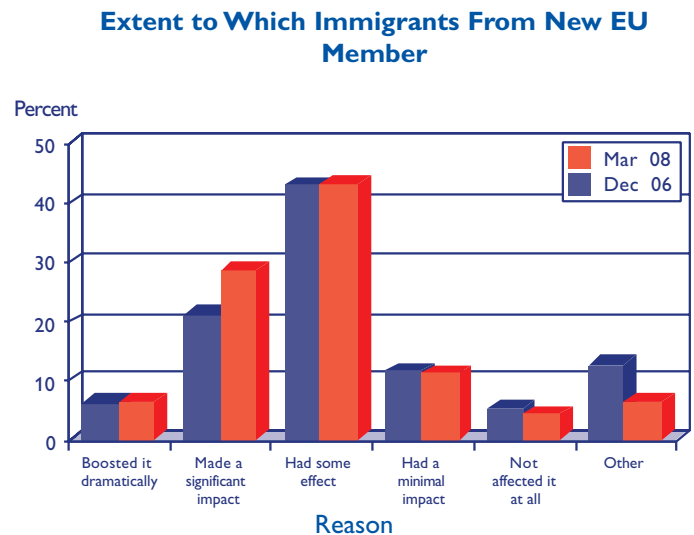
	Sep 07	Dec 07	Mar 08
One	24.1	24.8	34.6
Two	16.7	16.7	14.9
3 to 5	28.4	29.5	25.4
6 to 10	13.6	14.3	12.3
11 to 20	11.1	8.1	6.1
21 to 50	5.6	3.8	4.4
Over 50	0.6	2.9	2.2
Average (no. of properties)	7.0	7.7	6.8
Base: All answering	(162)	(210)	(228)



To what extent do you think immigrants from new EU member states have affected the private rental market in recent years?

Most respondents (78%) said that they thought immigrants from new EU member states had had at least some effect on the private rental market in recent years with more than a third (35%) saying that the impact had been at least significant and more than one in twenty (6%) saying they had boosted it dramatically.

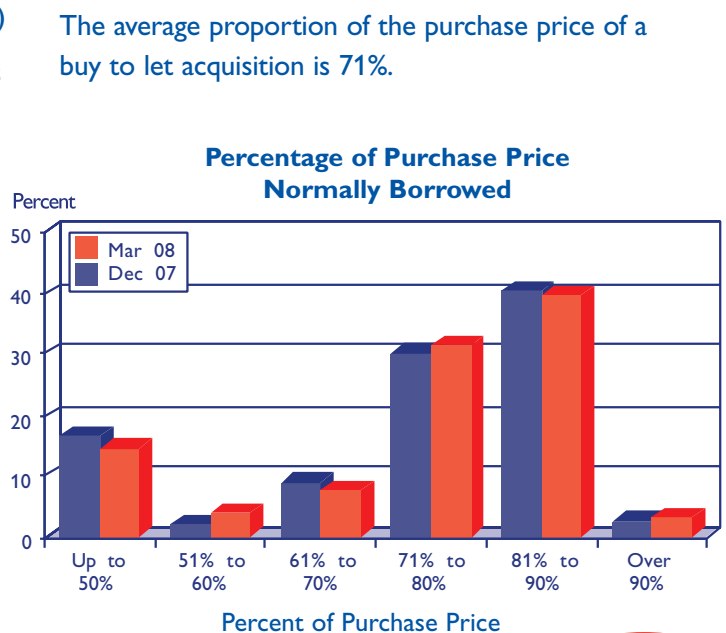
Extent of Effect	Percent of Respondents (%)	
	Dec 06	Mar 08
They have boosted it dramatically	6.2	6.4
They have made a significant impact	21.2	28.7
They have had some effect	42.9	43.1
They have had only a minimal impact	11.5	11.2
They have not affected it at all	5.3	4.3
Other	12.8	6.4
Base: All answering	(226)	(188)



What percentage of the purchase price of a buy to let property do you normally borrow from a lender?

The majority of respondents (71%) said that they normally borrow between 71% and 90% of the purchase price of a buy to let property. Nevertheless, a sizeable minority of more than one in seven respondents (15%) said they normally borrow less than half of the purchase price.

Percent of Purchase Price	Percent of Respondents (%)		
	Sep 07	Dec 07	Mar 08
Up to 50%	10.6	16.5	14.6
51% to 60%	1.3	2.1	3.8
61% to 70%	12.6	8.8	7.6
71% to 80%	23.2	29.9	31.4
81% to 90%	48.3	40.2	39.5
Over 90%	4.0	2.6	3.2
Average (%)	74.2	70.4	71.2
Base: All answering	(151)	(194)	(185)





The Charter

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.



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