

The ARLA Review & Index

of Returns on Residential Investment

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


FIRST QUARTER 2004

The ARLA Panel of Mortgage Lenders

 **NatWest**

 Birmingham
Midshires

 paragon
mortgages

 **GMAC** Residential Funding
A General Motors company

 **TMB**
The Mortgage Business

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 from almost 500 letting offices run by ARLA member firms.

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.

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.

N.B. 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 all ARLA surveys visit www.arla.co.uk

First Quarter 2004

The average capital asset values of both rented houses and rented flats have remained stable over the last three months.

The average weighted rental return on a rented house has fallen from 5.4% to 5.1% since December 2003 whilst the average rental return on a rented flat has fallen from 5.6% to 5.4%.

The average void period is unchanged at 31 days per year compared with the last quarter of 2003.

The average number of purely investment properties which are managed by ARLA members offices is now 81, down a little from 83 properties in December.

There remains an over supply of rented residential property. However, although 59% of ARLA members' offices report that there are more properties than tenants, this figure is down from 64% three months ago and there appears to have been a significant improvement in the situation in Prime Central London.

ARLA members' offices find they are now showing an average of 6.5 prospective tenants round a property before it is let, a figure which is up from 5.6 three months ago.

The average proportion of ARLA members' offices' portfolios which are made up of investment property has risen from 49% to 51% over the last quarter.

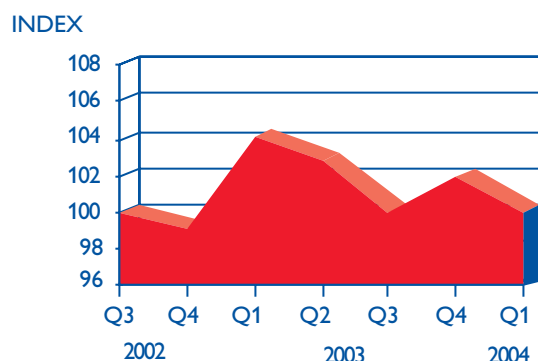
The average number of new tenancies signed up by an Arla member office in the first quarter of 2004 was 29, down from 32 in the fourth quarter of 2003.

The ARLA Index

(Q3.2002 - 100.0)

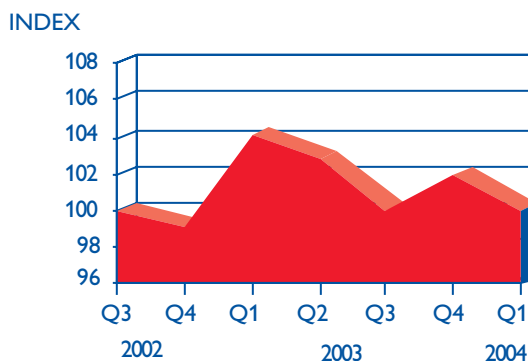
Cash Purchase 100.0

ARLA Buy to Let



Geared Investment 100.1

ARLA Buy to Let



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	4.80	35	4.34	8.55	10.82
Rest of London	5.30	36	4.77	8.55	11.12
Rest of South East	5.20	29	4.79	8.55	11.13
South West	5.10	28	4.72	8.55	11.08
Midlands	5.80	27	5.37	8.55	11.51
North West	6.60	27	6.11	8.55	12.01
North East	6.10	28	5.63	8.55	11.69
Scotland/Wales/NI	6.00	33	5.46	8.55	11.57
All Regions	5.30	31	4.86	8.55	11.17

Annual Rates of Return on Buy to Let Investment

(Geared Investment)

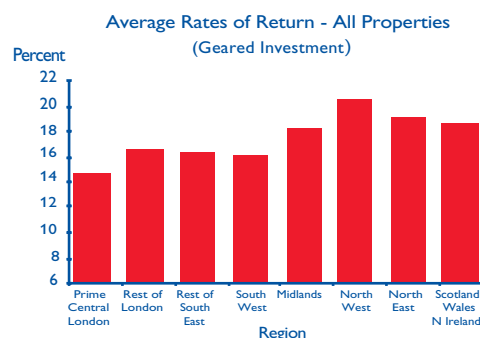
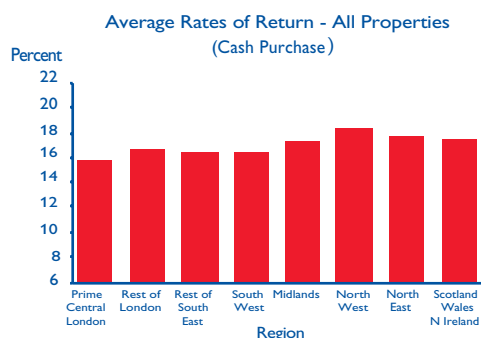
Region	Gross Annual Rental Yield (%)	Average Void Period (days per year)	Net Annual Rental Yield (%)	Capital Appreciation (% per year)	Rate of Return on Inv. (over 5 years)
Prime Central London	1.81	35	0.10	8.55	22.32
Rest of London	3.66	36	1.71	8.55	23.07
Rest of South East	3.29	29	1.76	8.55	23.09
South West	2.92	28	1.49	8.55	22.97
Midlands	5.51	27	3.90	8.55	24.06
North West	8.47	27	6.67	8.55	25.26
North East	6.62	28	4.88	8.55	24.49
Scotland/Wales/NI	6.25	33	4.24	8.55	24.21
All Regions	3.66	31	2.02	8.55	23.21

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 (8.55%)	Average +1%	Average +2%
Prime Central London	9.06	9.94	10.82	11.71	12.60
Rest of London	9.38	10.24	11.12	11.99	12.88
Rest of South East	9.39	10.25	11.13	12.00	12.89
South West	9.33	10.20	11.08	11.96	12.84
Midlands	9.80	10.65	11.51	12.38	13.25
North West	10.32	11.16	12.01	12.86	13.71
North East	9.99	10.84	11.69	12.55	13.41
Scotland/Wales/NI	9.86	10.72	11.57	12.44	13.31
All Regions	9.44	10.30	11.17	12.05	12.93



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

Region	Average -2%	Average -1%	Average for last 20 years (8.55%)	Average +1%	Average +2%
Prime Central London	17.64	20.03	22.32	24.53	26.67
Rest of London	18.51	20.83	23.07	25.23	27.32
South East	18.54	20.86	23.09	25.25	27.34
South West	18.39	20.72	22.97	25.14	27.23
Midlands	19.65	21.89	24.06	26.15	28.19
North West	21.04	23.18	25.26	27.28	29.25
North East	20.15	22.36	24.49	26.55	28.57
Scotland/Wales/NI	19.82	22.05	24.21	26.29	28.32
All Regions	18.67	20.98	23.21	25.36	27.44

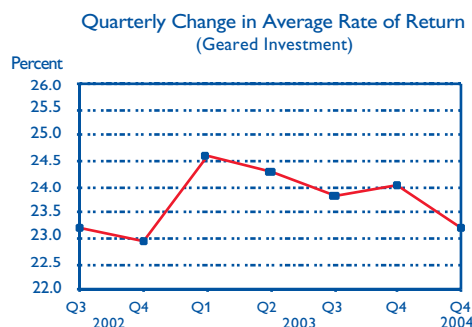
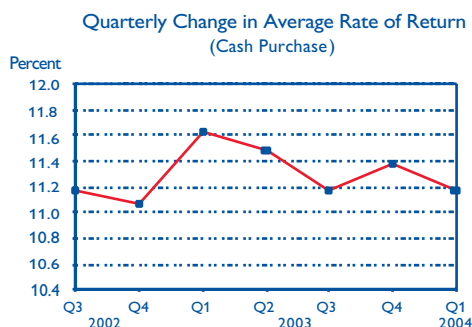
Quarterly Changes in Average Annual Rates of Return

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 fourth 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	Q2 2003	Q3 2003	Q4 2003	Q1 2004	Change Q1/Q4
Prime Central London	11.22	10.83	10.81	10.82	+0.01
Rest of London	11.37	11.20	11.68	11.12	-0.56
Rest of South East	11.39	11.15	11.35	11.13	-0.22
South West	11.54	10.78	11.38	11.08	-0.30
Midlands	11.87	11.36	11.67	11.51	-0.16
North West	12.24	12.33	12.19	12.01	-0.18
North East	11.65	11.82	11.95	11.69	-0.26
Scotland/Wales/NI	11.79	11.79	11.60	11.57	-0.03
All Regions	11.49	11.18	11.39	11.17	-0.22



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

Region	Q2 2003	Q3 2003	Q4 2003	Q1 2004	Change Q1/Q4
Prime Central London	23.63	22.96	22.60	22.32	-0.28
Rest of London	23.98	23.87	24.76	23.07	-1.69
Rest of South East	24.05	23.74	23.94	23.09	-0.85
South West	24.40	22.83	24.03	22.97	-1.06
Midlands	25.22	24.27	24.72	24.06	-0.66
North West	26.10	26.57	25.97	25.26	-0.71
North East	24.68	25.38	25.41	24.49	-0.92
Scotland/Wales/NI	25.02	25.30	24.57	24.21	-0.36
All Regions	24.28	23.83	24.04	23.21	-0.83

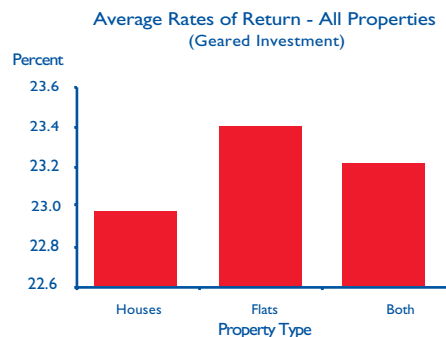
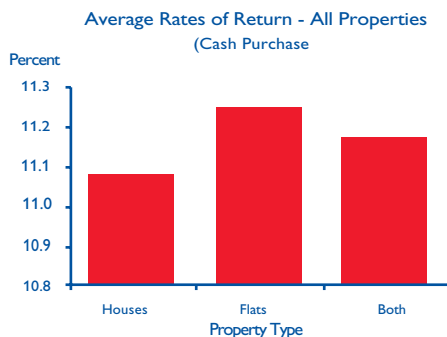
From these figures it is clear that, overall, average rates of return, which declined for most of 2003 but turned upwards at the end of the year have now returned to their downward trend and that this applies across the whole country. It seems likely that the upturn three months ago was probably a result of the postal strike in London.

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 Midlands 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	10.71	10.93	10.82
Rest of London	10.76	11.47	11.12
Rest of South East	11.07	11.19	11.13
South West	10.98	11.15	11.08
Midlands	11.50	11.50	11.51
North West	11.89	12.05	12.01
North East	11.68	11.64	11.69
Scotland/Wales/NI	11.46	11.71	11.57
All Regions	11.08	11.25	<u>11.17</u>



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

Region	Average annual rate of return (%)		
	Houses	Flats	Average
Prime Central London	22.04	22.59	22.32
Rest of London	22.15	23.94	23.07
Rest of South East	22.96	23.24	23.09
South West	22.72	23.16	22.97
Midlands	24.03	24.02	24.06
North West	24.98	25.37	25.26
North East	24.46	24.37	24.49
Scotland/Wales/NI	23.92	24.53	24.21
All Regions	22.97	23.40	<u>23.21</u>

Fourth Quarter Calculation Examples

Cash Purchase Example

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

Description	Amount (£)	Notes
Investment Purchase		
Property purchase price	269,352	
Acquisition costs	5,387	2% of purchase price
Total investment cost	274,739	
Source of Funds		
Deposit 100% price plus costs	274,739	
Mortgage 0% purchase price	0	
Rental Yield		
Gross annual rent - year 1	14,276	5.7% of purchase price
Assumed rate of rent inflation		2% p.a.
Rent lost in voids	1,197p.a.	31 days per year
Net income after voids - year 1	13,079p.a.	
Mortgage interest	0p.a.	
Net income after voids and interest	13,079p.a.	
AFTER 5 YEARS		
Value of property after 5 years	405,946	8.55% per year growth on original value
Selling costs	8,119	2% of sale price
Value of investment	397,828	Value after 5 years less sale costs
Capital growth after 5 years		44.8%
Net income yield after 5 years	68,743	
Annual Compound Rate of Return		11.17% 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	269,352	
Acquisition costs	5,387	2% of purchase price
Total investment cost	274,739	
Source of Funds		
Deposit 25% price plus costs	72,725	
Mortgage 75% purchase price	202,014	
Rental Yield		
Gross annual rent - year 1	14,276	5.7% of purchase price
Assumed rate of rent inflation		2% p.a.
Rent lost in voids	1,197p.a.	31 days per year
Net income after voids - year 1	13,079p.a.	
Mortgage interest	11,616p.a.	
Net income after voids and interest	1,463p.a.	
AFTER 5 YEARS		
Value of property after 5 years	405,946	8.55% per year growth on original value
Selling costs	8,119	2% of sale price
Value of investment	195,814	Value after 5 years less sale costs
Capital growth after 5 years		169%
Net income yield after 5 years	10,664	
Annual Compound Rate of Return		23.21% 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 assumed to be Bank of England Base Rate + 1.75%, currently 4.00% + 1.75% = 5.75%.
9. The average annual rate of house price inflation is based on the average for the last 20years 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

Investor Profiles

Surveys of investor landlords are carried out every six months through the ARLA Buy to Let website. Website surveys take place over a longer period of time than other surveys of this nature. A total of 578 respondents answered all or some of the questions.

The results show clearly that Buy to Let landlords are long term investors with a significant majority owning more than one investment property. The average Loan to Value ratio reported is 59%.

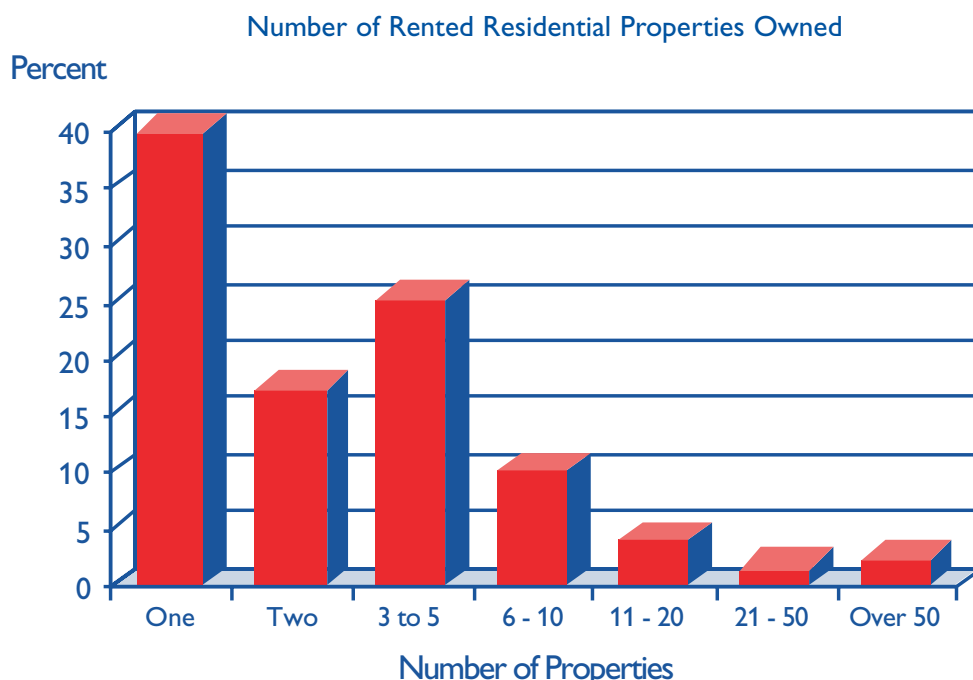
Responses covering the reasons for renting and the success, or otherwise, of other buy to Let landlords, are necessarily subjective. However, the size of the sample is significant enough to provide a relevant result.

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

The majority of respondents (57%) had only one or two properties in their portfolios although a significant minority of around one in thirteen (7.8%) had more than ten properties in theirs.

Number of Properties	Percent of Respondents (%)
One	39.7
Two	17.1
3 to 5	25.2
6 to 10	10.0
11 to 20	4.0
21 to 50	1.5
Over 50	2.3
Base: All answering	(519)

Analysis of these results shows that the average size of respondents' portfolios was 5.5 properties.

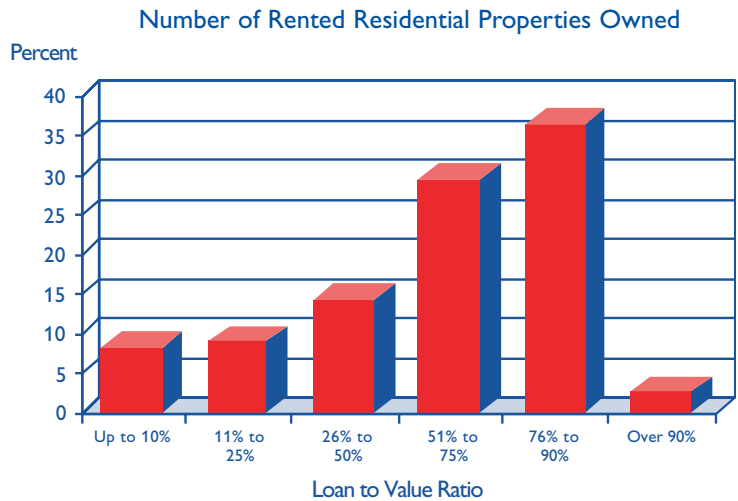


What is the average loan to value ratio of your rented residential property(s)?

Respondents to this survey were quite highly geared with almost four out of ten (39%) saying that the average loan to value ratio of their rented residential property was more than 75%.

Nevertheless, a sizeable minority of getting on for two out of ten (17%) said they had borrowing of less than a quarter of the value of their properties.

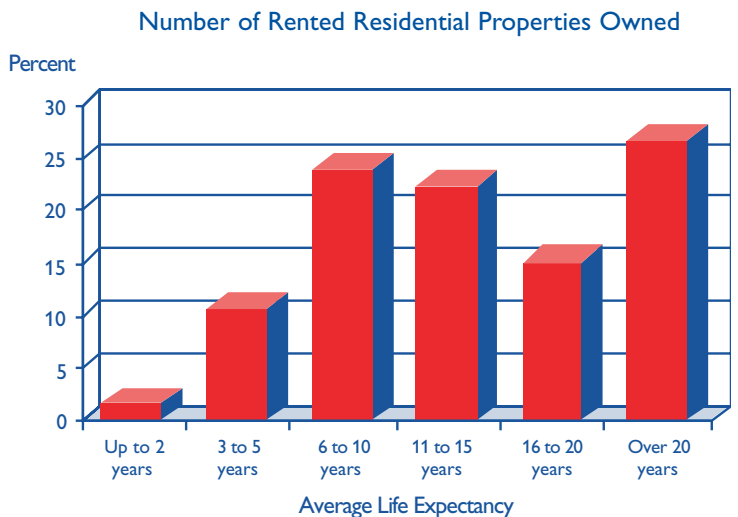
Loan to Value Ratio	Percent of Respondents (%)	Analysis of the responses to this question reveals that the average loan to value ratio is 59%
Up to 10%	8.1	
11% to 25%	8.9	
26% to 50%	14.3	
51% to 75%	29.5	
76% to 90%	36.5	
Over 90%	2.7	
Base: All answering	(509)	



How long do you expect each of your individual property investments to last?

Clearly most respondents see themselves continuing as landlords over the long term with more than a quarter (27%) saying they see the average life expectancy of their property investments to be more than 20 years and nearly two thirds (64%) saying more than 10 years.

Average Life Expectancy	Percent of Respondents (%)	Simple analysis of the responses to this question suggests that the overall average life expectancy of respondents' individual investments in property is 14.6 years
Up to 2 years	1.7	
3 to 5 years	10.6	
6 to 10 years	23.8	
11 to 15 years	22.3	
16 to 20 years	15.1	
Over 20 years	26.5	
Base: All answering	(511)	



What proportion of your tenants are renting for each of the following reasons?

Clearly landlords believe that the most prevalent reason for their tenants choosing to rent a property is that they cannot afford to buy one with, on average, landlords believing that 44% of tenants are renting for this reason..

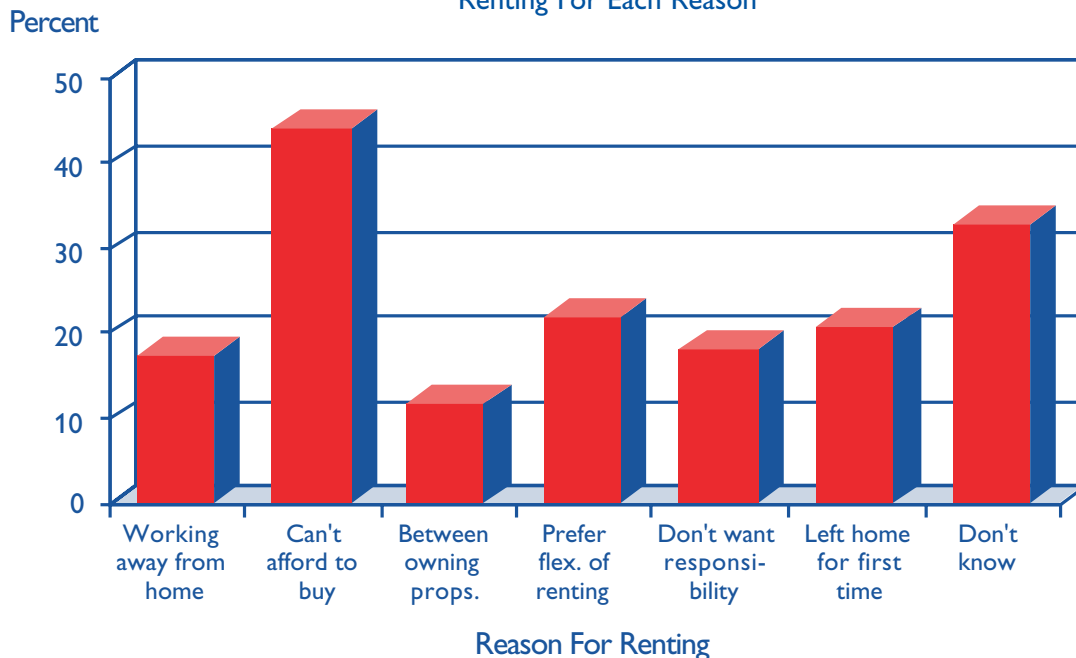
Compared with this, less than half as many (22%) are renting for the next most popular reason which is because they prefer the flexibility of renting.

The least given reason for which landlords think their tenants are renting is because they are between owning properties (12%).

Percent of Respondents Saying Proportion of Their Tenants Who Are Renting For Each Reason (%)

Proportion	Working away from home	Can't afford to buy	Between owning props.	Prefer flexibility of renting	Don't want responsibility	Left home for first time	Don't know
None	51.5	17.4	56.9	31.9	46.5	44.4	48.4
Up to 10%	9.2	9.7	14.2	13.6	15.3	12.0	8.7
11% to 25%	7.7	7.5	8.0	13.6	12.4	12.0	2.7
26% to 50%	13.8	16.5	10.7	19.1	7.9	10.7	5.5
51% to 75%	3.5	10.6	0.9	4.3	5.0	5.8	2.7
76% to 90%	2.3	6.5	0.0	3.8	3.0	1.8	1.8
Over 90%	11.9	31.8	9.3	13.6	9.9	13.3	30.1
Average	17.3	44.1	11.6	21.9	18.0	20.5	32.8
Base:							
All answering	(260)	(321)	(225)	(235)	(202)	(225)	(219)

Average Proportion of Respondents' Tenants Renting For Each Reason



Thinking of the people you personally know who are residential landlords, what proportion fall into each of the following categories regarding how well they have done?

According to respondents to this survey, more of their residential landlord acquaintances (46%) have built successful profitable businesses than fall into any of the other categories.

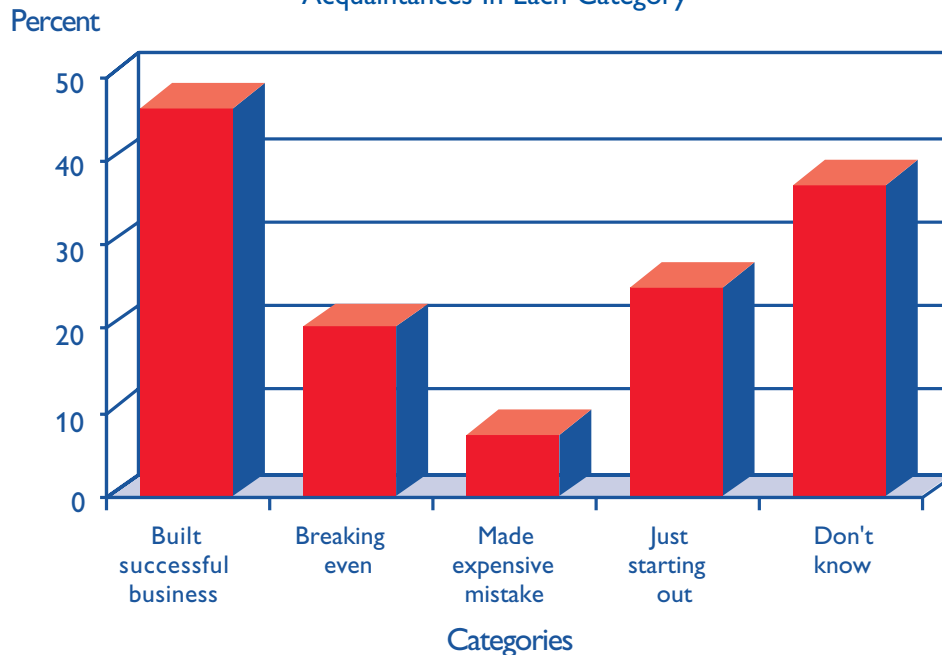
Nevertheless, on average, one in thirteen (7.5%) is perceived to have made an expensive mistake whilst two out of ten (20%) are breaking even and a quarter (25%) are just starting out as residential landlords.

For more than a third of their landlord acquaintances however (37%), respondents were unsure how they had fared.

Percent of Respondents Saying Proportion of Their Landlord Acquaintances are in Each Category (%)

Proportion	Successful business	Breaking even	Made mistake	Just starting	Don't know
None	9.0	20.4	47.2	22.7	43.1
Up to 10%	8.7	17.1	21.6	25.0	7.8
11% to 25%	11.8	20.8	14.1	17.0	6.9
26% to 50%	17.7	22.4	12.1	11.7	4.1
51% to 75%	16.1	7.8	2.0	3.8	1.8
76% to 90%	11.8	2.9	2.0	3.4	0.9
Over 90%	24.8	8.6	1.0	16.3	35.3
Average	46.1	20.0	7.5	25.0	37.1
Base: All answering	(322)	(245)	(199)	(264)	(218)

Average Proportion of Respondents' Landlord Acquaintances In Each Category





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 all ARLA surveys visit www.arla.co.uk



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The ARLA Panel of Mortgage Lenders

