Buy to Let Market Evaluation

By Ajay Ahuja

1. Introduction

I have decided to write this report to evaluate where the property market is heading specifically for buy to let investors.

I have decided to look at the key eras of buy to let and see if we can learn anything from the past to see how we can capitalise on the present and pan out how the future may look.

An era is based on two factors:

1. Whether prices are rising or falling
2. Whether credit is good or poor

I will describe how they affect the way we buy further in the report but it is important to acknowledge the existence of the 2 eras of the past, the current era in the present and the likely eras for the future.

The eras of the past are:

a) Deposit Buying (1996-2007)
b) Below Market Value (BMV) buying (2007-2009)

The current era is:

Hybrid Buying (2009-present)

And we have a new era on the horizon some time in the future (possibly 2011) which will either be one of the eras we experienced in the past:

a) Deposit Buying
b) BMV Buying

So let me describe what each method of buying is and what caused the change.

2. Deposit Buying (1996-2007)

This is where you raised a deposit from various funding sources and secured a buy to let mortgage to buy an investment property. The era was such because:

Factor	Status
Prices	Rising
Credit Availability	Good

So prices were rising and the availability of credit was good. Everything was going up! Raising the deposit was easy. You just remortgaged your current portfolio to get deposits to then buy more. Other methods included:

Credit Cards
Unsecured Loans
Overdrafts
2nd charge secured lending
125% home loans

But not only was it easy to raise the deposit it was easy to get a buy to let mortgage. Every lender had not only a buy to let product they had a buy to let range! So you could go for fixed, variable, tracker, stepped tracker even LIBOR rates. You named it and it would appear.

But it didn't stop there. If you had CCJs, defaults or late payments you could still get a buy to let mortgage at slightly higher rates.

To add fuel to the fire the deposit you needed to raise was small i.e. 10% of the purchase price. So a £1m portfolio could be bought by raising as little as £100,000 (which sometimes the vendor gave this to the investor) and the boom happened. But not over a quick period but over a very long time. From 1996 to 2007 it was a one way street. People simply got used to double digit capital growth.

It was a bit like the Madoff scandal. Madoff returned a consistent 10% on his fund year on year. It was so consistent that very smart wealthy people did not even need to evaluate whether Madoff's fund would return 10% or not as they were so sure it would happen. As we all know the past does not necessarily equal the future.

But for buy to let it all changed. Credit got withdrawn and quickly we entered in to a new era. The BMV buying era.

3. BMV Buying (2007-2009)

This is where the buy to let investor capitalised on the fall in the market. This era was so because:

Factor	Status
Prices	Falling
Credit Availability	Poor

Prices were falling and availability of credit was poor.

The ability to buy was really open for the privileged. The privileged being:

a) Creditworthy
b) Knowledgeable

Buying properties using the discount effectively as a deposit and a contribution to fees required a certain degree of skill and persistence. Firstly you had to believe it could be done and secondly you needed to find the professionals who could perform the transaction like solicitors, brokers and sourcing companies like ourselves.

It is fair to say that if you bought a property below market value in the last 2 years then you are definitely in the minority. Most people stayed away from buying property even people within the industry as the market looked like it was heading for a meltdown. For those who were able to buy were able to build large property portfolios without putting any money in at all.

It takes about 6 months for one era to come to an end and a new one emerge. This is because there is always a lag in the market. This is because prices agreed today do not hit the land registry till around 4 months after the deal was struck and then there is a reporting lag of around 2 months for the data to be published.

Once the data is out and exposed the media make what they want of it and a new direction is turned. This direction is where prices are now rising but availability of credit is poor.

4. Hybrid Buying (2009 – present)

By the summer we had entered in to a new era. The following was happening:

Factor	Status
Prices	Rising
Credit Availability	Poor

This is where we find ourselves today. Prices are rising but availability of credit is poor. Buy to let is still the game for the privileged and the knowledgeable but it seems we are:

a) battling with first time buyers who are slowly entering the market
b) battling with each other as investors out bid each other and accept lower discounts

It seems like the market has moved in to an era where the discount obtained on a property can be used to contribute to the deposit only and not the fees. So instead of doing no money down deals it is low money in deals.

We see this happening across the industry. 30% BMV deals are becoming rarer and rarer only really being available from the most desperate sellers which is rare also in such a low interest rate environment.

So we will see larger cash input from investors to buy investment properties as we all battle away with each other.

5. So what does the future hold for us?

At some point in the future something will switch. Either it will be the prices or the availability of credit. So we really only have two realistic outcomes in the future:

Future 1:

Factor	Status
Prices	Rising
Credit Availability	Good

Or

Future 2:

Factor	Status
Prices	Falling
Credit Availability	Poor

6. Evaluation of the different futures

Lets look at future 1:

Factor	Status
Prices	Rising
Credit Availability	Good

This will mean the availability of credit improves. This will undoubtedly happen. Currently banks are making a 4% margin on the mortgages they are granting. Back in the days when credit was readily available (1996 – 2007) banks were happy to accept a 1% margin.

So banks can lend a quarter of the amount to get the same profit levels. That means big profits but only quarter of the risk!

So banks are set to do very well in the future and this is good as it is these banks that help us investors. I would watch the big banks to see what information they put out regarding their financial status and their overall mood for the UK property market and specifically buy to let.

When all of this happens you can go back to buying a property in the normal way of raising deposits from various sources and buying.

Future 2 paints a very different picture:

Factor	Status
Prices	Falling
Credit Availability	Poor

This predicts that prices start to fall. If prices start to fall whilst the mortgage market still not improving we will go back to the BMV buying days. Big discounts will come back and you can say hello to buying no money down.

7. Strategy For The Investor

You can either act now or wait for either of the future outcomes.

Act Now

Acting now means you are able to build a monthly cash flow income. You will be able to capitalise on lending that is available now (which might not be in the future) and your will progress further in your goals.

The deals done now will be no more or less attractive than the deals potentially available in the future as the prices are all determined by the competition you face from other buyers which is a direct result of the finance that is available to all of you. No advantage can be had unless you had access to private finance which is very rare.

Act Later

This means waiting for either the availability of credit to improve or wait for prices to fall. Either way you have no idea how long this will be and it is yet to be proved that waiting will mean your financial situation will be better off by waiting.

If the availability of credit improves it will be great for buy to let but it will mean taking out larger loans.

If prices fall it will probably be a result of the availability of credit being poor. This means that even you might not be able to buy when prices start falling.

8. Conclusion

The methods of buying are applicable for the different eras each with their own merits. If you are able to buy then I would suggest you buy as it takes you further along towards your financial goals.

If you are unable to buy I would be doing everything you can to put yourself in a position to buy in the future for when the market changes.

If you want help in finding some property deals with little cash input then call 0870 990 3205 or email enquiries@ahuja.co.uk