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Buy-to-let and the housing market

BODY:

Will rising interest rates kill off the buy-to-let movement?

IN THE enclosure movement of the 18th century, greedy landlords snapped up the land the commonfolk had tilled, reducing the proud yeoman farmer to the status of an unpropertied tenant. To hear some tell it, we are living through a second enclosure movement today, as landlords take advantage of buy-to-let mortgages to snap up "starter" homes all over the country, leaving would-be homeowners as propertyless tenants. Between 2001 and 2003, the number of mortgages made to buy-to-let investors rose by 223,300, according to the Council of Mortgage Lenders (CML). Over the same period, the number granted to first-time buyers fell by 207,000.

Nothing could stop the first enclosure movement. But the second may be thwarted by the Bank of England. Most of those who buy in order to let, borrow in order to buy. And the costs of borrowing are rising. On June 10th, the Bank raised interest rates another quarter point to 4.5%— the fourth rise in eight months. Mortgages are thus becoming more costly, even as the houses investors hope to purchase become ever more expensive.

Though growing fast, buy-to-let loans still accounted for just 7.1% of the money lent by mortgage providers last year (see chart). And the surge in loan-making may overstate the size of the phenomenon, argues Ed Stansfield of Capital Economics. Not all of the £11.7 billion lent in the second half of 2003 was used to turn homes into rent-machines. As much as £4.45 billion went to existing landlords switching from traditional, and more expensive, commercial loans to cheaper buy-to-let mortgages. "Buy-to-let" is "just a new label for an old activity," he writes.

But a new breed does seem to be taking up this old activity. Individuals and couples owned less than half of the private rented stock in England in 1994, according to the government. By 2001, they held almost two-thirds of it: 30% of private landlords now own just one property.

How vulnerable is this buy-to-let market to tighter money? Rents are edging up again (although in parts of London, flats are standing empty for longer), and house prices are rising even faster. It is thus not a bad time to be an amateur landlord. But it is a bad time to become one. According to Capital Economics, someone who buys now, at inflated prices and higher interest rates, will barely cover the cost of his borrowing with the rents he collects (see chart). Some landlords may actually lose money, once the costs of replacing lightbulbs and unblocking drains are added.

Will this deter new investors? Many buy-to-letters fancy themselves as speculators, not rent-collectors. They hope to sell their overpriced properties at still higher prices in the future. Indeed, some analysts fear that they provide the "hot money" in the housing market. They are relatively liquid and account for a disproportionate share of transactions, according to Andrew Farlow, an economist at Oxford University. Since the vast bulk of properties do not change hands in any given year, prices are set by the few that do.

David Pannell, of Durlacher, an investment bank, characterises buy-to-letters as "pension refugees". They have fled from disappointing stock markets into an enticing housing market. If that too disappoints, they will flee elsewhere.

GRAPHIC: Sign of decline

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