Buy-to-let: Meet the man with the £5 million mortgage

Last Updated: 12:01am GMT 03/11/2007

Keep your head when all about you are losing theirs, and there is still money to be made, says Ross Clark

Anyone scared by their monthly mortgage statement should spare a thought for Ian Davison. His monthly repayments are £30,000. His only consolation is that the monthly rental income on his 38 properties currently comes to a little more than this: about £37,000. So is he bothered when he sees Northern Rock customers queueing up around the block to get their money out, or reads predictions of how the global credit crunch is going to make mortgages more expensive and possibly lead to a slide in house prices?

Landlord of all he surveys: buy-to-let investor Ian Davison still feels confident

He insists not. "I'm pretty well protected," he says. "A lot of my loans were taken out when interest rates were lower. Some are for 4.84 per cent, and some for 4.55 per cent. And the fixed rates are staggered to expire at different times, in 2008, 2009 and 2010. By the time it comes to renew them, hopefully rates will have come down again. Or maybe rents will be higher in a year's time. If they aren't, I may sell some of the properties. My total mortgage debt is about £5 million, but my properties are worth a total of about £8.5 million."

Davison, 29, is one of a growing army of buy-to-let investors who have decided to play the housing market big time in spite of the gloom expressed by many economists. Simon Rubinsohn, chief economist of the Royal Institution of Chartered Surveyors (RICS), recently warned that there is a one in 10 chance of a crash in the housing market, echoing warnings by Alan Greenspan, former chairman of the US Federal Reserve that Britain's housing boom could go the way of America's. There have been signs, too, from the auction room, that all is not well in the buy-to-let market. One two- bedroom flat in a waterfront development in Ipswich was recently sold as a repossession for £140,000 - half the £279,500 for which it was sold new in April 2006. There have been many more similar sales.

Yet in spite of the gloom, another 90,000 buy-to-let mortgages have been taken out in the past 12 months alone, according to the Council of Mortgage Lenders, bringing the total to 938,500 - a tenfold increase in nine years. And buy-to-let might not necessarily peak there, either. While first-time buyers have found it harder to take out large mortgages in recent weeks, or have been offered higher rates of interest, buy-to-let investors have in some cases been offered rates lower than those available for first-time buyers. According to a survey of 5,000 landlords undertaken by Mortgage Express, the largest buy-to-let lender, in June more than 50 per cent of landlords were at that stage planning to buy more properties over the coming six months.

A more recent survey by consultancy Property for Life, conducted since the Northern Rock crisis, suggested that 72 per cent of buy-to-let investors believe now is a good time to buy property. But they would say that, wouldn't they? The day a buy-to-let mortgage specialist puts out a survey saying 85 per cent of borrowers are bailing out will be the day that Air Traffic Control announces a flotilla of flying pigs 30,000 feet over Weybridge.

Nevertheless, it is clear that buy-to-let investors are living in a different world from many economists - and indeed the stock market, which punished Bradford & Bingley (owner of Mortgage Express), Paragon Mortgages and other lenders highly exposed to the buy-to-let market. Paragon shares are trading at less than half their peak. Even Paragon Mortgages's website hardly promises great returns. It includes a calculator to compute your likely returns on your buy-to-let investment. Its default position is for a £135,000 property, requiring £4,000 for refurbishment costs, after which it can be let for a gross annual rent of £6,000.

The investor buys the property on a mortgage of £97,500, paying an initial mortgage rate of 5.5 per cent, then sells up for £147,518 after three years. Result? Er, a return on the investment of minus 1.4 per cent per annum. Whoops!

These typical figures - it is very honest of Paragon Mortgages to put them on its website - underline the difficulty of making money from buy-to-let at a time when property prices are high, interest rates are rising and rents outside the prime London market fairly static.

Unless you are planning on letting your property - illegally - to 150 Lithuanians, it is hard to find a property nowadays where the rental income will pay the mortgage. If house price inflation were to exceed 10 per cent, this might not matter: your capital gain would exceed your day-to-day loss.

But with prices slowing, that is unlikely. So what is it that motivates investors?

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"House prices are slowing, but there are still investors coming into the market, which is slightly strange," says Richard Donnell of Hometrack. "On the face of it, the figures don't stack up, and for new entrants into the buy-to-let market with no capital it is very difficult. But if you are a high net worth investor who only needs a mortgage of 30 per cent of the value of a property, it is different. People are doing it for capital growth. As long as the rent pays the mortgage, annual house-price growth of 3 to 4 per cent can give you a good capital return because your investment is geared."

Gearing - where you are borrowing the money which you are investing - works wonders when house prices are rising. It works even better following the Chancellor's announcement in the autumn statement that for next April capital gains tax will be charged at one flat rate - 18 per cent, compared with 40 per cent as before. If prices start to fall, on the other hand, your have to remember that your losses, too, will be geared. Indeed, you can lose more than you invested. An apparent million pound profit can easily turn into a million pound loss.

Davison insists he is not worried. "I have bought a lot of my properties at a discount," he says. "I have a very good relationship with the sales negotiators at one big developer which has allowed me to buy, say, a £300,000 house for £220,000. Typically, I buy in blocks of five or more, off-plan, although sometimes I have been offered houses cheaply because a buyer has pulled out."

While this explains why Davison is happy to keep buying so many properties, it does make one wonder how solid the housing market is. If developers are dropping their prices so freely, just what is the market price for new housing? Is it the prices paid by bulk investors, or the higher prices paid by individual buyers? And do individual buyers know that they're missing out?

Buy-to-let stats

90k - Number of new buy-to-let mortgages taken out in the past 12 months
50% - Propertion of landlords planning to buy more properties between June nad December
938k - Total number of buy-to-let mortgages

Case history

Assurances by nervous-sounding estate agents that "no buy-to-let investors are selling at the moment" should be taken with a pinch of salt. Swelling auction catalogues, plus the appearance of sudden forests of "for sale'' boards outside apartment blocks, suggests there are some who don't like the way the economy is heading. There are always some buy-to-let investors selling, in any case. One is Nadine Pattison, who started building up her portfolio of 20 buy-to-let properties 10 years ago but who now reckons it is time to pare down the properties she owns and reduce her £7,000-a-month mortgage repayments - which she pays out of her £10,000 a month rental income.

Nadine is selling the first property she bought, a two-bedroom flat in Sandy, Bedfordshire, through Lane & Brown (01797 691122) for £124,000. She bought it 10 years ago as a repossession for £26,000.

"When I first bought it, I was getting £250 a month in rent," she says. "Now I am getting £525 a month. But as a yield it isn't as good. And if I sell this property, I won't be exposed to the market in the same way." Nadine's portfolio shows large discrepancies in buy-to-let returns across the country. While the rent on her Sandy flat has doubled in 10 years, that on two Edinburgh flats has remained stuck at £425 to £450 a month - although the flats have more than doubled in value, from £57,000 to £125,000.

There is only one property, though, which she really regrets buying: but that is in Melbourne, Australia. "I've just decided to get out," she says.

Case history

Negative sentiment on the property market hasn't deterred Margaret and Barry Simpson from staying in the York buy-to-let market. Over the past three years they have built up a portfolio of three student houses which they let out at about £67 per room per week. Their first house cost them £125,000. So long as they can keep its four bedrooms let at £67 a week, the property is returning a gross yield on their initial capital investment of 11 per cent - and that is before any potential capital growth is taken into account. "Where else could I get a return of over 10 per cent?" says Margaret.

It isn't quite such easy money, however. Her letting agent takes 10 per cent plus VAT, there is maintenance of the properties to take into account, and also the time and cost of refurbishing the properties before they can be let. "We always look for properties which we can add capital value to by refurbishing. We bought a six-bedroom house for £185,000 and spent £10,000 on it; it's now worth £250,000.