

The ARLA Review & Index

for Residential Investment

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

FOURTH QUARTER 2006



The ARLA Panel of Mortgage Lenders

Fourth Quarter 2006

The overall average capital asset value of rented houses has risen by 7.4% over the last three months as a result of rises of 11.4% in Prime Central London and 21.3% in the Rest of the UK. In contrast, the average value for the Rest of the South East fell by 4.4%. Over the same period the average value of rented flats throughout the country rose by 4.7%, again as a result of increases in Prime Central London (3.5%) and the Rest of the UK (16.0%) with prices of flats in the Rest of the South East falling marginally by 0.3%.

The average weighted rental returns for houses have risen a little from 4.9% to 5.0% compared with three months ago whilst the equivalent figure for flats has remained unchanged at 5.1%. On balance ARLA members report increased achievable rent levels over the last six months on all types of rented property with a higher proportion this quarter (61% compared with 56% in August) saying that this is the case in Prime Central London. Conversely, there was a decrease for the Rest of the South East (39% compared with 42% in August) whilst the figure for the Rest of the UK was little changed.

The balance between the supply of and demand for rented residential properties has continued to improve, particularly for members managing properties in Prime Central London with more than seven out of ten of these (71%) now saying there are more tenants than there are properties available for them, a figure which is up from 61% three months ago. The proportion of members in the Rest of the South East who say there are more tenants than properties is also up (from 34% to 37%) whilst the proportion of those in the Rest of the UK who say this is down from 34% to 32%. More than three out of ten ARLA members (32%) say that landlords are currently buying more properties, a figure which is up from 28% in the third quarter and which compares with only 14% who say landlords are currently selling properties. Compared with the third quarter, the average void period is again down slightly, from 3.7 weeks to 3.6 weeks (25 days) reflecting decreases in Prime Central London and the Rest of the South East.

The average number of new tenancies signed up in the fourth quarter of 2006 was 34.4, up from 33.3 in the third quarter largely as a result of seasonal factors although the long term trend is for this figure to increase slowly. The average proportion of ARLA members' offices' portfolios which are made up of investment property, at 53%, is up marginally from 52% in the third quarter of the year.

The average number of purely investment properties which are managed by ARLA members' offices is up compared with three months ago from 103 properties to 109 properties. On average, ARLA members say that tenants remain in the same property for a period of 15.7 months, a figure which is up marginally from 15.6 months in August.

The cost of alterations needed to comply with new regulations is seen by ARLA members' offices as having had the greatest impact on landlords' decisions on whether or not to stay in the HMO market. However, too much bureaucracy, too many new rules and the cost of obtaining HMO licences are all seen to have had nearly as much effect on those decisions.

More than four out of ten ARLA members' offices (81%) say they have noticed an increase over the last two years in immigrants who have come to Britain from new EU member states (e.g. Poland) and who want to rent residential property and two thirds (66%) say they have had at least some impact on the market although only 5% believe they have boosted it dramatically.

Most ARLA members' offices (72%) say that it is at least quite difficult to obtain references on prospective new tenants who are immigrants from new EU member states with 8% saying it is impossible.

More than three quarters of ARLA members' offices (77%) expect to see an increase over the next two years in immigrants who have come to Britain from new EU member states (e.g. Romania) and who want to rent residential property.

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 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 372 letting offices run by ARLA member firms and 279 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). 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 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.

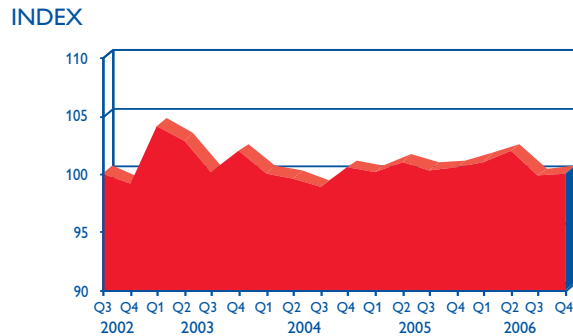
For the detailed results of all ARLA surveys visit www.arla.co.uk

The ARLA Index

(Q3.2002 - 100.0)

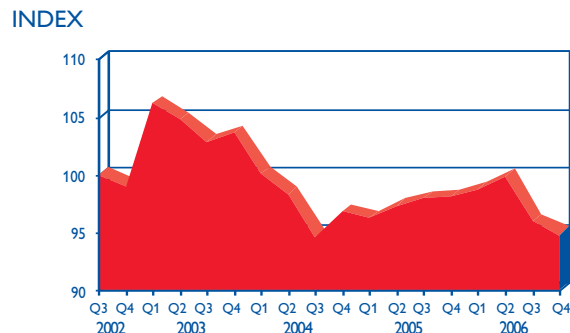
Cash Purchase 100.0 (Q3-99.8)

ARLA Buy to Let
Cash Purchase Index



Geared Investment 94.7 (Q3-95.9)

ARLA Buy to Let
Geared Purchase Index



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	5.40	26	5.02	8.66	11.38
Rest of London	5.27	23	4.93	8.66	11.32
Rest of South East	5.07	24	4.74	8.66	11.19
South West	4.47	22	4.21	8.66	10.83
Midlands	4.67	27	4.32	8.66	10.91
North West	4.46	31	4.08	8.66	10.74
North East	4.97	28	4.59	8.66	11.09
Scotland/Wales/NI	5.82	27	5.39	8.66	11.62
All Regions	5.06	25	4.71	8.66	11.17

Annual Rates of Return on Buy to Let Investment (Geared Investment)

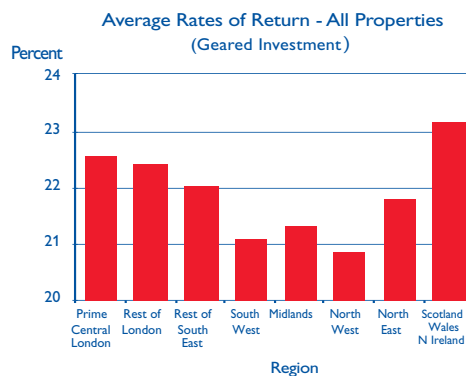
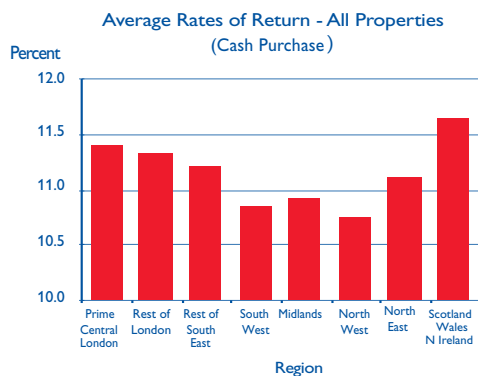
Region	Gross Annual Rental Yield (%)	Average Void Period (days per year)	Net Annual Rental Yield (%)	Capital Appreciation (% per year)	Rate of Return on Inv. (over 5 years)
Prime Central London	1.37	26	-0.17	8.66	22.51
Rest of London	0.83	23	-0.52	8.66	22.36
Rest of South East	0.02	24	-1.31	8.66	22.02
South West	-2.35	22	-3.42	8.66	21.07
Midlands	-1.55	27	-2.96	8.66	21.28
North West	-2.41	31	-3.93	8.66	20.84
North East	-0.35	28	-1.90	8.66	21.75
Scotland/Wales/NI	3.04	27	1.30	8.66	23.14
All Regions	-0.01	25	-1.41	8.66	21.97

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 (8.66%)	Average +1%	Average +2%
Prime Central London	9.65	10.51	11.38	12.25	13.13
Rest of London	9.59	10.45	11.32	12.20	13.07
Rest of South East	9.44	10.31	11.19	12.07	12.95
South West	9.06	9.94	10.83	11.72	12.61
Midlands	9.15	10.02	10.91	11.80	12.69
North West	8.97	9.85	10.74	11.63	12.53
North East	9.34	10.21	11.09	11.97	12.86
Scotland/Wales/NI	9.91	10.76	11.62	12.49	13.36
All Regions	9.43	10.30	<u>11.17</u>	12.05	12.93



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

Region	Average -2%	Average -1%	Average for last 20 years (8.66%)	Average +1%	Average +2%
Prime Central London	17.84	20.22	22.51	24.72	26.85
Rest of London	17.66	20.06	22.36	24.58	26.72
South East	17.26	19.69	22.02	24.26	26.42
South West	16.15	18.67	21.07	23.38	25.61
Midlands	16.40	18.89	21.28	23.58	25.79
North West	15.88	18.42	20.84	23.17	25.41
North East	16.95	19.41	21.75	24.01	26.20
Scotland/Wales/NI	18.57	20.90	23.14	25.30	27.40
All Regions	17.21	19.64	<u>21.97</u>	24.22	26.38

Quarterly Changes in Average Annual Rates of Return

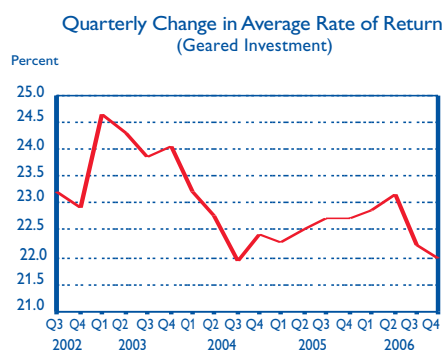
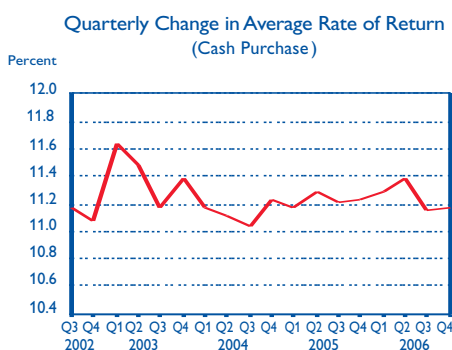
The tables below show how the net annual compound rates of return over five years from this quarter have changed compared to the projection for the last quarter.

These figures are based on the average rate of house price inflation over the last 20 years.

This is currently 8.66% per year.

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

Region	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Change Q4/Q3
Prime Central London	11.18	11.32	10.99	11.38	+0.39
Rest of London	11.48	11.58	10.67	11.32	+0.65
Rest of South East	11.35	11.37	11.12	11.19	+0.07
South West	11.03	11.28	11.33	10.83	-0.50
Midlands	11.44	11.39	11.19	10.91	-0.28
North West	11.35	12.07	11.45	10.74	-0.71
North East	11.55	11.46	11.28	11.09	-0.19
Scotland/Wales/NI	11.16	11.37	11.68	11.62	-0.06
All Regions	11.29	11.39	11.15	11.17	+0.02



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

Region	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Change Q4/Q3
Prime Central London	22.63	22.97	21.81	22.51	+0.70
Rest of London	23.37	23.63	20.97	22.36	+1.39
Rest of South East	23.04	23.11	22.16	22.02	-0.14
South West	22.22	22.86	22.68	21.07	-1.61
Midlands	23.26	23.14	22.33	21.28	-1.05
North West	23.06	24.83	23.01	20.84	-2.17
North East	23.56	23.31	22.58	21.75	-0.83
Scotland/Wales/NI	22.56	23.10	23.59	23.14	-0.45
All Regions	22.89	23.15	22.23	21.97	-0.26

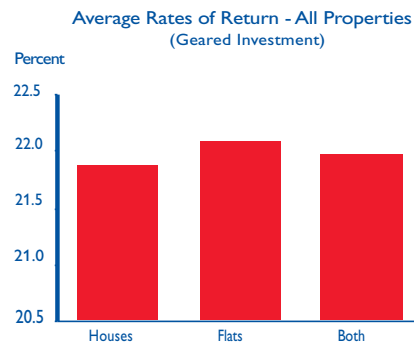
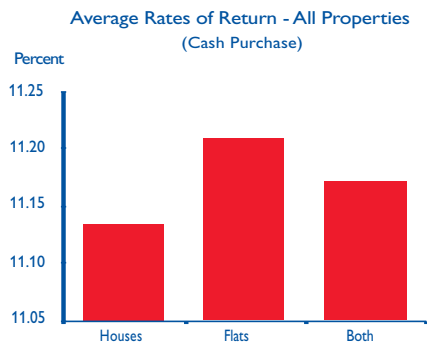
From these figures it is clear that, overall, average rates of return, which had been rising for 18 months, fell quite sharply in the third quarter of 2006. This was partially accounted for by the fall in the 20 year average rate of house price inflation and, for geared investments, by the increase in the base rate in August. In the last quarter of 2006, returns on geared investments fell again as a result of another increase in base rates whilst those for cash purchases recovered a little.

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 in all regions except the Rest of London, the Midlands, the North West and the North East.

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

Region	Average annual rate of return (%)		
	Houses	Flats	Average
Prime Central London	11.29	11.47	11.38
Rest of London	11.38	11.27	11.32
Rest of South East	11.15	11.23	11.19
South West	10.68	10.98	10.83
Midlands	10.98	10.84	10.91
North West	10.87	10.62	10.74
North East	11.27	10.90	11.09
Scotland/Wales/NI	11.41	11.84	11.62
All Regions	11.13	11.21	11.17



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

Region	Average annual rate of return (%)		
	Houses	Flats	Average
Prime Central London	22.27	22.76	22.51
Rest of London	22.50	22.22	22.36
Rest of South East	21.91	22.13	22.02
South West	20.68	21.46	21.07
Midlands	21.46	21.10	21.28
North West	21.17	20.51	20.84
North East	22.23	21.27	21.75
Scotland/Wales/NI	22.58	23.69	23.14
All Regions	21.88	22.07	21.97

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	309,617	
Acquisition costs	6,192	2% of purchase price
Total investment cost	315,809	
Source of Funds		
Deposit 100% price plus costs	315,809	
Mortgage 0% purchase price	0	
Rental Yield		
Gross annual rent - year 1	15,664	5.06% of purchase price
Assumed rate of rent inflation		2% p.a.
Rent lost in voids	1,082p.a.	25 days per year
Net income after voids - year 1	14,582p.a.	
Mortgage interest	0p.a.	
Net income after voids and interest	14,582p.a.	
AFTER 5 YEARS		
Value of property after 5 years	490,000	8.66% per year growth on original value
Selling costs	9,380	2% of sale price
Value of investment	459,620	Value after 5 years less sale costs
Capital growth after 5 years		45.5%
Net income yield after 5 years	76,644	Assuming 2% rental inflation
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	309,617	
Acquisition costs	6,192	2% of purchase price
Total investment cost	315,809	
Source of Funds		
Deposit 25% price plus costs	83,596	
Mortgage 75% purchase price	232,212	
Rental Yield		
Gross annual rent - year 1	15,664	5.06% of purchase price
Assumed rate of rent inflation		2% p.a.
Rent lost in voids	1,082p.a.	25 days per year
Net income after voids - year 1	14,582p.a.	
Mortgage interest	15,674p.a.	
Net income after voids and interest	-1,092p.a.	
AFTER 5 YEARS		
Value of property after 5 years	469,000	8.66% per year growth on original value
Selling costs	9,380	2% of sale price
Value of investment	227,407	Value after 5 years less sale costs
Capital growth after 5 years		172%
Net income yield after 5 years	-1,728	Assuming 2% rental inflation
Annual Compound Rate of Return		21.97% 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 5.00% + 1.75% = 6.75%.
9. The average annual rate of house price inflation is based on the national average for the last 20 years which was 8.66% for 1985-2005, was 8.80 for 1984-2004, was 8.70% for 1983-2003 and 8.55% for 1982-2002.
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

Investors continue to expect to remain in the business of Buy to Let for the long term, for an average of 15.5 years. Nearly a quarter (22,4%) expect to hold their property investments for more than twenty years.

If property prices were to fall, only 2.1% of all respondents would sell out of Buy to Let.

Six out of ten respondents expect to acquire further properties in the next twelve months.

Tenants are staying for an average of 17.3 months regardless of the length of the initially agreed term – This is a month longer than a year ago.

Three out of ten of these tenants are aged between 23 and 30 and a quarter, (26%) are between 31 and 40. Another quarter are between 41 and 65, while one in six are under 23.

Investor landlords have noticed a more significant impact from immigration for the new EU states than letting agents report. However, it is clear that fewer landlords than letting agents have attempted to obtain references for prospective immigrant tenants..

The survey for the fourth quarter 2006 was carried out during October and November. 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 base. All results are obtainable on the Buy to Let section of the ARLA website, www.arla.co.uk

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

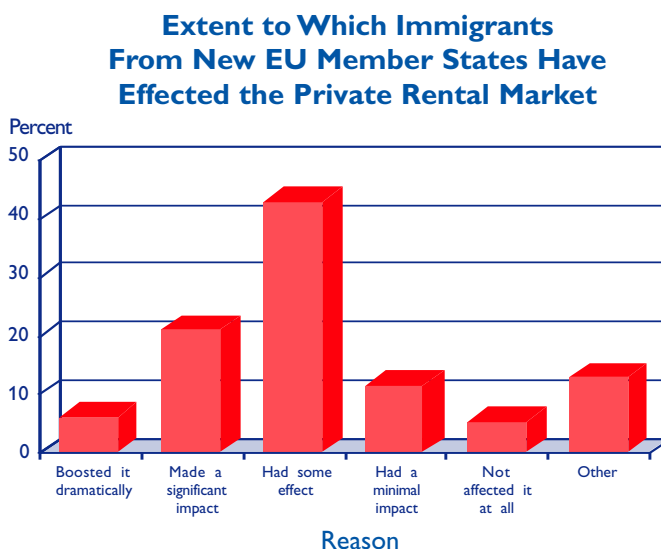
Most respondents (70%) said that they thought immigrants from new EU member states had had at least some effect on the private rental market in recent years with more than a quarter (27%) saying that the impact had been at least significant and more than one in twenty (6%) saying they had boosted it dramatically.

Only one a small minority of in twenty respondents (5%) said they thought immigrants from new EU member states had had no impact on the private rental market at all.

Extent of Effect	Percent of Respondents (%)
	Dec 06

The've boosted it dramatically	6.2
The've made a significant impact	21.2
The've had some effect	42.9
The've had only a minimal impact	11.5
The've not affected it at all	5.3
Other	12.8

Base:
All answering
(226)

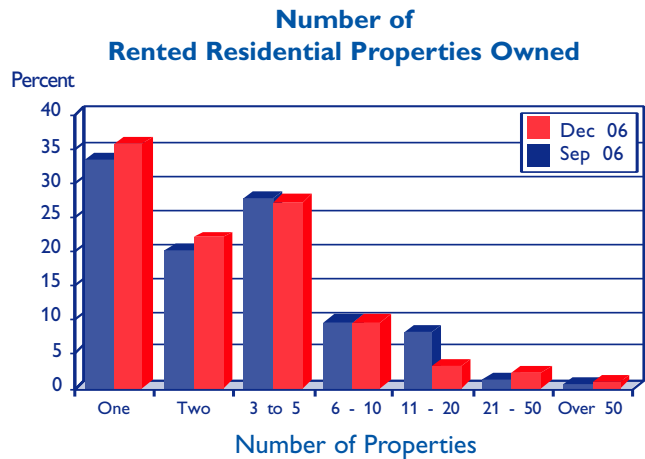


How many rented residential properties do you currently have in your portfolio?

Nearly six out of ten respondents (58%) had only one or two properties in their portfolios whilst a little over one in twenty (6%) had more than ten properties in theirs.

Number of Properties	Percent of Respondents (%)		
	Jun 06	Sep 06	Dec 06
One	33.7	33.3	35.8
Two	18.9	19.9	21.8
3 to 5	21.9	27.6	27.2
6 to 10	16.5	9.6	9.5
11 to 20	7.1	8.0	2.9
21 to 50	1.3	1.1	2.1
Over 50	0.7	0.4	0.8
Base: All answering (297)	(261)	(243)	

Analysis of these results shows that the average size of respondents' portfolios was 4.4 properties, down from an average of 4.5 properties three months ago.

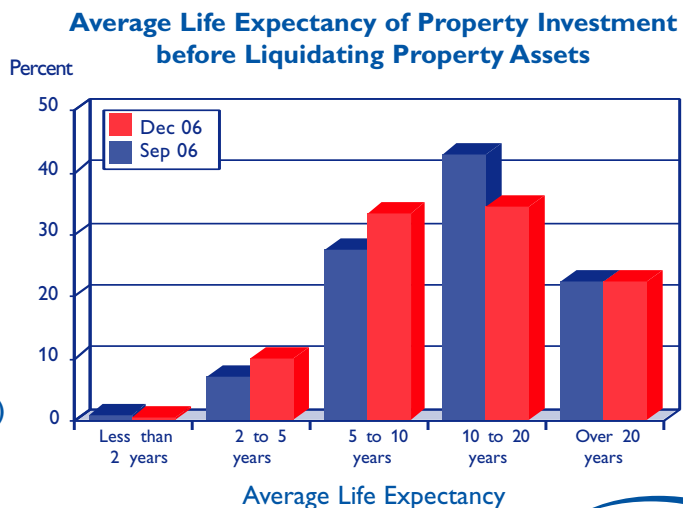


From original acquisition time, what do you expect to be the average life expectancy of your property investment, before you liquidate your property assets?

Clearly the vast majority of residential landlords are in the business for the long term with nearly six out of ten (57%) saying that the average life expectancy of their property investments is more than 10 years.

Average Life Expectancy	Percent of Respondents (%)		
	Jun 06	Sep 06	Dec 06
Less than 2 years	-	0.8	0.4
2 to 5 years	6.1	7.0	9.7
5 to 10 years	27.0	27.5	33.3
10 to 20 years	45.1	42.6	34.2
Over 20 years	21.8	22.1	22.4
Base:			
All answering	(293)	(258)	(237)

Simple analysis shows that the average life expectancy of these property investments is 15.6 years, which is down from 16.0 years in the last survey three months ago.



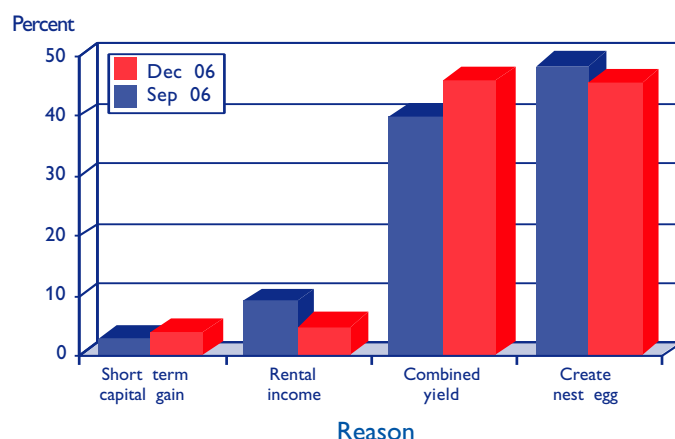
Why did you first decide to invest in residential property?

Most residential landlords are split equally between those who became residential landlords in order to achieve a combined yield from rental income and capital appreciation and those who did so in order to create a nest egg for their long term future (46% in both cases).

However, one in twenty respondents (5%) said they became landlords in order to obtain a stream of rental income whilst only one in twenty five (4%) said they did so in order to make a short term capital gain over a period of less than 5 years.

Reason	Percent of Respondents (%)	
	Sep 06	Dec 06
Short term capital gain (less than 5 years)	2.7	3.9
Rental income	8.9	4.7
Combined yield from rental income & capital appreciation	39.9	45.9
Create nest egg for long term future	48.4	45.5
Base:All answering	(258)	(233)

Reasons For Investing in Residential Property



If house prices were to fall, would you sell your residential property investments?

More than eight out of ten respondents to this question (82%) said they would not sell their residential property investments if house prices were to fall with another 16% being unsure whether they would or not. Only a small minority of one in fifty (2%) said that they would sell their residential property investments if house prices were to fall.

Response	Percent of Respondents (%)		
	Jun 06	Sep 06	Dec 06
Yes	1.5	4.7	2.1
No	86.7	84.8	82.2
Don't know	11.6	10.5	15.7
Base:All answering	(293)	(256)	(236)

Compared with three months ago, respondents were, on average, slightly less certain what they would do if house prices were to fall.

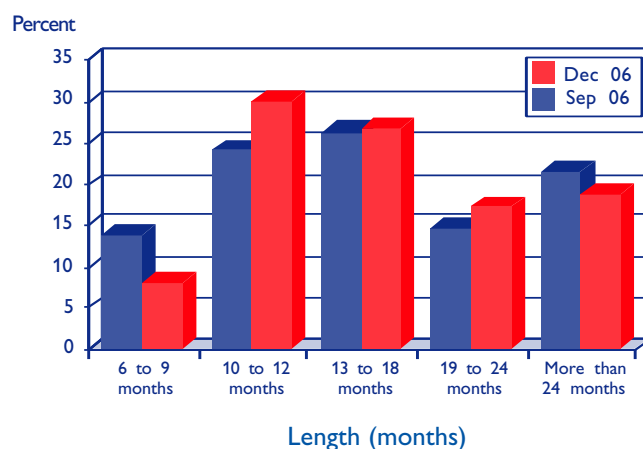
Irrespective of the length of any initial fixed term, on average how long are the same tenants staying continuously in the same property?

Well over half of respondents (56%) said the average length of a tenant's continuous stay in the same property was between ten and eighteen months. However, almost two out of ten (19%) said the average stay was more than two years whilst only less than half as many (8%) said the average stay was less than ten months.

Length of Fixed Term Tenancy	Percent of Respondents (%)		
	Jun 06	Sep 06	Dec 06
6 to 9 months	8.5	13.7	7.8
10 to 12 months	30.5	24.0	29.9
13 to 18 months	26.5	26.2	26.5
19 to 24 months	16.2	14.6	17.2
More than 24 months	18.4	21.5	18.6
Base: All answering	(291)	(253)	(234)

Analysis of these figures shows that the average length of a tenant's continuous stay in the same property is 17.3 months.

Average Length of Continuous Stay



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

Nearly six out of ten respondents (57%) said that they expected to acquire further Buy to Let investment properties during the next 12 months but nearly a quarter (24%) said that they did not. In addition, almost two out of ten landlords (19%) were unsure whether or not they would acquire further properties in the next year.

Response	Percent of Respondents (%)		
	Jun 06	Sep 06	Dec 06
Yes	62.1	54.5	56.5
No	17.1	26.5	24.1
Don't know	20.8	19.1	19.4
Base: All answering	(293)	(257)	(237)



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



ARLA Administration, Maple House 53-55 Woodside Road, Amersham, Bucks. HP6 6AA
Telephone 0845 3455752 Fax:01494 431530 www.arla.co.uk Email: info@arla.co.uk

©ARLA 2006



The ARLA Panel of Mortgage Lenders

