



Q4 2016

# LANDLORDS CAUTIOUS AHEAD OF TAX CHANGES



Despite turbulence in the Private Rented Sector (PRS) dating back to the Government's 2015 Summer Budget, Paragon Mortgages' latest PRS Trends report shows a modest increase in confidence among landlords as they come to terms with impending changes to tax relief.

Buying intentions remain some way off their peak, but are improving, with 13% expecting to purchase buy-to-let property in the next quarter, up from 11% in the previous quarter. While a higher proportion (17%) of landlords expect to sell, this is down from 21% three months ago.

With the Government's tax changes set to be phased in from April 2017 we've reached a critical time for landlords looking to plan ahead, and this is reflected in the Q4 report as more than half of respondents (58%) who pay income tax at above basic rate now say they have already taken or will take action.

## Q4 2016 HIGHLIGHTS

94% of landlords describe tenant demand as stable or growing

Void periods remain low at 2.7 weeks

Average LTV ratio is 37%

Selling expectations down to 17% from 25% (Q1 2016)

The most commonly reported actions have been to increase the rent they charge to cover some or all of the increased cost (24%), to maintain their current properties but not buy any more (21%) and to sell some of their properties and not buy any more (16%).

As a consequence of this forward planning, overall sentiment has remained largely stable. But while the majority (65%) of landlords report no change in sentiment, 22% are now more optimistic about the prospects for their property portfolios, with little more than half as many (12%) saying that, compared with three months ago, they are now more pessimistic.

Despite increasing optimism in the PRS, we must remain cautious. The tax changes haven't started to be implemented yet and therefore the real impact has not even started to be felt. In the last quarter, 33% of landlords have seen their total rental income increase – boosted by the 24% that have actively increased rent – which is not necessarily good news for everybody. And while 71% of landlords say they believe they understand the implications of the income tax relief change, 29% either do not fully understand the changes or feel they need more information.

Unsurprisingly in the current landscape, tenant demand remains high, with 94% of landlords describing the market as stable or growing, and fewer than one in 30 suggesting a decline. Tenant demand continues to impact average void periods, which remain unchanged at 2.7 weeks, with almost half (48%) of respondents reporting that their properties stand empty for less than two weeks. Average yields have also remained remarkably stable for a number of years, running at 6.1% in Q4.

In summary, it would be wrong to say that landlords are no longer concerned about the impact of Government policy on the sector but we are starting to see some improvement as landlords develop their strategies to address the impact of the changes. More than half of the landlords we surveyed have taken, or will take, action and improved sentiment is perhaps a result of the anticipated impact of these actions after a period of uncertainty.

It is, however, difficult to predict how the changes will affect the PRS post-April 2017 – particularly among the 29% of landlords yet to take stock – and I expect to see fluctuation across the board in 2017.



**John Heron**

*Managing Director, Paragon Mortgages*



## JUMP TO...

### OUR PANEL

Our panel are long-term investors in the Private Rented Sector (PRS) with 86% having been a residential landlord for ten years or more. More than three in ten landlords (32%) have been involved in the PRS for more than 20 years.

## OUR LANDLORDS

Our landlords are highly experienced. Of those surveyed this quarter, 84% have been residential landlords for more than ten years, and 29% for more than 20 years. Well over half (61%) of respondents are classed as professional landlords – owning three or more properties – and the proportion of landlords with 11-20 years' experience is the largest at 55%.

## PORTFOLIO SIZE AND VALUE

The size of the average property portfolio among our landlords is 13.3, up from 11.9 three months ago. This is expected to rise to 13.5 in the next 12 months. Despite some fluctuation, the average portfolio size has remained largely stable over the past six years.

Paragon's landlord panel reported an average property portfolio value of £1.7m, up 10.9% on the previous quarter. They expect the average value to increase by 2.5% over the next 12 months, in contrast to an expected decrease of 0.3% reported three months ago.

## SENTIMENT

Although nearly two thirds of residential landlords (65%) say there has been no change in their view of the prospects for their property portfolio over the last three months, more than two out of ten (22%, up from 18% three months ago) say they are more optimistic now than they were three months ago. Just over half as many (12%, down from 18% three months ago) say they are now more pessimistic.



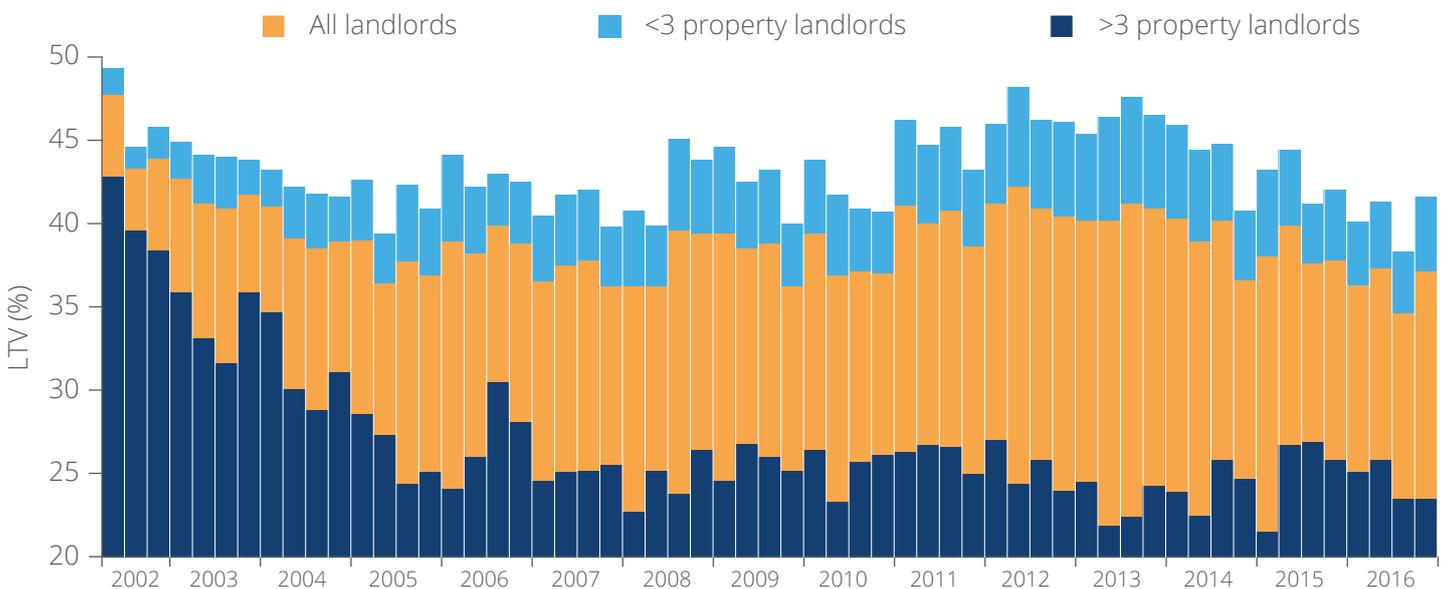
3 months

## GEARING

The level of equity in landlords' portfolios remains significant and steady over the long-term. More than six out of ten residential landlords (63%) have borrowings of less than half of the value of their investment property portfolios. The average loan-to-value stands at 37%, a slight increase on last quarter but in line with recent results.

Over the last three months the average market value of residential landlords' investment property portfolios has risen by 10.9% from £1.5m to £1.7m, more than reversing the decrease seen three months ago, and the average gearing of these portfolios is up from 35% to 37%, also reversing the decrease seen three months ago. On average, landlords spend 27% of their rental income on mortgage payments.

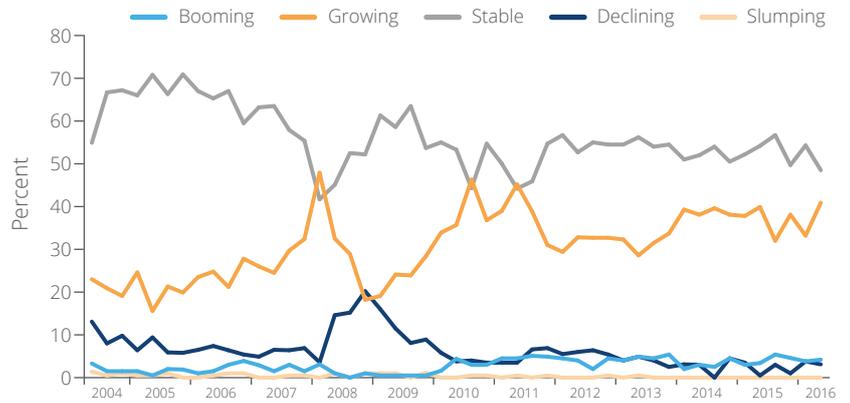
Average gearing of investment property portfolios



## TENANT DEMAND

There is a notable increase in the proportion of our landlords who think that tenant demand is 'growing' or 'booming', up to 45% from 37%. Meanwhile fewer think that tenant demand is stable than did three months ago. Half of residential landlords expect tenant demand to increase over the next 12 months while only a small minority (5%) expect it to decline. More than a third (36%) expect tenant demand to stabilise in the next 12 months.

How tenant demand for residential property is changing



## VOID PERIODS

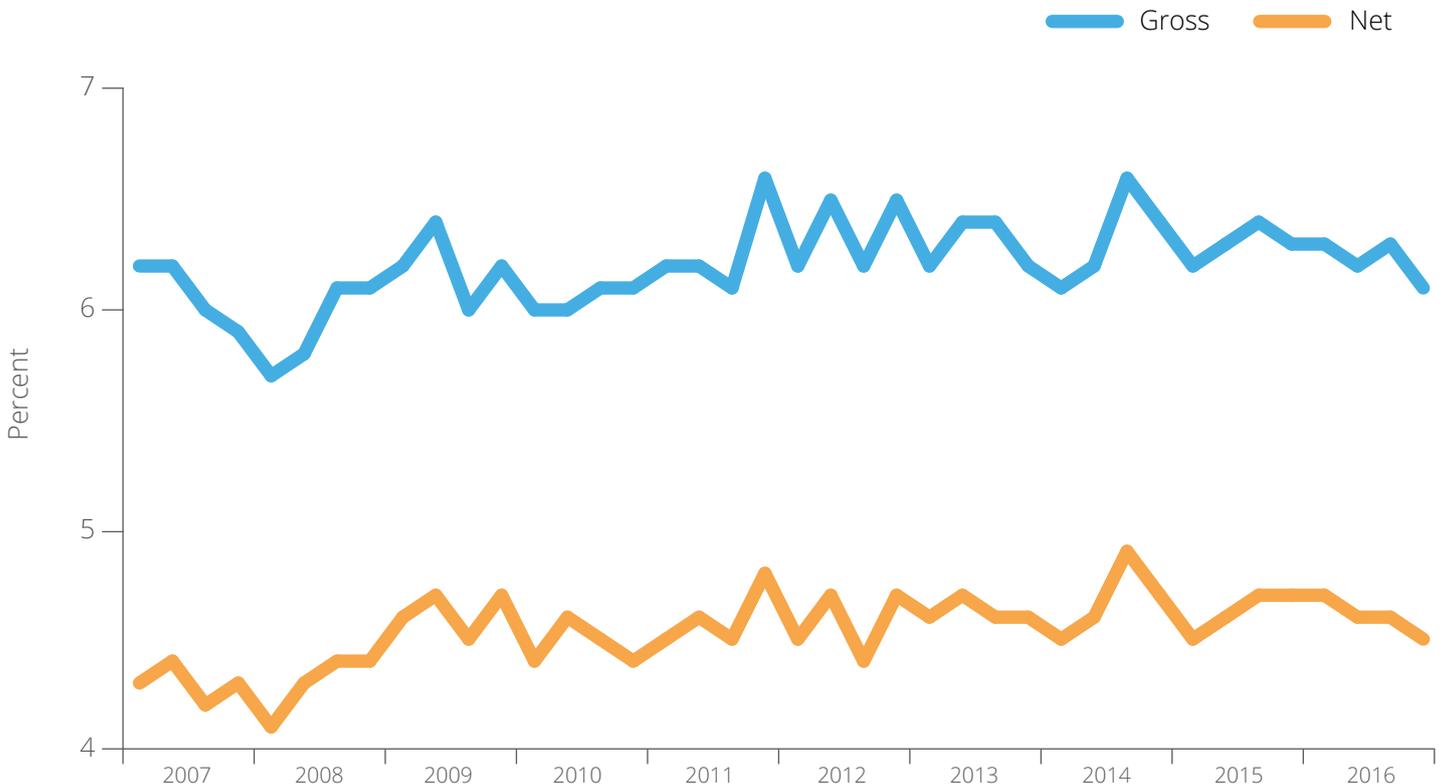
Void periods remain unchanged versus the previous quarter, at 2.7 weeks. This is a slight increase on the same period last year (2.6) following a record low of 2.5 weeks in Q3 2015.



## GROSS RETURN

More than six out of ten residential landlords (64%) report average gross annual rent equivalent to between 4% and 7% of the value of the portfolio. 22% are doing better than this and 8% are achieving a return greater than 10%. The average gross rental rate of return for all landlords is 6% – a remarkably stable average over the past ten years.

Average current rental rate of return

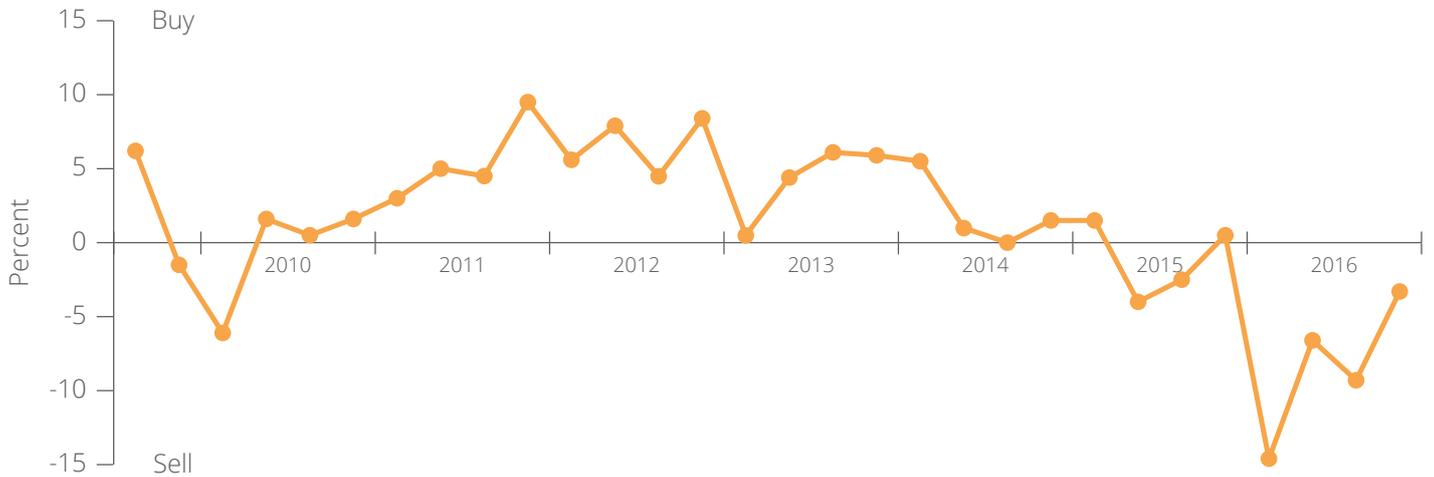


## BUYING, SELLING & PROPERTY TYPES

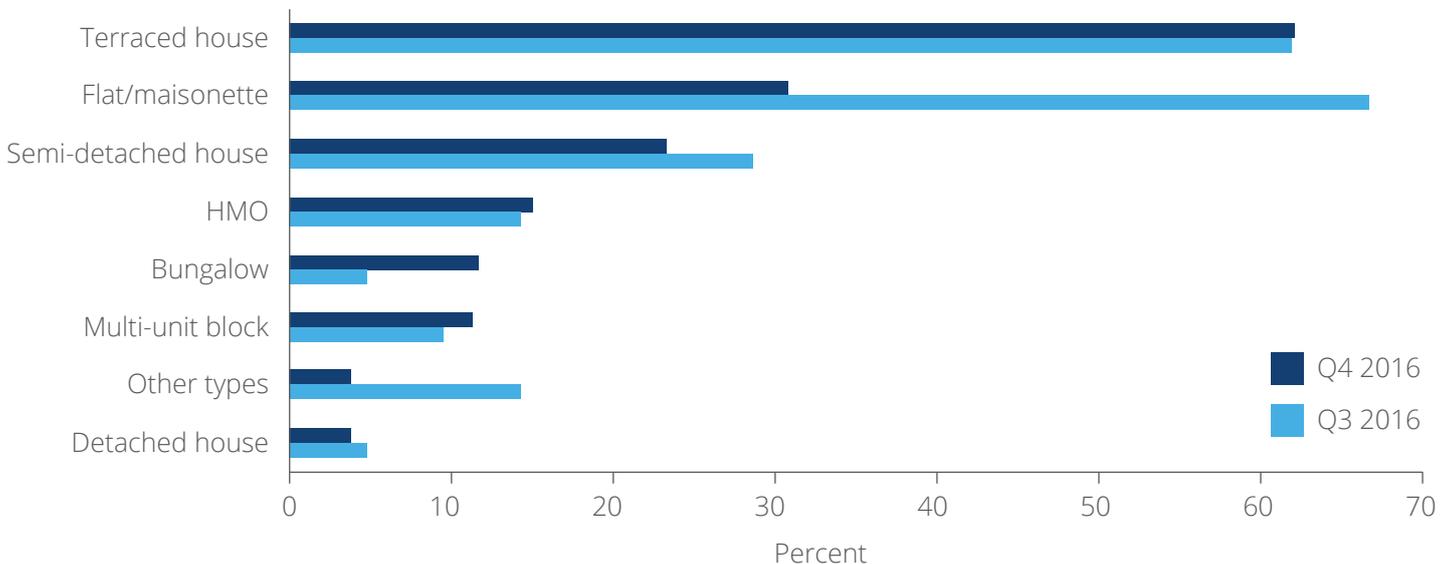
More than one in eight (13%) residential landlords surveyed expect to purchase buy-to-let property in the next quarter, up from 11% in the previous quarter. A higher proportion of landlords (17%) say they expect to sell buy-to-let property in the next quarter, down from 21% in the previous quarter.

Amongst landlords expecting to purchase, most plan to buy terraced houses (62%), flats/maisonettes (31%) or semi-detached houses (23%). Intention to purchase flats/maisonettes has decreased from 67% in the previous quarter.

Difference between landlords expecting to buy vs. sell in the next quarter



Type of property landlords expect to buy



Nearly six out of ten residential landlords (58%) have taken, or are planning to take, some action as a result of the change in income tax relief on buy-to-let mortgages, but more than two out of ten (21%) have not taken any action and do not think they will.

The most popular actions have been to increase the rent charged to cover some or all of the increased cost (24%), to maintain their current properties but not buy any more (21%) and to sell some of their properties and not buy any more (16%).

71% of landlords believe they understand the implications of the income tax relief change. One in ten (11%) say they do not understand and 18% say they feel they need more information.

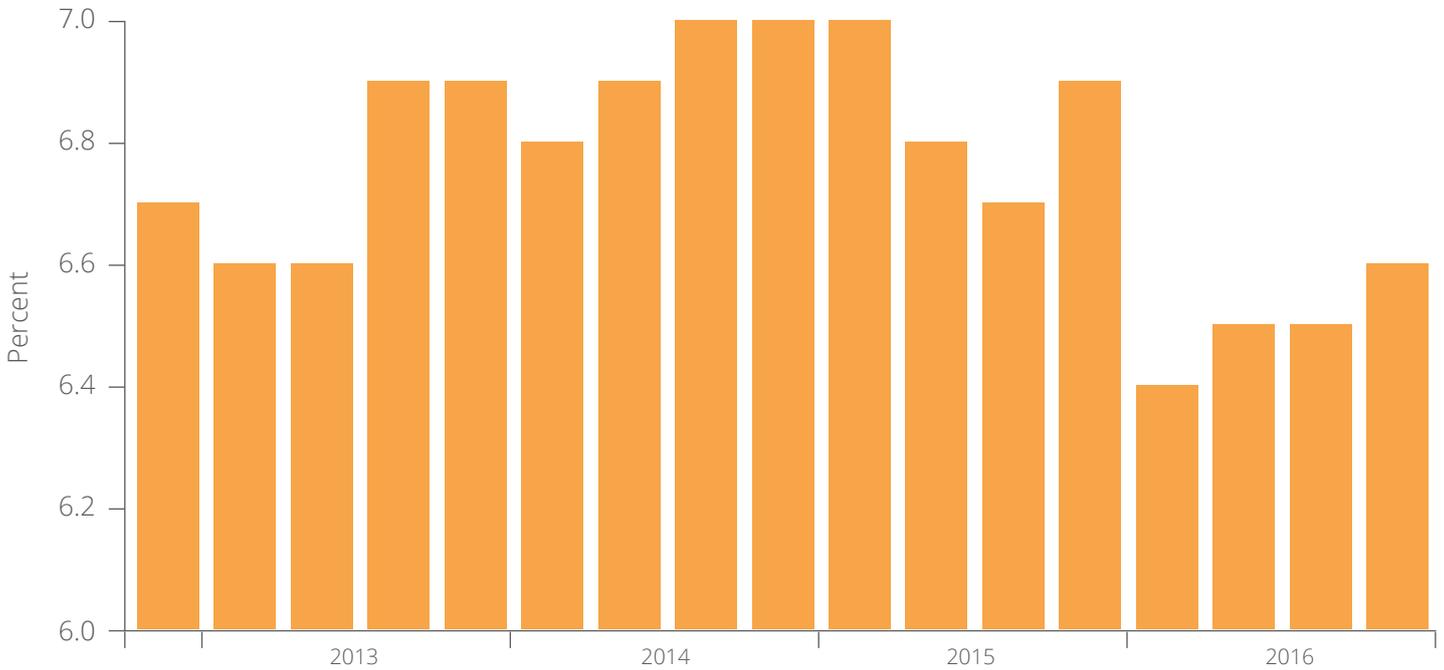


## OVERALL PROSPECTS

Despite continued uncertainty around buy-to-let investment, the majority of landlords surveyed responded positively about prospects for the PRS in 2017. On average, positivity was recorded at 6.7 out of ten, where ten equates to very positive and one to very negative. This represents a third increase this year, up from 6.5 in Q1 and 6.6 in Q2.

### Overall prospects for the PRS in next 12 months

(Average rating out of 10)



## ABOUT PARAGON MORTGAGES

Paragon Mortgages' PRS Trends report has been tracking sentiment amongst residential landlords since 2001 with a panel of approximately 200 landlords. For this quarter's report 204 landlords were surveyed and results are an indication only of landlords' views.

Paragon is a leading specialist lender of buy-to-let mortgages to landlords and residential property investors in the UK, a loan servicing provider for third party clients and an active acquirer of loan assets and portfolios and has most recently established a banking subsidiary, Paragon Bank.

Paragon has £12.9 billion of loan assets under management. Since being established in 1985, it is the only specialist lender to maintain an independent position within the UK mortgage market.

Paragon is a member of the Council of Mortgage Lenders, the Intermediary Mortgage Lenders Association, the National Landlords Association and the Association of Residential Letting Agents Lender Panel.

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