in Association with the NLA

bdrc continental

allsop

the rent check

Issue 7: Spring 2016 – covering England & Wales

PRS Barometer

40% of landlords anticipate rental growth over the next 6 months (up 14% year on year)

14% of landlords purchased at least 1 property in the preceding 6 months (down 3%)

37% of landlords saw tenant demand increase over the last 6 months (down 4%)

3% of landlords have lowered rent across their portfolio in the last 12 months (down 1%)

18% of landlords intend to purchase at least one more property in the next 12 months (down 11% since last Spring)

59% of landlords believe recent Government announcements will damage their profitability

Regional Snapshot

Average 2 bed flat pcm

	Q1 2016	annual change
London (zone 3-6)	£1,190	+£80
South East	£775	+£10
South West	£685	+£5
East England	£650	+£55
West Midlands	£570	-£5
Wales	£585	+£25
East Midlands	£590	+£35
North West	£570	+£15
North East	£535	+£45
Yorkshire & Humber	£595	+£60

Regional Snapshot

Average 3 bed property pcm

	Q1 2016	annual change
London (zone 3-6)	£1,460	+£25
South East	£995	+£40
South West	£875	+£0
East England	£790	+£40
West Midlands	£650	-£85
Wales	£615	+£35
East Midlands	£675	+£45
North West	£625	+£5
North East	£600	+£75
Yorkshire & Humber	£625	+£5

Rounded to the nearest £5 pcm

45% of landlords are higher rate income tax payers

5% of landlords structure their business as a limited company, 41% are considering doing so

71% rate property investment as preferable to any other form of investment

The Rent Check interviewed 2,461 landlords across England & Wales over the six months to March 2016.

introducing

the **rent** check

The Rent Check is a collaboration of expertise from BDRC Continental – the UK's largest independent market research consultancy – and Allsop LLP – one of the leading property consultancy firms and advisors on the residential property market.

The Rent Check is a unique measure of the rents being agreed by landlords for Private Rented Sector tenancies across England and Wales. This research tracks the experience of a large sample (2,461 in the six months to March 2016) of members of the National Landlord Association (NLA), providing a statistically robust overview of the rental market - covering 20,071 properties.

The Rent Check is supplemented by the 'Tenant Panel' in order for us to gain the perspective of the tenants. This provides us with an inclusive outlook of the private rental sector that other indices do not cover.

These surveys will continue to track movements and evolutions in the private rented market each six months, analysing movement in agreed prices, regional variations and providing unique landlord and renter insight.

The Rent Check is a survey forming part of the BDRC owned 'Landlords Panel' which will provide supplementary analysis on future rental trends, tenant profile and landlord confidence in future survey releases.

the integrity of

the **rent** check

The data included in the Rent Check has been analysed and scrutinised by BDRC Continental's research analysts and draws on their experience in the consumer research arena. BDRC Continental has a seven year history of conducting research with residential landlords and have carried out focused research on the buy-to-let market and private rental sector on behalf of a wide range of clients and interested parties.

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the **rent** check

BDRC Continental's Landlords Panel is the only regular, commercially available study of the UK's private rental and buy-to-let sectors. Established in 2006 and run in partnership with the National Landlords Association, the subscription based study provides important insight into the market dynamics of this multibillion pound industry. Each quarter more than 1,000 online landlords across the UK are interviewed about the key aspects of their letting activity, as well as general economic indicators including optimism and market outlook. Results are independently analysed and published by BDRC Continental.

The Tenants Panel will be carried out quarterly, with around 1,000 private tenants participating in the survey each wave. For sake of clarity, the tenants are randomly selected from commercial lists within which participants self-select by declaring that they are private tenants. They are not connected to NLA members, although we do not rule out that some may coincidentally rent from them.

Unintended consequences; reviewing 12 months in the PRS

Much has been made in recent months of the negative reaction by landlords to the Government's pursuit of their home ownership agenda at the expense of the Private Rented Sector (PRS). Commentators have expressed significant disappointment at the changes to taxation and lending policies and deep concern over a potential landlord exodus from the PRS. The seventh issue of the Rent Check considers the immediate impact on rental levels since the Rent Check began in 2013 to March 2016 and discusses the prospects for rental growth, and the potential for landlords to re-look at their attitudes to investment management strategies to protect their returns.

A year of political and regulatory intervention

It is now 12 months since the May 2015 General Election returned a Conservative majority Government to power. It is easy to forget with the passage of time, but the result was, in many ways, highly unexpected. In the run up to polling day, many had predicted that the election would be much closer than the final result suggested and a hung parliament - or the continuation of the Conservative / Liberal Democrat coalition - was considered by many expert commentators to be the most likely result. In terms of the politics surrounding the provision of privately rented housing, stakeholders saw the key battleground as, in the blue corner, home ownership and defence of the free market, versus, in the red corner, potential rent control and increased regulation.

Perhaps what has been even more unexpected than the election result itself has been the unanticipated, yet significant, amount of Government intervention into the PRS market through tax policy changes and, driven by the Bank of England (BoE), the Prudential Regulation Authority (PRA)'s proposals for tougher standards for buy-to-let lending. These standards are to be considered by the BoE for ratification after a consultation ends in June.

As a result of the above, landlords are facing the following changes:

- Higher rate tax paying landlords will be affected by a phasing towards basic rate tax relief only on mortgage interest which will reduce net income. This group make up 28% of the Rent Check sample
- All investors will face higher acquisition costs through increased SDLT obligations for additional properties above and beyond their own home
- If implemented, investors requiring buy-to-let finance will face a requirement for higher personal cash reserves and more pessimistic interest rate stress testing which will halve the number of buy-to-let mortgage approvals, according to the PRA

The significance of these changes should not be underestimated. Whether landlords have small or large scale portfolios or are debt or equity investors, the numbers surrounding current and future investment decisions have changed. Yet, the past tells us that the residential investment market does tend to be resilient; ultimately housing is a necessity and not just a luxury and we have a known long-term undersupply of residential property in the UK with no realistic way of plugging the gap quickly.

> **"Landlords are feeling battered by the recent, unexpected, raft of government intervention, it's unprecedented from their perspective, and they are beginning to seriously consider their options."**
>
> Mark Long, BDRC

The rental reality - short term fluctuations; long term stability

The reality on the ground is that there is some evidence of an immediate rent hike across the UK as a result of taxation changes. Although on the 16th of March it came as a surprise to larger-scale investors that they would not be exempt from a SDLT surcharge on second properties, smaller landlords had already been bracing themselves for the impact on their ability to extend their portfolios.

Our research suggests that in many areas of the country, rents have risen in the last 12 months - particularly so for two bedroom flats. Landlords report the highest increases in the North East and Yorkshire and Humberside, although in other areas such as the South East, South West and the West Midlands landlords reported rents are fairly flat. For three bedroom houses, with the exception of the North East which has seen the highest level of reported growth, all other regions have seen a maximum of 4.7% increases (East Midlands). Most other regions have seen marginal price rises of up to 3%. The West Midlands has seen the greatest reported fall in rents of 8.5%, year on year.

Unintended consequences; reviewing 12 months in the PRS

(Continued)

2 bed flats	% Change 2015-2016
Yorkshire & Humber	9.7%
North East	8.1%
Wales	7.3%
East England	6.6%
London (zone 3-6)	5.1%
East Midlands	4.4%
North West	4.1%
South West	1.5%
West Midlands	0.9%
South East	-1.0%

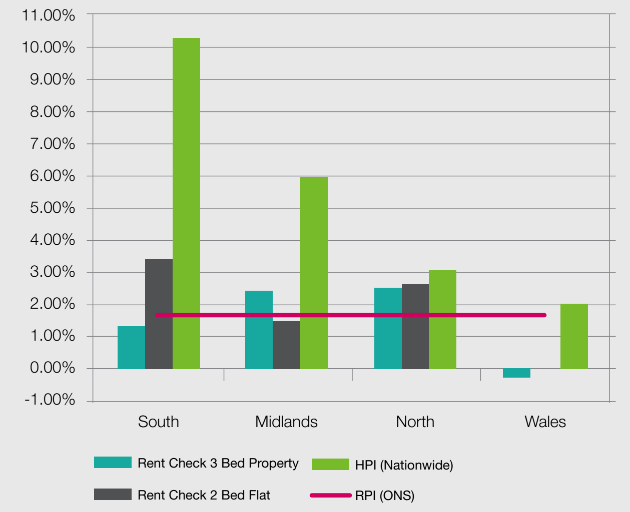
3 bed property	% Change 2015-2016
North East	10.6%
East Midlands	4.7%
East England	3.6%
Wales	2.9%
London (zone 3-6)	2.1%
South East	1.8%
Yorkshire & Humber	1.6%
South West	0.3%
North West	-0.8%
West Midlands	-8.5%

So, is there a clear trend that rents are shooting up? Well, no. Unfortunately, it is not such a simplistic picture; once we take a medium term view and consider rental trends over the last three years rather than the short term fluctuations, the analysis is much less volatile.

We now have three years of Rent Check data upon which to reflect - and the rental growth analysis definitely paints a very interesting picture since we began issuing our six monthly reports. Combining the regions into larger areas for the purposes of analysis, whether in Northern England, Southern England or the Midlands, the average annual rental growth for two bed flats and three bed houses have risen at levels in line or marginally below the average rate of RPI in what has been a very low inflationary environment. This very much matches known long term trends for rental levels; we do not typically experience rapid growth in rental prices so often associated with housing market increase for home purchases. This is illustrated by comparing rental changes over the last three years to average house price increases according to Nationwide during the same time period. It is very clear that rent rises have been much less pronounced than capital value appreciation.

Rent Check 2 Bed Flat and 3 Bed Property Rental Growth and Nationwide HPI Against Annual RPI

(Spring 2013-2016)



Before the market gets excited about some short term rental pricing changes, it is important to consider why this longer term trend has occurred. We consider that there are three key market drivers which help to explain recent rental pricing performance, and help us to understand the likely direction of rents going forward.

1. Rents are linked to tenants' ability to pay not tenants' ability to borrow. It is not possible to obtain bank lending to specifically cover high rental payments so there isn't a leveraging affect that can push prices as for house prices. The ability to pay is key.

2. Tenants are more sensitive to rental prices and increases than they would be to mortgage payments. Although rents do, naturally, tend to be above the cost of a mortgage on the same property, this reflects a shorter term low interest rate environment. Additionally, tenants are often saving for deposits to buy their own property and therefore seek to save as much money as possible by limiting rental outgoings.

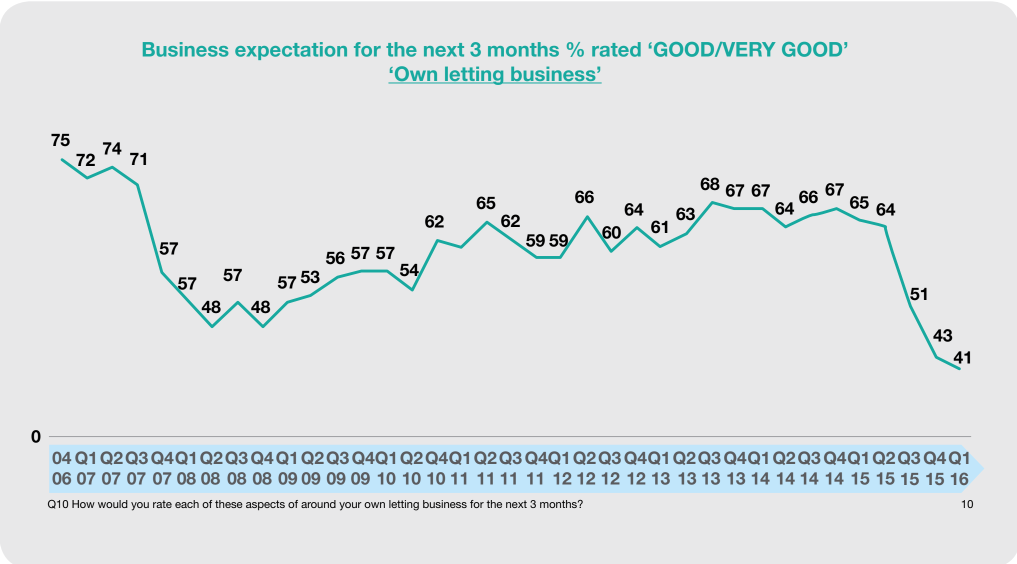
3. Market rental levels are highly likely to be more volatile than house prices. While there is inbuilt market inertia that protects capital values since, in general terms, most homeowners will not sell at a loss and prefer to hold on to assets until prices are higher than they paid. Tenants on the other hand may choose to vacate for a number of reasons given the inbuilt flexibility of the AST framework. Landlords facing a vacancy are much more likely to offer an incoming tenant a lower rent if they face a lengthy period without a tenant.

Unintended consequences; reviewing 12 months in the PRS

(Continued)

How will landlords react? Rent rises, reduced supply, greater uncertainty for tenants - or none of the above?

It is difficult to put a positive spin on the starting point of landlord's reaction to recent changes, with confidence at a historic year low according to the most recent Landlords Panel survey. Landlords reporting 'good' or 'very good' expectations for their letting business fell to 41% in Q1 2016, down from 43% in Q4 2015. Putting these figures into context, the highest ever recorded confidence was 75% in Q4 2006 and the previous low before Q4 2015 was at the start of the previous recession in Q2 and Q4 2008 when only 48% of landlords had confidence in their businesses. Yet, how will landlords react to the market? Will rents rise and will supply fall or will being a tenant in the new environment for residential investment get easier - or tougher?



So, will rents rise?

As we described earlier, in many ways the rental market is much more difficult to read than the housing market; essentially because it is a short term focus on both the part of occupier and owner. No funding leverage is available for tenants so an ability to pay is as important as a landlords desire to increase rents - that is why going backwards, and forwards, it is hard to break from a long term tie to wage growth and RPI. The only exception is where there is super-demand for a rental product in a given location - or arguably a new market product as is the case with many planned 'build-to-rent' developments - but chances that above inflation growth year after year will be unlikely. There will come a point where the rental amount asked does not look value for money against, albeit inferior, market alternatives.

Coupled with this, landlords are well aware of the disproportionate costs of voids on returns which acts as a keen stabiliser against widespread rental growth. The rental maths shows that it doesn't take long for a landlord to lose out by asking for a higher than market rent (which may be achieved after a longer marketing period) than taking a slightly lower rent straight away. And while BDRC's research shows us that tenants do think of their tenanted property as their home, they aren't as emotionally tied to it as homeowners can be. Tenants may not want to move, but they are sensitive to rental levels.

Given the above, our conclusion is that although landlords will wish to increase rental income to offset taxation losses, this isn't as straight forward as it sounds, except in areas where there is an acute shortage of stock.

Will landlords leave the sector en masse?

Any form of property investment is always said to be for the long term. It is not a rapidly tradeable asset as a company share or Government Bond can be via the financial markets. Having said that, we are fortunate in the UK that we have a functional housing market and that there are good levels of interest in home purchases, which makes residential property not as illiquid as it could be. However, anyone who has ever sold a property knows it is not as simple at putting a sign outside a house or flat to divest. It is certainly not a case of one phone call to an intermediary as can be the case for disposing of financial investments. The quickest option for sale would be via auction, but even that will take a number of weeks from the time of appraisal to bringing the property to market, selling it under the hammer and applying for buy-to-let finance, then completing the legal formalities of a sale.

Additionally, a landlord may not have any other attractive option for transferring their capital into following a sale of their rental property, in which case many may choose to simply retain their asset. Savings rates remain historically low and there is typically an acquisition and management cost to any form of other investment. Equally, with global economic uncertainty, other forms of investment may feel more risky.

Some landlords will undoubtedly decide they have had enough and seek to exit the market. However, given the natural inertia which accompanies a long term investment, it is more likely that moves towards divesting will be slower and orderly rather than rapid and dramatic.

Unintended consequences; reviewing 12 months in the PRS

(Continued)

What is perhaps more predictable, is that new supply to the rental market could likely reduce due to the introduction of a Stamp Duty surcharge of 3%. It is not possible to include Stamp Duty obligations as part of a mortgage application and therefore this cost comes from equity. Coupled with larger deposits, a good number of landlords may not practically be able to add the number of dwellings to their portfolio - whether they wanted to or not. Having said that, 18% of the Rent Check sample landlords were planning to acquire further properties in the next 12 months.

"Whilst the intuitive reaction of many landlords will be to increase rents to offset any projected impact on profitability, real world rental market conditions may well be a significant constraint."

Paul Winstanley, Allsop

How will landlords look to protect their financial position

Research tells us that landlords are making moves to protect their own financial position, which is completely understandable in the circumstances. In our view, this will most likely be in one of three ways:

1. Rent increases. Subject to our comments above about the practicalities of implementing rent reviews, 40% of landlords do tell us that they are planning to increase their rents to help offset pressure on their profitability. The success of this strategy will reflect the local, rather than national rental market.

2. Implementing more frequent rent reviews for existing tenants. The taxation changes may tip the balance for landlords between keeping the rent the same for good tenants and exercising a rent review. Research tells us that more landlords won't have the option to keep rents the same so, unfortunately, in these cases good tenants will likely be affected. Again though, local rental dynamics will likely influence actual landlord behaviour which could mitigate the impact of landlord's intentions.

3. Changed management strategy. There are other ways whereby landlords can increase their efficiency. While self-management may be cheaper, our research indicates that 27% of landlords now consider an online agent to be a more attractive proposition than a traditional managing agent, and 31% would consider using an online letting agent. Through experience of implementing our own 'virtual agency' management & letting product, it would not surprise us if the preference for online lettings grows in the coming years. A hybrid model of providing expert advise by technological advances, allows for innovative management and letting solutions, particularly for investors offering build-to-rent properties.

the **rent** check

To subscribe to the rent check please email: **rentcheck@allsop.co.uk**

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