

Changing Strategies



The changes to landlord tax relief and stamp duty announced in 2015 have, by now, had plenty of time to sink in. Understanding of the personal implications of the changes has grown in Q1 2016. Indeed, asked if they understand the implications of the tax changes, more than three quarters (76%) of our landlord panel now say they do, up from 62% in the previous quarter. Likewise, those saying they don't understand are down from 11% to 7% and those needing more information down from 26% to 16%.

So, what impact is this increased understanding having on our panel?

As might be expected, the higher rate of stamp duty on buy-to-let purchases has impacted landlords buying intentions. Just 9% of our landlord panel indicated they intended to purchase a property in the next three months, down from 14% in the previous quarter. With reference to the income tax changes, there are indications that some landlords might have already reduced their exposure. This quarter has seen the average number of properties owned by our panel reduce from 12.7 in Q4 2015, to 12.5, a decline albeit a modest one. Asked what size portfolio they expect to own in 12 months, our landlords are expecting a further reduction, to an average of 12.3.

John Heron

Managing Director, Paragon Mortgages

Expectations of reduced portfolios have also had a corresponding impact on the value landlords expect from their portfolios. Despite the average portfolio value having risen in Q1 2016 to £1.56 million, from £1.52 million in the previous quarter, fewer landlords expect to see growth in portfolio values over the next 12 months. Just over a quarter (26%) of landlords expect to see growth in the value of their portfolio in Q1 2016, compared to 27% last quarter, whilst those expecting a decrease in value have risen from 9% in Q4 2015 to 13% currently.

However, not investing in property acquisition doesn't necessarily mean not investing at all. Our latest data shows a marked increase in the number of landlords seeking to increase spending on their current portfolios. The percentage of landlords saying they would reduce maintenance of their current portfolios as a result of income tax changes has decreased from 25% in the previous quarter, to 12%. Likewise, those saying they would make fewer improvements to their existing portfolio are also down, from 31% to 14%.

So, whilst some landlords might be discouraged from growing their portfolios, they may seek to invest instead in developing and adding value to their existing property.

This quarter has also seen landlords' credit profiles strengthen further. Levels of gearing among our panel have reduced from 38% in the previous quarter, to 36% now. Affordability indicators are also strong with more than half of all respondents (51%) saying they spend less than a quarter of their rental income on mortgage payments.

So, with tenant demand remaining strong, returns stable and void periods low, our panel are still looking for ways to invest in their portfolios, but are adapting their strategies in light of changes to the tax landscape.

Q1 2016 Headlines



OUR LANDLORDS

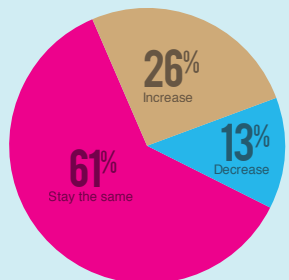
Our panel are long-term investors in the Private Rented Sector (PRS) with 83% having been a residential landlord for ten years or more – down slightly from 86% in Q4 2015. Nearly a third (28%) of our panel have been involved in the PRS for more than 20 years.

PORTFOLIO SIZE AND VALUE

The size of the average portfolio is 12.5 properties – a slight reduction on the previous quarter's figure of 12.7. Landlords expect this figure to reduce further to 12.3 properties over the next 12 months.

Our panel reported an average property portfolio value of £1.56 million in Q1 2016, an increase from the previous quarter's figure of £1.52 million. Around a quarter (26%) of our landlord panel expect the value of their portfolio to increase over the next 12 months, whilst 13% expect a decrease in value - 61% expect no change in the overall value of their portfolio over the next 12 months.

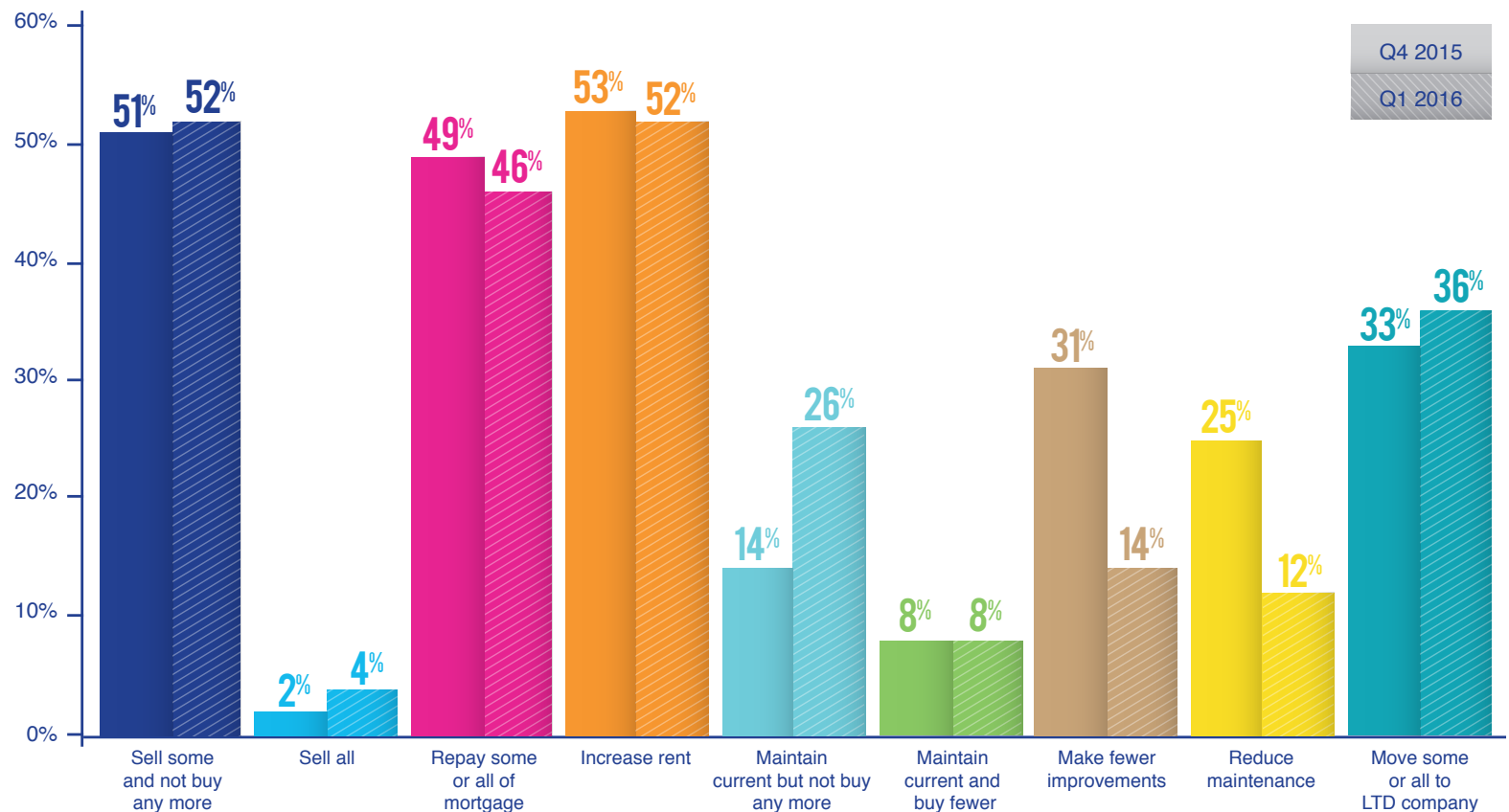
Expected change in property value over coming 12 months



INCOME TAX RELIEF CHANGES

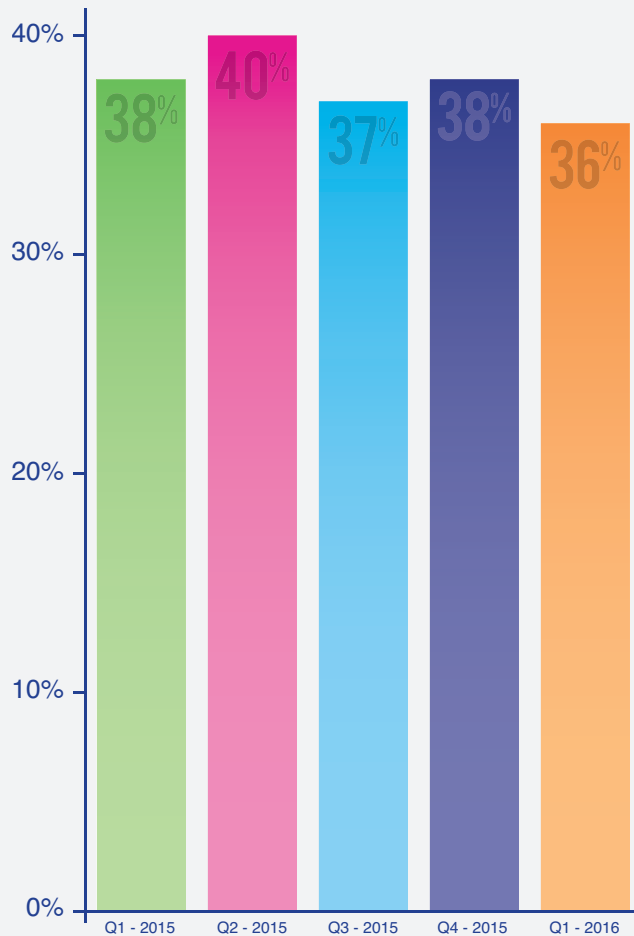
For panel members most impacted by the forthcoming changes to income tax relief on buy-to-let mortgages – for example those using buy-to-let finance and paying income tax at higher rates – awareness of the implications of the tax change is growing. Asked whether or not they understand what the changes to income tax relief will mean for their portfolios, more than three quarters said they did, up from 62% in Q4 2015. Meanwhile just 7% said they didn't understand, down from 11% in the previous quarter, while 16% said they needed more information.

Asked what action they would take as a result of the changes, 52% of landlords said would seek to reduce the size of their portfolio and not buy any further properties. Elsewhere, the proportion of landlords saying they would reduce maintenance of their portfolio and make fewer improvements has halved since the previous quarter, indicating that landlords are seeking new ways to invest in their current portfolios.



PORTFOLIO GEARING

The level of equity in landlords' portfolios remains significant and continues to grow over the long-term. Q1 2016 has seen landlords further grow the equity in their portfolios, and decrease average LTVs from 38% in Q4 2015, to 36% currently.



Do you understand the implications of the income tax relief changes announced in 2015?

76%
Yes

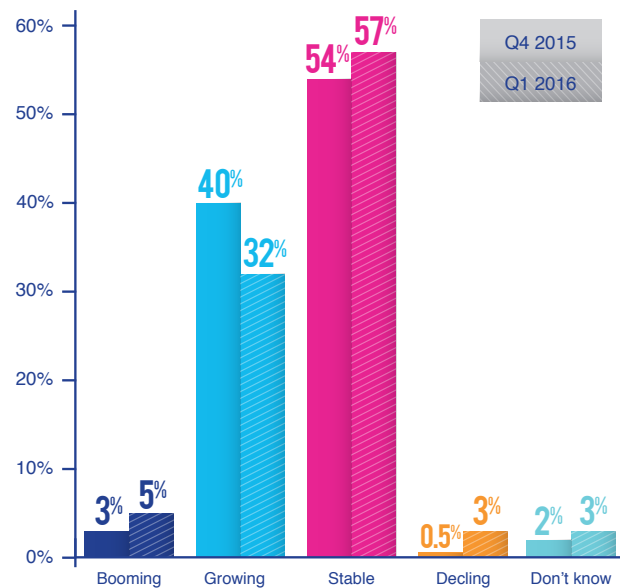
7%
No

16%
Need more information

1%
Not stated

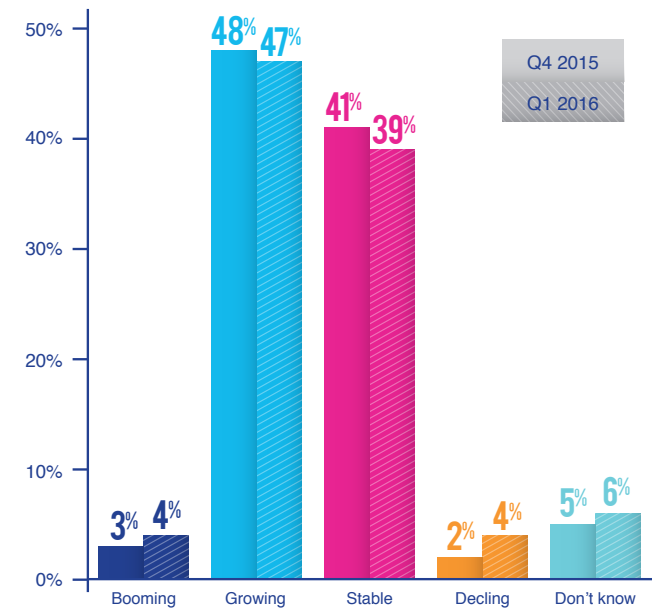
TENANT DEMAND

Reported tenant demand remains high in Q1 2016, with 37% of respondents saying it is either 'booming' or 'growing', down from 43% in the previous quarter. Those reporting demand as stable have increased correspondingly from 54% to 57%, while those reporting a decline in demand have increased from 1% to 3%.



FUTURE TENANT DEMAND

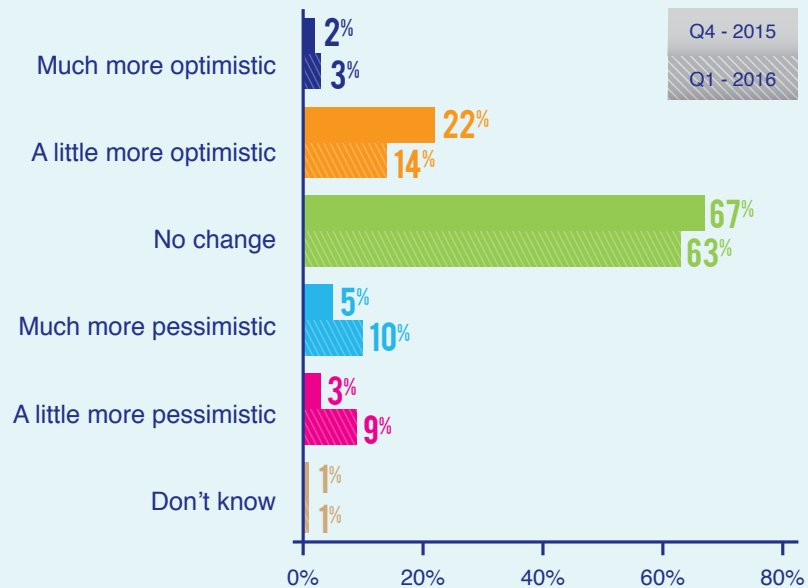
On the question of how demand will change over the coming 12 months, despite some changes since the previous quarter, more than half (51%) expect demand to 'boom' or 'grow' – a figure unchanged on Q4 2015. There has also been a small increase in the number of people expecting a decline in demand from 2% to 4%.



PROSPECTS FOR PORTFOLIOS

Reflecting more cautious buying intentions and a greater awareness of the impact of tax relief changes and the stamp duty increase, optimism about the prospects for the sector and property portfolios has dipped in Q1 2016. Those reporting feeling 'much' or 'a little more' optimistic about their portfolios stand at 18% in Q1 2016, down from 24% in the previous quarter. There has been a corresponding increase in pessimism.

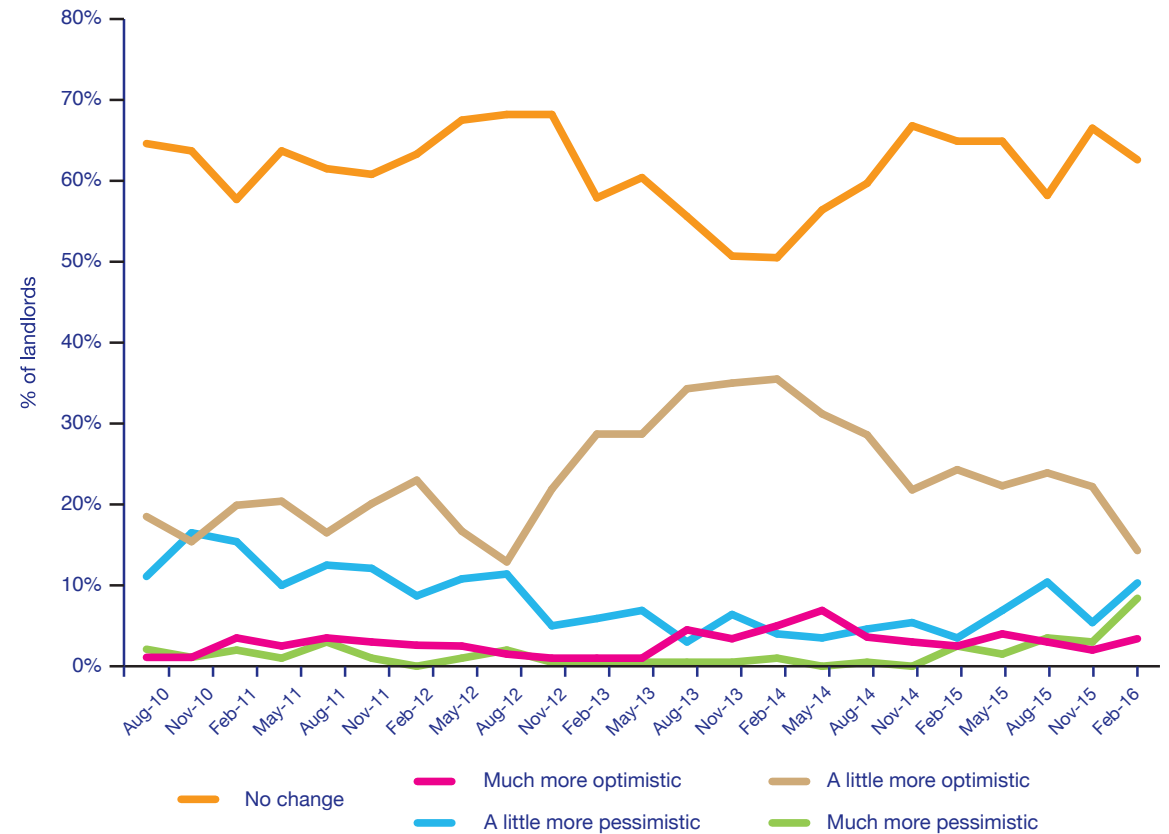
VIEW OF PROSPECTS



VOID PERIODS

Void periods remained at historic lows in Q1 2016. For nearly half of respondents (48%), the average void period per year is less than two weeks, while for a third (34%) it is between two and four weeks. Average void periods now stand at 2.5 weeks, unchanged since the last quarter.

How optimistic are you about your portfolio, compared to three months ago?



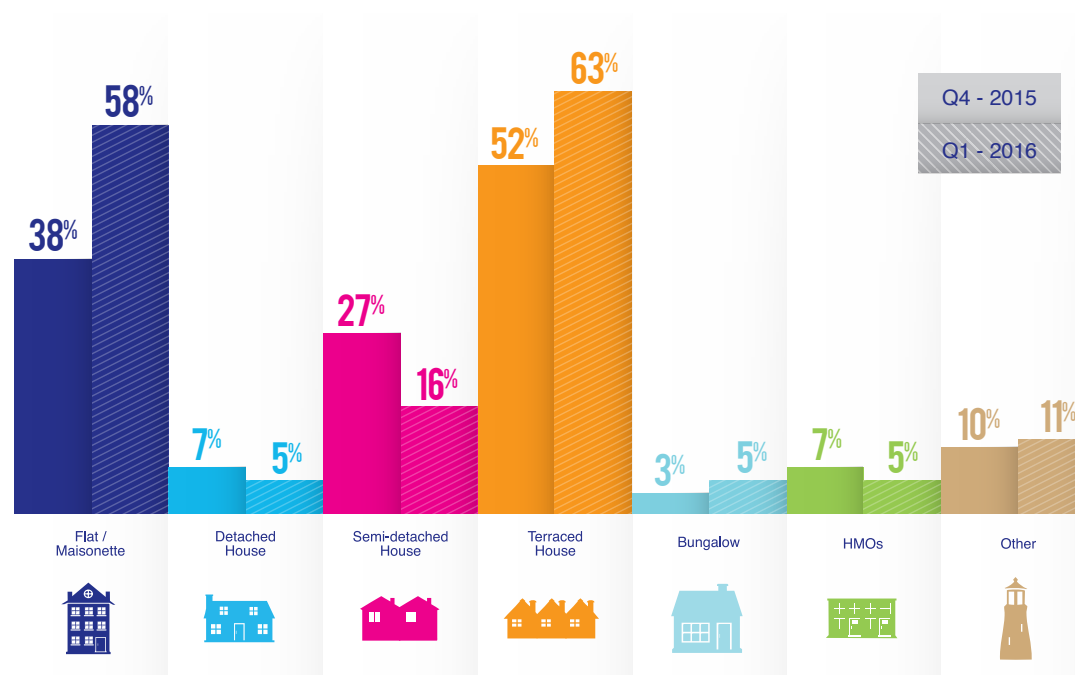
RENTAL YIELDS

Rental yields – the amount of rent receivable as a percentage of portfolio value – averaged 6.3% in Q1 2016 - unchanged since the previous quarter. More than six in ten respondents (63%) report average gross annual rent receivable equivalent to between 4% and 7% of the value of the portfolio while nearly a quarter (23%) are doing better than this with 7% achieving a return greater than 10%.

BUYING EXPECTATIONS

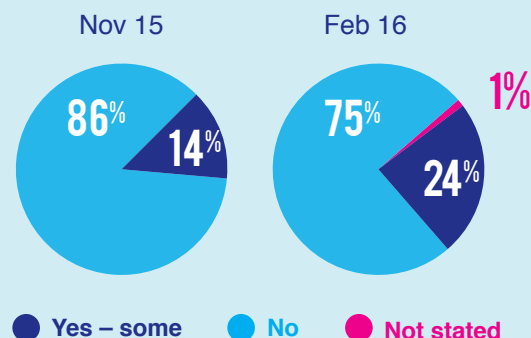
The introduction of increased stamp duty on buy-to-let purchases has impacted buying intentions in Q1 2016 with just 9% of landlords indicating that they expect to purchase a buy-to-let property over the next three months. This is down from 15% in the previous quarter and 18% in Q3 2015.

Amongst those looking to make a purchase there has been a strong move towards the traditional buy-to-let 'safe havens' of flats/maisonettes and terraced houses. More than half (63%) said they intended to buy a terraced house, up from 51% in Q4 2015, while 58% said they intended to buy a flat/maisonette, up from 38% in the previous quarter.



SELLING EXPECTATIONS

Alongside decreased buying expectations, Q1 2016 has also seen the number of respondents looking to sell property increase. Almost a quarter (24%) of landlords surveyed indicated that they intended to sell property in the second quarter of 2016, up from 14% in the previous quarter. Correspondingly, those saying they wouldn't be selling any properties over the next quarter has declined from 86% to 75%.



PROSPECTS FOR THE PRS

Uncertainty around buy-to-let investment has impacted sentiment around the prospects for the PRS in Q1 2016. Asked to rate prospects for the PRS from one (very negative) to ten (very positive), Q1 2016 saw respondents give an average score of 6.4, down from 6.9 in the previous quarter.



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ABOUT PARAGON

Paragon Mortgages' PRS Trends report has been tracking sentiment among residential landlords since 2001 with a panel of approximately 200 landlords. For this quarter's report 203 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 £11.2 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.

The Group 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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