

Q1 2017

# A LONG ROAD AHEAD



Almost two years on from the 2015 Summer Budget and the Government's move to create "a more level playing field" between landlords and homeowners, April 2017 is finally here and the tax relief changes on buy-to-let mortgage interest have started to be implemented – although the full effect will not be felt until 2021.

Looking back on the 21 months since the then Chancellor George Osborne's announcement, it's encouraging to see the Private Rented Sector (PRS) has not been negatively impacted to the degree that had been widely predicted, despite some turbulence.

However, we remain cautious, as landlords will not be fully impacted for some years yet and, whilst we have been able to track a modest recovery in confidence since 2015, the sector is still some way off its peak; the PRS is finely balanced and will remain so for some time.

## Q1 2017 HIGHLIGHTS

Average portfolio size stable at 13 properties, despite tax changes and rising stamp duty

Landlords expect little change in portfolio size over the next 12 months

Average LTV ratio is 35%, continuing downward drift in gearing since 2013

Increased understanding of tax changes and implications – 78% of landlords, up from 71%

Although buying intentions remain subdued, one prophecy that has not been fulfilled as yet is a large-scale sell-off by landlords of buy-to-let properties, as we see in Paragon Mortgages' latest PRS Trends Report for Q1 2017.

The size of the average portfolio is 13 properties, unchanged from Q4 2016 and the forecast is stable, as landlords indicate they do not expect their property portfolios to change in size over the next 12 months.

Of particular interest in the Q1 2017 PRS Trends Report is the average loan-to-value (LTV) ratio, down to 35%. Since 2013, we've tracked a substantial reduction in gearing and the latest figures show 68% of landlords now have borrowings of less than half the value of their investment property portfolios.

Average gearing is low and getting lower, and this long-term de-leveraging demonstrates just how financially conservative buy-to-let landlords are in contrast to the perception in some quarters. Looking ahead, it's realistic to expect this downward drift in gearing to continue as the PRA's new buy-to-let underwriting standards take effect.

With the Government's tax changes now being phased in, we asked landlords taxed at the higher rate whether they believe they understand the personal implications of the changes. Encouragingly, 78% said they did, up from 71% in Q4 2016.

This increase in understanding and the fact that the tax relief changes are now upon us may be the key driver for a steadier picture in terms of overall optimism amongst landlords, preserving a modest upward trend since the beginning of 2016.

In summary, our PRS Trends Report paints a picture of a resilient sector in Q1 2017. Whilst landlord confidence remains at lower levels, it has improved in recent months as landlords have understood better the impact of the tax changes on their own businesses. Landlords are clearly purchasing fewer properties but we are not seeing the sell-off predicted by some commentators and this augurs well for the future of the sector.



**John Heron**

*Managing Director, Paragon Mortgages*



## JUMP TO...

### OUR PANEL

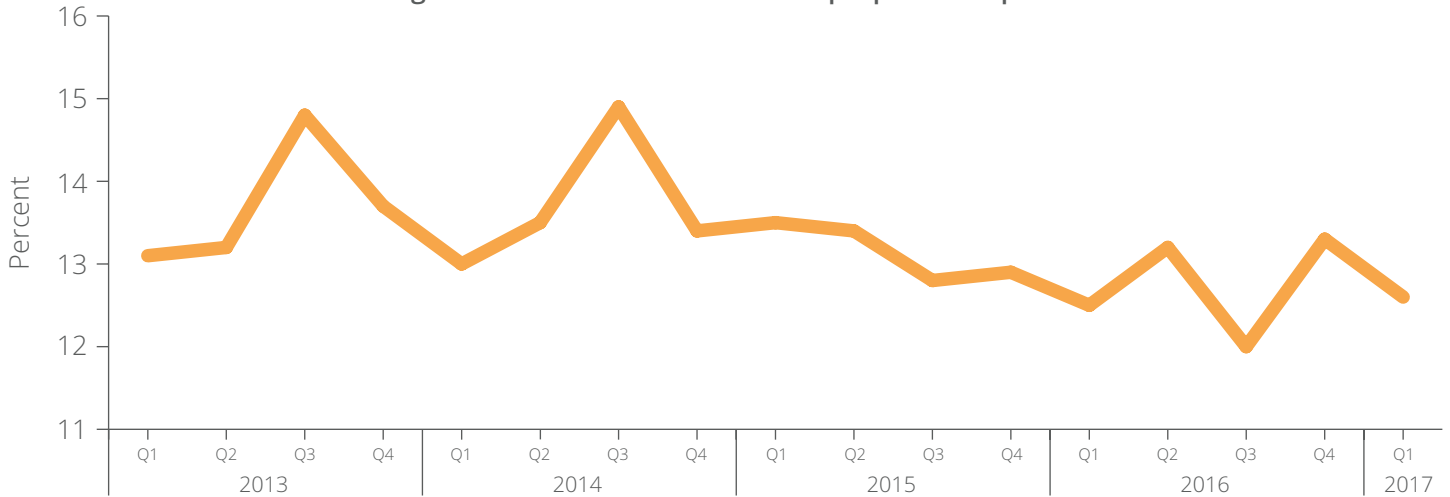
Our panel is an experienced group of buy-to-let landlords, with 85% of the 203 surveyed for this report having been landlords for more than ten years, and a third for more than 20 years. Almost three quarters (67%) of the landlords surveyed in Q1 2017 are classed as professional – owning three or more properties – and our sample is an accurate reflection of both the rented residential sector and Paragon Mortgages' customer base of residential landlords.

## PORTFOLIO SIZE AND VALUE

The size of the average portfolio in Q1 2017 is 13 properties, unchanged from the three months previous. 13 is also the long-term average, since Q1 2013, and has seen little fluctuation since the start of 2015, despite the 3% increase in stamp duty on buy-to-let purchases and the planned changes to tax relief. Landlords have indicated they do not expect their property portfolios to change in size over the next 12 months.

The average value of investment property portfolios is unchanged at £1.7 million following a sharp increase in Q4 2016 and is now reaching its highest ever levels. 25% of landlords expect value to increase in the next 12 months, whilst just 8% think it will decrease.

Average number of rented residential properties in portfolio



## GEARING

Average gearing is low and getting lower. 68% of landlords now have borrowings of less than half the value of their investment property portfolios and the average LTV ratio decreased by 2% in Q1 2017, to 35%.

Since Q2 2012, average gearing has reduced significantly, from 42%, indicating the PRS is de-leveraging and has been for some time. Looking ahead, it's possible this drift may continue as the PRA's new buy-to-let underwriting standards take effect.

On average, landlords spend 30% of their rental income on mortgage payments, with almost half (43%) in Q1 2017 saying they spend less than a quarter.

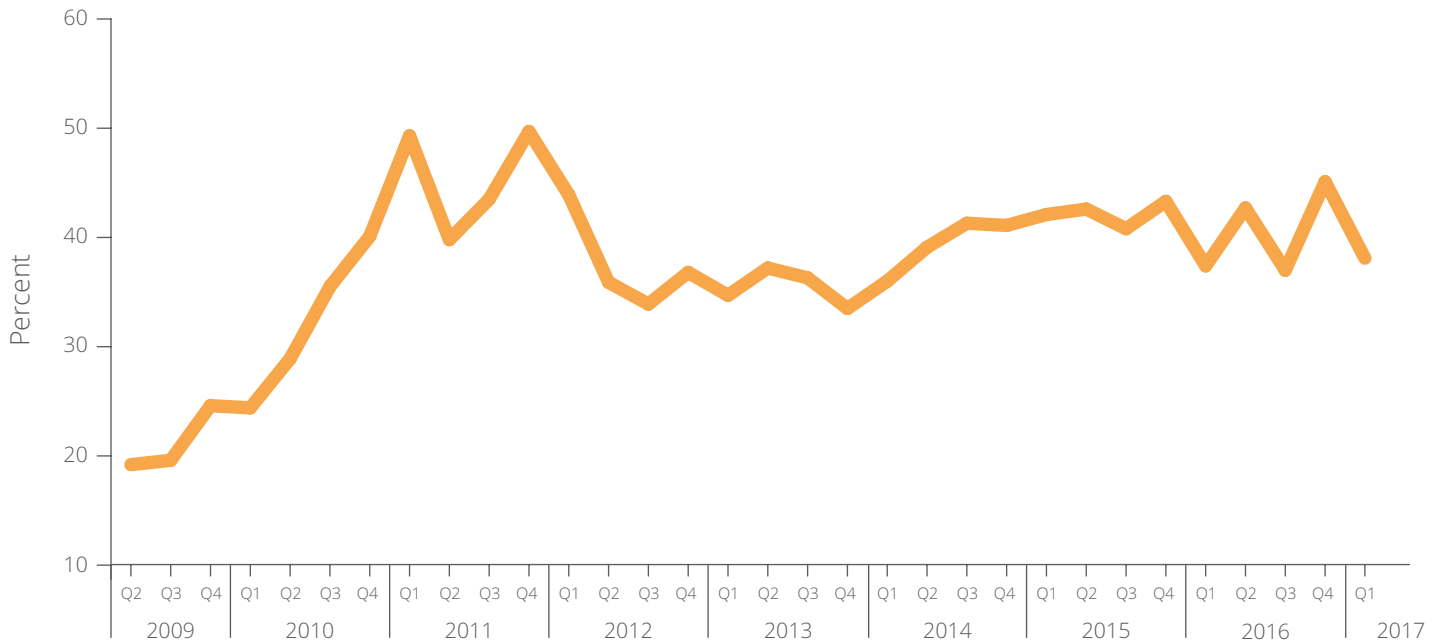
Average gearing of investment property portfolios



## TENANT DEMAND

According to our panel, demand from tenants has eased in the previous three months, with 38% of landlords saying demand is 'growing' or 'booming'. However, sentiment remains historically high and almost half (46%) of landlords believe tenant demand will increase over the next 12 months.

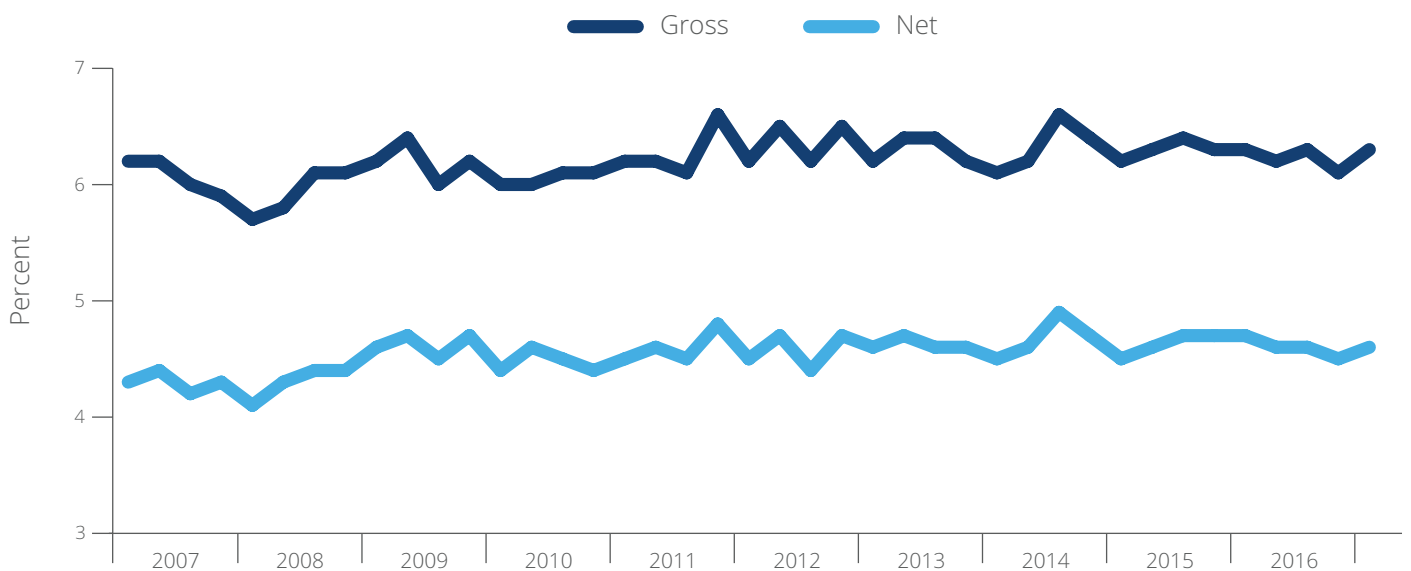
Proportion of landlords saying tenant demand is 'growing' or 'booming'



## GROSS RETURN

The average gross rental rate of return for all landlords is 6%, in line with the long-term average which has remained stable since Q4 2005. In Q1 2017, 64% of landlords report average gross annual return of equivalent to between 4% and 7%. 22% are doing better than this and almost one in ten (9%) are achieving a return greater than 10%.

Average current rental rate of return

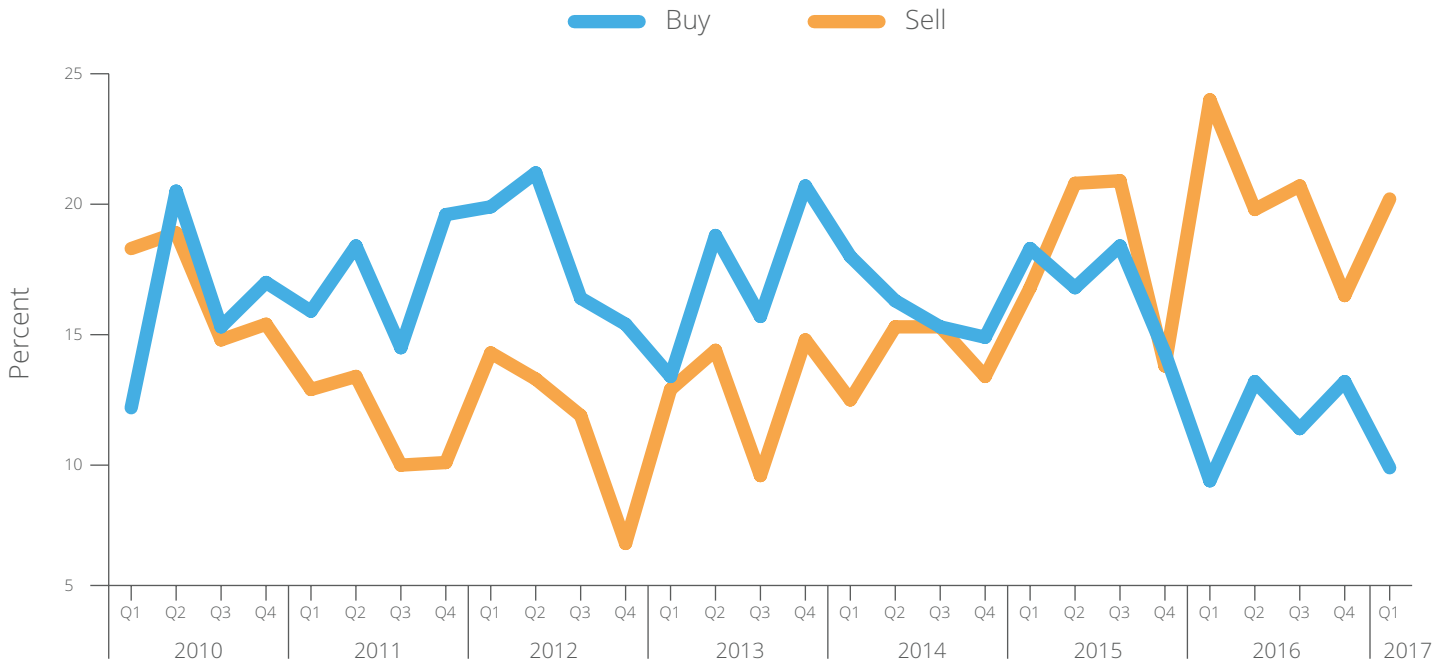


## BUYING VS. SELLING EXPECTATIONS

In Q1 2017, the gap widened in favour of selling, as 20% of all landlords said they expect to sell buy-to-let property in the second quarter, up from 17%, whilst one in ten (10%), down from 13%, expect to purchase new property in the next three months.

Amongst landlords expecting to purchase buy-to-let property in Q2 2017, the most common type of property is flats/maisonettes, with almost half (44%) indicating this as most likely. The next most common types are terraced houses (41%), semi-detached houses (35%), and detached houses (18%).

Proportion of landlords expecting to buy and sell property in the next quarter

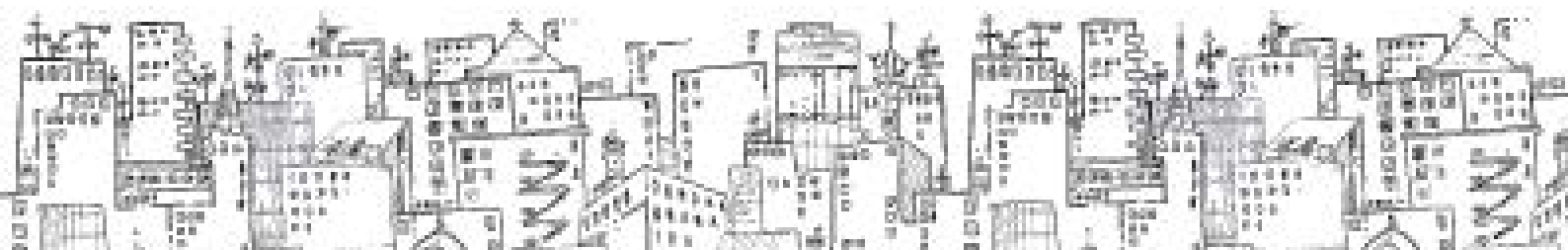
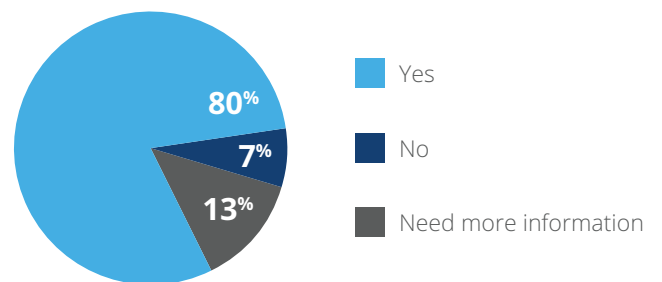


## UNDERSTANDING OF TAX CHANGES

With the Government's income tax relief changes phased in from April 2017, we asked landlords taxed at the higher rate whether they believe they understand the personal implications of the changes, with 78%, up from 71% in Q4 2016, saying they do.

This increase in understanding is paired with a smaller percentage of landlords saying they do not understand the implications (7% from 11%) or they require more information (13% from 18%).

Understanding the personal implications of tax income changes

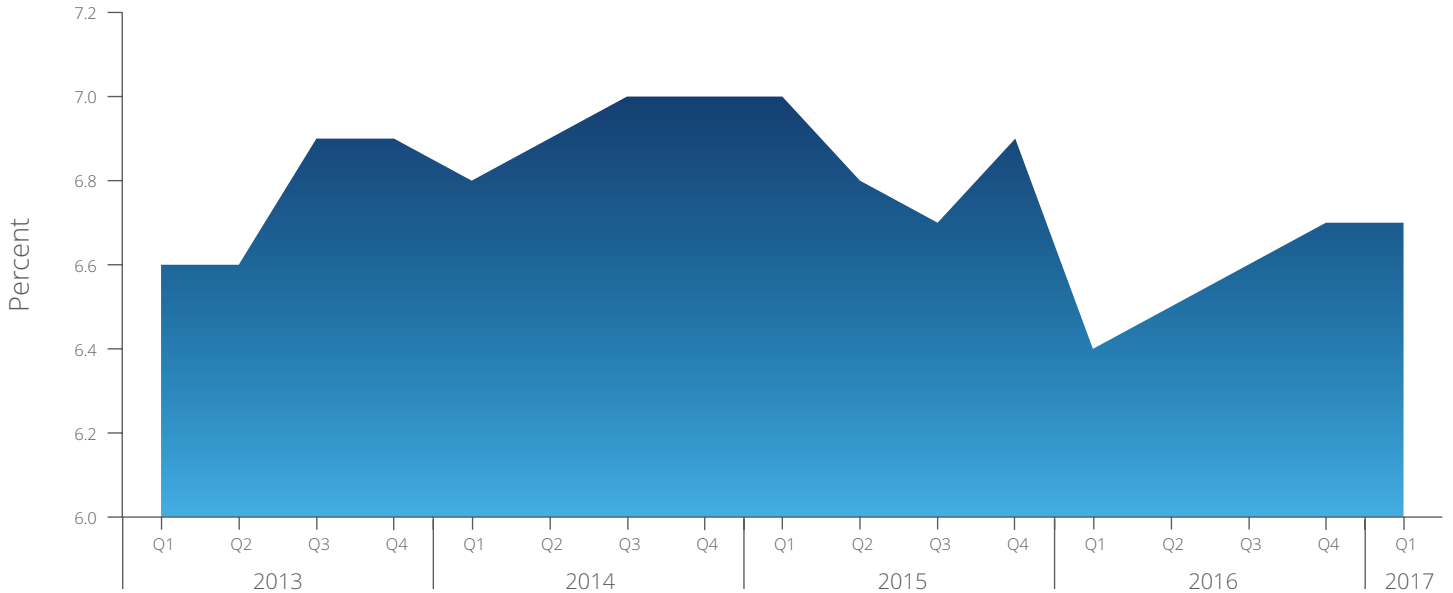


## OVERALL PROSPECTS FOR THE PRS

Optimism was largely stable in Q1 2017, with the overall average rating of prospects for the PRS over the next 12 months now at 6.7. This maintains a modest upward trend since Q1 2016 and suggests confidence is returning amongst landlords following a turbulent 18 months.

### 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 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 £12.3 billion of 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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