



Q2 2017

LANDLORD MORALE LOW DESPITE A RESILIENT PRS



We're now three months into the four-year phasing in of the Government's tax relief changes on buy-to-let mortgage interest and our latest PRS Trends report for Q2 2017 paints a picture of reduced confidence amongst landlords, despite key performance indicators suggesting sustained resilience in the Private Rented Sector (PRS).

The proportion of landlords saying that they are now more optimistic compared with the previous quarter has reached its lowest level in two years – perhaps unsurprising given the introduction of the tax changes in April and uncertainty surrounding the 2017 UK General Election.

Landlords also reported an easing in demand from tenants in Q2 2017. This marks the first time in five years that tenant demand has slowed in successive quarters, with 30% of landlords now saying demand is 'growing' or 'booming', down from 45% six months ago.

Q2 2017 HIGHLIGHTS

Government tax relief changes take effect during the quarter

Sentiment down as landlords report easing in tenant demand growth

Void periods remain stable at 2.7 weeks, suggesting a more resilient market

Landlords call on new Government to reverse tax relief changes

However, whilst business confidence may be at a low ebb, key performance indicators in our Q2 survey signal strength and a sustained level of resilience.

The average void period remains very low at 2.7 weeks, unchanged in four consecutive quarters. This does not support the view of slowing tenant demand reported by landlords. Where we would expect to see average void periods increase as demand falls, in fact remains close to historic low levels.

Yields have also remained remarkably stable in the long term, with the national average gross rental return at 6% since Q2 2005 and showing no signs of easing.

It's encouraging that, with the Government's tax changes now being phased in, an increasing number of landlords say they understand the personal implications of the changes. In Q2 2017, 88% of landlords said they do, whilst just 5% do not and 7% need more information. That knowledge, however, has done little to improve landlords' view of the overall prospects for the PRS in the next 12 months.

The proportion landlords expecting to buy property in Q3 2017 has reached its lowest ever level, at 7%. Of those landlords expecting to buy, the most common type of property is terraced housing, with half (50%) indicating this as most likely. However, there has also been a sharp increase in landlords expecting to purchase HMOs in Q3, up to 34% from just 9% in Q1, making it the second most likely type of property landlords will purchase in the next three months.

One of the key drivers for landlords not expanding their buy-to-let portfolios is the Government's tax relief changes on buy-to-let mortgage interest. Following the 2017 UK General Election, we asked landlords in our Q2 survey to rank their most preferred action to be taken by the new Government to help with their residential lettings business. The highest-ranking answer was a reversal of income tax relief changes, further highlighting the damage caused by the policy to overall sentiment.

In summary, having taken active steps in preparing for a difficult period of transition as tax relief changes continue to be phased in, landlords are now facing up to the challenge ahead. But, as measures of sentiment begin to trend downwards, there is clear stability in key measures of actual performance within the PRS.



JUMP TO...

OUR LANDLORD PANEL

Our panel is an experienced group of buy-to-let landlords, with 85% of the 201 surveyed for this report having been landlords for more than ten years, and 39% for more than 20 years. Almost three quarters (68%) of the landlords surveyed in Q2 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.



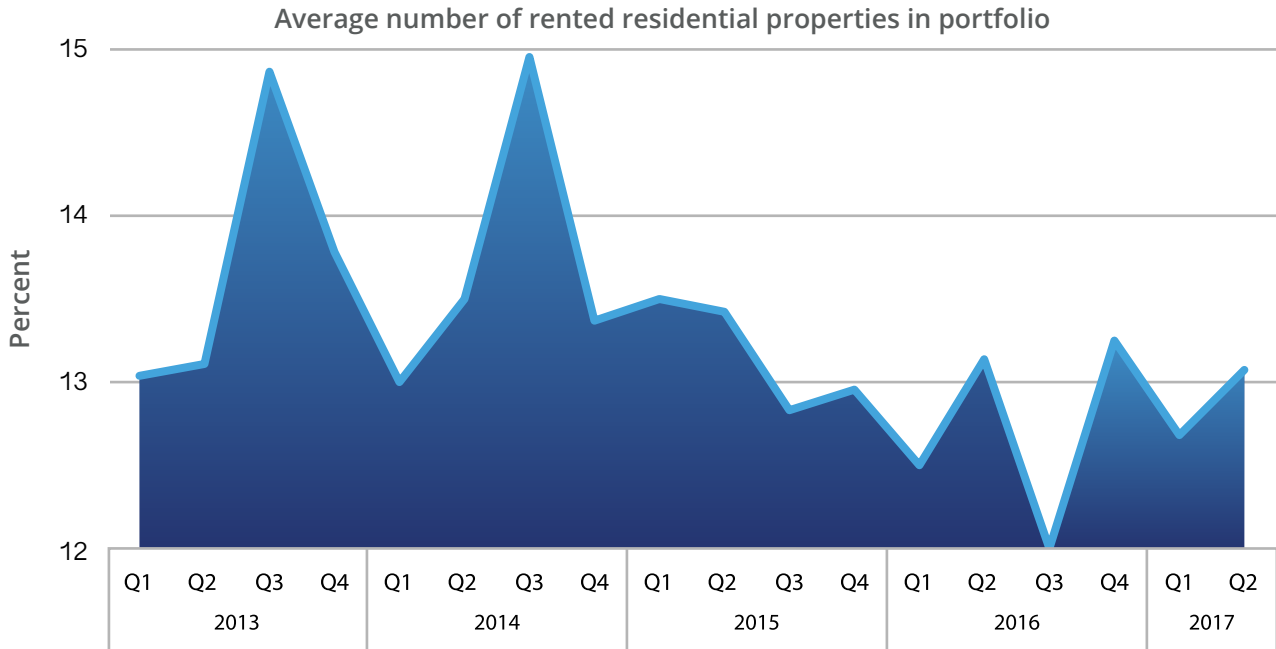
John Heron

Managing Director, Paragon Mortgages

PORTFOLIO SIZE AND VALUE

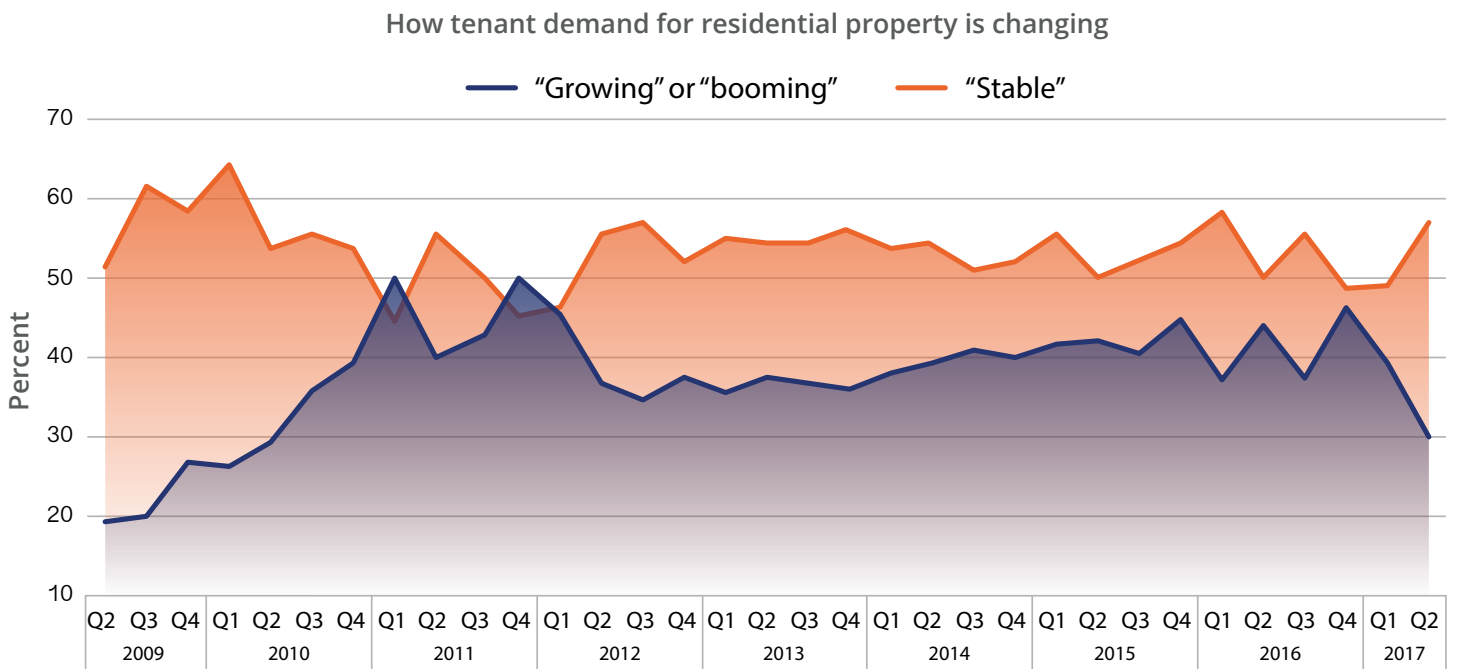
The size of the average portfolio in Q2 2017 is still 13 properties, unchanged from the previous two quarters. 13 is also the long-term average, since Q1 2013, and has seen little fluctuation since the start of 2015, despite the 3% increase in stamp duty on buy-to-let purchases and changes to tax relief now being phased in. 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 has decreased slightly to £1.65 million but remains high following a sharp increase to record levels in Q4 2016 and Q1 2017. 19% of landlords expect value to increase in the next 12 months – down from 25% last quarter – whilst 13% now think it will decrease. The overwhelming majority of landlords (69%) expect value to stay the same.



HOW TENANT DEMAND FOR RESIDENTIAL PROPERTY IS CHANGING

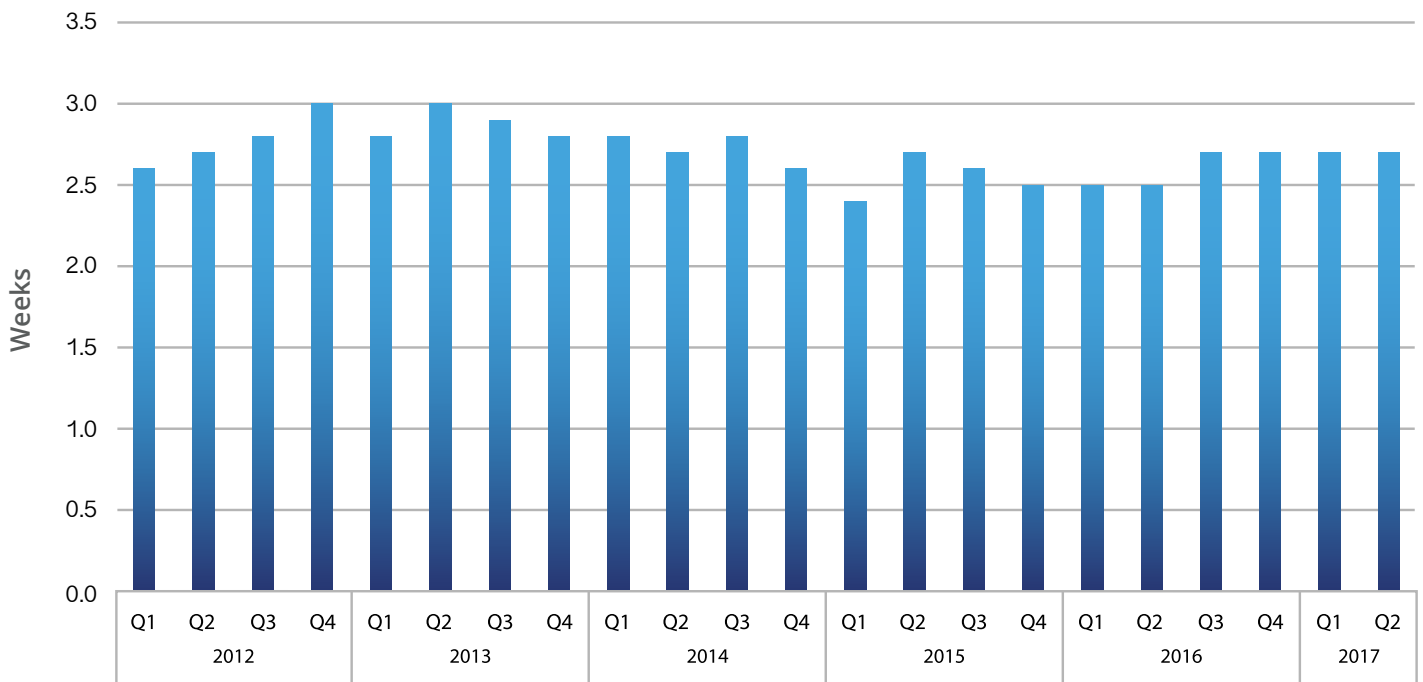
According to our panel, demand from tenants has eased for the second successive quarter, for the first time in five years, with 30% of landlords now saying demand is 'growing' or 'booming', down from 45% six months ago. Looking forward, sentiment has also eased from historic highs of 45-50%, with a lower proportion (39%) of landlords expecting tenant demand to increase over the next 12 months. However, an increased majority (41%) believe demand will remain stable.



VOID PERIODS

The average void period remained stable in Q2 2017 at 2.7 weeks. The fact that this has held level for the last four quarters suggests that the balance between the supply of property to the PRS and tenant demand is finely balanced.

Average void period

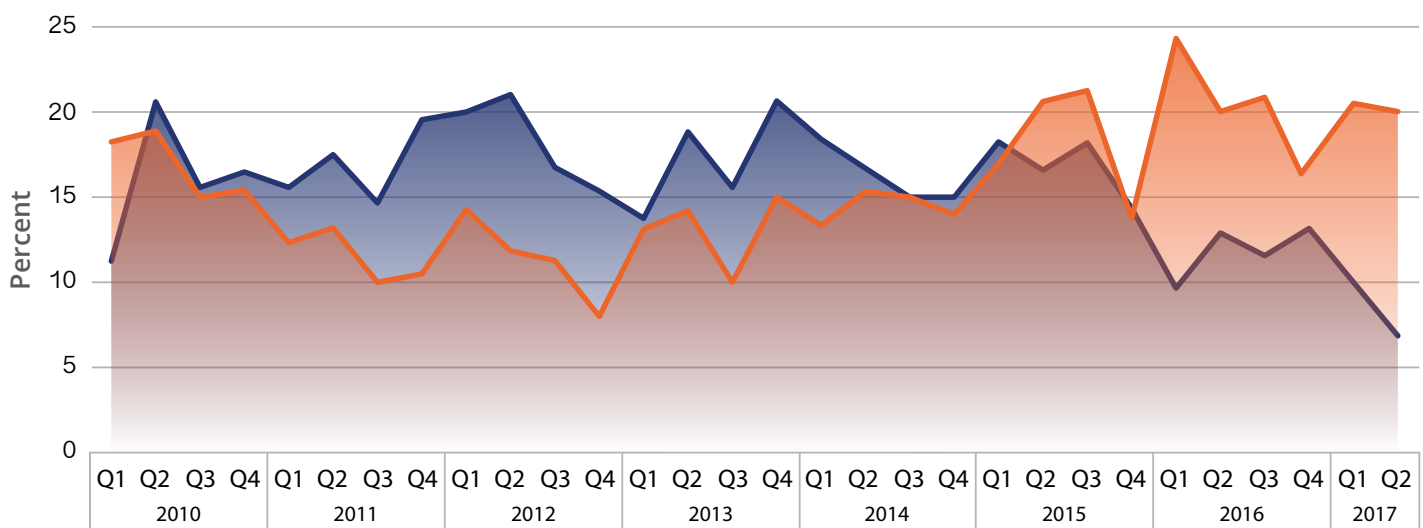


BUYING VS. SELLING EXPECTATIONS

The gap widened further in favour of selling in Q2 2017, despite the proportion landlords expecting to sell buy-to-let property in the next quarter remaining the same. 20% said they expect to sell property in Q3, however, fewer landlords now expect to purchase, down to 7% from 10% three months ago. This marks the largest decline since the start of last year as buying expectation reached its lowest ever level for this survey.

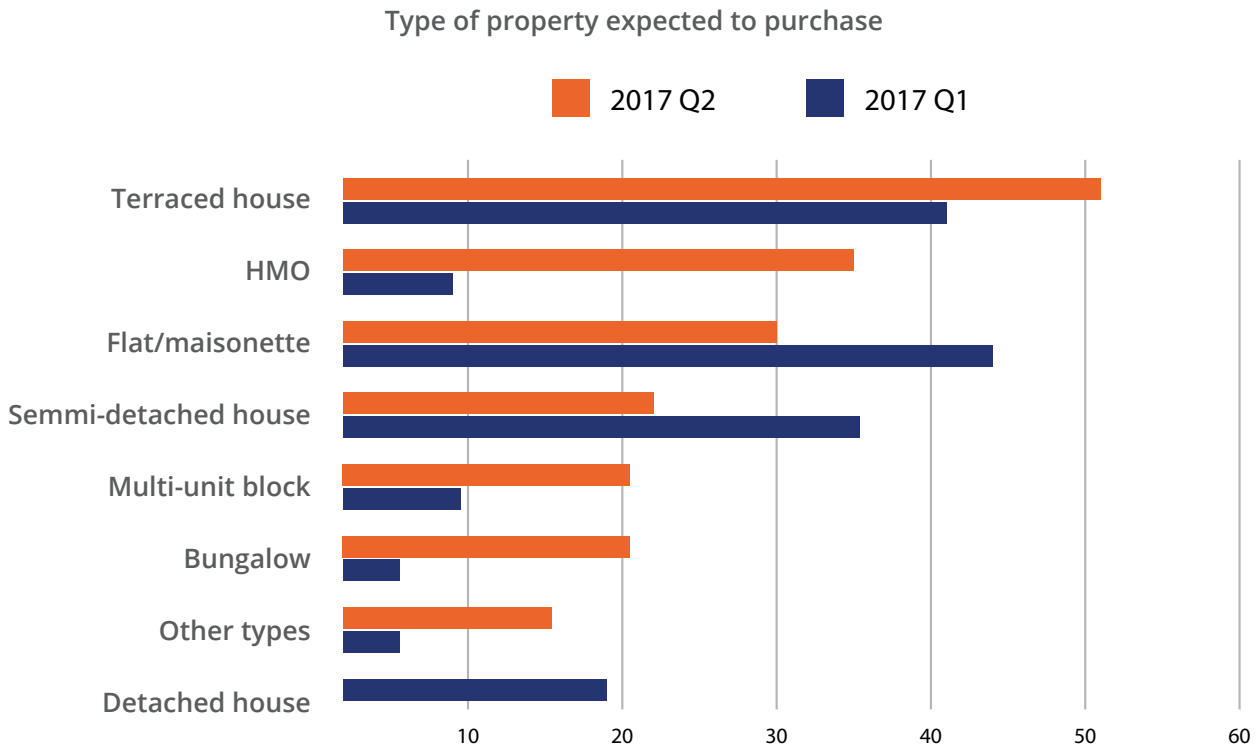
Proportion of landlords expecting to buy and sell property in the next quarter

— Buy — Sell



PROPERTY TYPES

Amongst landlords expecting to purchase buy-to-let property in Q2 2017, the most common type of property is terraced housing, with half (50%) indicating this as most likely. There is a marked increase in landlords expecting to purchase HMOs in Q3, up to 34% from just 9% in Q1, making it the second most likely type of property landlords will purchase in the next three months.

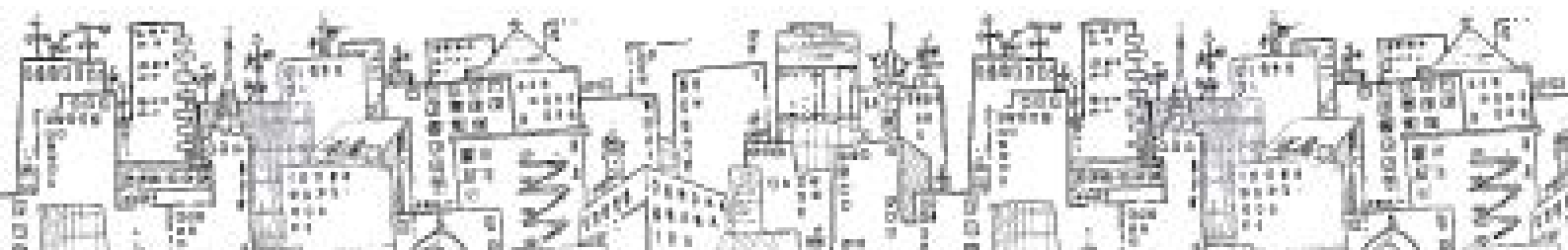
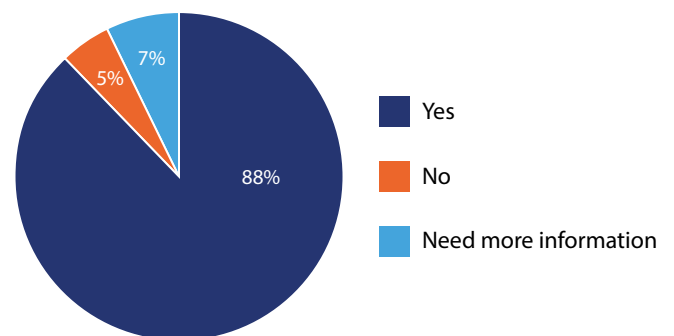


UNDERSTANDING OF TAX CHANGES

The phasing in of the Government's income tax relief changes began during Q2 2017, and we asked landlords taxed at the higher rate whether they believe they understand the personal implications of the changes, with 88%, up from 78% in Q1 2017, now saying they do.

This increase in understanding is paired with a smaller percentage of landlords saying they do not understand the implications (5% from 7%) or they require more information (7% from 13%). This indicated that, in total, 12% of landlords remain unclear as to the personal implications of the tax changes, despite them having already come into effect.

Understanding the personal implications of tax income changes

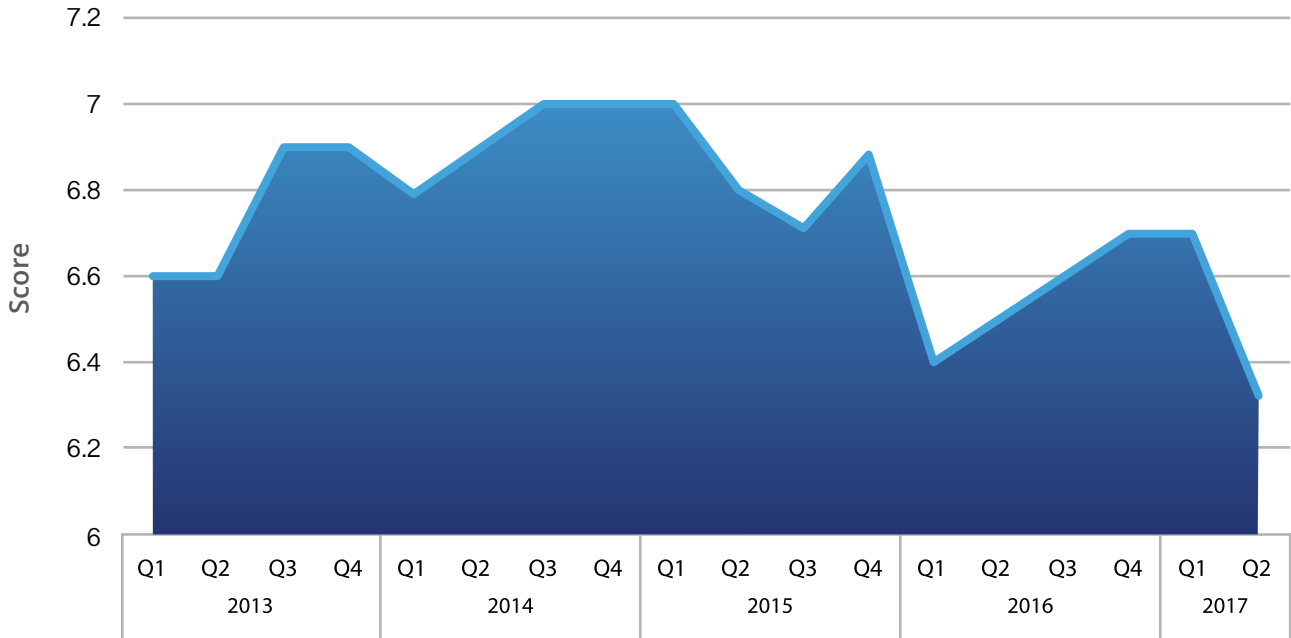


OVERALL PROSPECTS FOR THE PRS

Following a sustained upward trend in the year between Q1 2016 and Q1 2017, optimism in Q2 2017 decreased from a score of 6.7 out of ten to 6.3. This represents the lowest recorded figure since we began tracking overall prospects for the PRS in the following 12 months, in Q1 2012. It's likely that the phasing in of the Government's tax relief changes and uncertainty surrounding the 2017 UK General Election are the main causes of this fall in optimism.

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 201 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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FMNL14112 (03/2017)

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