

Q1 2019 HIGHLIGHTS

- Landlords bolster financial strength
- Portfolio gearing down
- Mortgage costs reduced

LANDLORDS COUNT THE COST OF TAX CHANGES

Paragon's PRS Trends Report for the first quarter of 2019 highlights how the UK's largest and most experienced landlords have adapted their approach to stay resilient to tax and regulatory change by prioritising measures to bolster financial strength over portfolio expansion.

Paragon's latest quarterly survey, which tracks the experience of more than 200 landlords with an average of 12.8 properties and over 20 years' experience in the UK's Private Rented Sector (PRS), shows that while landlords in this group remain engaged in the sector, tax and regulatory developments have led to significant changes in their behaviour.

Nearly six out of ten (58%) landlords said their 2017-18 tax bill was higher than the year before as a result of the tax changes, pointing to an average annual increase of £3,039.

To offset these costs, the survey demonstrates how landlords have reduced their reliance on mortgage debt and improved affordability by spending less of their rental income on mortgage payments.

Average portfolio gearing – which measures the proportion of debt finance relative to a portfolio's overall value – has fallen from 40% in 2014 to 33% today.

Meanwhile mortgage costs as a proportion of rental income are down from 30% at the beginning of 2017 to 27%, also aided by landlords re-mortgaging onto lower interest rate and longer-term fixed mortgage deals.

However, despite greater financial strength, landlords remain cautious about the outlook for the sector as the phased withdrawal of mortgage interest tax relief progresses.

Following a sharp drop from a peak of 40% in Q1 2014, the proportion of landlords feeling optimistic about the prospects for their portfolio has now settled at around 10%.

Landlord buying intentions are also consistently lower, with the percentage of those planning to buy property halving from 15-20% between 2010 and 2014 to just 7-10% from 2017 onwards.

And, while it's encouraging that many of the largest landlords are still looking to add to their portfolios, since 2016 they have been outnumbered by those planning to sell, with the gap between the two groups continuing to widen.

The recently released 2017-18 English Housing Survey showed that 219,000 new households entered the PRS in the twelve-month period prior to the survey, over double the number entering the owner-occupied and social housing sectors combined.

Given this level of demand, our PRS Trends Survey highlights the need to encourage an increase in landlord investment if we are to avoid storing up problems in the shape of property shortages and rental inflation for future generations.



John Heron,
Managing Director of Mortgages, Paragon

OUR LANDLORD PANEL

Our panel is an experienced group of 204 buy-to-let landlords, with 87% of those surveyed having been residential landlords for more than ten years and 45% having been involved for more than 20 years.

Three quarters (75%) of landlords surveyed in Q1 2019 are classed as professional – owning three or more properties – making our results a more accurate reflection of landlords with larger property portfolios.



87%

LANDLORDS FOR 10 YEARS +



45%

LANDLORDS FOR 20 YEARS +



75%

OWNING THREE OR MORE PROPERTIES

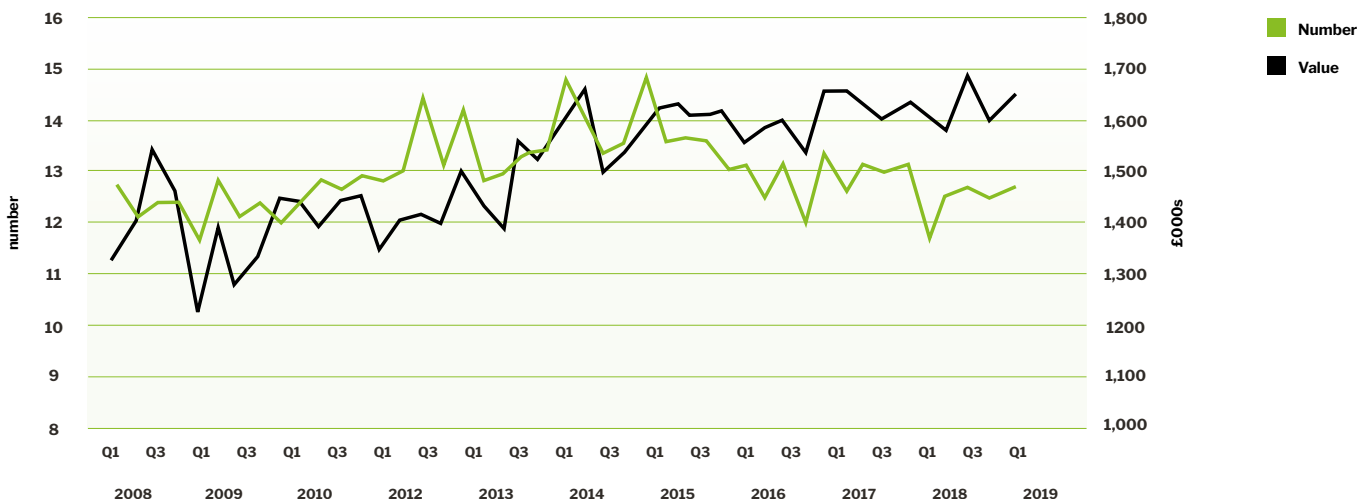
PORTFOLIO SIZE AND VALUE

On average, residential landlords had 12.8 properties in their rental portfolio in Q1 2019, up from 12.4 last quarter and 11.6 properties 12 months ago.

These modest additions appear to have boosted landlords' perceived value of their portfolios, with estimated portfolio value rising 3.7% £1.69 million compared with last quarter and 3.8% compared with a year ago.

Looking ahead landlords are slightly more cautious however, with only 14% expecting an increase in portfolio value over the next 12 months.

Average number of residential properties in rental portfolio



FEATURED SUBJECT: TAX IMPACT

The January 2019 self-assessment deadline was the first time that landlords reported under new mortgage interest rate tax rules and we asked our panel to quantify the impact.

Mortgage interest tax relief for buy-to-let landlords is being phased out over a four-year period and replaced with a basic rate tax credit. In the 2017-18 tax year, landlords could deduct 75% of mortgage interest costs from rent. This was reduced to 50% in 2018-19. It will fall to 25% in 2019-20 and then to zero.



Nearly **six out of ten (58%)** landlords reported an increase in their 2017-18 tax bill.



Landlords with three or more properties were more likely to report an increase than those with smaller portfolios, with an average **increase in tax of £3,039** for those reporting a rise.



While over **60%** of landlords confirmed that the change in their 2017-18 tax bill was as expected, one third (**33%**) said it was either a little or a lot more than expected.



Almost half (**49%**) of landlords who reported a higher than expected increase said they would make a change to their portfolio as a result, with the most popular measures including selling property (**24%**), increasing rent (**20%**) and reducing borrowing (**19%**).

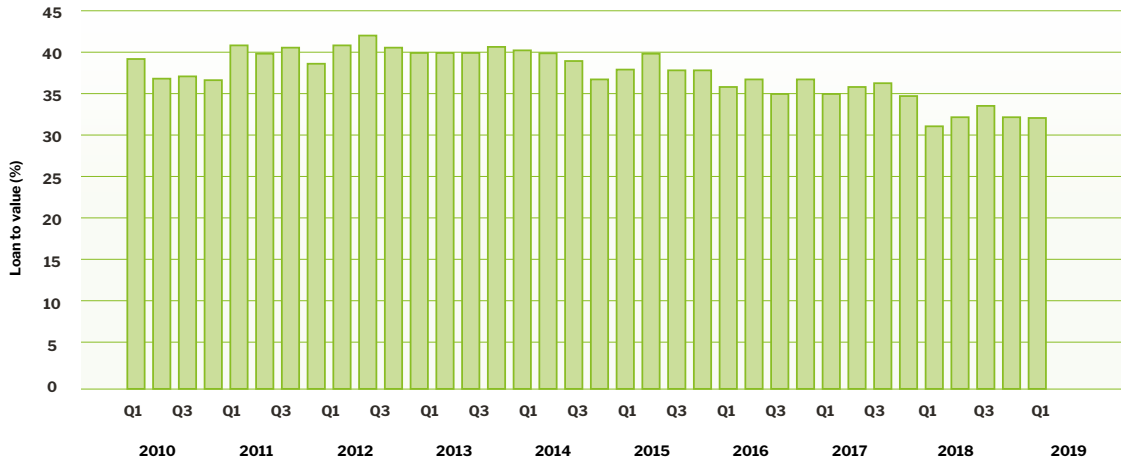
GEARING AND FINANCE COSTS

Our survey suggests that while landlords in our panel remain engaged in the sector, they are taking action to minimise their finance costs in an attempt to mitigate higher taxation.

Gearing represents the value of mortgage debt relative to a landlord's overall portfolio value. Seven out of ten landlords (70%) now have borrowings less than half the value of their portfolio, with average gearing standing at 33.3%.

Larger-scale landlords tend to borrow more, with an average portfolio loan to value of 36.1% compared with 24.3% for their smaller-scale counterparts.

Average gearing of investment property portfolios



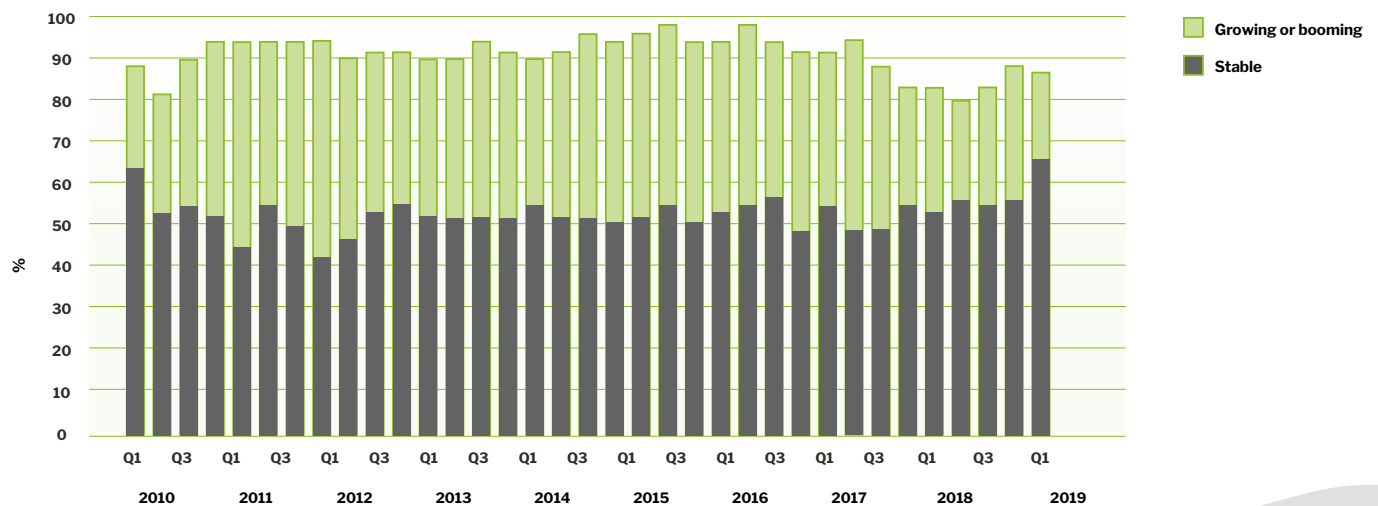
The gradual reduction in gearing that has taken place over the last few years – combined with the trend for landlords to remortgage on to lower interest rate products – means landlords also now spend a smaller proportion of their rental income on mortgage payments – down from 30% at the beginning of 2017 to 27% today.

TENANT DEMAND

Landlords continue to report a relatively optimistic picture on tenant demand, with almost nine out of ten landlords saying demand for rental property is either stable, growing or booming.

However, there has been an increase in the proportion of landlords reporting stability – up 8 percentage points to 65% - compared to those who describe demand as growing or booming – down 10 percentage points to 21%.

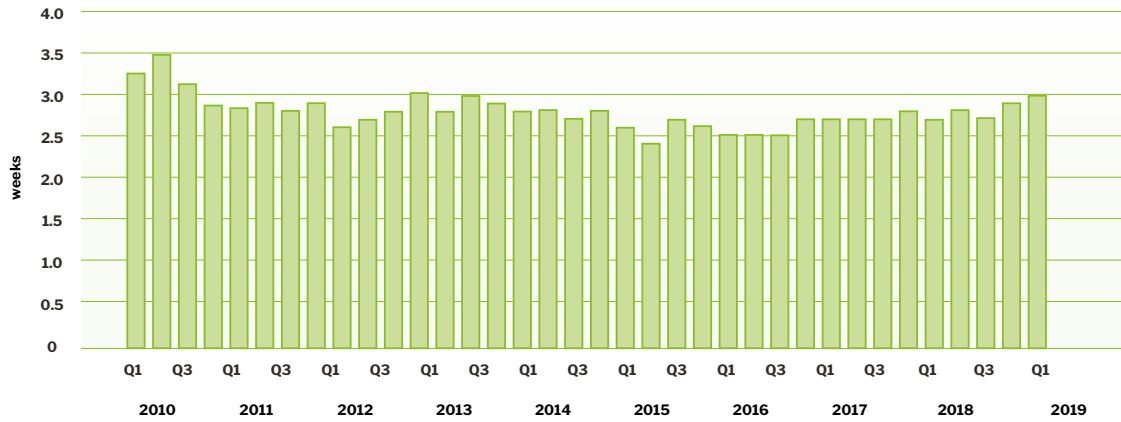
Proportion of landlords who say tenant demand is growing or booming



VOID PERIODS

Strong demand for rental property means that void periods remain firmly within a long-established range of 2.5 to 3 weeks. The void period measures the average amount of time rental properties are vacant each year, with this quarter's survey recording a void period of 2.9 weeks.

Average void period

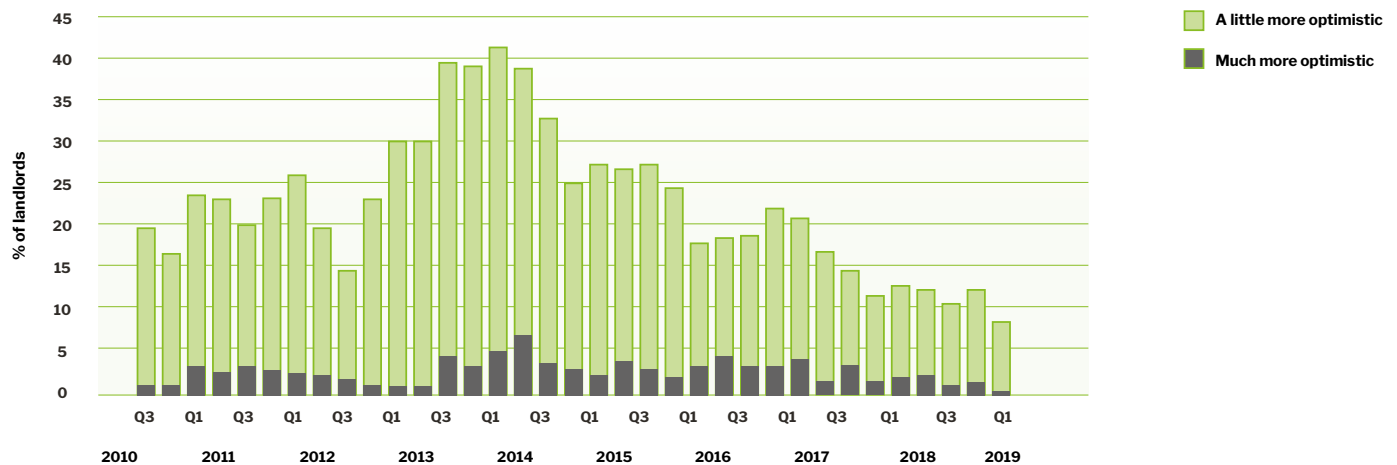


VIEW OF PROSPECTS FOR PROPERTY PORTFOLIO

Against the backdrop of a more restrictive tax landscape, landlord optimism about the prospects for their portfolio has clearly taken a knock.

Prior to announcement of the planned tax changes, an average of one third of landlords (33%) felt optimistic about the future back in 2014. This fell to just over one in ten landlords (12%) in 2018 and has now dropped again to just 7% in the latest results.

Landlord optimism about portfolio prospects



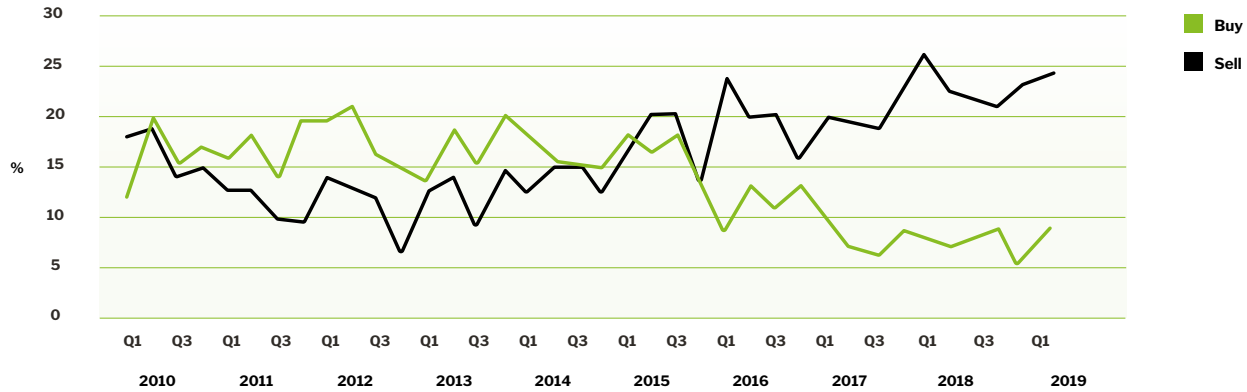
BUYING VS. SELLING EXPECTATIONS

Not surprisingly, landlords are now far less likely to consider adding to their portfolio than before.

Back in 2014, between 15-20% of landlords consistently indicated an intention to buy property in the next quarter, just above those planning to sell.

Since mid-2015, that position has reversed and today those planning to buy comprise between 7-10% of the landlord population, almost 3 times lower than those who plan to sell.

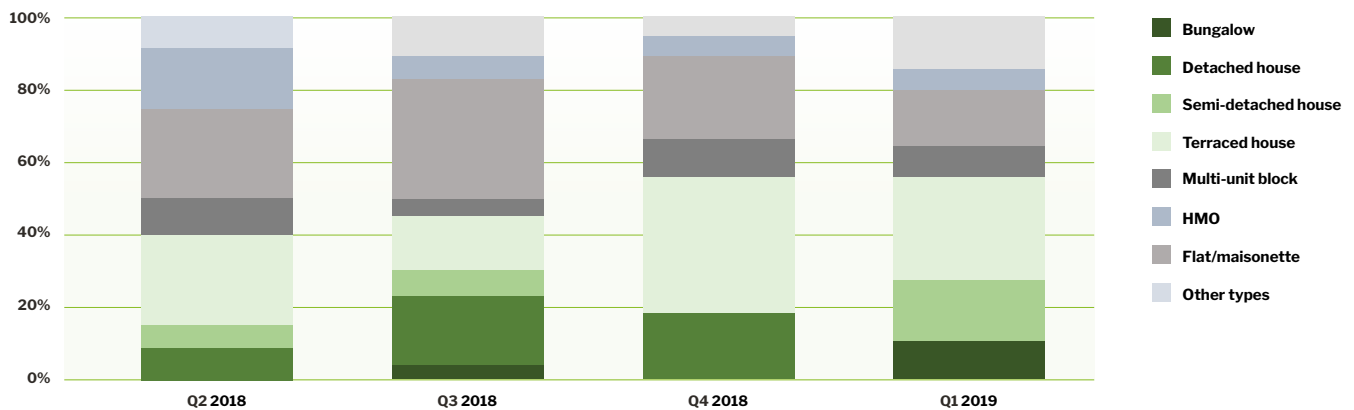
Proportion of landlords expecting to buy and sell property in the next quarter



PROPERTY TYPES

Interestingly, among those landlords who intend to add to their property portfolio, there has been a growing interest in houses relative to flats or multi-unit blocks. This may tie in with growing demand for PRS accommodation from families, with the recent MHCLG English Housing Survey pointing to a 795,000 increase in PRS households with dependent children over the last ten years.

Type of property expected to purchase



ABOUT PARAGON

Paragon is a leading provider of buy-to-let mortgages for landlords with property portfolios, both big and small, through its portfolio and non-portfolio range. Paragon also offers second charge and specialist residential mortgages.

Paragon lends to private individuals and limited companies and has mortgages suitable for single, self-contained properties, as well as HMOs and multi-unit blocks. Paragon can accommodate higher aggregate lending limits and more complex letting arrangements including local authority leases and corporate leases along with standard ASTs.

Paragon introduced its first product aimed at the professional property investor in 1995 and is a member of UK Finance, the Intermediary Mortgage Lenders Association (IMLA), National Landlords Association (NLA) and the Association of Residential Letting Agents (ARLA).

Paragon Bank PLC a subsidiary of the Paragon Banking Group PLC which is a FTSE 250 company based in Solihull in the West Midlands. Established in 1985, Paragon Banking Group PLC has over £12 billion of assets under management.

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