The future of Buy to Let

Kate Faulkner

Managing Director of Designs on Property

Author of Which? Renting and Letting and Property Investment Handbook

Agenda

- The history buy to let
- What are the future trends of buy to let?
- What risks could affect your investment?
- How can you avoid the risks?
- How can you maximise the rewards?

Growth of buy to let

Stage One

- Government started to sell off council homes in the 80s

Stage Two

- To compensate, growth was generated in the Private Rental Sector(PRS) The Housing Act of 1988 created a legal framework which ensured landlords could evict non-paying tenants

Stage Three

- The new laws meant more lenders were happy to support Buy To Let (BTL)

Stage Four

- The 1990s recession increased the demand for the PRSThe recession also meant would-be sellers rented, rather than sold, properties

Stage Five

- BTL mortgages that took account of rental income were introduced

Growth of buy to let

Year	Buy to let mortages	Growth
1999	44,000	
2000	48,400	10%
2001	72,200	49%
2010	1,290,000	1687%

- The growth in BTL mortgages came from existing landlords re-mortgaging AND new property investors/landlords
- In 2012 BTL mortgages reached over 1.4 million (www.cml.org.uk/cml/media/press/3274 Aug 2012)

Question: Will BTL continue to grow in the future?

Factors affecting BTL growth

Key factors that could affect buy to let growth:

- Finance available for BTL properties
- Government policy and legislation changes
- BTL taxation
- The economy
- BTL returns via:
  - Capital growth
  - Rental income

1. Finance for buy to let

Mortgage finance

- Banks, building societies, overseas investment
- Buy to let finance with 25% + deposits is seen as a 'safe' lending option
  - Some lenders are starting to offer 15% deposits
- New entrants into buy to let are likely to increase the competition
- Better deals are anticipated to be developed for BTL investors from 2012

Institutional investment

- Pension funds & other organisations investing in residential property
- This is a new initiative that is being encouraged by the Government and recommended by other organisations/institutions
  www.communities.gov.uk/news/newsroom/2204419
- Returns on investment of 5%+ are, in 2012, looking good versus other assets
  www.ft.com/cms/s/0/7ff57300-e797-11e1-8686-00144feab49a.html#axzz29ZBwzlJ0
- Main barrier to institutional investment is thought to be the lack of projects available for institutionalised investors to consider
  www.communities.gov.uk/publications/housing/privaterentedhomesreview

2. Government legislation

National Government policy and legislation

- The UK Government recognises the need to increase the number of rental properties in the UK
- They are, however, sending some mixed messages to investors:
  - Capping of LHA rents restricts the money investors can earn
  - Due to the caps, investors in London may be better off renting to private individuals
  - Encouraging local authorities to take the action they need to tackle some rental issues
    - For example, Oxford now requires a licence for multiple occupancy properties: "All privately rented houses occupied by three or more people (including children) who form two or more households will require a licence"
    - The licence costs landlords up to £500
  - Rejected the industry's request to regulate letting agents
    - Leaving landlords and tenants open to financial loss if they don't use an ARLA or NALS agent

2. Government legislation

National Government policy and legislation

- However, Wales, Scotland and Northern Ireland are increasing regulation for landlords
  - Landlord registration, tenancy deposit schemes, etc.
- Check your updated regional housing strategy for more information:
  - www.wales.gov.uk/topics/housingandcommunity/housing/strategy/?lang=en
  - www.scotland.gov.uk/Publications/2012/04/5779
  - www.dsdni.gov.uk/private_rented_sector-_strategy
  - www.communities.gov.uk/publications/housing/housingstrategy2011
  - www.london.gov.uk/priorities/housing

3. Buy to let taxation

Currently buy to let is taxed via income and capital gains growth

The tax you pay is determined by your overall wealth and tax, it's not taxed separately

Income and capital gains tax depends on your current income tax

- For example, a 20% tax payer would typically pay:
  - 20% tax on net rental income
  - 18% on any capital gains
- A 40% tax payer would typically pay:
  - 40% tax on net rental income
  - 28% on any capital gains
- The level of tax you pay will differ if your rental income plus other income takes you into the 40% tax bracket

However, the Government has stated property is 'under taxed' in the UK, so this tax regime could change, severely affecting earnings from BTL

It is essential you seek tax advice from a specialist property tax expert

4. Economic predictions

Interest rates

- Likely to stay low until 2016, but mortgage rates can rise irrespective of interest rate

  http://www.cebr.com/uk-in-recession-already-base-rates-on-hold-till-2016/

  - Impact on BTL investors - bad news for those on SVRs

  - Landlords on base rate trackers should continue to benefit from low rates

  - All landlords need to 'stress-test' their properties based on mortgage rates of 7%

Mortgages

- Supply reliant on whether a second 'credit crunch' is caused by Europe
- More entrants and better deals coming on to the market in 2012
- Growth in BTL mortgages likely to continue

Inflation

- Affects the value of your rental income

4. Economic predictions

- The long term outlook, subject to economic shocks, is an annual inflation rate of 2-3%
  - This depends on commodity pricing, e.g. oil, food, etc.
- Ideally, you need to increase your rent in line with inflation to retain its value, especially if you're investing for personal pension purposes

Unemployment

- Affects tenants' ability to rent and pay
- Likely to continue to increase in 2012 and peak from 2013 to 2016, depending on the length of the double-dip recession Various, hence the different deadlines: CBI to 2013, CEBR 2016
- Need to consider what happens if a tenant defaults due to unemployment

Media influences

- This affects people's confidence to buy instead of rent
- Affects amateur investor confidence
- When they report property prices falling, it can be a good time to bag a bargain
- When reporting a rise in property prices, it is harder to secure a deal which stacks up

4. Economic predictions

In summary, economic predictions are in favour of the BTL investor:

- Low demand for people to buy a property
- Difficult for buyers to secure mortgages
- Uncertain economic times
- People prefer to keep their lives flexible
- A good condition rental property in a good area can help maximise your profitability

5. The future of buy to let returns

From 2012 to 2017

- Most of the return from BTL will accrue from income
- Few areas/properties will see capital growth keeping up with inflation
- Many properties need to grow 20%+ in value to recover their 'real' value (including the impact of inflation)
  - Wealthier areas of London and other cities are the main exceptions to this
  - Typically, prices are keeping up with inflation
- Some properties/areas are likely to drop further, with real falls in capital returns by up to 50%
- Rents are likely to rise in line with net earnings
  - Some areas will see falls throughout 2012
  - Many areas will recover to 2008 highs by 2014/15
  - In some areas, rents will rise enough to outstrip inflation

The future is bright!

Increase in number of private renters now and in the future

- Cultural trend away from buying to renting a property
- First time buyers are 'disappearing' fast

  - Young people don't want to save for a deposit or tie themselves to a property
- Squeeze on student finances

  - May mean more of student population stay at home

  - Increased student debt may delay property purchase, resulting in more renting
- Renting is much more attractive than it has been before (Kate – please supply evidence of why) The reasons below:-

  - Flexibility and mobility

  - Better homes and better landlords!

  - Legally let homes are safer than bought properties
- Ageing population

  - Selling their homes and renting

  - Likely to happen more in the future

The future is bright!

- Supply may dwindle suddenly when property price market picks up
  - Accidental landlords can account for up to 30% of letting agents' rental stock

Rents are likely to continue to rise steadily for the foreseeable future

- Some properties will keep pace with inflation, others won't
- Rents are conforming to rises, keeping pace with wage increases
- Rents will vary more in line with property prices in the future
  - Currently rents don't vary much from one postcode to another
  - This is likely to change in the future as demand increases faster than supply

Capital growth for properties will return

- It will take many years for them to recover to their intrinsic market values (incl. inflation)
- Some areas, such as Kings Cross, have already recovered their values
- Other areas will take five years to recover capital earnings

The future is bright!

- Some areas may take another 10 or more years, depending on local:
  - Demand and supply
  - Economic conditions
  - Wage growth
  - Rental stock condition and location

Summary

- The future is bright, for smart investors!
  - Capital growth will take a while, income will be good
  - Watch what you buy, let the best property in the best condition
  - Regularly review your property/portfolio's performance
- Look out for new markets developing:
  - Landlords exiting the market
  - Aging population potentially become renters
  - Increase in specialist housing requirements
    - People with disabilities or mobility issues
    - May be able to secure more rent, better yields
- Watch out for:
  - Squeezes on mortgages
  - Rents not keeping up with inflation and tenants defaulting

Summary

- Affects of local authority licensing, from a cost and regulation perspective
- The growth and potential impact of institutional investment in your area