The Kent Reliance
Buy to let Britain report

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Kent Reliance
for Intermediaries

A foreword

Welcome to the inaugural edition of Kent Reliance's Buy to let Britain report, a new half-yearly report analysing the trends in Great Britain's private rented sector, and the buy to let mortgage market that supports it.

We have all become used to reading about "Generation Rent" in recent years. The lack of high LTV and affordable mortgage finance since the credit crunch has taken its toll on home ownership. Difficult conditions for first-time buyers and sluggish wage growth have been compounded by house prices climbing once more.

But the change hasn't happened overnight. Since the start of 2001, two million households have been added to the private rented sector. This report examines the dramatic rise of private renting, and reveals the sheer size of an industry that exists to support the growing tenant population. "Generation Let" now comprises 1.4 million landlords[1]

Our first issue looks back at how the private rented sector has grown in both volume and value since the start of the 21st century, and in particular tracking performance since the last economic boom in 2007, analysing data between 2001 and the second quarter of this year. We provide detail on the yields and annual returns landlords enjoy, and the amount of rental income generated across Great Britain. All the stats are broken down by region, revealing how different parts of the country have developed in very different ways.

We hope you enjoy reading our Buy to let Britain report.

Andy Golding, CEO, Kent Reliance

[1] National Landlords Association

Andy Golding, Chief Executive Officer

Andy has over 29 years' experience in financial services and has held senior positions at NatWest, John Charcol and Bradford & Bingley. Prior to joining OneSavings Bank he was the CEO of Saffron Building Society, where he had been since 2004. He holds a number of positions with industry institutions including membership of the Building Societies Association's Council and the Council of Mortgage Lenders Executive Committee. Andy is passionate about simplicity and fairness in financial services and is a published author on the subject of financial education.

Executive summary

Market overview

- Private rented sector expands by 71.4% since start of 2001, adding nearly 2 million households
- Value of buy to let property across Great Britain hits £930.7bn, an increase of £109.5bn in last year alone
- Since 2001, the value of privately rented property has increased by £669bn, with London and the South East key contributors
- Sector forecast to grow to five million households by end of 2016, nearly 19% of households, with £4bn in rent to change hands every month by Q2 2015.
- Landlords' assets forecast to hit £1 trillion by late spring next year

Landlords

- Rental inflation has slowed in 2014, although total rent received by landlords in Britain has reached £3.8bn a month as sector expands
- London accounts for more than a third of the national rent budget owing to strong tenant demand on the back of high property prices, and limited supply
- Falling yields result from capital appreciation outstripping rent rises across Great Britain
- However, total annual returns climb to six-year high at 15.1%, meaning landlords reap £123.6bn nationwide
- Since the last housing boom, the average landlord has made a gross total return of more than £83,000 per property

Lenders

- Buy to let lending increasing to support demand, with volumes up 34% in last year
- £154.3bn lent to investors since start of 2007
- Total value of mortgaged property in private rented sector now stands at £384.4bn, up nearly £26.3bn in last year
- Product numbers more than triple since 2010 as funding conditions ease and provider numbers climb
- Consumer protection European Mortgage Credit Directive is necessary, and won't derail long-term market growth

Buy to let Britain: From boom to boom?

- 80% of the growth in the number of households since 2001 has been in the PRS
- Since the start of 2001, the PRS has grown by nearly 2 million households

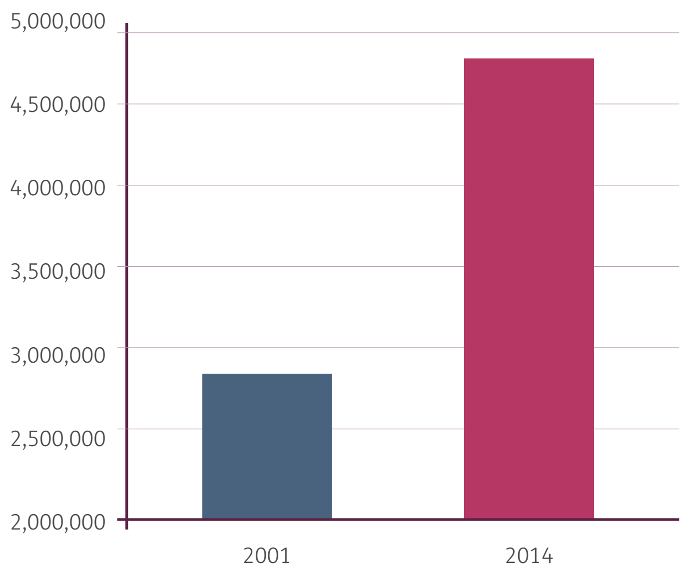
The 21st century has seen a structural shift in the housing market. As Britain's population has grown, it is the private rented sector (PRS) that has expanded to match the increasing need for accommodation, growing in proportion at the expense of socially rented and owner-occupied households. In fact, 80% of the growth in household numbers since 2001 has been in the private rented sector, close to an additional two million renting households.

The PRS now provides accommodation for nearly 18% of all households in Great Britain (up from 11.5% in 2001), representing more than 4.6 million households. The recent description of "Generation Rent" may seem like a catchy sound bite, but without the private rented sector, the housing crisis in Britain would be far worse.

Over these 13 years, the number of households in the country has climbed by around 10.3%, or 2.5 million homes. By contrast, the PRS has seen seven times that growth. In 2001, there were 2.7 million homes (just 11.5% of households) in the private rented sector, with the last 13 years seeing the sector grow by 71.9%.

Between 2001 and 2007, the peak of the housing boom, 986,000 households were added to the sector despite more buoyant conditions for new buyers, a growth of 36.4%. The financial crisis did little to dampen the long-term growth of the sector. In fact, since 2008, the private rented sector has grown by a further 913,000 households. The availability of high LTV lending was one of the casualties of the credit crunch, and the number of first-time buyers able to get a foot on the property ladder has plummeted. Recent estimates by Genworth suggest that there have been 1.8 million fewer first-time buyers since the peak of the market in 2007 than we would have seen over the period as a result[2]

Total households in PRS



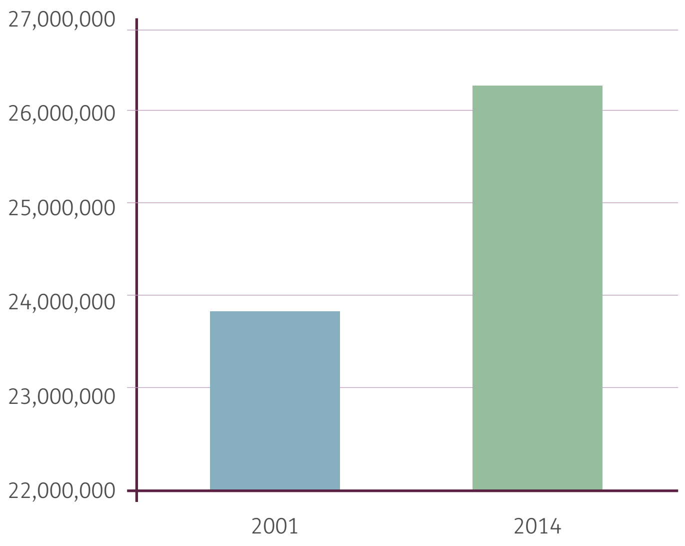
[2] Genworth, August 2014

At the same time, pay packets have been under growing strain, making saving for a deposit difficult. Wage growth has been largely stagnant, rising just 14% over the same period, while inflation over the period stands at 23%. With real wages reduced, high student debts and a rapid recovery in house prices in recent years, at a time when changes in the mortgage market have placed a greater focus on affordability, reduced lenders' appetite for risk and limited high LTV lending, it's no wonder many otherwise natural first-time buyers have had no option but to rent.

This has been compounded by ongoing net migration in the country, totalling more than 1.2 million since the peak of the last housing boom in 2007. With the vast majority of newcomers unlikely to be initially seeking home ownership, they have instead moved into privately rented homes.

However, the growth of the PRS has been far from uniform across the country. London and the South East have spearheaded the expansion, accounting for one third of the number of households added to the sector since the last housing market boom, some way ahead of their share of all UK households. In the last seven years, London has seen the number of rented households increase by 216,000, while the South East has seen growth of 131,600. With the economic recovery since the recession centred initially in these areas, they have seen some of the strongest demand from young professionals migrating for employment. Equally, with the highest house prices in the country, a historically low level of high LTV lending has contributed towards growing rental demand.

Total households in Great Britain



£1 trillion asset class

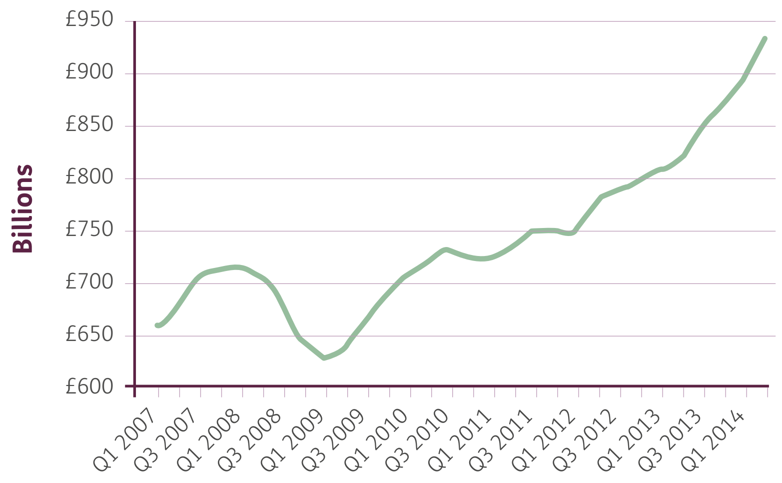
- The total value of property in the PRS in Great Britain has now reached £930.7bn
- The value of the PRS has more than tripled since 2001, rising by £668.6bn

As the size of the sector has grown, so too has the total value of landlords' assets, a process accelerated by the strong recovery in property prices since the depths of the housing market downturn in 2009. The total value of property in the PRS in Great Britain has now reached £930.7bn, three and a half times its value of £262.1bn in 2001.

From its trough in 2009, the sector has gained £302.5bn, meaning it has now risen by more than quarter of a trillion pounds (£272.bn) since 2007, the peak of the property boom, up by 41.3%. In the last year alone, the sector's value has climbed by £109.5bn, a rise of 13.3%.

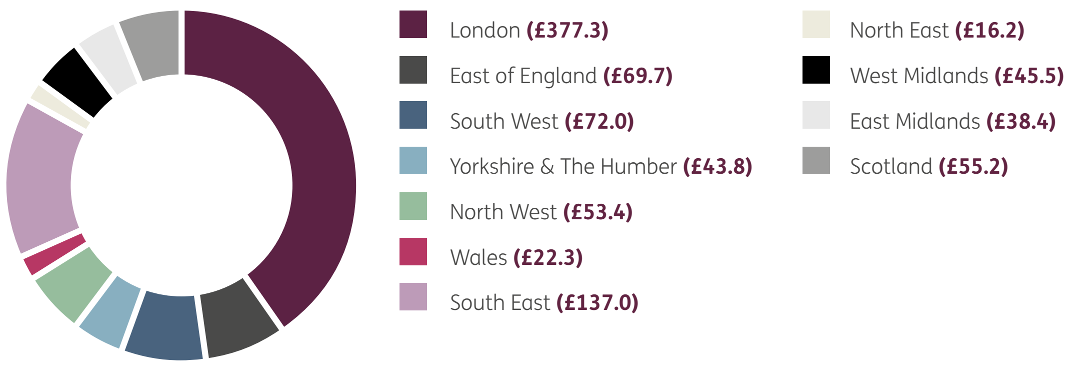
While there are signs that the rapid house price growth may be slowing, we forecast that on current market trends, the PRS will break through the £1 trillion barrier in the second quarter of 2015.

Total value of the PRS in Great Britain

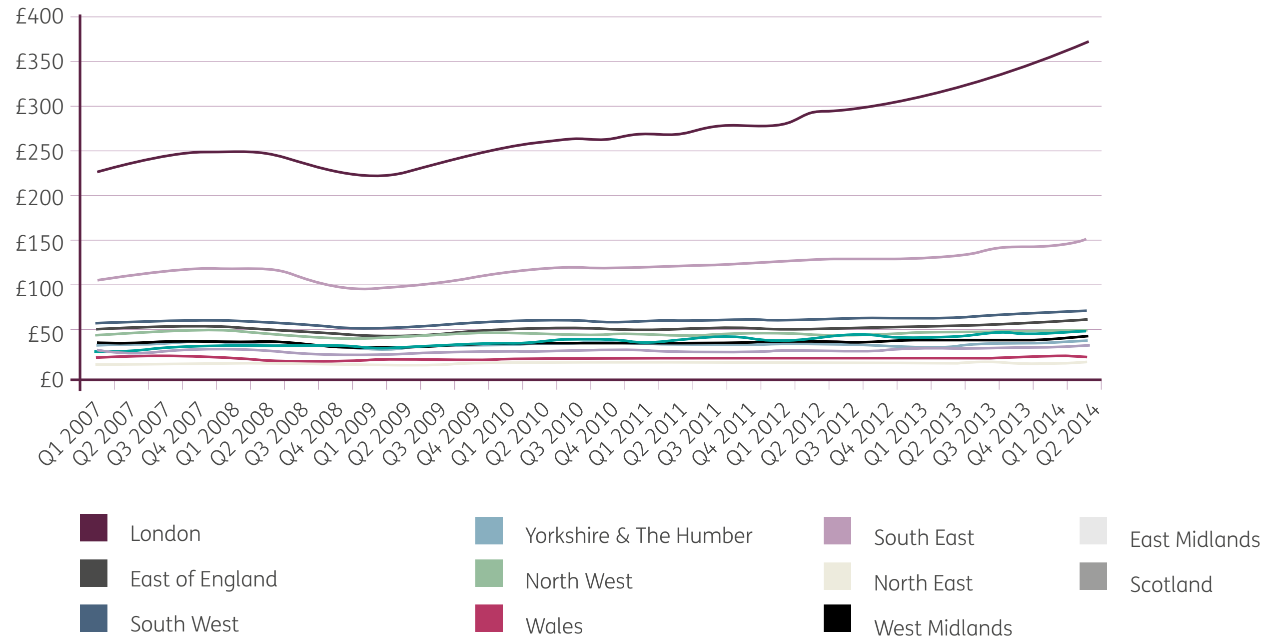


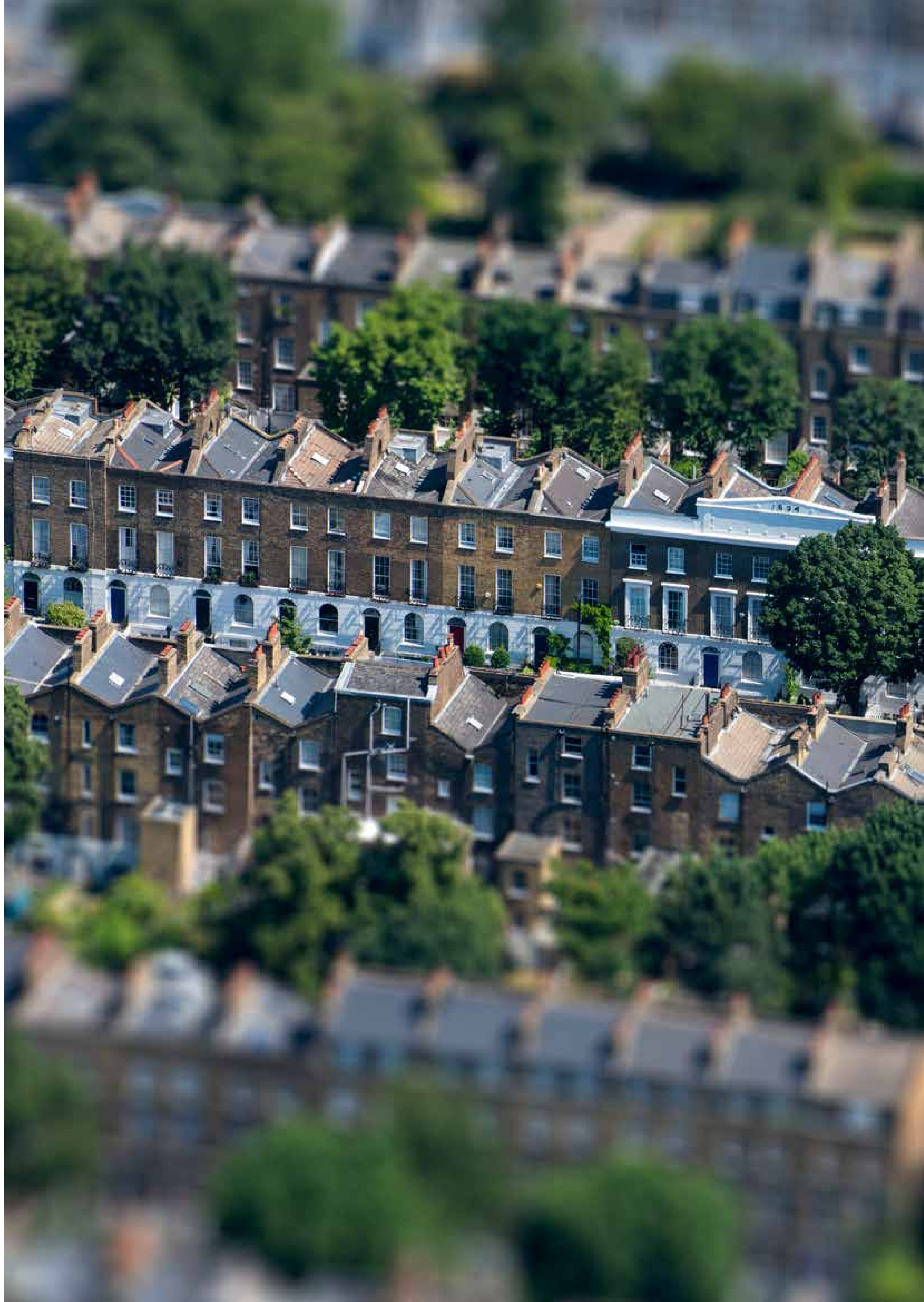
Given the London-centric nature of house price growth in the last few years, London has been the catalyst for the growth in the value of the PRS. Since 2007, 61% of the increase in the PRS' value has been down to the boom seen in the capital. London's landlords have seen the total value of their assets rise by £165.9bn, equivalent to 78.5%, in the past seven years. The South East has contributed a further £34.8bn, the next best, while the North East has seen the smallest increase in cash terms (a meagre £0.9bn) with a growing PRS unable to compensate for property prices still one fifth below their 2007 level.

Value of the PRS by region (£bn)



Growth in value of PRS by region (£bn)





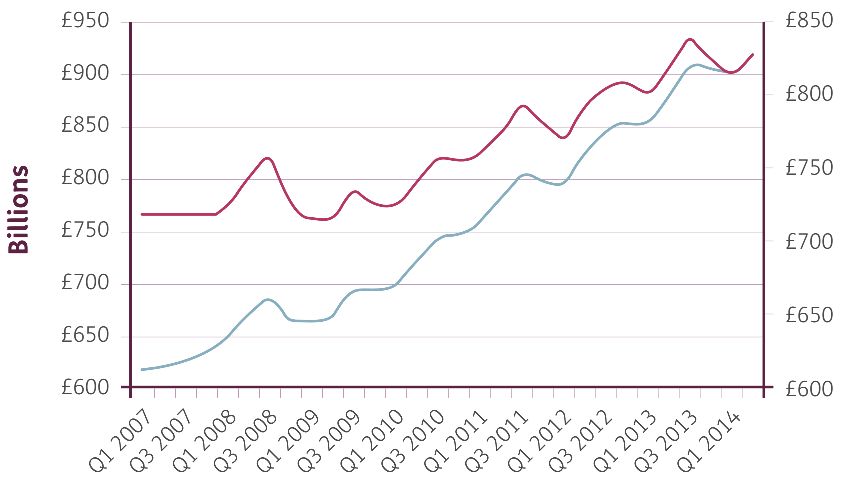
Annual rents approach £45bn

- Landlords in Great Britain receive £3.8bn on a monthly basis, up from £2.5bn seven years ago
- London landlords received more than a third of the total paid out in the last 12 months

The dramatic and necessary expansion of the PRS has drastically increased the amount of rent being paid each month. Landlords in Great Britain now receive £3.8bn on a monthly basis. Seven years ago, the total amount paid was £2.5bn per month.

In the last seven years, tenants in Great Britain have paid £274.4bn in rent to landlords. £44.8bn now changes hands each year, equivalent to nearly half the UK's total household expenditure on food[3]. The amount of rent paid in the last 12 months is up by £2.3bn (5.5%) compared to a year ago.

Total monthly rent vs average rent per property



Total rent paid across PRS (LHS) Average monthly rent (RHS)

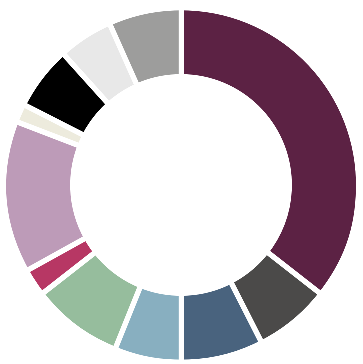
In the last year, the lion's share of the total increase in rent paid across the country is down to the growth in the number of households in the sector. The increase in rents themselves (rental inflation per property) is slowing. While total rent paid has risen £158m per month compared to a year ago, an increase of 4.4%, the average property's rent has risen by only 1.1%. This compares with annual rental inflation of 2.9% in the second quarter of 2013. The average rent in Britain now stands at £812.80 per month, up from £804.10 a year ago.

With lacklustre wage growth being outstripped by inflation, tenants can ill afford sharp rent increases. Equally, low interest rates have meant landlords continue to benefit from historically low mortgage costs, and do not have the same need to ratchet up rents to cover their cost base. Furthermore, landlords would much rather forgo a rent rise than risk losing a tenant and enduring a costly void period where the property lies empty. A void of four weeks, for example, would cost a landlord almost 8% of his annual income.

In the event that interest rates are raised next year, the direct knock-on impact on mortgage costs may provide an added strain for the landlord population. If a 1% rise in the Bank Rate triggered a similar increase in typical mortgage rates, a landlord seeking finance to buy a £200,000 property with an LTV of 70% would see monthly mortgage costs become 24% higher than at present. In this instance, it is likely we would see landlords at least partially cover these costs with rent rises.

On a regional level, London landlords received more than a third of the total paid out in the last 12 months (£16.2bn). This disproportionate contribution has evolved due to the extremely high tenant demand in the capital as the population swells, underpinned by high property prices and chronic supply constraints. £6.3bn was paid in the South East, with the North West accounting for £3.7bn. Scotland saw £2.8bn change hands, compared to £1.1bn in Wales.

Monthly rent paid by region (£m)



London **(£1,352)**
East of England **(£255)**
South West **(£282)**
Yorkshire & The Humber **(£237)**
North West **(£316)**
Wales **(£91)**
South East **(£525)**
North East **(£66)**
West Midlands **(£216)**
East Midlands **(£189)**
Scotland **(£246)**

[3] ONS Consumer Trends Survey Q4 2013

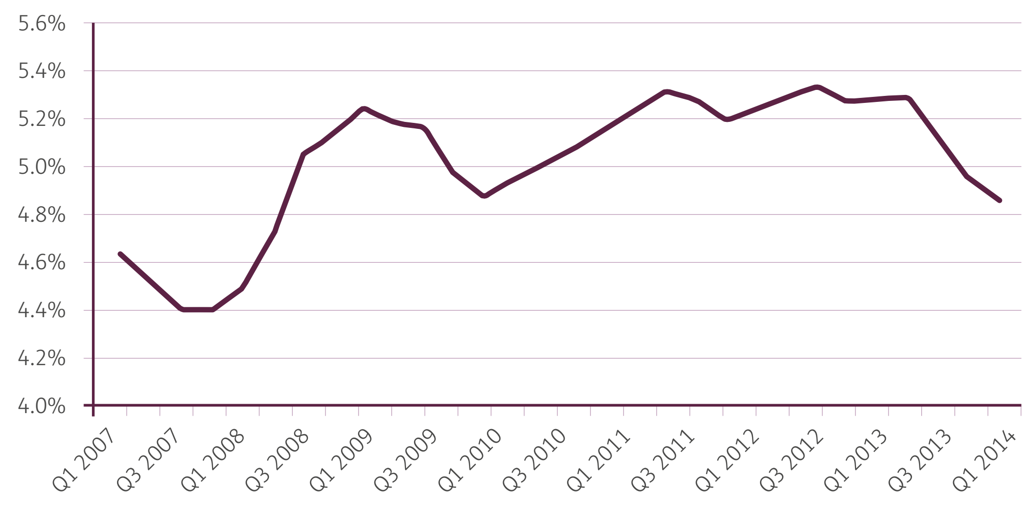
Yields under pressure

- The average yield in Great Britain stands at 4.9%, down from 5.3% a year ago
- The lowest yields on our records preceded the financial crisis, at 4.4% in 2007

One potential fly in the ointment for investors is the recent performance of yields. With rents losing some of their upwards momentum, and property prices on a steeper upwards trajectory, yields have been under pressure. This is particularly a problem for newly bought property, as landlords must earn an income from more expensive property.

Across Great Britain, the average rental property has a gross yield of 4.9%. This is down from 5.1% at the end of 2013, and 5.3% a year ago. Yields were at their lowest on our records before the onset of the financial crisis, dropping to just 4.4% at the end of 2007 when a speculative boom meant amateur landlords (who were really just speculators) disregarded income in the search for capital growth. At that time, interest rates on buy to let loans were well above yields. That is not the case today. However, as we have seen above, when rates do rise, they will bring up the cost of mortgage costs. While we are currently in a sweet spot for investing, with low costs and strong capital appreciation, it's important that buy to let landlords factor in the potential for their cost base to rise in the future. Investment in the sector must be sustainable, rather than speculative, and it is this the Bank of England's Financial Policy Committee is looking to ensure through requesting greater regulatory powers.

Gross yields in Great Britain

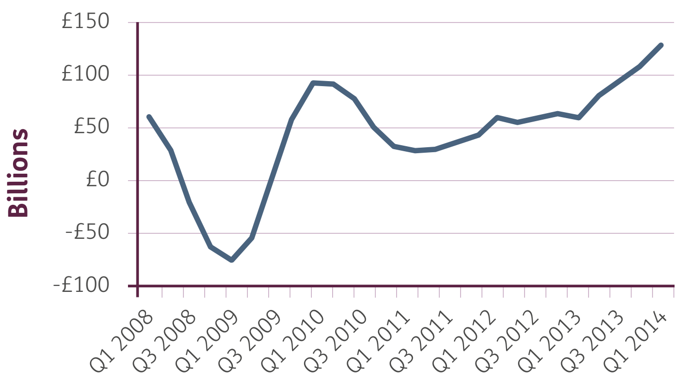


Returns hit six-year high

- Total annual returns hit 15.1%, highest in at least six years
- Across Great Britain, annual returns totalled £123.6bn in last 12 months

Although solid income must always underpin a buy to let investment, climbing property values are currently supplementing low yields. Indeed capital appreciation has driven total returns to their highest in at least six years. Without factoring in additional costs such as management fees and maintenance, the average landlord will have seen a total annual return of 15.1% in the last 12 months, outstripping all other mainstream asset classes. This represents an average return of £27,475 per property. Across the rented sector as a whole, annual returns totalled £123.6bn.

Total annual returns across PRS



The national level picture masks incredible variation throughout the regions. Returns are at their lowest in the North East (6.1%), where property value inflation has been among the lowest in Great Britain. Meanwhile in London, property investors have boasted an average of 21.4%, following capital appreciation of 16.4% in the last 12 months alone.

Current yields and total annual returns

	Current yields	Total annual returns
London	4.3%	21.4%
East of England	4.4%	12.7%
South West	4.7%	10.2%
Yorkshire and The Humber	6.5%	10.1%
North West	7.1%	9.2%
Wales	4.9%	7.7%
South East	4.6%	12.7%
North East	4.9%	6.1%
West Midlands	5.7%	10.6%
East Midlands	5.9%	12.5%
Scotland	5.4%	11.2%
Great Britain	4.9%	15.1%

The improvement in returns caps a remarkable turnaround, given the impact of the financial crisis on property values. Five years ago, gross total annual returns were negative, dropping to -10.7% in the first quarter of 2009, after buy to let property values fell 15.2%. However, on the flip side, for those looking to invest for income, the fall in value was not mirrored by a fall in rents at the same rate, meaning yields climbed to 5.2%.

Gross total returns since 2007

	Capital appreciation	Gross rental income	Gross returns
London	£109,941	£114,316	£224,257
East of England	£2,930	£56,103	£59,033
South West	-£6,914	£59,417	£52,557
Yorkshire and The Humber	-£20,726	£52,114	£31,388
North West	-£21,796	£52,309	£30,513
Wales	-£17,111	£39,474	£22,363
South East	£12,748	£67,725	£80,473
North East	-£25,104	£34,965	£9,861
West Midlands	-£13,152	£52,457	£39,305
East Midlands	-£13,177	£50,403	£37,225
Scotland	£22,178	£58,906	£81,085
Great Britain	£16,728	£66,647	£83,375

Since 2007, the average landlord has made £16,728 in capital gains per property, with a total of £66,647 in gross rental income (excluding voids and the impact of tenant arrears). This means that landlords who purchased at the end of the last economic boom and held their property through the downturn, will have seen total gross returns of £83,375 on average. A combination of strong rental income and rapid house price inflation means London landlords have seen the strongest returns by far, £224,257, nearly three times the national average. While several regions have not yet seen buy to let property prices return to their 2007 level, rental income has driven returns in an era of super-low interest rates, when the search for yield has characterised investor behaviour not just in the UK, but around the world.

Looking ahead, even if we see less rapid house price growth over the next 12 months, an average buy to let investor could see an annual return of 12.2%. Across the PRS, this would total £113.5bn.

The business of buy to let

An investor buying a £200,000 property with a 70% LTV would be raising a mortgage of around £140,000, with equity of £60,000.

After factoring in the average fixed rate mortgage rate, and an assumed cost for ongoing maintenance of 1%, the investor would face annual outgoings of £7,838.

Current yields suggest the investor would receive £9,737 in rental income per year. However, with capital appreciation standing at 9.8%, capital gains would total £19,533.

This gives an investor a gross total annual return of £21,431 on their outlay, equivalent to 35.7% (on their equity stake of £60,000).

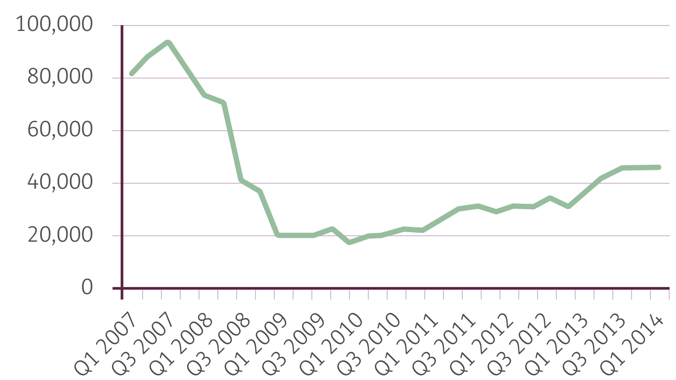
By way of comparison, leading easy-access ISA rates currently return around 1.55%, which would generate a return of £930 on the same initial investment.

Buy to let lending mini-boom?

- £154.3bn lent to investors since start of 2007
- Valued of mortgaged property in the PRS climbs £26.3bn in last year to £384.4bn

A vibrant buy to let mortgage market is fundamental to the health of the PRS, and has been key to its expansion. In total £154.3bn has been lent to property investors since the start of 2007 – a total of 1.2m new loans, according to analysis of the CML's data[4]. However, progress has not been constant. While lending peaked at £45.7bn in 2007, the mortgage market practically ground to a halt following the onset of the credit crunch, which restricted many lenders' ability to fund lending through wholesale markets.

Number of new buy to let loans



Source: CML

The current market, by contrast, is showing signs of its former vigour. In the first half of 2014, there were 93,900 buy to let loans issued, up by 34% compared to the same period a year ago. In fact, the number of mortgages advanced in the first six months of the year is already more than in the whole of either 2009 or 2010. The government's Funding for Lending scheme, not to mention general improvement in wholesale funding conditions, has improved operating conditions for lenders. Securitisation has shown tentative signs of a recovery in 2014, and these factors mean banks and building societies have been able to boost the supply of finance for the sector. Equally, the growth in the number of providers in the market has boosted the range of options available to landlords to match their circumstances. All of this has boded well for prospective buy to let borrowers, who have benefited from a broadening in product choice. According to Mortgages For Business' analysis, total buy to let product numbers have climbed from 142 in the first quarter of 2010 to 627 in the second quarter of 2014[5].

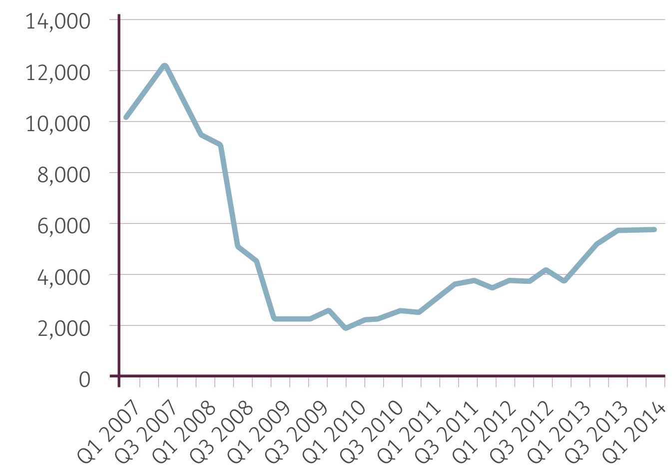
However, it is not just product and provider choice that has improved, but mortgage rates. Rock-bottom interest rates, combined with improving funding conditions for lenders, have helped drive down mortgage costs for new borrowers, stimulating demand for mortgages.

Between July 2007 and July 2014, the average buy to let fixed deal fell by 1.86 percentage points according to Moneyfacts.

As a result, the total value of new lending is rising. At £12.9bn, the amount paid out in new buy to let lending in the first half of 2014 was 45% greater than the same period a year ago. While this is still far below the pre-recession peak, it is the greatest value advanced in the first half of a year in six years. This trend seems set to continue. In July 2014, 17,500 buy to let loans were advanced, with a total value of £2.4bn – a year-on-year increase of 18% and 26% respectively.

As property prices have risen, the average gearing of property investors across their portfolios has fallen back. Despite this, the expansion of the sector means that the total value of mortgaged buy to let property has risen in the last year, climbing by £26.3bn to £384.4bn.

Value of new buy to let loans (£m)



Source: CML

[4] CML buy to let lending data, Q1 2007 – Q2 2014
[5] Mortgages For Business Complex Buy To Let Index

Outlook and conclusion

- PRS to climb to 5 million households by 2016, nearly 19% of households
- Value of PRS forecast to hit £1 trillion in Q2 2015

The future looks bright for the growth of the private rented sector. Demographic trends mean the total number of households will rise by 221,000 per year in England alone, according to ONS. Social housing tenure is falling, and while lending to first-time buyers has improved, it is not matching the increasing level of demand for accommodation. Public funding will not be sufficient to plug the housing gap, and the investment provided by private landlords will be even more crucial in the future. It is easy to knock landlords, but they play an incredibly important role, and current market conditions should encourage "Generation Let" to grow.

Even if we see some of the heat come out of property price inflation following the blistering capital gains landlords have seen in the last year, more modest rises, in concert with strong rental incomes, will draw the eye of investors. However, it is not just established or professional property investors who are likely to contribute to the ongoing growth of the sector. The well-publicised new pensions freedoms take effect from April next year. With those at retirement no longer needing to purchase an annuity, we are likely to see a sizeable number of those retiring looking to use lump sums to fund or part-fund property investment, to provide an income in retirement.

That is not to say there aren't clouds on the horizon that have the potential to weigh on the sector's growth. Interest rates are widely predicted to rise in spring 2015, and a sharper increase than expected could deter prospective property investors by increasing monthly mortgage costs. As we have seen, a 1% increase in a typical fixed mortgage rate could cause payments to be higher by nearly a quarter for a £200,000 property. However, in the case of a sharp hike, it's important to note that mortgage interest is offset against rental income, which will go some way towards mitigating the impact.

Looking further ahead, the European Mortgage Credit Directive, which will be brought into force by March 2016, has the potential to cause some turbulence. The Treasury's consultation will likely see the regulation of those parts of the buy to let market closest to being a consumer market – lending to the accidental landlord who inherits a property and lets it out, or lets their current property when moving home. Given the likely influx of first-time landlords following new pensions freedoms and the performance of buy to let as an asset class, providing consumer protection to this segment of the market is vital. Nevertheless, the limited number this will affect in context of the whole private rented market, should not undermine mainstream growth of the sector.

Either way, the number of households in the PRS in Great Britain will continue to climb, and we forecast that there will be 5 million rented households by the end of 2016, equivalent to nearly 19% of households. Looking further ahead, we anticipate the sector will encompass 5.4 million in 2019, nearly 20% of all households.

Given the rate of house price inflation, the value of privately rented homes in the UK should breach the £1tr barrier by the second quarter of next year. As the supply of properties continues to improve, and anaemic wage growth limits tenants' budgets, rental income is likely to increase more slowly. Yields are unlikely to shoot up in the next 12 months. Nevertheless, we estimate that the total rent paid each month will climb to surpass £4bn in the fourth quarter of 2015.

Methodology

Kent Reliance's research team analysed ONS census data to establish the size and growth of the private rented sector. Rental property prices are based on the average differential between rental property and house price data from Land Registry and Registers of Scotland. Rental data incorporates figures taken from Citylets and yield data from LSL Property Services. All rental and property value data has been weighted to account for the changing regional composition of the private rented sector. Buy to let mortgage data is based on analysis of figures from the CML and ARLA. Rental data is limited to the period between 2007 and the second quarter of 2014.

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