# The Kent Reliance
# Buy to Let Britain report

Edition Two

KentReliance
for Intermediaries

# Report highlights

- In the last year, 77% of the new households formed in Great Britain were created in the private rented sector (PRS), which now accounts for 18% of all households in total
- The average landlord made a total annual return of 12.5% per property at end of first quarter of 2015
- Total rent collected by landlords across Great Britain has risen to £4bn per month, up 7.2% in the year, with annual rents rising on average 3.9%
- London remains the key driver of growth in value in the PRS, accounting for 51.8% of the uplift last year, but this is down from 56.7% the year before as regions outside London, particularly the South East, show signs of recovery
- The buy to let market remains structurally attractive as the number of first time buyers continues to run at half pre-crunch levels and the 141,000 new houses built last year were over 100,000 short of the required level
- The value of buy to let property across Great Britain is expected to reach £1.07 trillion by March 2016, having increased 11% in the year to March 2015, to £990.7bn

# A foreword

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

In our last issue we documented the rapid growth the PRS has undergone in the 21st century, with the number of private rented households increasing by more than 2 million since 2001, and the value of the sector rising by more than £270 billion since the last economic boom.

The PRS continues to grow apace, leading us to forecast that it will break through the £1 trillion barrier this quarter, and that the number of PRS households will reach just under 5 million (nearly one in five households) by March 2016.

In this edition we examine in detail the growth in value and size of the PRS in the last 12 months, revealing the lack of uniformity across the country and where it has been most impacted by slowing house price growth. We also examine how capital appreciation and rental income across Great Britain's 4.8 million rented households is leading to total annual returns of more than £112 billion.

With the buy to let market continuing to grow and, we believe, remaining structurally attractive, we take a closer look at some of the future dynamics of property investing. We look at how long it typically takes the average property investor to unlock enough capital to finance their second rental property, and the implication this will have on returns over a twenty year period.

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

**Andy Golding, CEO, Kent Reliance**

**Andy Golding, Chief Executive Officer**

Andy has nearly 30 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

- In the last year, over three quarters of new households in Great Britain were created in the PRS, reinforcing its status as a critical component of the UK housing market
- Number of private rented households climbs nearly 150,000 in last year, now 18% of all households in Great Britain. Sector forecast to hit 5.5 million households by 2020
- The value of buy to let property across Great Britain is expected to reach £1.07 trillion by March 2016
- The value of PRS increased 11% in the year to March 2015, hitting £990.7bn
- Despite the prospect of regulatory change, the structural fundamentals of the UK housing market make a compelling case for ongoing growth in the PRS

## Landlords

- Average landlord makes total annual return of 12.5% per property at end of first quarter of 2015
- Total annual returns slow on moderating house prices, but still total £111.5bn across PRS in March
- Average landlord could expect to double their portfolio within ten years, purely by using growing equity to fund new purchases
- Over a twenty year period, single property investment is forecast to see equity grow by £376,876. Doubling portfolio after ten years increases this to £616,224
- Total rent collected by landlords across Great Britain has risen to £4bn per month, up by 7.2% annually

## Lenders

- Buoyant remortgage market supporting portfolio expansion and refinancing, with volumes up 23% year on year
- Increasing appetite for fixed-rate mortgages to provide security over affordability of mortgage payments
- Buy to let mortgage product choice increased 43% in last year alone
- Across the PRS, the value of mortgaged property stands at £382.9bn, up from £358.0bn a year ago
- Regulatory change is on the horizon, with greater protection for amateur landlords

# PRS houses 77% of new British households in last year as first time buyer numbers remain depressed

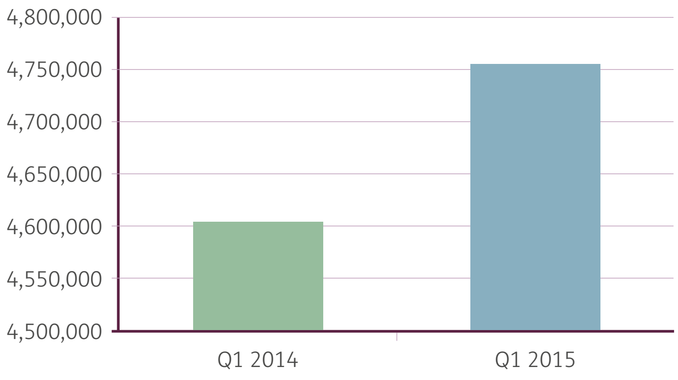
- PRS grows by nearly 150,000 households in last year alone
- First time buyer numbers still half pre-crunch level, supporting buy to let market

There are two key driving factors behind the ongoing growth in the value of the private rented sector (PRS), and how it varies across the country (which we discuss on page 8): the number of rental households being created and the changing value of rental properties.

## Rental household creation

The number of rental households is being driven up by the sheer scale of tenant demand. As a result, there have never been more households in Great Britain's PRS. By the end of the first quarter of 2015, there were 4.8 million rented households – 18.0% of all households in the country. This represents an increase of nearly 150,000 in the last year alone. In fact, private rented households account for a staggering 77.4% of the new households created in the last year across all tenures, more than four times the current proportion of stock that is privately rented, underpinning the strength of the buy to let market.

Total households in PRS




Tenant demand is being powered by the low level of lending to new buyers. First time buyer numbers are still historically depressed. In the five years before the credit crunch, 2.4 million first time buyers bought homes with a mortgage[1]. In the last five years, just half that number have secured their first home. The increased opportunity for first time buyers in the market place has been a hot topic for media commentary in the last year, with a key focus on demand side reforms such as the Help to Buy Scheme, amendments to the slab structure of stamp duty, and the newly launched Help to Buy ISA. But the reality is that any improvement has been marginal rather than fundamental, as a combination of limited finance and high house prices take their toll.

In the last twelve months[2], 304,700 first time buyers bought properties with a mortgage. This was a 7.5% increase on the same period a year ago – but represented a net addition of just 21,300. Indeed, despite the increase, first time buyer numbers were just three quarters of the average annual number before the credit crunch, and just 58.9% of the level reached in 2002.

Availability of high LTV lending is reportedly improving, but we are still a long way from pre-crunch levels and it remains relatively expensive – the marginal cost of the top 5% slice of a 95% mortgage is eye-wateringly expensive compared to a 90% loan. Equally, criteria remain tight – a factor that has been exacerbated by the impact of last year's Mortgage Market Review.

On top of this, house building is a long way from matching growing demand, reinforcing the unaffordable nature of house prices for new buyers. Just 141,000 homes were completed in the last year, 35.7% fewer than the amount created in the year before the credit crunch, and well shy of the 243,000 per year required[3]. This is set to continue,

[1] Council of Mortgage Lenders, analysis of 12 months to February for each year to incorporate latest data
[2] Year to February 2015, CML data
[3] A Holmans (2013) – New Estimates of Housing Demand & Need in England, 2011 to 2031

with no political party providing a convincing, detailed plan for fully matching the shortfall. Whether or not these properties are allocated for owner occupation or rental is not pertinent. The key is that supply of homes increases, rectifying the supply and demand imbalance, making house prices and rents more affordable.

All of this has made house purchase a more difficult prospect for prospective first time buyers, and is directly impacting buyer aspirations. Halifax's Generation Rent 2015 report shows the number of 20 to 45 year olds now saving for a first home has fallen by 6% in the last year. As a result, long-term dependence on the PRS is increasing, boosting tenant demand and the number of rented households.

## Rising buy to let property value

The second element driving the growth in the total value of the PRS is house price inflation. Aside from supporting tenant demand, by making it harder for first time buyers to afford to get a step on the ladder, it is increasing the average value of landlords' holdings.

However, this is starting to moderate. In the year to March, the average buy to let property in Great Britain saw its value rise by 7.5%. While still a healthy rate of increase, it compared to an annual rate of 9.6% in December, and the recent peak of 10.9% in September. However, with house building figures still unable to cope with the growing number of households, house prices are solidly anchored for the long term, although we anticipate it will return to a more sustainable level. We forecast that annual price growth will slow to around 4.4% in 2016, rising slightly to 4.8% in 2017.

The housing market – and PRS – is by no means uniform across the country, and the regional variation in house price growth reflects this. In London, the concentration of the greatest demand for property, has seen the average buy to let property value climb by 10.6% in the last year, with the East of England the next fastest riser (9.3%). Although all regions have experienced rises, the North East has seen the slowest annual increase (0.8%).

Number of loans to first time buyers


Source: CML

# Landlords' property wealth hits £990.7bn

- Value of PRS increases by £97.8bn in last year
- London accounts for 52% of increase in value

The PRS has yet to break the £1 trillion barrier as an asset class, but it is tantalisingly close. At the end of March, the total value of property owned by landlords stood at £990.7bn.

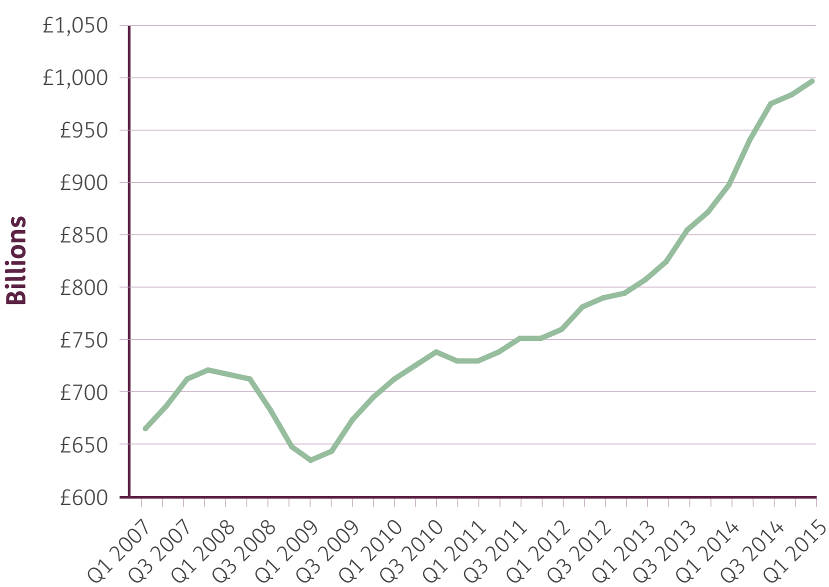
In the last 12 months alone, landlords' holdings have increased by £97.8bn, an increase of 11.0%. However, this has been slowing from its peak rate last year – in September, the sector's value was rising at an annual rate of 14.5% – £123.1bn.

London remains the driving force behind this growth and has contributed 51.8% of the increase in the PRS' value in the last twelve months. Although London accounts for the lion's share of growth, there are signs that the market outside the capital is strengthening in relative terms; a year ago, London accounted for 56.7% of annual growth.

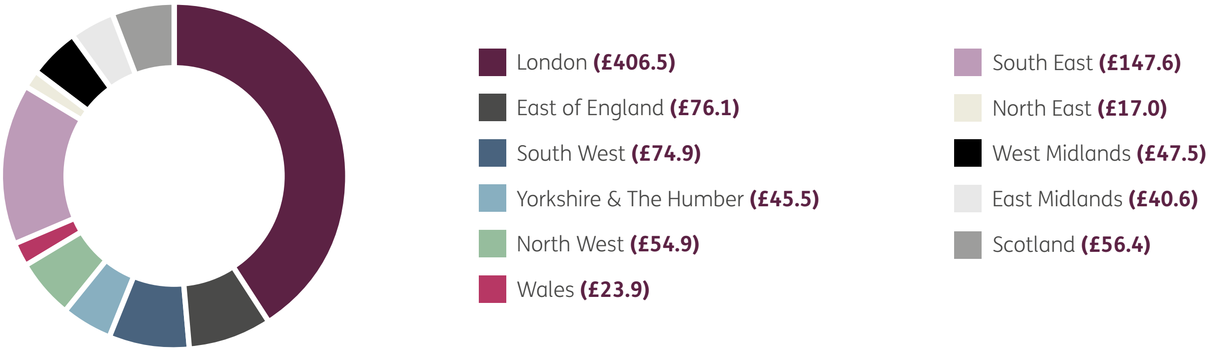
Beyond London, the South East has seen its influence increase as price growth and tenant demand there have remained brisk. It accounted for 12.5% of the total PRS value in March 2014, a figure that has risen to 16.0% in Q1 2015. While house price inflation in London has become more measured in recent months, the rate of deceleration has been much slower outside the capital, and the South East has been the region with the next greatest rental demand.

Overall, London's PRS has a value of £406.5bn, up by £50.7bn in the last year. The South East is the next most valuable, at £147.6bn, with the East of England valued at £76.1bn. The value of Wales' PRS (£23.9bn), is just one seventeenth of the value of London's rented property. Nevertheless, even the more modest rise in cash terms in the last year (£2.2bn) represents an annual increase of 10.1% for investors in Welsh property.

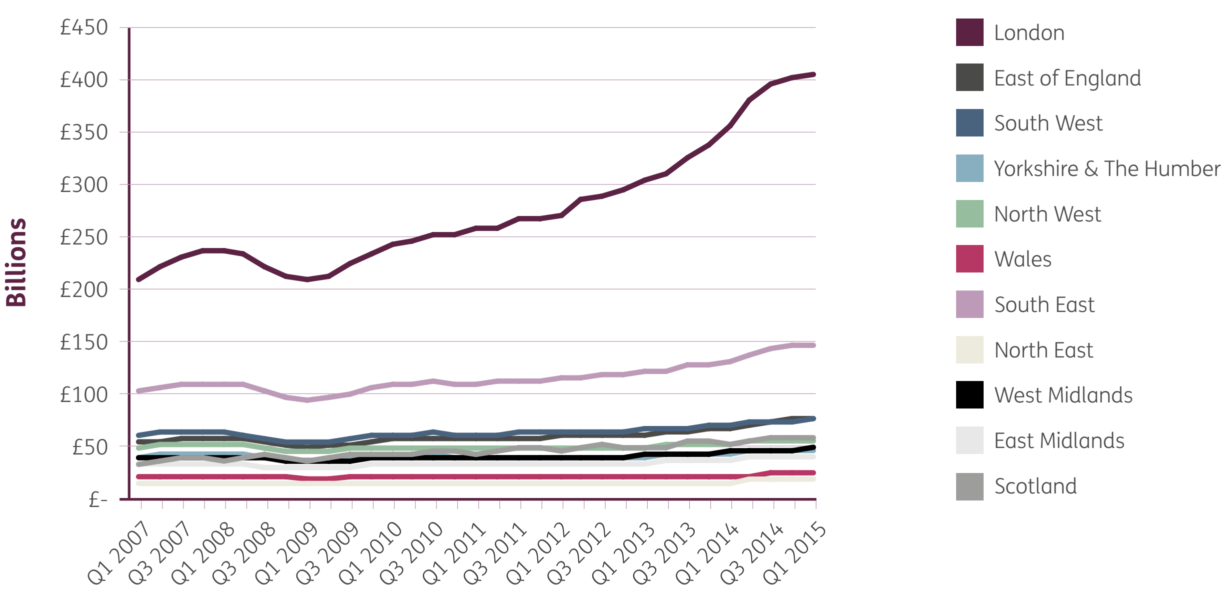
Total value of the PRS in Great Britain



## Total value of the PRS in Great Britain (£bn)




## Growth in PRS, by region



# Rental inflation provides cheer for property investors

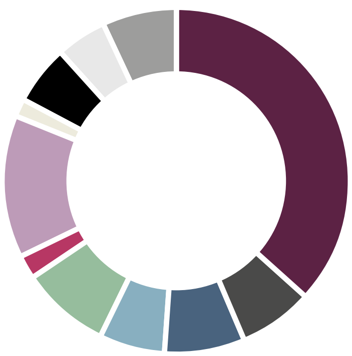
- Landlords see rental income of £4bn per month across PRS
- Rents climbing by an annual rate of 3.9%

As tenant demand grows, increasing competition for rental accommodation has supported rental inflation. By the end of the first quarter of 2015, the average rent in Great Britain (£832.0) had risen by 3.9%, the highest rate of increase since the third quarter of 2013. This is crucial for property investors. It is rental income that underpins the success of a long-term investment, allowing landlords to meet the cost of property ownership each month.

Overall, by March the total rental income collected by landlords across the country had risen to £4.0bn per month, up by 7.2% (£266m) in the last year, factoring in the swelling number of households as well as increasing average rent. Landlords now receive £46.8bn each year in rental payments, up by £2.5bn compared to a year ago, with two thirds of this rise due to the increase in the size of the PRS.

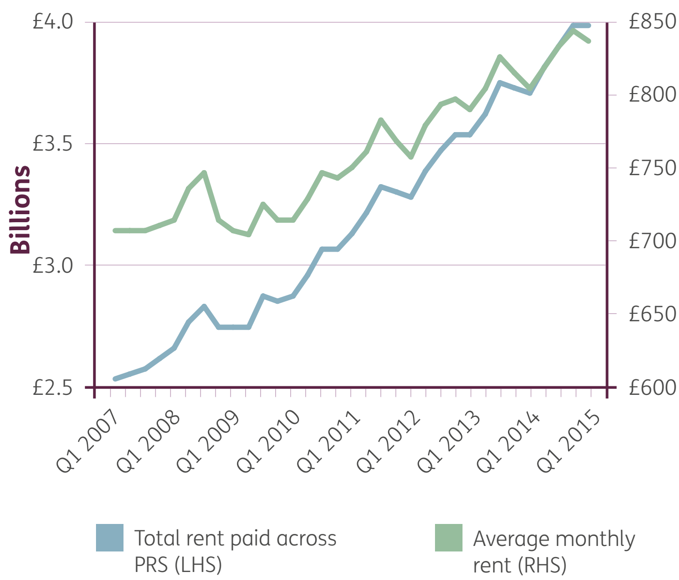
Due to its disproportionate size, and significantly higher average monthly rents, London's PRS accounts for 36.3% of the total annual figure (£17.0bn). The South East accounts for 13.8% (£6.5bn), while the North West accounts for 8.3% (£3.9bn).

Monthly rent paid by region (£m)



London **(£1,457)**
East of England **(£279)**
South West **(£293)**
Yorkshire & The Humber **(£243)**
North West **(£325)**
Wales **(£91)**
South East **(£529)**
North East **(£70)**
West Midlands **(£214)**
East Midlands **(£193)**
Scotland **(£264)**

Total monthly rent vs average rent per property



# Yields fall on annual basis, but landlords generate £112bn in annual returns

- Yields decline to 4.8% compared to 5.0% a year ago
- Despite decline, annual gross returns are up £5.8bn compared to March 2014

Yields are an important measure for long-term property investors, highlighting the level of income they receive on a property each year against the value of the property.

Despite moderating, property price rises have outstripped rental inflation in the past year, and this has taken its toll on yields on an annual basis. Across Great Britain, gross yields have fallen by two percentage points, standing at 4.8% in March, compared to 5.0% a year ago.

A cocktail of lower yields and decelerating property price growth has weighed on landlords' total annual returns. However, that is not to say the returns are inconsiderable.

Across Great Britain, landlords have seen gross returns of £111.5bn in the last twelve months. While this figure was up from the £105.7bn landlords saw in March 2014, it represented a 18.9% decline compared to the recent peak of £137.5bn in September, when average capital gains were at their highest in seven years.

Despite the decline in total returns across the PRS, the average buy to let property generated a gross annual return of £24,221 in the past twelve months, just £1,000 less than the average salary in Great Britain (£25,198)[4]. This was an increase of 2.2% from March 2014, although a decline from the recent peak of £30,345 in September. In percentage terms, total annual returns stood at 12.5% at the end of the first quarter.

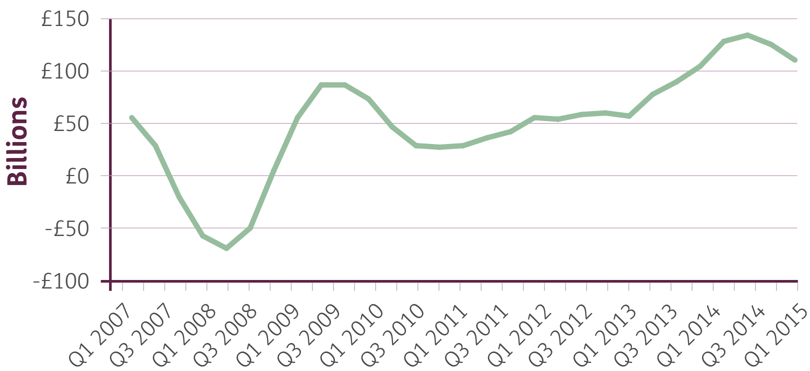
Again, London and the South East stood out in particular, with returns of £59,455 and £27,909 respectively. Across the PRS, these two regions alone contributed to a combined £71.3bn in total annual returns.

**Current yields and total annual returns**

| | Current yields | Total annual returns |
|---|---|---|
| London | 4.3% | 15.1% |
| East of England | 4.4% | 13.6% |
| South East | 4.3% | 13.3% |
| Wales | 4.6% | 12.0% |
| Scotland | 5.6% | 10.0% |
| East Midlands | 5.7% | 9.8% |
| Yorkshire & The Humber | 6.4% | 9.4% |
| West Midlands | 5.4% | 9.2% |
| North West | 7.1% | 8.5% |
| South West | 4.7% | 8.4% |
| North East | 4.9% | 6.0% |
| **Great Britain** | **4.8%** | **12.5%** |

[4] ONS 2015 April Average Weekly Earnings, £485 per month

Total annual returns across PRS




Gross yields in Great Britain


# ‘Second Step’ landlords double portfolio in ten years

- Landlords able to build enough capital for second property in 10 years
- Doubling portfolio could see equity growth of £616,224 over 20 year period

Although slowing, the rate of capital appreciation is supportive for landlords looking to expand their portfolios without needing to inject fresh capital. Our analysis suggests a typical property investor will be able to secure a second buy to let property after 10 years, purely from equity built in their first property. Using a conservative forecast for house prices to exceed nominal growth (real terms GDP growth adjusted for inflation) by just 1% per year, and using the average LTV for a buy to let property, a landlord who bought their first property in 2015 would have built up enough equity to place a deposit on a second property by 2025. This purchase would be based on capital gains alone, and without their portfolio’s gearing increasing from its initial level.

On the same basis, it is eight years into a property investment with an average sized deposit (£58,731), that a landlord will own a majority of their property, without factoring in any form of mortgage repayment.

The rate at which landlords can increase their holding as a result of equity growth is dependent on how quickly property prices rise. Our range of forecasting shows that if property price growth lags nominal economic growth by 1% a year, it will take 16 years to accumulate enough for a second property. If, by contrast, house prices outpace economic growth by 3% a year, it will take just eight years to build enough capital to double a portfolio.

| **Rate of house price growth** | House prices lag GDP growth by -1% | House prices match GDP growth | House prices exceed GDP growth by 1% | House prices exceed GDP growth by 2% | House prices exceed GDP growth by 3% |
|---|---|---|---|---|---|
| **Years until second property** | **16** | **13** | **10** | **9** | **8** |

For property investors, doubling portfolio size without increasing mortgage debt can be lucrative in the long term. Even with our conservative assumption of property price growth at 1% above economic growth, over the next twenty years, an investor with one property would see their equity grow by £376,876, with the property rising in value to £585,216. This is a return of 641.7%, excluding rental income.

Assuming the same growth, over the same period, a landlord that remortgaged and bought a second property after ten years would see their initial equity rise to £674,956, an increase of £616,224 – a prospective gross return of 1,049.2% across their two property portfolio.

When investing in property with mortgage finance, it's crucial that rental income is used first and foremost as a means to meet the cost of meeting the costs of ownership, such as monthly mortgage payments. This ensures that if there is a short-term market correction, and landlords do fall into negative equity in the short term, they are able to retain the asset for a longer period until the market returns to its longer-term trend of growth, meeting monthly commitments. At present, it is easy to forget the importance of this. With interest rates at historic lows, yet rental income climbing, there is a generous gap between the average landlord's income and mortgage payment.

According to our analysis, the average outstanding mortgage rate in March across all product types was 4.73% in March. This means the average landlord in the PRS is facing an annual mortgage cost of £7,077, £2,907 less than gross average annual income – a buffer of £2,232 when adjusting for void periods and maintenance costs.

# Buoyant remortgage market supports portfolio expansion

The buoyant nature of the current buy to let remortgage market is helping underpin the expansion of landlords' portfolios, leading landlords to remortgage to extract surplus equity, which we discuss above. Meanwhile, an ever longer time horizon for bank rate rises, and increasing competition in the marketplace is pushing down rates, encouraging landlords to refinance and secure low fixed-rate products.

According to CML data, the number of buy to let remortgages in February exceeded the number of loans for buy to let house purchase (8,400 compared to 7,400). This is the fourth consecutive month we have seen this trend. In fact, in February, landlords secured 22.8% more remortgages than a year ago – with the total value of lending up 31.3% year on year.

Analysis of our proprietary data shows that investors looking to refinance or secure a new mortgage are increasingly opting for fixed-rate deals, as investors look to lock into low long-term rates to guarantee the affordability of their mortgage payments, and future-proof against interest rate increases. Our data shows that the total value of assets now held on non-discounted fixed rate deals is 2.1 times the value of assets on tracker non-discounted tracker or variable rates – a ratio that has increased from 1.5 times a year ago.

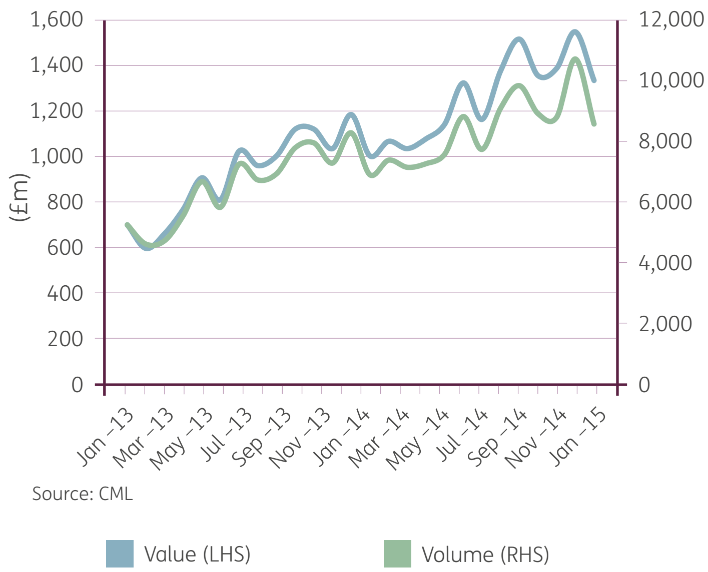
It is not just the remortgage market that is growing. The value of lending for house purchases in the sector rose 3.4% year on year in February, up slightly also in volume terms. As a result, total buy to let lending across the whole market is buoyant, with the total amount of new lending up 15.8% in February compared to a year ago. This contrasts to a more subdued owner-occupier mortgage market.

While the CML forecasts lending for house purchase to climb by 4.3% in 2015, the buy to let market is showing the potential to exceed £30bn this year – growth of more than 9%.

Product choice continues to expand for property investors. According to Mortgages For Business' analysis, in the first quarter of 2015 there were an average of 839 buy to let products available on the market. This represents a 43.2% increase on the 586 available on average in Q1 2014. With landlords' needs and demands becoming ever more disparate as the PRS evolves, this depth of product choice is vital.

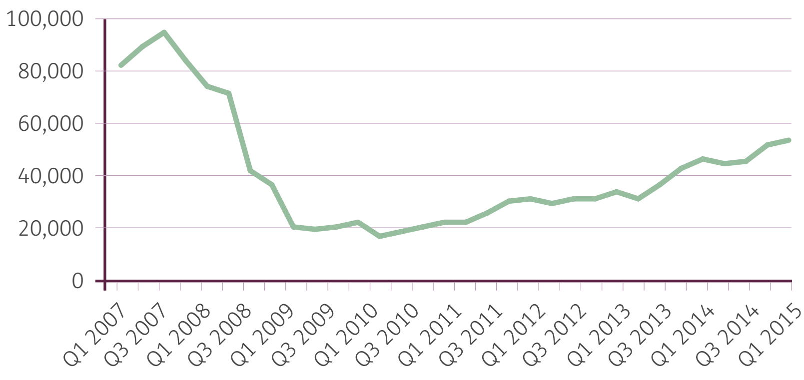
Across the PRS, the total value of mortgaged property stands at £382.9bn, up from £358bn a year ago.

## Buy to let remortgage lending



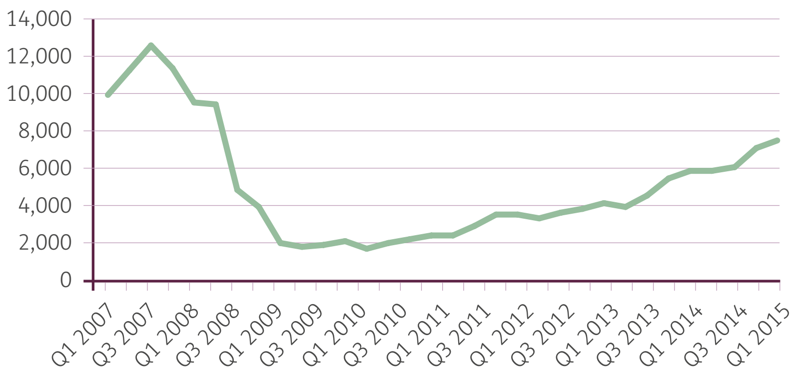

Source: CML

## Number of new buy to let loans




Source: CML

## Value of new buy to let loans (£m)




Source: CML

# Outlook

House price growth has slowed in 2015, and encouragingly is showing signs of settling to a more sustainable level of inflation, and we anticipate this will continue. The chronic supply and demand imbalance will not be solved in the short term and means that property retains its attractiveness as an investment vehicle, especially given the relatively benign interest rate outlook.

Even if buy to let property price growth falls back to around 5.4%, a conservative estimate by historic standards, a landlord investing today could expect capital gains of more than £375,000 per property over a 20 year horizon. Additionally, the resurgence of the buy to let market should give further impetus to the sector, allowing it to grow to cover the shortfall in social housing and the reduced level of home ownership.

That's not to say there aren't obstacles that will affect landlords. Regulatory uncertainty remains. The Financial Policy Committee's minutes from its meeting in March 2015 highlighted that it will be taking a close look at the buy to let sector. This follows the committee being granted powers to control loan-to-value and debt-to-income ratios for owner-occupied and buy to let residential mortgages. On top of this, the implications of implementing the European Mortgage Credit Directive have yet to be felt, and there is still the question of whether amateur landlords, such as those using the new pensions freedom to unlock pots and enter the market, should receive consumer protection. However, we do not feel that regulation is inherently negative, or will tarnish the long-term growth of the sector if implemented appropriately. Buy to let investment is a business decision, and the different working parts involved are not always straightforward. With this in mind, if we do see an influx of amateur landlords this year, greater consumer protection is important. Ultimately, the buy to let mortgage market will continue to thrive on the basis of responsible and appropriate lending, as it has done in recent years.

Overall, the PRS is on track to break through the £1 trillion barrier this quarter. Looking further ahead, we anticipate rented housing in Great Britain will be worth £1.07 trillion by March 2016, and £1.45 trillion by the end of 2020.

In turn, we expect the number of households in the private rented sector to reach 4.9 million by March 2016, and 5.5 million by 2020. By this point, private rented households are likely to account for more than 20% of housing tenure.

### 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. House price projections are based on the conservative assumption that property values will rise 1% faster than nominal GDP in the long term. The OBR's latest inflation and real GDP growth forecasts were used to calculate nominal GDP growth for the period.

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