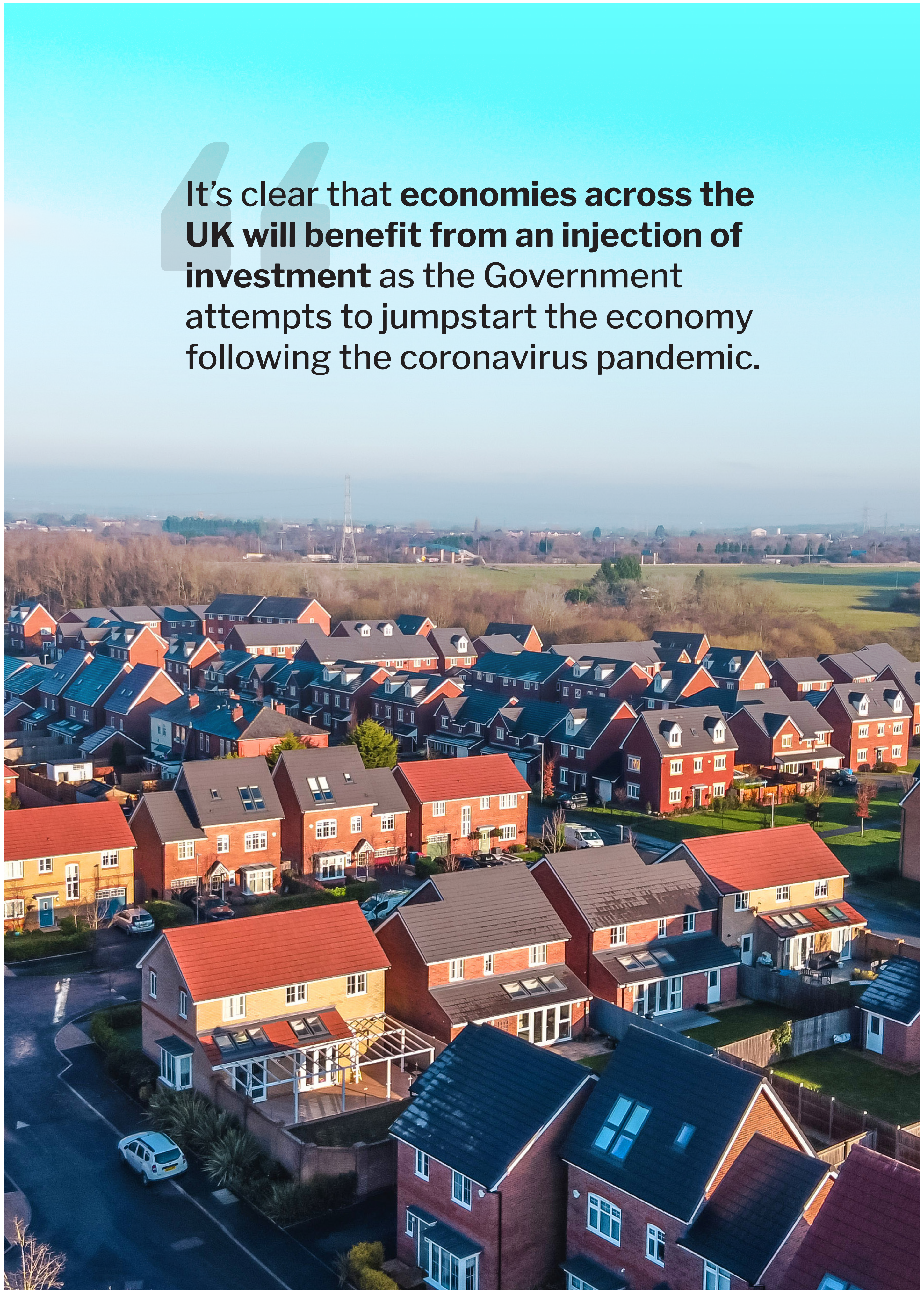
paragon

Examining the impact of the COVID-19 pandemic on long-term regional trends in the buy-to-let market

How buy-to-let lending, landlord behaviour and tenant demand in regional markets has been impacted by the pandemic and the Government's policy towards Stamp Duty

> It's clear that **economies across the UK will benefit from an injection of investment** as the Government attempts to jumpstart the economy following the coronavirus pandemic.



An introductory note from Richard Rowntree

The past 12 to 18 months have provided challenges on an unprecedented scale for most business sectors. A recent report by UK Finance suggests pandemic trends could lead to a fundamental shift in homebuying patterns, with the potential to have a permanent impact on the regional buy-to-let market.

Boris Johnson and his Government were elected on a clear promise to 'level up' the UK, achieving balance between the economic powerhouse of London and the South East with the rest of the country – but, inevitably, the coronavirus crisis has impacted the Prime Minister's strategy.

Historically, London and the South East, as well as the East and South West, have seen higher volumes of buy-to-let investment. However, these areas have already been more acutely impacted by a combination of tax changes and Brexit than those regions in the Midlands and North.

With an ongoing challenge of supply being unable to meet demand, 'levelling up' the UK might in fact create additional imbalance in the private rented sector (PRS), leading to greater rental inflation. According to Hometrack, in Q1 2021 the new supply of property coming to the market outside London was 5% lower than in Q1 last year.

Whilst some renters are making a move, at the same time, a mixture of affordability constraints and reluctance to make larger investment decisions during the pandemic, means the typical flow of renters out of the sector is not happening at the usual pace, putting more pressure on supply.

At the same time, despite a temporary surge in transactions following the Stamp Duty holiday, investment into the PRS has not regained the levels seen in 2015 before the additional Stamp Duty was introduced for investors.

It's clear that economies across the UK will benefit from an injection of investment as the Government attempts to jumpstart the economy following the coronavirus pandemic. Combine that with societal and demographic changes that were already well underway – such as the growth in single person households – and the PRS will have a vital role to play in meeting the country's housing needs.

The Government has made clear that the growth of one area of the country will not be at the expense of another. The need for good quality, private rented stock is required throughout the country to help the Government achieve its aims.

The PRS is a fluid, reactive sector, fuelled by landlords' ability to quickly adapt to changes in market demand. But in order to do so, they require adequate funding, a fair tax system and a regulatory environment that fosters investment.

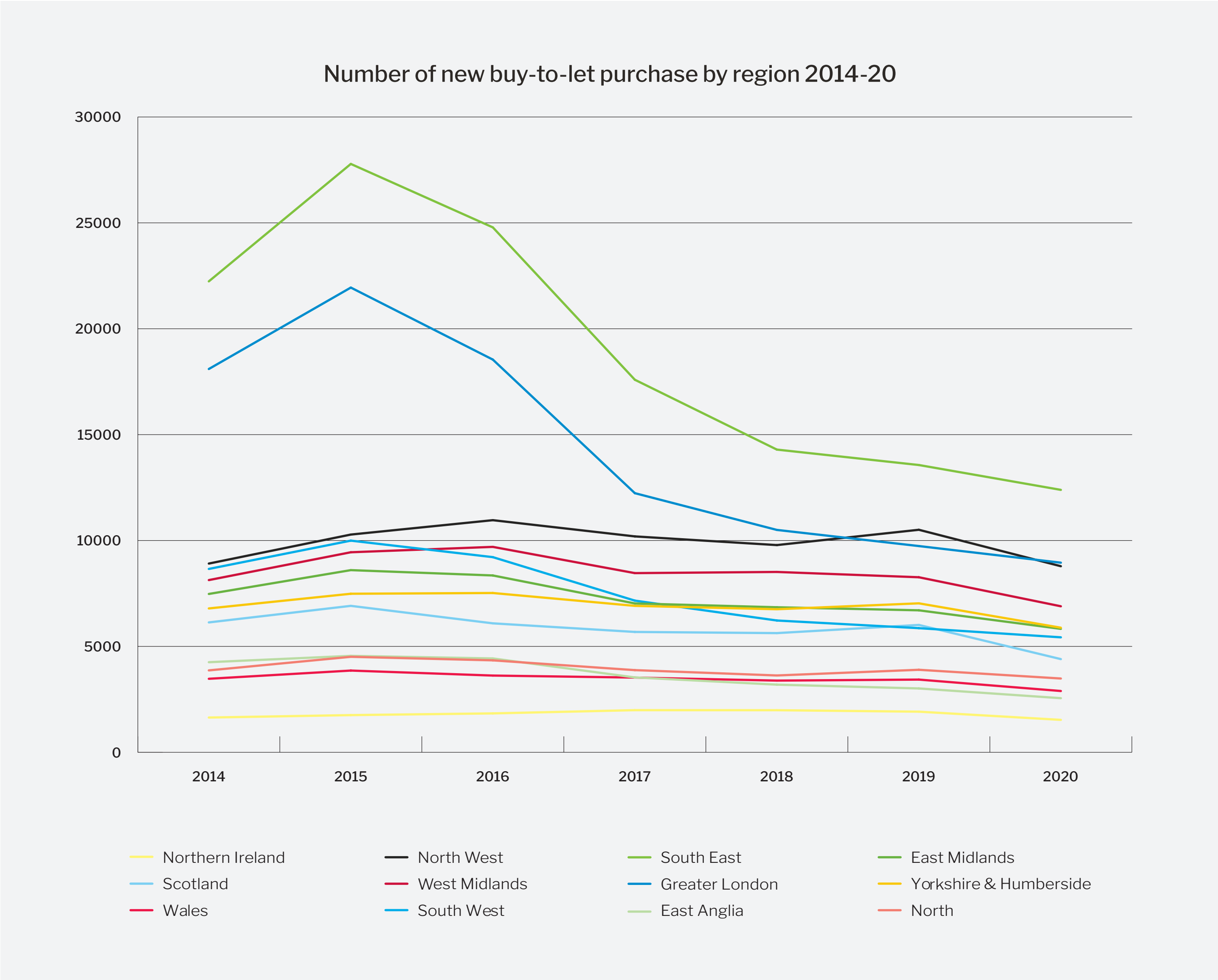
It's imperative that Government considers that as it develops its plans for the levelling up agenda in order to maintain growing optimism in a resilient but challenged buy-to-let market.

Richard Rowntree
Director of Mortgages
Paragon Bank

The impact of Stamp Duty on regional lending trends

The Stamp Duty holiday, introduced in the summer of 2020, reversed some of the long-term decline seen in higher house price regions

When analysing trends in regional lending in recent years, it's important to distinguish between the market pre- and post-Covid, with Stamp Duty having a major bearing on landlord buying behaviour during both periods.



Source: UK Finance

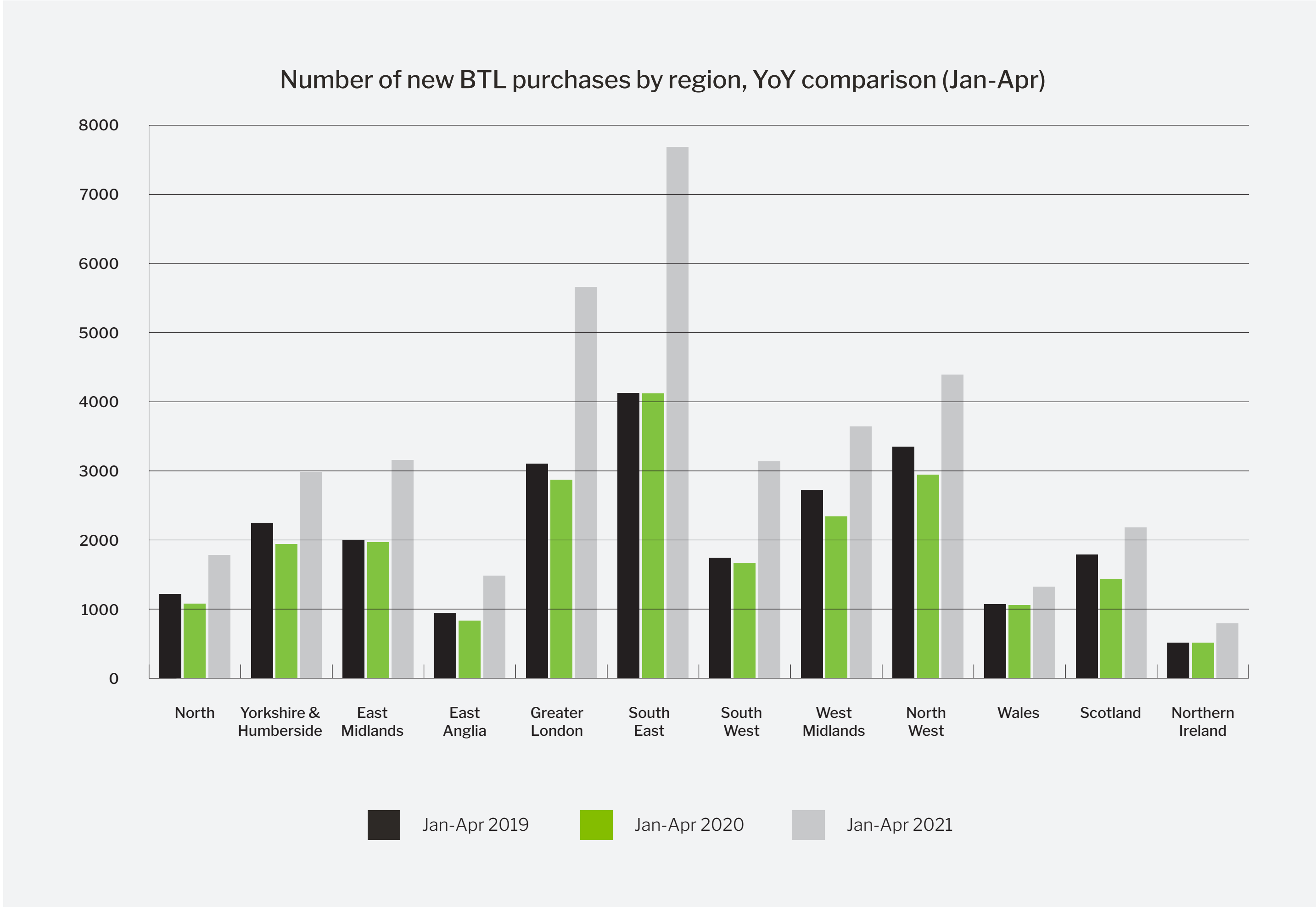
The introduction of the Government's 3% Stamp Duty surcharge on buy-to-let properties in 2016 had the greatest impact on regional borrowing behaviour in the sector's history.

The Greater London and the South East regions have historically seen the highest level of new buy-to-let purchases, accounting for four in every 10 new buy-to-let properties in England alone between 2014 and 2019.

These are markets with the most transient populations and strong house price growth made buy-to-let purchase attractive in these locations.

However, analysis of annual regional lending data for new house purchase highlights how various Government initiatives impacted certain regions more than others.

All regions across the UK recorded fewer new buy-to-let properties in 2019 compared to 2015, the year before Stamp Duty changes increased the cost of buying a rental property, but Greater London and the South East have seen the most pronounced falls.



Source: UK Finance

Greater London was hardest hit, with 58% fewer new buy-to-let purchases in 2019 than 2015, followed by a 54% fall recorded in the South East. Other markets that experienced significant falls following the introduction of the surcharge included the South West and East Anglia, the common denominator being higher than average house prices in these regions.

Conversely, the North West was the least impacted region, falling just 4.3%, and the number of new buy-to-let purchases in this region outstripped Greater London for the first time on record in 2019.

Regions that were less impacted by the Stamp Duty Land Tax (SDLT) change were typically those where average property prices were below £200,000 – the North West, North East, Yorkshire & Humber, West Midlands and East Midlands.

Not only was the cost of purchasing property less prohibitive in these markets, landlords paid less tax on the purchase and could generally achieve more attractive yields. Additionally, rental inflation typically keeps pace with property price inflation in these regions, creating stability for the landlord investor and tenants.

Although overall buy-to-let house purchase was down in 2020, predominantly due to the lost second quarter when the housing market was mothballed, Government stimulus packages helped revitalise purchase in those regions that had been most negatively impacted by the buy-to-let surcharge

In July 2020, Rishi Sunak's announcement of a temporary cut in SDLT for properties below £500,000 removed a barrier for landlords to invest in property. At the time, Paragon's analysis showed landlords in London would save an average of £15,000 off their Stamp Duty bill following the Chancellor's announcement, with those in the South East saving £7,197 and South West £5,064.

Region	Average BTL property value	Pre-SDLT holiday duty	SDLT holiday duty	Saving
London	£578,167	£36,253	£21,253	£15,000
South East	£343,946	£17,515	£10,318	£7,197
South West	£301,279	£14,102	£9,038	£5,064
East Anglia	£247,581	£9,879	£7,427	£2,452
West Midlands	£219,744	£8,487	£6,854	£1895
East Midlands	£187,091	£6,854	£5,612	£1,242
Yorkshire & Humber	£178,218	£6,410	£5,346	£1,064
North	£172,986	£6,149	£5,186	£963
North West	£170,191	£6,009	£5,105	£904

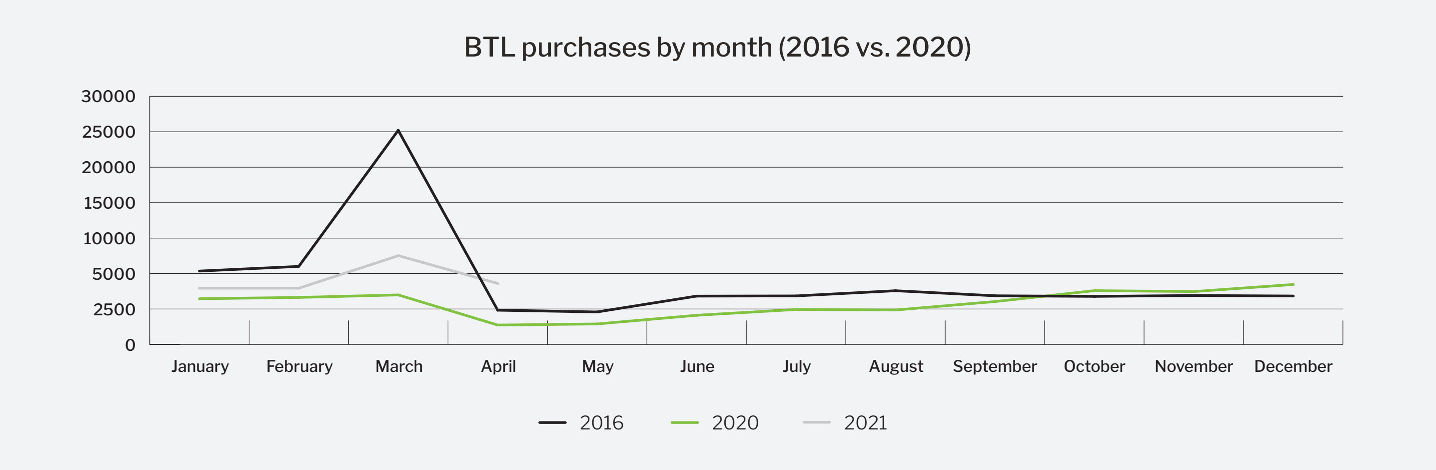
Source: Land Registry July 2020

Buy-to-let house purchase immediately started to track upwards once the housing market reopened in May 2020, but started to accelerate once the Stamp Duty holiday commenced in July 2020.

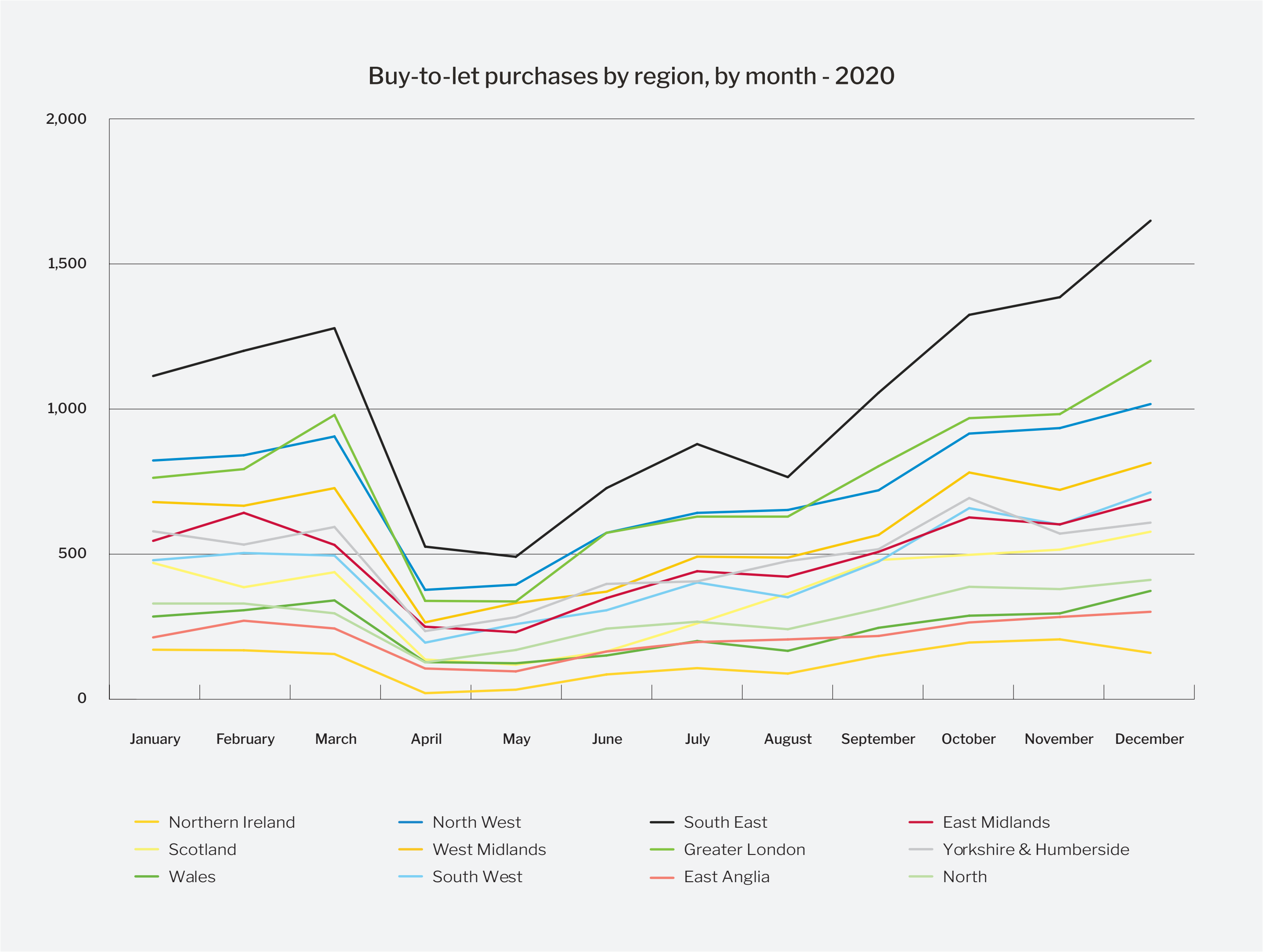
The renewed strength in purchase activity across the country continued into 2021, as the graph on page 3 highlights, with those markets hardest hit by the introduction of the surcharge enjoying the strongest resurgence.

Comparing data from the first four months in each of the past three years demonstrates the strong recovery in certain regions, particularly considering that we didn't see the impact of coronavirus hit Q1 2020 completions.

UK Finance data for January to April 2021 showed steep rises in the volume of new purchases across all regions, but these were most pronounced in Greater London and the South East. The South West also enjoyed a strong recovery as landlords reacted to the desire for more space, as well as the UK's new-found love of staycations.



Source: UK finance

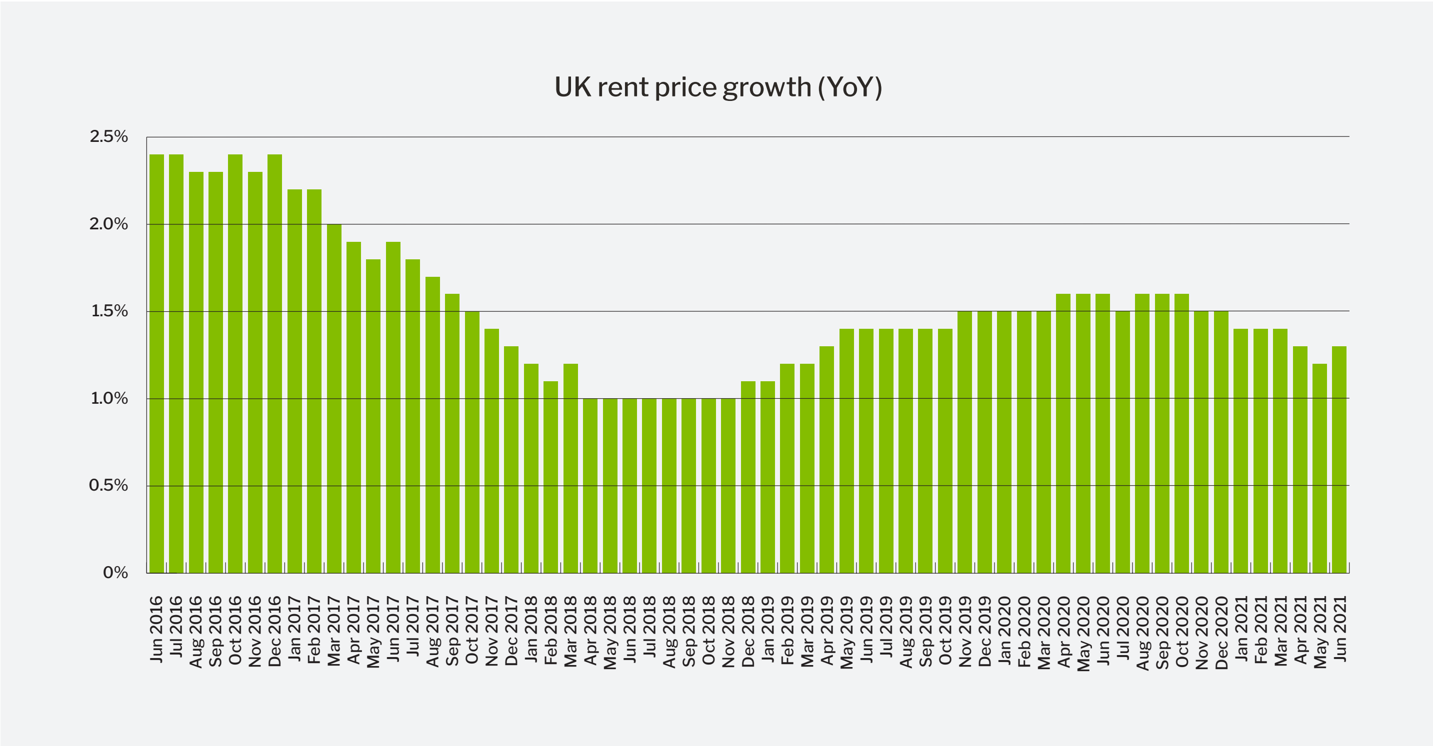


Source: UK Finance

An additional extension to June 2021 created a much stronger second quarter this year, though it remains to be seen how buy-to-let purchases will be impacted now that the Stamp Duty holiday came to an end in September. We would expect purchase activity to return to levels seen before the pandemic began. Once the Stamp Duty Land Tax (SDLT) holiday does finally come to an end.

Regional rent inflation

Most regions have seen rents rise on the back of strong tenant demand, although London has lagged



Source: ONS

Private rental prices paid by tenants in the UK increased by 1.2% in the 12 months to June 2021, having remained broadly flat throughout 2020. Overall, the beginning of 2021 has seen a slowdown in rental price growth, which has been driven by prices in London.

In the 12 months to June 2021, rental prices for the UK excluding London increased by 1.8% according to government data, up from an increase of 1.7% in May 2021. However, London private rental prices decreased by 0.1% in the same period.

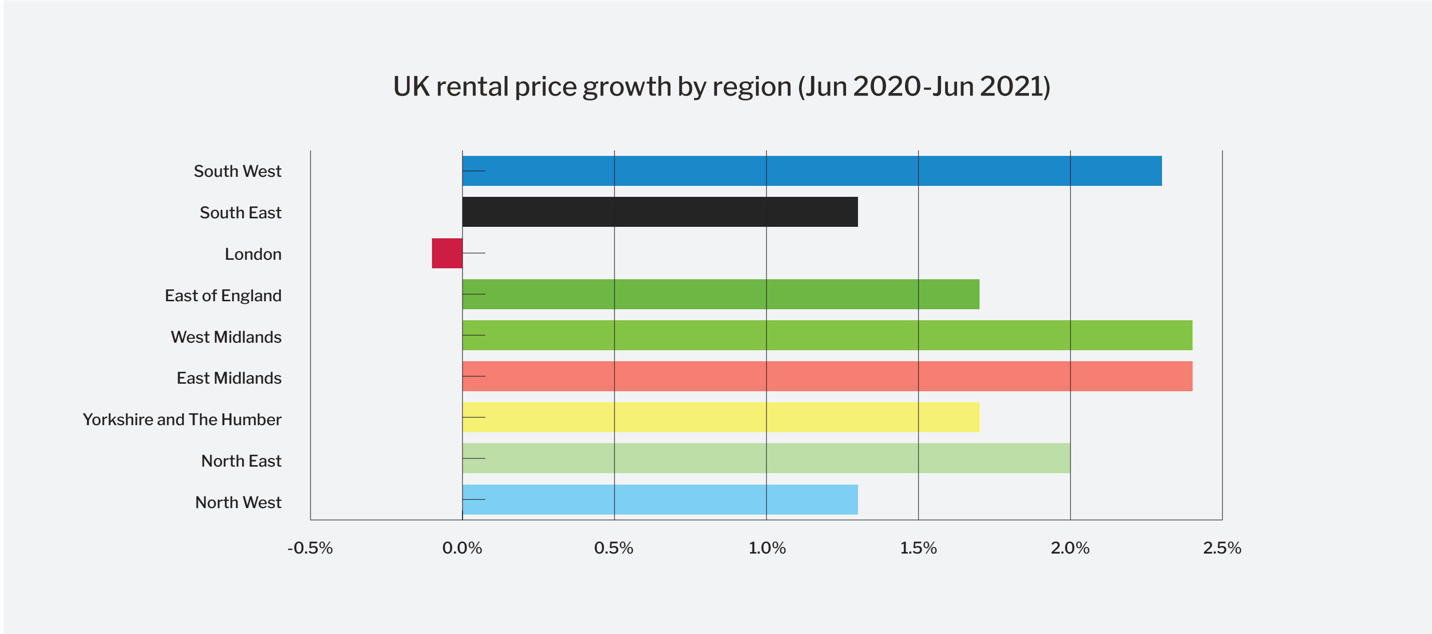
This private rental price growth in London has slowed since November 2020, with growth of 0.1% in June 2021 lower than any other English region. This reflects both a decrease in demand, such as remote working shifting housing preferences, meaning workers no longer need to be close to their offices, and an increase in supply, such as an excess supply of rental properties as short-term lets change to long-term lets.

Rents in the North East accounted for a fifth of average income for a single earner before the pandemic compared to the UK average of 32%. The growth in rents over the last year has pushed this measure of affordability to 22%, but it still remains one of the most affordable regions in which to rent a property.

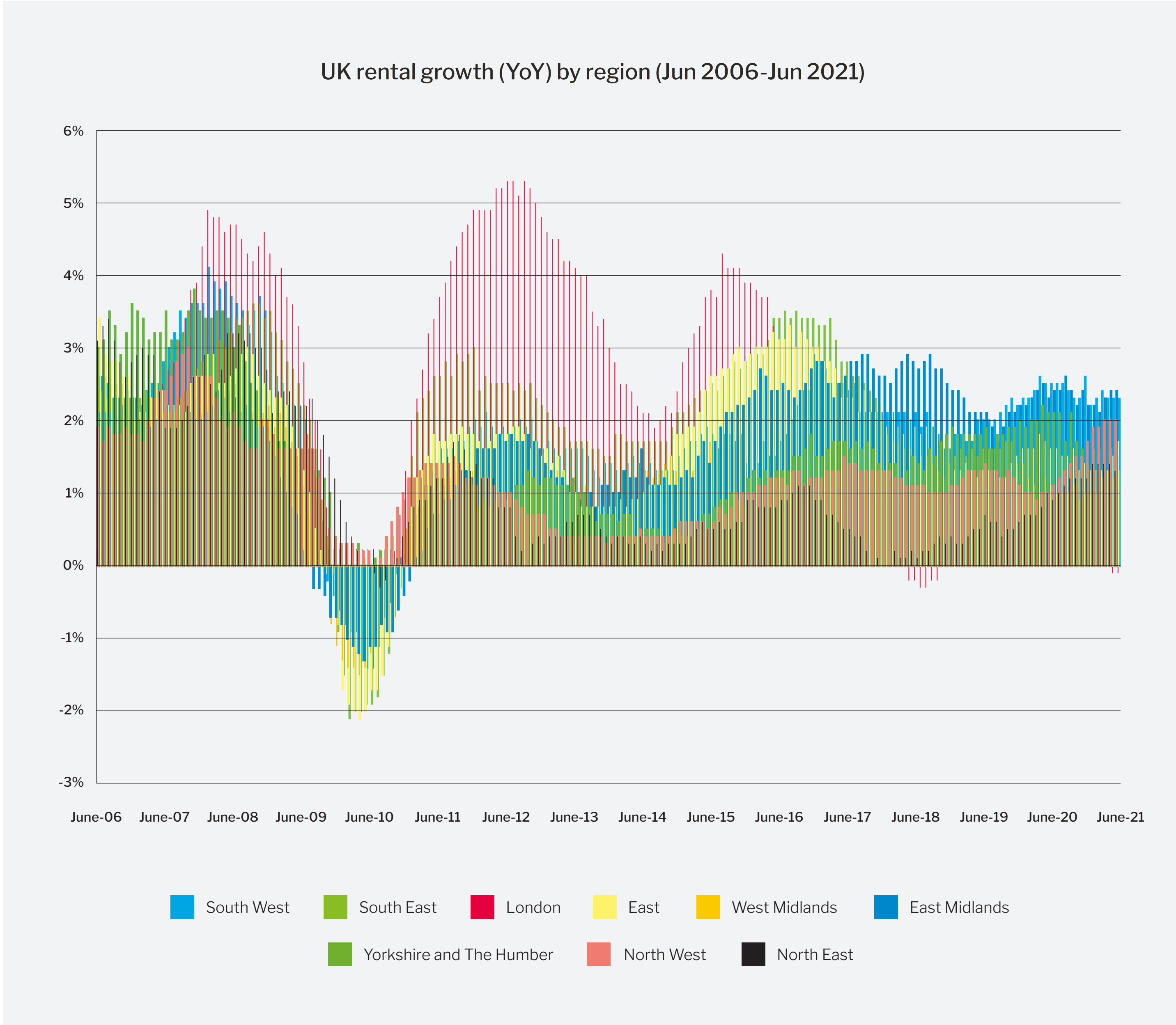
Separately, Research by Hometrack reveals rental growth hit a 10-year high in March in the North East, South West, East Midlands and in Wales, and rents are rising fastest in the North East of England, which is one of the most affordable rental markets in the UK.

According to ONS data, the largest annual rental price increase in the 12 months to June 2021 was in the East Midlands and West Midlands, both at 2.4%. East Midlands remained unchanged since May 2021, while West Midlands was up from 2.2% in May 2021.

Rental growth hit a 10-year high in March in the North East, South West, West Midlands and in Wales.



Source: ONS



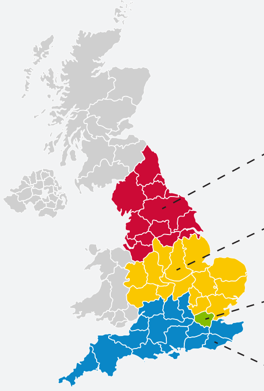
Source: ONS

Portfolio composition

Portfolio composition varies significantly from region to region

Landlords are heavily concentrated in the South of the country, with London and the South East accounting for six in 10 landlords. That concentration is in line with lending figures, which shows that these regions have historically accounted for over half of buy-to-let house purchase. Across the rest of England, the split of landlords is roughly equal between the Midlands and North of the country.

6 in 10 landlords operate in London and the SE



	% English households*	% of landlords operating in region**	# properties in average portfolio
North	29%	23%	8.2
Midlands	30%	25%	9.0
London	15%	19%	6.3
South	26%	41%	6.2

*English Housing Survey **Exceeds due to multi-region landlords

Source: BVA BDRC

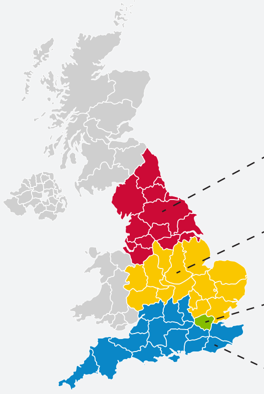
Property and tenant type

There are clear trends with regards to property type per region, with London heavily weighted towards flats. Nearly eight in 10 portfolios contain a flat within the Capital, the highest level in the country.

Elsewhere, the incidence of houses in portfolios is significantly higher, with the North recording the highest level at 88%. Generally across the country, the three most common property types in most regions are terraced houses, flats and semi-detached houses. In terms of other property types, the incidence of houses in multiple occupation is greatest in Wales at 27%, whilst landlords in the East Midlands have the greatest incidence of detached houses at 25%.

With regards to tenant type, London is again the outlier. Young singles (54%) and young couples (47%) are the most common tenant type in London, whereas in other parts of the country families dominate. BVA BDRC data showed that 54% of landlords in the North, Midlands and South reported families as the most common tenant type in those markets.

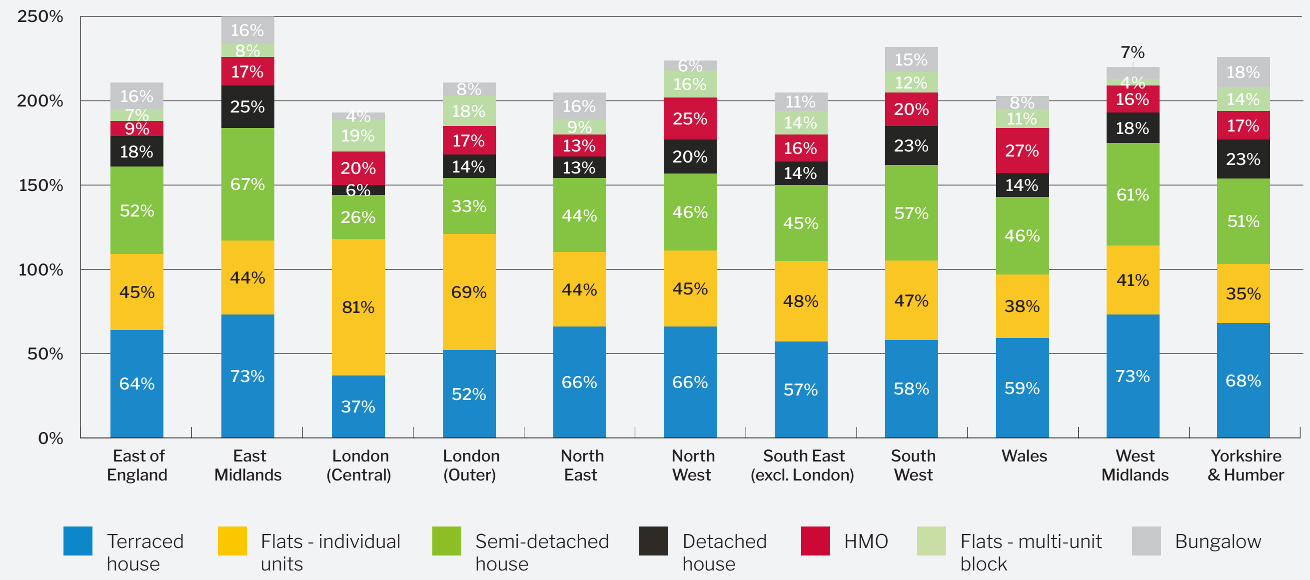
Portfolio composition varies markedly by region



	PROPERTY TYPE Incidence	Most common TENANT TYPE
North	Flats: 50% | Houses: 88%	Families: 54% | Older singles: 45%
Midlands	Flats: 57% | Houses: 82%	Families: 51% | Older singles: 49%
London	Flats: 79% | Houses: 59%	Families: 54% | Older singles: 47%
South	Flats: 54% | Houses: 74%	Families: 54% | Older singles: 39%

Source: BVA BDRC

Property type by region



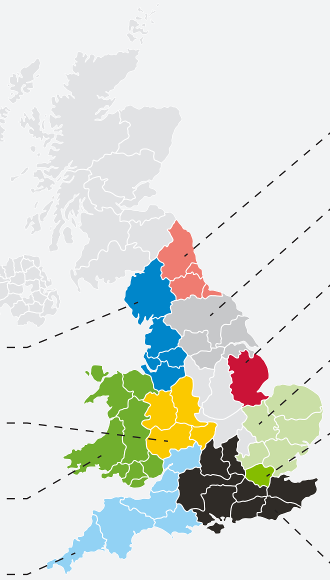
Source: BVA BDRC

Portfolio values and rental income

Portfolio values in London are higher than other parts of the country, even though portfolio sizes are typically smaller. Reflecting higher property values in the city, the average portfolio value in central London during Q3 2021 was £2.4 million, falling to £2 million in the outer parts of the capital. Rental income is also higher in this market at £94,000 for central parts and £80,000 for outer London.

Elsewhere, the typical portfolio in the South West, Yorkshire & Humber and South East exceeds £1.5 million, whilst the North East records the lowest portfolio value figure at £808,000.

Gross annual rental income & portfolio value levels by region



Region	Estimated portfolio value	Estimated gross rental income
North West	£1,210,000	£59,000
West Midlands	£1,105,000	£50,000
Wales	£826,000	£37,000
South West	£1,635,000	£62,000
North East*	£808,000	£48,000
Yorkshire & Humber	£1,572,000	£66,000
East Midlands	£1,357,000	£65,000
East of England	£1,276,000	£59,000
London (Central)	£2,446,000	£94,000
London (Outer)	£2,054,000	£80,000
South East	£1,521,000	£62,000

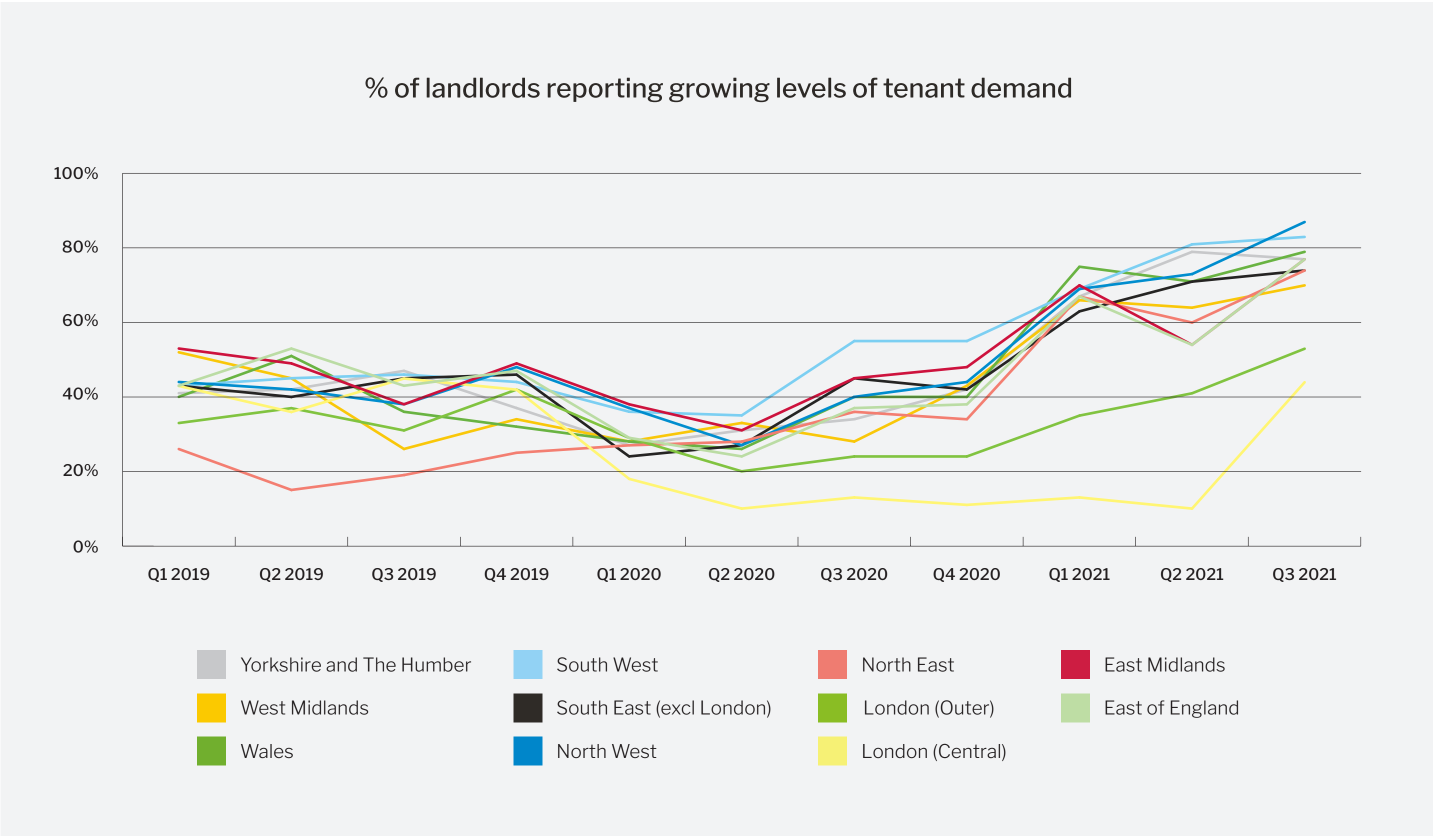
Source: BVA BDRC

Tenant demand

Tenant demand has surged in most regions following the reopening of the housing market in the early summer of 2020. Regions that experienced the strongest consistent growth included the North West and South West as tenants looked for more green space and different housing provision following the pandemic.

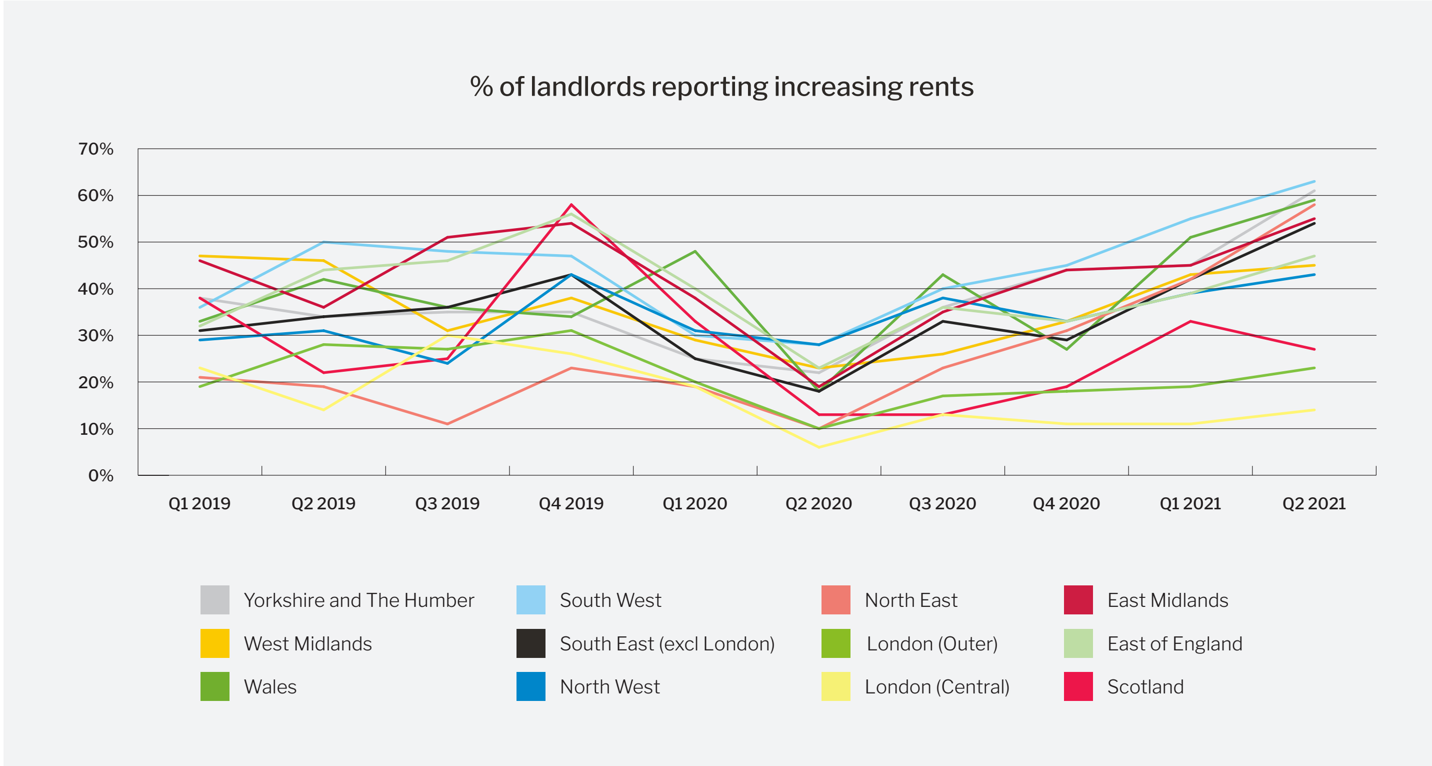
Central London, however, experienced subdued tenant demand as tenants left the city following the onset of coronavirus. London is a transient city with predominantly younger tenants moving to the capital from other parts of the UK and wider world. As the pandemic's grip tightened and offices, entertainment and nightlife closed, many of those moved away.

However, London tenant demand showed renewed signs of life during Q3 2021 as the economy reopened and people started returning to normal life.
The percentage of landlords reporting growing levels of tenant demand increased from 10% during Q2 2021 to 44% in Q3. Outer London saw more consistent quarterly increases, accelerating in the past two quarters, which could be attributed to people moving from more central locations to suburban areas.



Source: BVA BDRC

The growth in tenant demand is mirrored by the growth in landlords reporting increasing rents. This has been more prominent in areas such as the South West and South East as tenants have sought more space, whilst rent inflation in London has been more subdued. However, the proportion of landlords reporting rising rents in the capital has started to shift upwards in more recent quarters as tenant demand has returned.

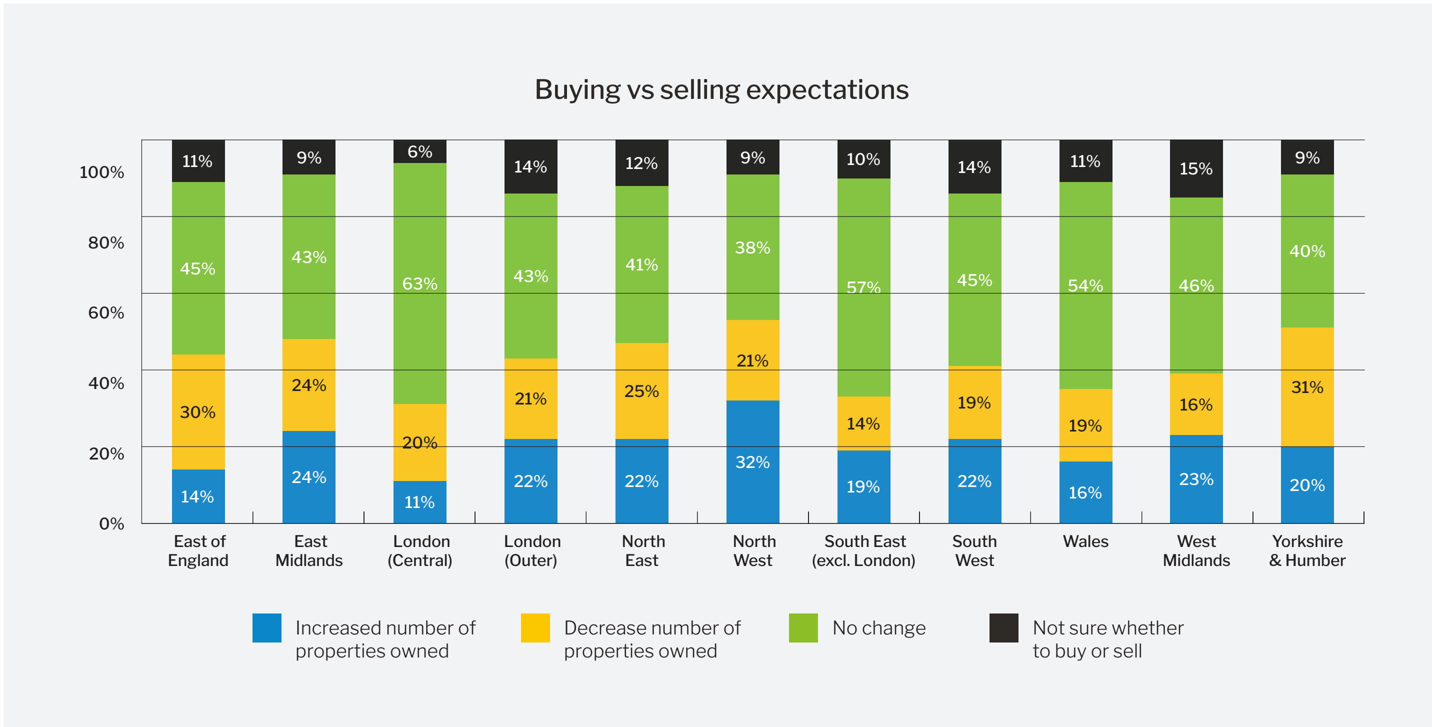


Source: BVA BDRC

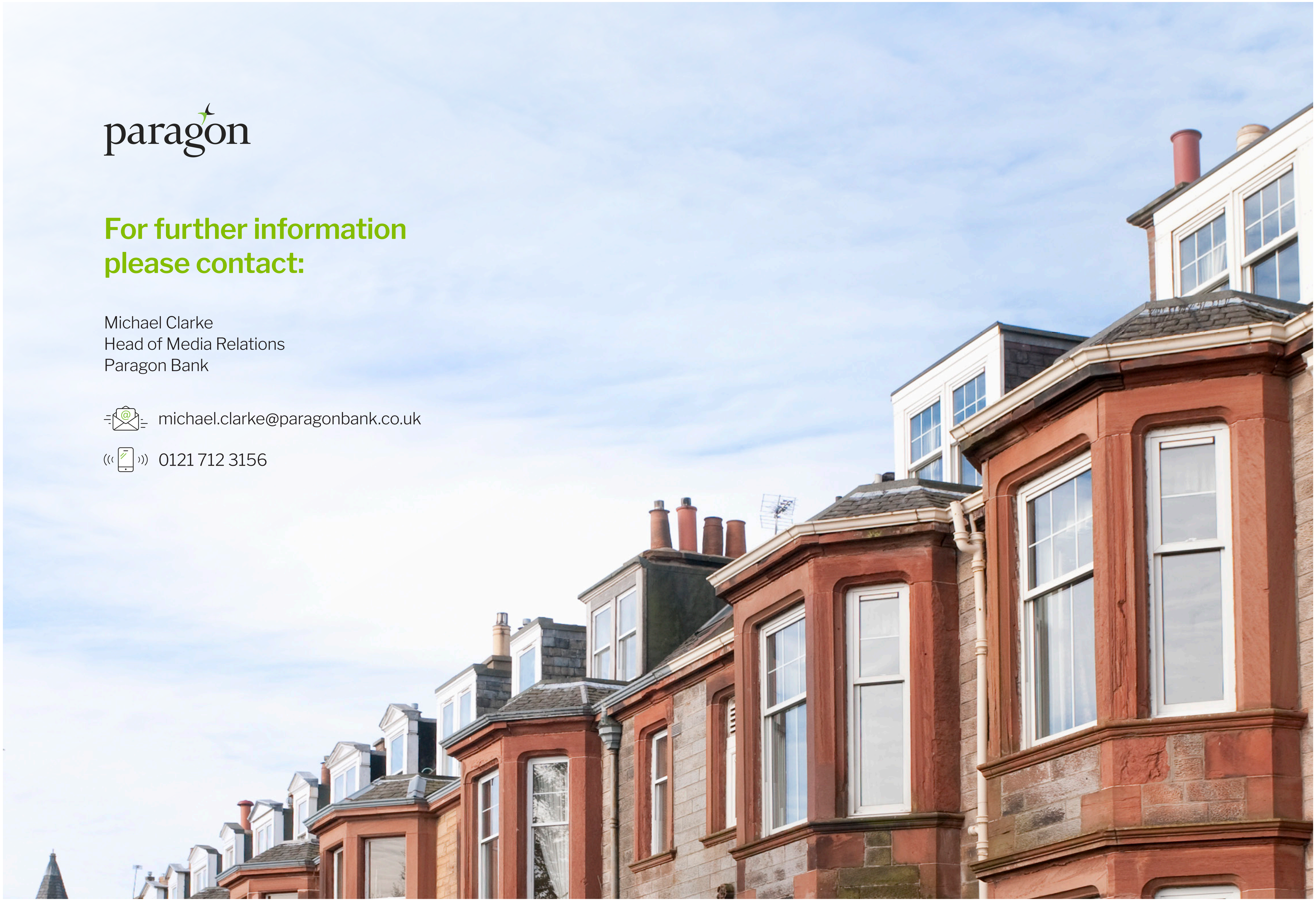
Landlord investment intentions

Whilst landlords have clearly responded to tenant demand and the Stamp Duty holiday to acquire new buy-to-let property in higher numbers across the country, looking forward, buying expectations significantly differ.

The incidence of landlords intending to buy over the next 12 months is strongest in the North West (32%) and the East and West Midlands (24% and 23% respectively). The percentage of landlords planning to buy in outer London is also strong at 22%. Conversely, the uptick in tenant demand for central London has failed to result in a similar increase in buying expectations, with just 11% of landlords planning to acquire in central locations. However, that was still a sharp increase from the 3% recorded in Q2 2021.



Source: BVA BDRC



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