

Financial Services Forum

March 2021

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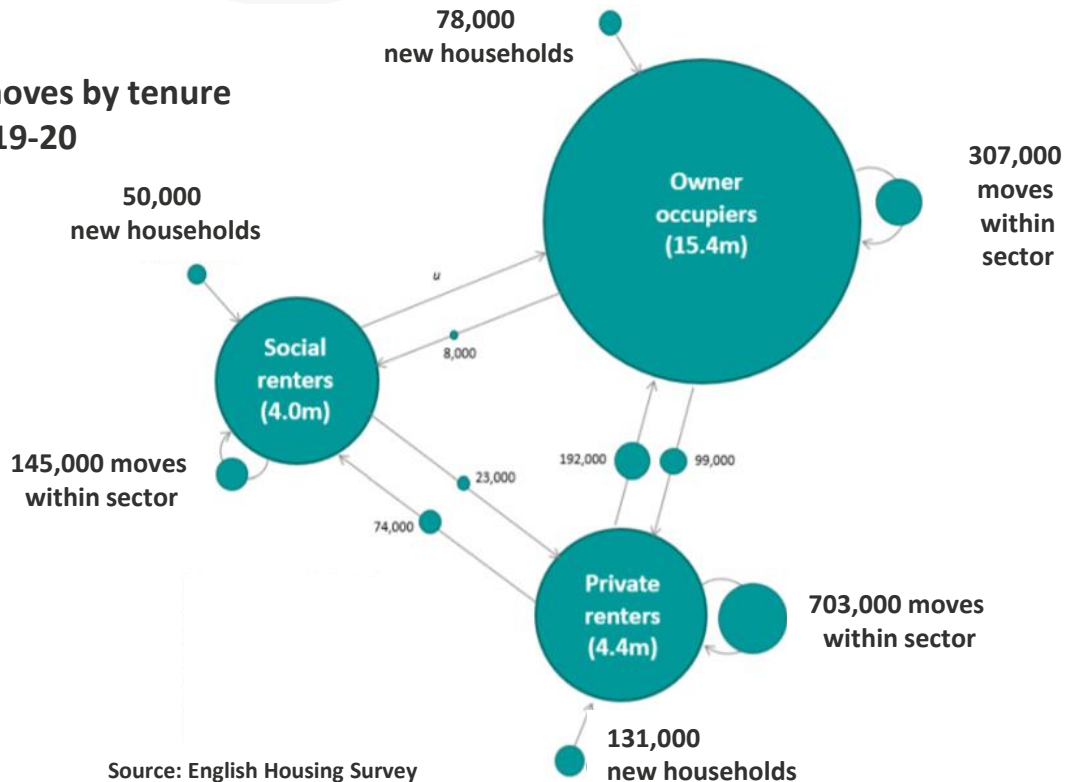


paragon

The role of buy-to-let in society

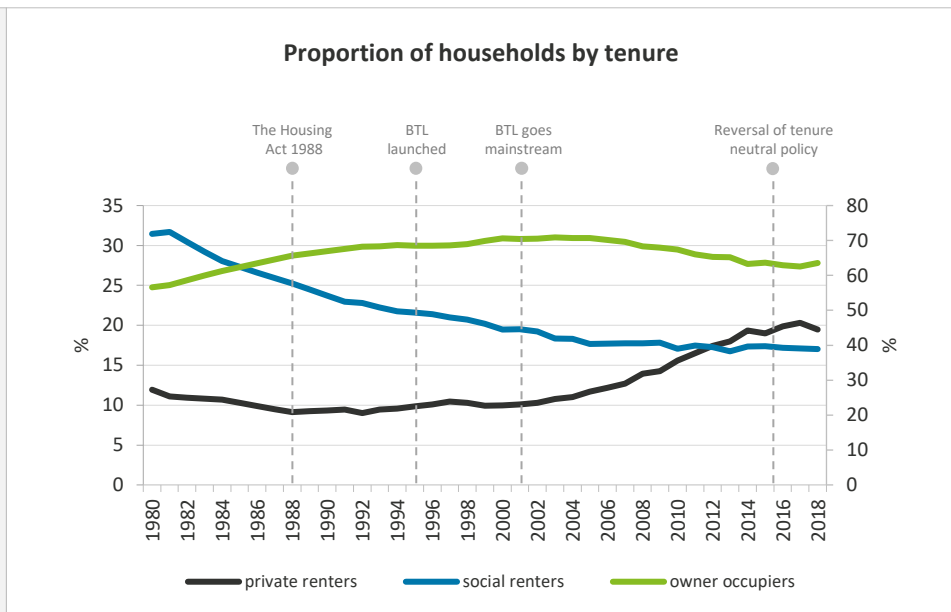
Buy-to-let is not just a mortgage product, but a social good that provides a frictionless option for all stages of life.

Household moves by tenure
2019-20



Increasing reliance on rented property for good quality housing

- Two decades of growth in the private rented sector (PRS)
- Expansion driven by structural increase in tenant demand and relationship between investment in tenures
- PRS represents 1 in 5 households today
 - 4.4 million households in total
 - 1.6 million households with dependent children (2010-11: 1.1 million)



Source: English Housing Survey

A range of factors are driving PRS demand

Population growth, demographic changes, lower investment in social housing and mortgage affordability constraints are the key factors driving the structural increase in demand for housing in the UK's private rented sector.

Growth in immigration



+56%

of UK population growth is attributed to net migration between 1991 and 2018

Drop in household size

5 PEOPLE
(1910)

average household size



2.4 PEOPLE
(2020)

average household size



Expansion in higher education

19,000
(1980)

First degrees awarded



424,540
(2019)

First degrees awarded

Lower investment in social housing

4.2 MILLION
(2001)

Dwellings



4.0 MILLION
(2018)

Dwellings



Housing affordability

4.0x
(2000)

Median house price:
Median gross earnings



8.0x
(2018)

Median house price:
Median gross earnings

Owner occupiers getting older

5.0 MILLION
(2003/4)

Owner occupiers
aged 25-44



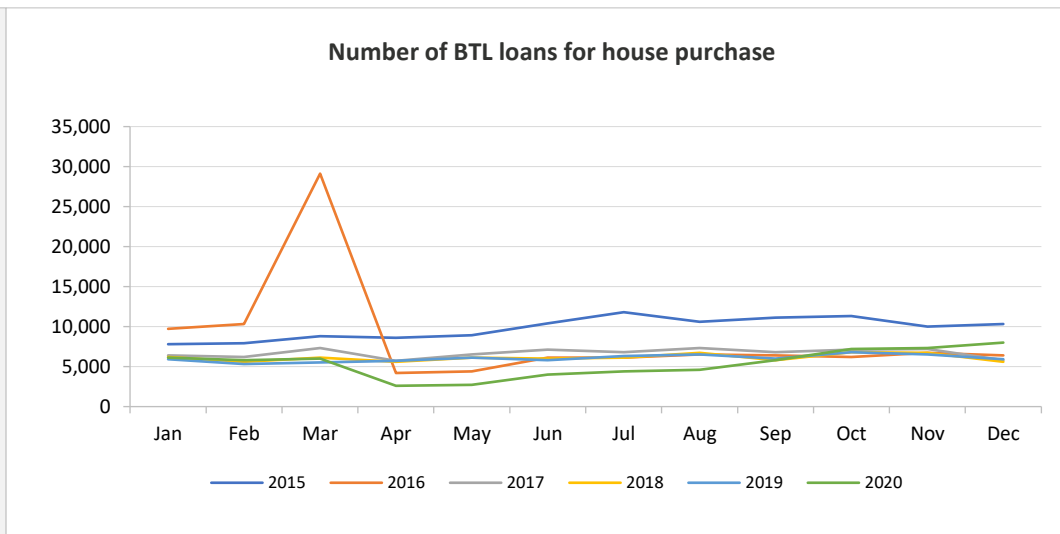
3.4 MILLION
(2017/18)

Owner occupiers
aged 25-44

Buy-to-let house purchase recovered in the second half of 2020

Buy-to-let lending for house purchase hit highest levels since 2016 during Q4 2020

- 2020 buy-to-let lending for new house purchase was 17% higher in the final quarter of the year compared to 2019
- Accelerated in final quarter as post lockdown #1 sales completed
- Market stimulated by Stamp Duty Holiday and pent-up purchase demand from landlords
- Market remains significantly below 2015 levels, the year before Stamp Duty surcharge, and other regulatory measures, introduced

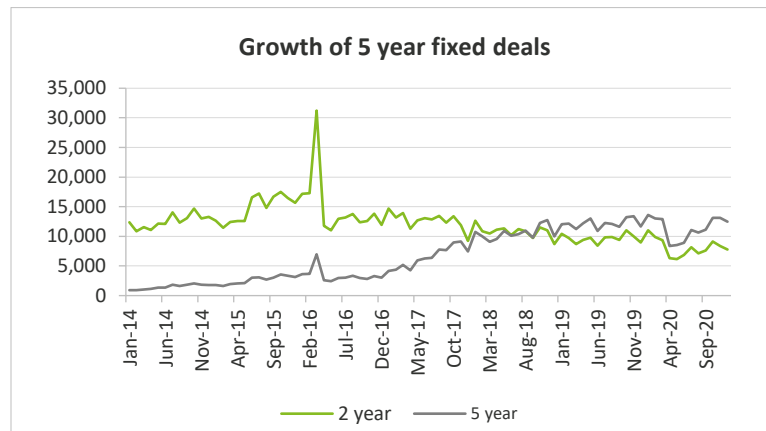
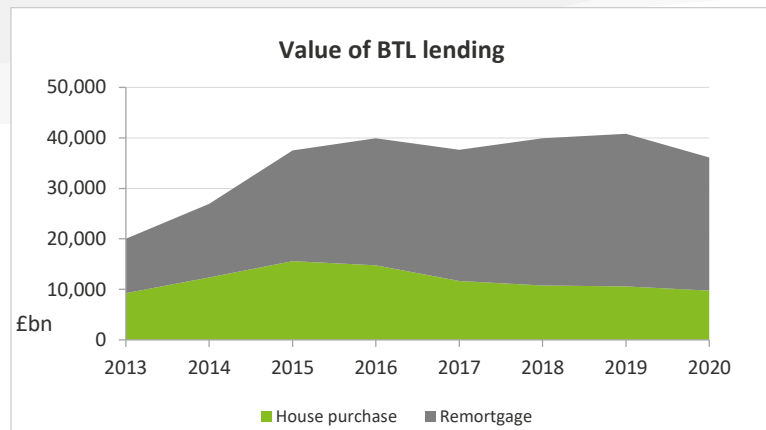


Source: UK Finance

Overall market down last year but 2021 prospects look strong

Overall market fell during 2020, but opportunities exist for strong 2021, spurred by purchase and remortgage business

- Overall, buy-to-let lending was down 13% in 2020 to £37 billion despite the strong recovery in the final quarter
- Both house purchase and remortgage fell during the year
- 2021 has been boosted by the extension of the Stamp Duty Holiday to the end of June and then tapering to September
- Growing remortgage opportunity for five-year fixed deals maturing from Q2 onwards
- Five-year rates started to grow in popularity from 2016, so those deals are maturing this year

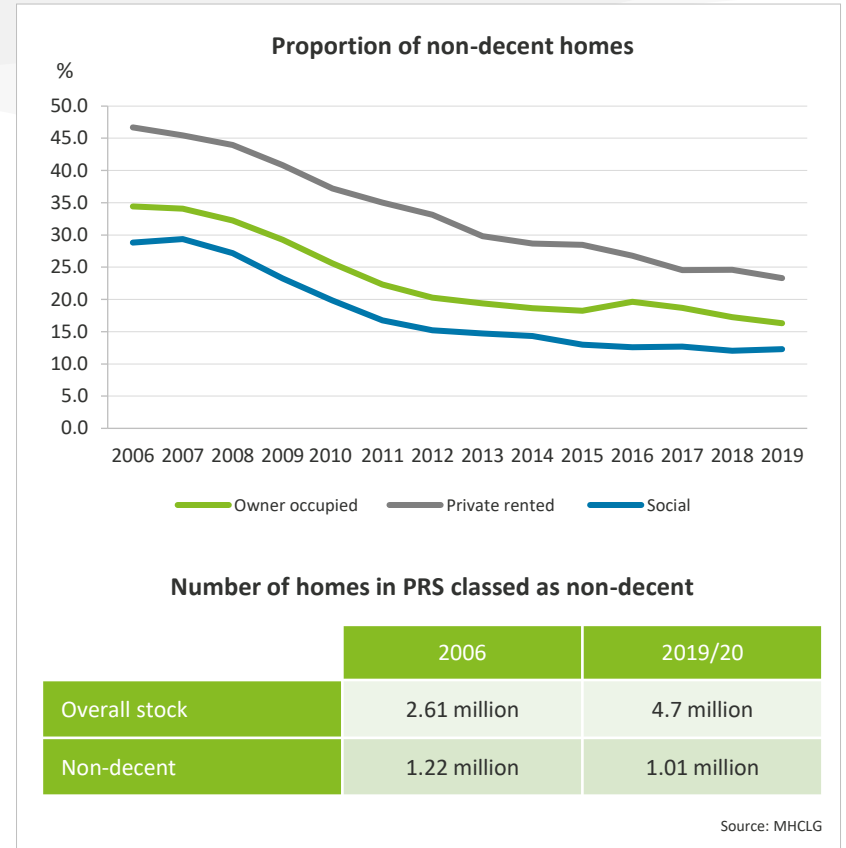


Source: UK Finance

Improvements in PRS stock driven by BTL investment

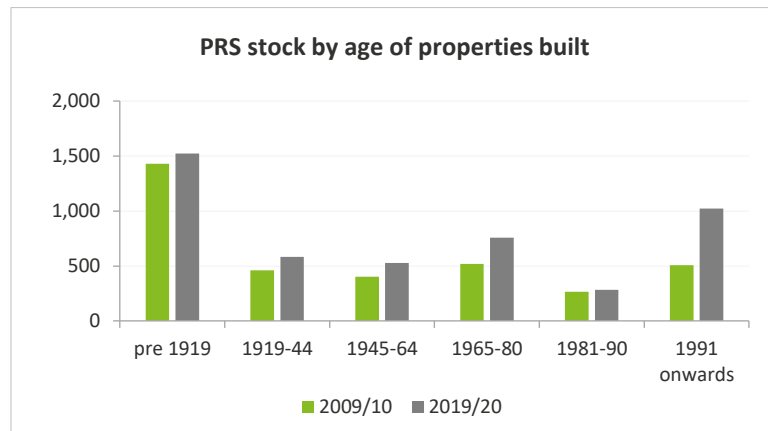
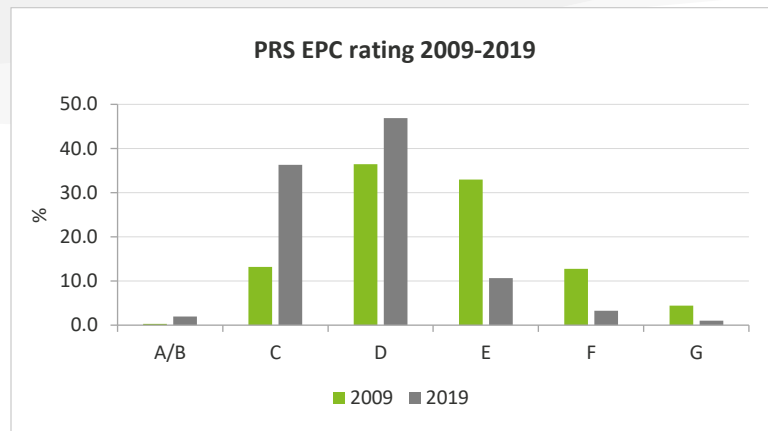
The proportion of non-decent homes has fallen

- Fall in the portion of homes in the sector classed as 'non-decent' - 46.7% to 23.3%
- In the PRS, 1.01 million homes are categorised as non-decent compared to 1.21 million in 2006
- In the same period there has been a 52% reduction in non-decent homes in the owner-occupied sector and 56% reduction in social sector
- This suggests that the growth in new properties coming into the PRS over that period is driving up standards for the sector overall and diluting the stubborn proportion that remains non-decent



PRS stock is larger, newer and more energy efficient than 10 years ago

- 272% - increase in the number of PRS homes with energy rating of C or above since 2009
- 100% - increase in the number of PRS homes built after 1991
- 31% - growth in the number of PRS homes since 2009
- 34% - increase in number of homes with 70m2 floorspace of above
- 51% - proportion of PRS homes located in suburban residential areas



Source: MHCLG

But the clock is ticking with energy efficiency

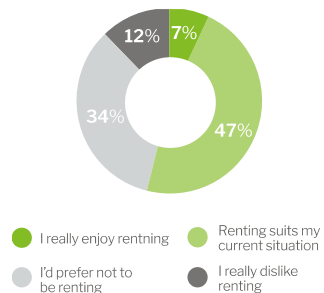
- The Government has an overall target of making the UK's housing stock carbon neutral by 2050. Private rented homes are first in line of sight
- Under Government proposals, all new property being let for new tenancies in the PRS must have an energy performance rating of at least C by 1 April 2025. This applies to all let property by 2028
- Nearly four in 10 privately rented homes in England – 38.3% - have an Energy Performance Rating of C or above, compared to 35.5% in the owner-occupied space
- Just under half of PRS dwellings are built pre-war, whilst a quarter are mid-terraced, which are more difficult to generate tangible improvements

Perceptions of reluctant renters should be challenged

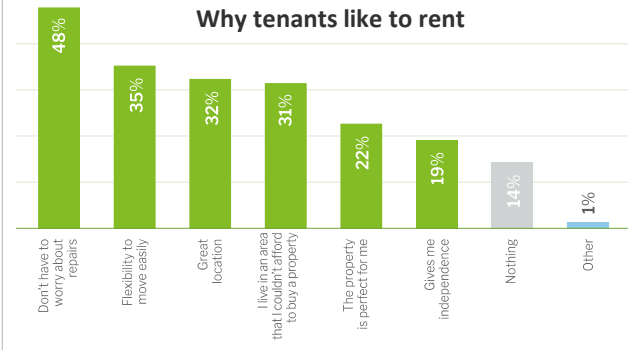
- Home ownership is part of our national psyche and most have aspirations to own their own home - support should be provided to help these people
- Renting meets needs of a diverse mix - Nearly half of tenants (49%) are between the ages of 25 and 44, with just under one in four (23%) aged 55 or over

- Paragon tenant research challenged perceptions
 - 68% of tenants said they have a positive working relationship with their landlord
 - 54% state that renting either suits their current situation or that they enjoy renting
 - 59% like the property they live in

Attitudes towards renting



Why tenants like to rent

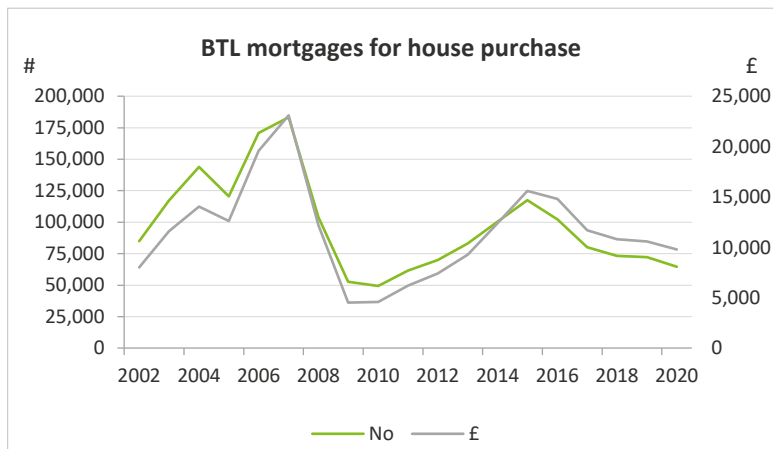


- Despite this, phrases like 'Turn Generation Rent into Generation Buy' are unhelpful and perpetuate the misconception that renting is a poor relation to owning

Source: Paragon/BVA BDRC

Government policy has prioritised home ownership

Measures introduced to curb growth of buy-to-let purchase activity successful



Source: UK Finance

New tax measures for landlords



Stamp duty: Landlords must pay an additional 3% stamp duty on property purchased to rent over and above standard rates (since April 2016)

Buy-to-let mortgage interest tax relief: Effective from April 2017 and phased over a four-year period, tax relief for finance costs is restricted to a basic rate tax credit

Wear and tear: Only the actual cost of replacing furnishings in the tax year of replacement is allowable for deduction (since April 2016)

Minimum underwriting standards for lenders



Mortgage affordability: Minimum affordability calculation introduced which must include the increase in landlord costs as a result of tax changes, together with a minimum stressed interest rate (since January 2017)

Portfolio landlords: Requirement for more thorough underwriting of landlords with four or more mortgaged properties for all lenders (since October 2017)

PRS regulation



HMO licencing: Mandatory licencing of properties with 5 or more tenants regardless of number of storeys (since October 2018)

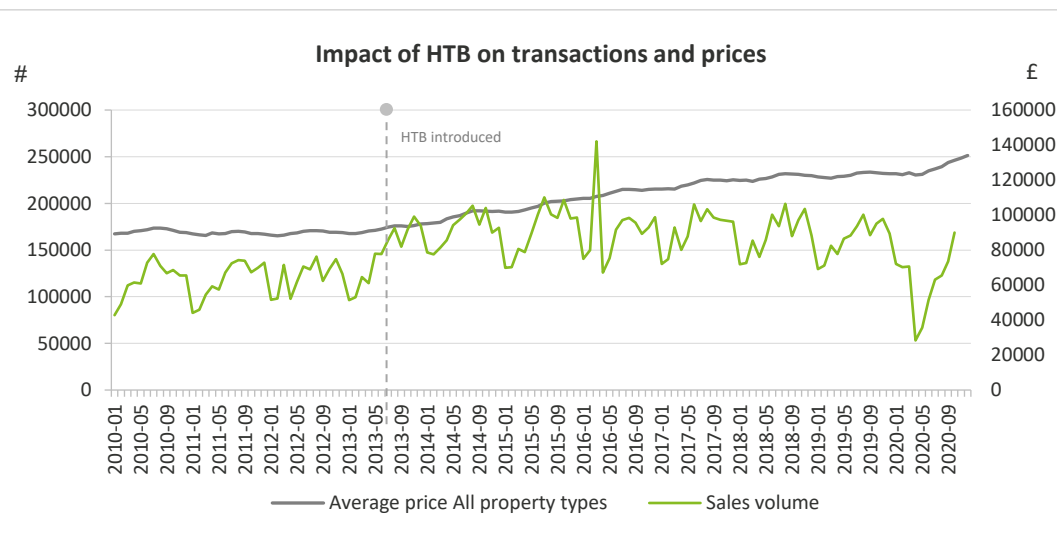
Tenant Fees Act: Ban on unfair letting fees and cap on tenancy deposits at 5 weeks' rent (since June 2019)

Review of Section 21: Consultation to ban section 21 of Housing Act, effectively creating open-ended tenancies

Schemes such as Help to Buy have been successful in raising ownership, but with consequences

Help to buy has fuelled house price growth

- Help-to-buy was introduced in 2013 and corresponded to increasing house prices
- Nearly 300,000 transactions have been supported by the scheme since launch
- New variant of the scheme to be introduced in April 2021:
 - First-time buyers only
 - Regional caps introduced



Source: Land Registry

Mortgage guarantee scheme is latest initiative to support purchase

- Inclusion of existing stock should help to manage inflation while providing opportunities to incentivise making older properties more energy efficient
- Will require a review of current affordability testing
- Greatest benefits for buyers in lower-value housing markets, supporting the levelling up narrative and policy approach of Government
- Cladding and space concerns

		Feb-20	Mar-20	Jul-20	Jan-21	Feb-21
Fixed and variable rate products	Total product count – all LTVs	5,076	5,222	2,728	2,893	3,215
	Product count – 95% LTV	405	391	14	8	5
	Product count – 90% LTV	776	779	70	160	248
	Product count – 60% LTV	611	604	540	452	481

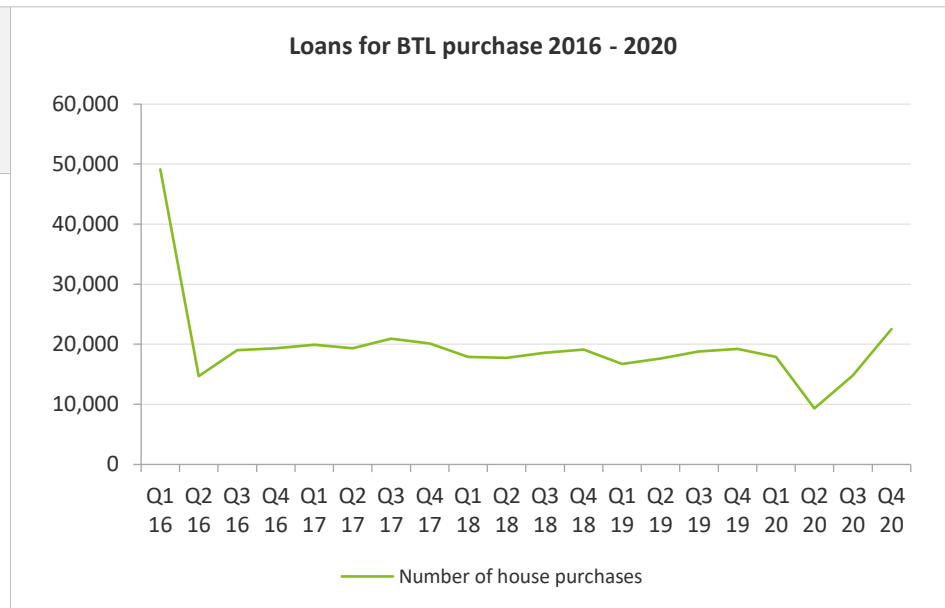
Source: UK Finance

Capital Gains Tax could be next Government initiative

- The Office of Tax Simplification (OTS) suggested an alignment of CGT and income tax and a lowering of the threshold at which it is paid
- CGT on the sale of a BTL property or second home will increase from 10% to 20% for basic-rate taxpayers and from 28% to 40% for higher rate taxpayers, with additional rate taxpayers paying 45%
- Over a third (37%) of landlords with 20 or more properties would cancel planned further investment in BTL if CGT is increased
- Despite the misconceptions of rich tycoons managing vast property empires, 45% of landlords have just one rental property (English Private Landlord Survey 2018)

Stamp Duty holiday highlights demand to buy – surcharge acts as brake

- 22,500 loans written for BTL house purchase during Q4 2020 highest since Q1 2016, when the Stamp Duty surcharge was introduced
- Regional variance – greater take-up in more expensive regions where investors would achieve the greatest tax savings. London saw 25% more BTL loans for purchase in the final quarter of last year than the same period in 2019, North West was just 1.5% higher
- Paragon pipeline hit a record high during the first quarter of 2021
- As a result of the extension, over 4 in 10 say it is likely that they will purchase another one or more properties



Source: UK Finance

Despite measures to increase home ownership, tenant demand continues to grow

arla | propertymark

The number of tenants seeking properties surged by more than a quarter (27%) in January

ARLA Propertymark's January Private Rented Sector Report



Net balance of +26% increase in tenant demand in the three months to February

RICS' UK Residential Survey

paragon

32% of landlords reported increase in tenant demand in Q4 2020, the highest level since Q1 2016

Paragon

Zoopla

Houses letting 30% quicker than they were 12 months ago

Zoopla UK Rental Market Report

A number of factors are driving tenant demand

A once in a generation opportunity	Successive lockdowns have helped us to reassess what makes our homes important to us
The 'race for space' and de-urbanisation	With the necessity to work from home minimising the need to live close to centrally located offices, some city dwellers have also eyed moves to smaller towns and more rural settings. Here, prices can be lower than central areas and properties can benefit from more access to green space
Re-urbanisation	Rightmove data has revealed that due to falling prices, there are now growing signs that renters are starting to return to city life. All of Rightmove's top 10 latest rental hotspots are within Zones 1 & 2
Nothing new	People are drawn into and out of cities based on their circumstances
Stability	Rented property has provided a stable home for many during a time of uncertainty
Barriers to affordability	Current stress testing can limit the ability to purchase for some first-time-buyers

Will Build to Rent fill the gap?

- Completed build-to-rent properties account for 53,750 or approximately 1% of homes within the UK PRS, rising to 2.5% in London. More in pipeline
- BTR was previously largely restricted to London but recording strong regional growth
- Modern and high-spec with concierge, on-site parking and shared areas such as gyms, lounges and dining spaces
- Appeal to wealthy in urban centres but at present, less provision for families and lower earners
- How will legacy of pandemic impact this type of communal living?

Build-to-rent homes completed, being constructed or in planning		
London	Q4 2019	74,429
	Q4 2020	80,721
	% increase	8%
Regions	Q4 2019	77,293
	Q4 2020	99,114
	% increase	28%
Total	Q4 2019	151,722
	Q4 2020	179,835
	% increase	19%

Source: British Property Federation

What trends could we see over the coming 18 months?

Stamp Duty deadline	Strong levels of buy-to-let house purchase activity in the first and second quarters of 2021 as landlord's complete transactions ahead of the tapered Stamp Duty holiday deadline
Return of the amateur	In 2020 the proportion of buy-to-let purchases financed with cash hit the lowest level since the survey began eight years ago. Driven by small and first-time landlords financing purchases with mortgage borrowing – Hamptons
More institutional investment	Lloyds is planning on becoming large scale landlord to tap into demand that will sustain appealing long-term investment returns of an annual 11% over the 30 years to 2019, according to Savills
Other players	They would join the likes of Legal & General who have 2,400 homes built and rented, and a further 3,400 on the way

Conclusion

- Pitching of tenures against each other is unhelpful
- BTL should not just be viewed as a mortgage product but contributing vital finance to an important component of the housing market
- Societal changes will impact future levels of tenant demand

