Property market report Q2 2021

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Property Market Report

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About this Report

Like any investment market, the value of property fluctuates over time. At any given point, property prices and their corresponding rental returns can be influenced by a myriad of competing economic and social factors. For many landlords and investors alike, delving into reems of economic data and social surveys can be both a time consuming and dull task.

The aim of this report is to separate the signal from the noise. That is, to cut through the data and provide landlords with an easily digestible summary of the property market in its current state and to shed light on what we might expect to see in the future. It is hoped that this report will equip landlords with the knowledge they need to effectively invest and manage their portfolios.

This report looks at a range of data sources relating to the housing market and economy to reflect on the performance of the property market over the last quarter. This data and commentary is then aggregated and condensed to provide a detailed yet palatable commentary on the UK property market.

Quarter 1, 2021 – Property Market Update

Highlights of Q2 2021

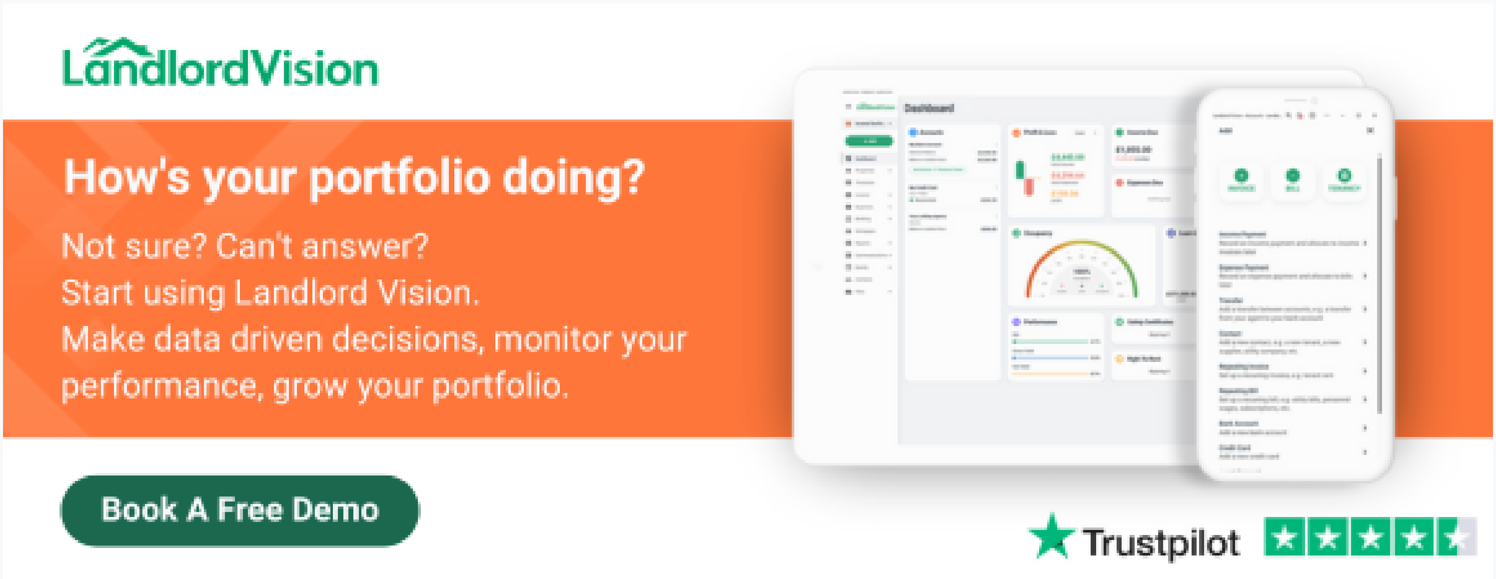
- The Halifax House Price Index shows a quarterly increase in average house prices of +2.9% and an increase of +8.8% over the past 12 months.
- There continues to be a severe imbalance between supply and demand, as the market experiences a sellers' drought.
- Outside of city-centre locations, the lack of lettable properties is continuing to push rents upwards.

Summary

The UK housing market has continued to increase unceasingly during the second quarter of this year. As this report highlighted in Q1, the market continues to tell a tale of the 'haves' and the 'have nots'. Land rich property owners have seen average prices rise at a phenomenal rate, with average house price growth standing at a 14-year high of +9.6% in May. Even on a quarterly basis, prices have increased +2.9% since the last publication of this report.

Landlords content with their property portfolios will read these figures with delight. When the power of leverage is applied to this growth, the returns are positively eye watering. A property with a loan-to-value (LTV) of 75% this time last year could have generated its owner a return on investment (ROI) of +38.4% over the past 12 months. However, there is always another side to the story. Landlords and homebuyers with capital to invest will have found themselves increasingly frustrated at the sheer lack of reasonable properties coming to market. Instructions have continued to fall throughout the second quarter, exacerbating an already imbalanced supply and demand picture.

Is this momentum set to continue? It seems increasingly likely that the market will begin to pause for breath during the second half of this year. The latest month-on-month figures for June showed that house prices fell -0.5%, with agents reporting a cooling of demand throughout the last month. It is unlikely that there will be a substantial fall in prices any time soon, however it would not be surprising to see the rate of growth slow to a more recognisable level as sanity begins to return to the market.



Rental Market

The private rental market in the UK is suffering from a structural deficit in supply and demand. Years of hostile government legislation have depleted the stock of private rental properties, whilst pandemic related experiences have shifted tenant preferences and created a new wave of would-be renters entering the market. Understandably, the vast majority of letting agents expect rents to continue rising over the next three or more months.

The supply of lettable properties coming to market has continued to dwindle during the first half of 2021. The increasing burden of government legislation has encouraged many landlords to reassess and rationalise their portfolios, a trend which has been evident for a number of years. However, the recent boom in house prices has only hastened this trend, with many landlords taking the opportunity to sell their less profitable properties. Therefore, it is unsurprising that letting agents throughout the UK have reported unprecedentedly low levels of stock during the second quarter.

Whilst the supply of lettable properties is dwindling, the demand for properties is beginning to simmer. The effects of the pandemic, and more particularly lockdown, have encouraged people to re-evaluate their living arrangements. The number of divorce enquiries made to law firms has almost doubled in recent months, leading to a spike in demand for small 1-2 bed properties. Equally, young adults living with their families have started to seek an escape, yet face increasingly burdensome deposits when buying a house. For many of these young adults, rental properties will be the only affordable option. Finally, an increasing number of people have sold their home and opted to rent whilst they wait to find the perfect property. Combined, these factors have contributed to letting agents reporting the highest net balance in tenant demand since 2013.

Focusing on specific regions, rural and suburban areas are continuing to outperform. Traditionally less attractive locations are experiencing even more acute shortages in the number of private rental properties. Much like their homeowning counterparts, prospective tenants in Yorkshire and the North are increasingly searching for larger properties, driving up the demand for 3-4 bed homes. Elsewhere, in London rents remain below their pre-coronavirus levels. The local fall in house prices has dissuaded landlords from selling and a lack of foreign residents continues to weigh on rental demand.

Property Price Analysis

Quarterly house prices in the UK increased +2.9% during the second quarter of this year. The current annual house price growth for the 12 months running up to June is +8.8%, down somewhat from the 14-year high of +9.6% in May. Last year, as most of the population sat at home concerned for their lives and their livelihoods, few would have envisaged that prices would have increased at such an astounding rate. Yet, an intoxicating cocktail of loose monetary policy, government incentives, changes in social preferences and increasing personal wealth have combined to defy expectations.

Over the past three months, prices have increased throughout every region of the UK. Respondents to the Registered Institute of Chartered Surveyors (RICS) UK Residential Market Survey for June, highlighted net positive price growth across every single region. Geographically, Yorkshire, Wales and Northern Ireland have witnessed the greatest demand from buyers. At the opposing end of the spectrum, London and Scotland have lagged behind the rest of the UK. Whilst these regions have experienced some price growth during Q2, it has been less universal than elsewhere in other regions.

Reports also indicate a chronic lack of supply across most regions of the UK. Sellers appear to be reluctant to list properties as they doubt their ability to find a new home in the current market. Those properties which do come to market at an attractive price tend to result in a feeding frenzy, as multiple buyers compete to bid up prices. Despite this, there are some signs that demand is beginning to abate somewhat with the withdrawal of the Stamp Duty Holiday. Although demand remains elevated, a significant number of respondents highlighted that activity began to slow slightly in June.

Looking Ahead

Whilst the property market in the first half of 2021 has been nothing short of buoyant, it remains unlikely that this momentum will continue into the second half of the year. Coronavirus and the lockdowns it brought about have been one of the key catalysts driving property markets over the past 12 months. Whilst many of the changes may be lasting, there is the potential for some reversal as the country continues to unlock.

The first and most well-documented headwind in the near future is the tapered withdrawal of the Stamp Duty Holiday. The original deadline of March 31st caused prices to stall in February, although prices quickly rebounded following the extension. The new tapered nature of the withdrawal is likely to prevent the same cliff-edge, however the reintroduction of Stamp Duty will certainly take some of the fizz out of demand.

The build-up in private household savings has been another instrumental factor driving house price growth. Millions of people have spent the past

12 months accruing savings that would have otherwise been spent on entertainment, holidays and more lavish purchases. Instead, many have opted to invest their savings in their home by either purchasing a new one or re-vitalising their current one. It is likely that these savings may begin to stagnate or dwindle as the country emerges from lockdown and people shift their spending back to their previous habits.

Whilst property predictions are always uncertain, these headwinds may help to slow the growth in house prices. There is the potential for prices to fall marginally, but the most likely outcome is that they may continue to grow at a slower pace or just pause for breath. That being said, it would not be surprising to see a reversal in some of the more granular trends. Currently unappealing flats may regain some popularity as young people and divorcees seek affordable accommodation and central locations become more sought after. By the same token, city centres may see a rebound in performance as people return to office work and the hospitality sector begins to stretch its muscles. Finally, foreign investment in Q2 was down 94% on the year. Measures to allow vaccinated travel and in-person university education will help to rejuvenate prices in areas like central London and Manchester.

Q2 – Monetary Policy Update

At its meeting ending on 22 June 2021, the Bank of England's (BoE) Monetary Policy Committee (MPC) determined that the current monetary policy stance remains appropriate, meaning that no immediate changes were deemed necessary.

Highlights

- The MPC Committee voted unanimously to maintain the Bank Rate at 0.1% and maintain the stock of investment grade corporate bonds. By a margin of 8-1, the committee decided to continue financing the purchase of government bonds to reach their £875bn target.
- The UK economy continues to surpass expectations, with first quarter GDP falling less than expected and second quarter GDP predicted to increase by 5.5%.
- Increasing competition amongst lenders may help to drive mortgage rates lower.

Monetary Policy Stance

In its most recent meeting, the MPC chose to maintain its current monetary policy. As was the case last quarter, there was a unanimous decision to hold the Bank Rate at 0.1% and to maintain the current stock of assets held for Quantitative Easing (£895 billion).

What does this mean for landlords and property investors? The MPC's decision means that the bank rate is set to remain at its historically low level for the immediate future. As highlighted in Q1, the MPC is unlikely to increase rates over the next 12 months and will continue to support financial markets, facilitating their ability to lend and invest.

The picture may be less rosy in the medium term, with the spectre of increasing inflation hanging over the economy. May's CPI Inflation reading was 2.1%, both higher than expected and above the BoE's 2% target. The MPC expects that increases in energy and commodity prices will drive inflation above 3% in the near term. However, this rate of inflation is estimated to be temporary, with the BoE arguing that the inflation is 'transitory'. That is, the inflation is a result of a recovering economy rather than a lack of capacity in the economy.

Current Economic Conditions

The UK economy has shown its resilience in the face of adversity, beating expectations during the first half of 2021. Rising cases and stricter lockdown measures during the first quarter inhibited growth and caused GDP to contract by -1.5%. However, this contraction is significantly lower than was expected at the time (c.-4.1%), as both consumers and businesses learned to adapt to the enforced economic climate.

The first buds of optimism can be seen in the second quarter of 2021, as predictions continue to be revised upwards. Overall GDP is expected to increase by 5.5% in Q2 with vaccinations and the easing of restrictions buoying demand. However, this would still leave GDP 4% below is pre-Coronavirus level.

The UK labour market has continued to beat expectations, with the unemployment rate falling to 4.7% in Q2 and HRMC payroll numbers increasing by 200,000 people in May alone. Data from the furlough scheme is showing equally positive indications. The number of jobs furloughed has fallen from 5 million in February to below 2 million in May. Of those jobs still furloughed, over half are using a flexible form of furlough where employees still undertake some work.

Economic Outlook

Economic predictions continue to be revised upward as the UK economy continues to defy gravity and beat expectations. Forecasters are now expecting GDP to surpass its pre-coronavirus levels before the end of the year, with predictions for the year increasing significantly. In effect, the economic recovery that was expected to take place in 2022 is now being frontloaded to 2021.

Predictions are that GDP will increase 7.25% in 2021 and a further 5.75% in 2022. Inflation this year will surpass the BoE's 2% target due to global increases in commodity prices, shipping fees and energy costs. The MPC remain confident that this increase in inflation is transitory and will return to target next year.

Unemployment is forecast to increase slightly in the second half of 2021 as the government withdraws some of its economic stimulus, such as the furlough scheme. Unemployment is predicted to increase to 5% by the year end, before falling back to 4.25% by 2023.

Economic Forecasts

Forecasts	2021	2022	2023
GDP	7.25%	5.75%	1.25%
Inflation	2.50%	2.00%	2.00%
Unemployment	5.00%	4.50%	4.25%

Supply of Credit

For many borrowers, 2020 proved to be both a frustrating and costly period. Despite the bank rate falling to 0.1%, mortgage rates increased. In fact, mortgage rates on 90% LTV mortgages increased by 1.7% during the advent of the pandemic, as lenders accounted for increased economic headwinds and lowered their risk appetite. Just as frustratingly, coronavirus related restrictions severely hampered the operations of many lenders, leaving them unable to adequately respond to the 40% increase in mortgage approvals and leading to increasing purchasing delays.

Thankfully, the lending environment has improved throughout the first half of 2021. The average mortgage rates on 75% and 90% LTV mortgages have fallen by 0.3% and 0.4% respectively as the economic outlook improves. Furthermore, lenders have invested in their operational capacity to cope with increased demand. Lenders have become increasingly competitive in Q2, focusing on increasing or maintaining their market share. This has resulted in a range of new products becoming available and more lenders re-entering the high LTV market. In fact, there are reports of a new 'mortgage war', with Nationwide offering homeowners five-year fixed mortgages with rates below 1%.

What Does This Mean for Property Investors?

References to the 18-Year Cycle are becoming common currency in many landlord and property investment publications. Whether the theory has merit or not, the property market is certainly booming. With both property prices and rents rising, those landlords who have weathered the storm of government legislation finally have something to smile about. Much like the UK economy, the property market has proved more resilient than could have been expected.

For landlords seeking to refinance their properties, the lending environment is continuing to improve. The bank rate is likely to remain at its current rate whilst risk premiums fall, which should lead to further reductions in mortgage rates. The coming months could well be an attractive window for landlords to refinance their current properties or finance the purchase of new properties.

Landlords and property investors with cash to spare may struggle to find attractively priced properties in a competitive market. It is likely that purchasers will face bidding wars and elevated prices when buying attractive suburban properties. Investors will face the challenge of having to invest at inflated prices and with less appealing return ratios. Should rents and prices continue to rise, then the decision to do this may be warranted. However, anyone looking to buy a property currently should be conscious of the ‘winners curse’. Brave investors may see value in the doldrums of the market. City centre locations and flats may currently be less attractive properties, however if the nation continues to adapt and recover from coronavirus, their appeal may soon return. Investors could have the opportunity to purchase less fashionable properties at relatively competitive prices.

Finally, landlords take care to actively review the rents being charged on properties. With inflation picking up and a sheer lack of lettable properties on the market, rents are expected to rise throughout the year. Should inflation continue to rise, landlords may have license to increase rents by upwards of 3% when the opportunity arises.

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