Q1 2020

Quarterly Property Investor Review

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Current UK Market

It seems like the days of the Brexit debate have disappeared into the mists of the distant past and have been overtaken by recent events. We are now in the midst of a crisis that looks like it will affect all our lives in ways which were unimaginable not that long ago and that of course is the Corona Virus pandemic and Covid-19.

There is now a worldwide debate about how to balance the medical challenges of the virus with the financial ones. It would be utterly unacceptable for any government to let the virus run its course in order to preserve the economy.

But the financial impact the virus is having on millions of people also cannot be ignored. What we are seeing is a balancing act with Governments trying to weigh up the need to protect their health services and populations especially those who are more vulnerable to the effects of the virus against the potential economic fallout. At some stage there will be a tipping point when the potential economic impact of a recession of some type or at worst a depression will actually cause more suffering and cost more lives than the virus itself.

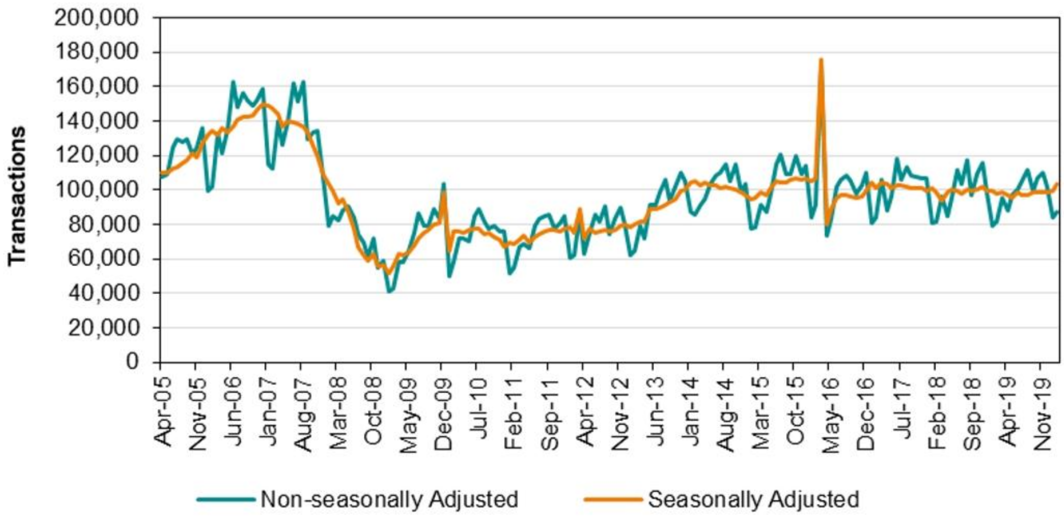
Like everyone we are struggling to work out what that impact is going to be. We will take a closer look at what this could mean for the UK housing and property investment market at the end of this review.

At this point I think it is worthwhile taking a look back over the last year.

The story of the residential property market in 2019 was one of increasing regionalisation and stagnation of prime locations. There was a significant shift away from the dominance of London and the South in the top echelon of house price growth.

After three and a half years of Brexit uncertainty the recent election did at least result in some clarity. Britain formally left the EU as of 31st January and we have now entered a formal 11-month transition period. Though again the impact of Covid-19 will undoubtedly be felt during this period and the negotiations are likely to be extended.

Monthly UK residential transactions:



The graph above shows the number of residential transactions recorded by HMRC in each month over the last 3 years. The greater level of political clarity resulting from the general election had a positive impact on the market and resulted in relatively strong sales activity in the first two months of this year. We do feel that any fall in activity due to the current crisis must be viewed in the context of the strong start to the year and as a result we believe that the underlying market fundamentals remain strong.

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Current UK Market

Recent data released by NAEA Propertymark back up this trend showing the number of homes sold rose again in February to hit their highest level in six months in a further sign that the housing market was picking up early in the year. The data, gathered prior to the coronavirus outbreak being declared a pandemic, reveals that the number of sales agreed per branch increased from eight sales in January, to nine in February – the highest figure recorded since August 2019.

The latest UK House Price Index has revealed that average house prices in the UK increased by 2.2% over the year to December 2019, up from 1.7% in November 2019 with a current average value of £234,742

UK house prices have risen again according to the latest from Rightmove.

The property portal has reported that asking prices hit a record high of 312,265 pushing annual growth to 3.5%. This growth was primarily the result of strong buyer demand and a lack of supply.

Miles Shipside, Rightmove director and housing market analyst commented: “The average asking prices of over 110,000 properties that have come to market this month are at a record high as we enter the traditionally busy spring moving season. As a result, we are measuring the highest annual rate of increase since December 2016. Many more properties are being bought, and bought more quickly than at this time last year. This is further fuelling the existing shortage of property available for sale, driving up prices to a new record high.

In the February 2020 Royal Institute of Chartered Surveyors (RICS) Residential Market Survey it was reported that new buyer enquiries, agreed sales and fresh listings all reportedly increased over the survey period, extending a run of positive readings going back to December.

In terms of new buyer demand, a headline net balance of +20% of contributors saw an uplift in enquiries during February (net balance was +23% previously). As such, this marks a third consecutive report in which demand has risen, with growth being cited across virtually all parts of the UK over the month.

On the back of these stronger demand trends, sales continue to rise, evidenced by a net balance of +22% of respondents noting an increase at the national level. Regarding the regional breakdown, the monthly pickup in transactions was most widespread in Northern Ireland, East Anglia and London. Meanwhile, at the other end of the spectrum, Scotland was the only area where respondents reported a decline in sales, posting a net balance reading of -10%

So, in general terms the market appeared to be in good health at the beginning of the year with rising demand placing upwards pressure on prices.

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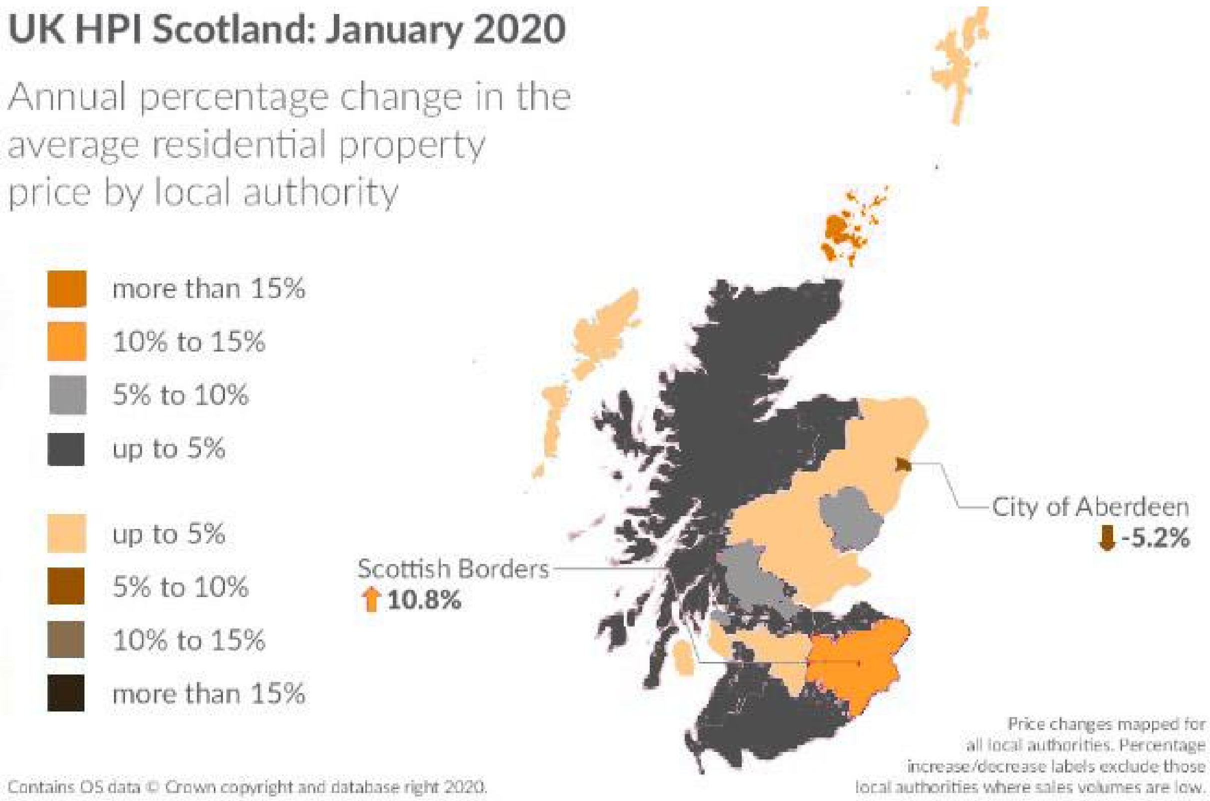
Focus on the Scottish Market

As before I would like to take some time and look at the market before the current crisis really began to bite.

In the most recent set of figures available from the Registers of Scotland the average price of property stood at £152,121 which equated to an annual increase of 1.6% compared to an average UK price of £231,185 which was an increase of 1.3% on January 2019

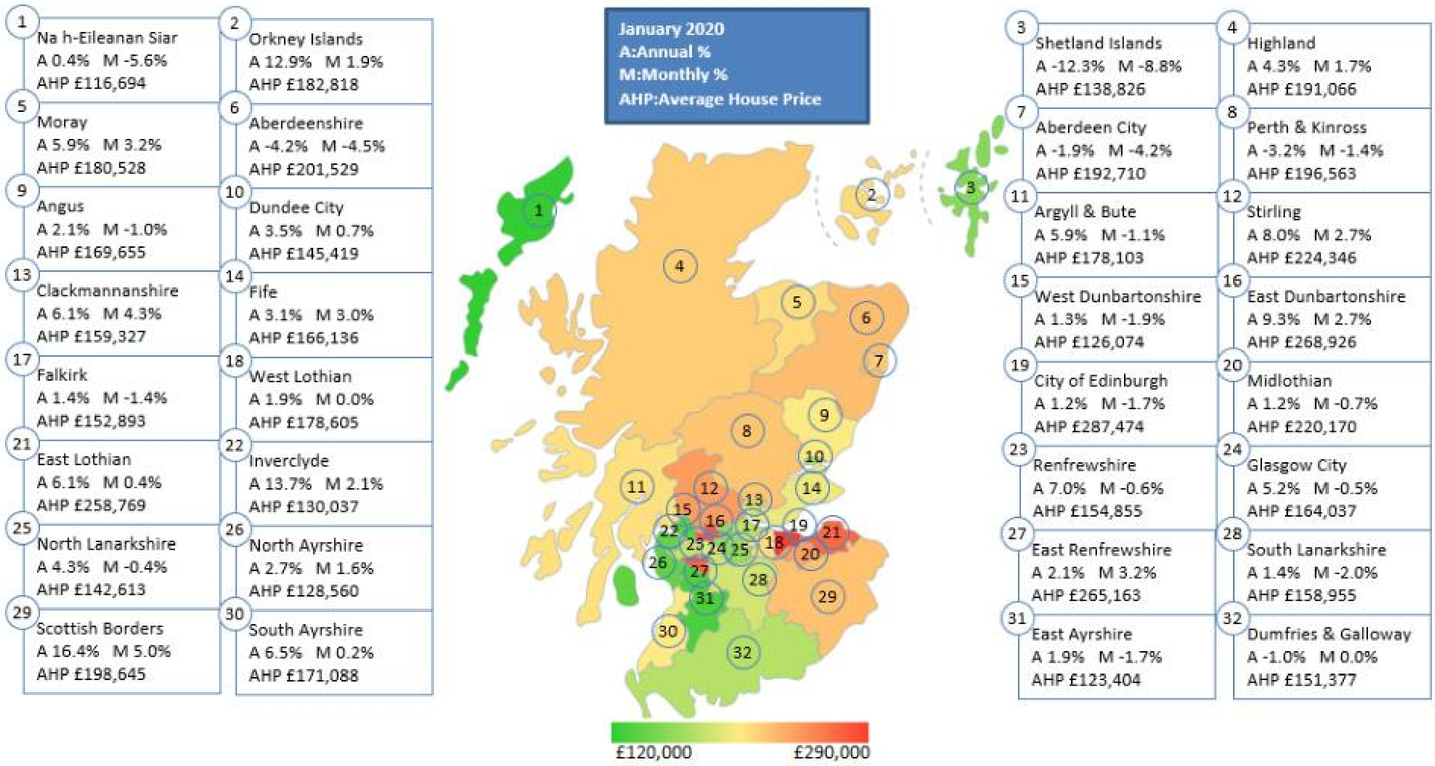


Source: Registers of Scotland

Your move reported that the average house price in Scotland rose by £125, or +0.1%, in January and now stands at £187,626. This sets a new record average price for Scotland as a whole, and as prices continue to climb, albeit slowly, it is also the third month in a row in which this has occurred. Over the last twelve months, prices have risen by some £5,100, or +2.8%, which represents an average increase of £425 per month.

Overall, 16 of the 32 local authority areas in Scotland saw prices rise in January, which is three less than the number with price rises in December. Overall, we can conclude that there has been a slight slowing of price growth in Scotland's housing markets as we enter the New Year.

Focus on the Scottish Market



Source: Your Move

In October 2019, the latest month for which the official ONS statistics are published, transactions in Scotland totalled 9,250 properties. This was 544, or 6.2%, more than the previous month, against a seasonal increase of 5% (based on the last seven years data, excluding 2016), so sales volumes were 1% up on the level which would normally be expected for the time of year. Sales volumes are similarly 1% higher in October 2019 compared to one year earlier.

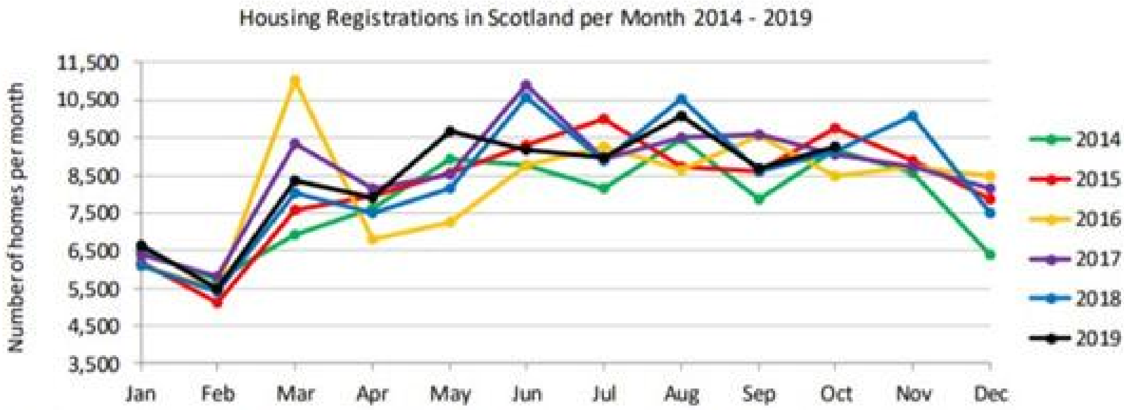


Figure 2. The number of sales per month recorded by Registers of Scotland based on entry date, for the period 2014 - 2019
Source: Office for National Statistics.

The UK Rental Market

The potential impact of Coronavirus and Covid-19 onto the rental market is so far hard to analyse and again we will examine this in more detail later. As above I think it would be worthwhile setting the picture by examining the situation pre-Corona.

According to the Office of national Statistics the UK's population is predicted to grow by 5.5% over the next ten years and pass 70 million by mid-2029. Over the last twenty-five years levels of owner occupation have declined and there has been a major shift in housing which has led to an increased bias to private renting both out of choice and out of need. Added to this residential rental property has soared in value by over 50% over the last five years.

The fundamentals of the housing situation across all tenures in the UK remain unchanged; the market is significantly undersupplied. There are various policies being implemented at local and national level that seek to address this but whether they are having any impact on the current shortage of housing is debatable.

The value of assets PRS now totals some £1.62 trillion (source Savills) and fact, it's worth has now surpassed that of mortgaged owned occupier stock for the first time. The PRS in the UK is now the fastest growing sector in the country and makes up approximately 20% of all households which equates to a growth of some 2.5 million rental homes since the year 2000.

An extra 560,000 households are expected to be renting a home by 2023, taking the proportion of housing in the private rented sector to 22%, up from 20.6% today

Latest data released by ARLA Propertymark revealed that demand for rental accommodation reached a record high in January with an average of 88 prospective tenants registered per member branch. The figures show that agents have witnessed a 57% increase in the number of prospective tenants registered since December. Year-on-year, demand for rental accommodation has increased by a fifth (21%), rising from 73 in January 2019 to 88.

But at the same time there has been a constriction in supply as the changes to taxation and increasing regulation has resulted in landlords exiting the market. ARLA report that the number of properties managed per branch fell from 206 in December to 191 in January. Supply has not been this low since July last year when it stood at 184. Year-on-year supply is down from 197 in January 2019, but up from 184 in January 2018.

The trend is reflected in some recent data released by home.co.uk in which it was reported that the supply of rental housing stock on letting agents books fell by 15% in March compared to the same month in 2019.

This has led to further upward pressure on rental values with the average rents increasing across the UK. ARLA report that the number of tenants experiencing rent increases rose in January, with 42% of letting agents witnessing landlords increasing them, compared to 32% in December last year. Year-on-year, this figure is up from 26% in January 2019, and 19% in January 2018.

David Cox ARLA Propertymark Chief Executive said:

"Our recent research found that tenants could miss out on nearly half a million properties as more landlords exit the traditional private rented sector and turn towards short-term lets which will only serve to worsen the problem for those seeking longer-term rental accommodation."

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The UK Rental Market

In a report carried out by the portal home.co.uk it was found that rents for two bed properties in the South East had increased from £950 per calendar month (pcm) to £975pcm; in the East Midlands, Scotland and Wales from £600pcm to £625pcm; from £485pcm to £495pcm in the North East; from £535pcm to £550pcm in Northern Ireland; and from £593pcm to £600pcm in the North West.

Before the Covid-19 crisis hit research carried out by Paragon showed that tenant demand was expected to grow over the course of 2020. The research revealed that nearly four out of ten landlords believed that tenant demand for residential property would increase over the course of 2020 and this came on the back of a strong end to 2019, with 27% of landlords experiencing an increase in tenant demand.

Paragon's Trends research found that 37% of landlords expect tenant demand to grow during 2020, compared to 7.3% predicting a fall.

The RICS reported tenant demand (monthly non-seasonally adjusted series) rose at the headline level for a third consecutive month. At the same time, landlord instructions fell once again, extending a persistent run of decline stretching back to 2016. It was expected that rents were to rise in the near term, while twelve-month projections were around 2%. Further out, over the next five years, rental growth was expected to accelerate to average roughly 3% per annum through to 2025.

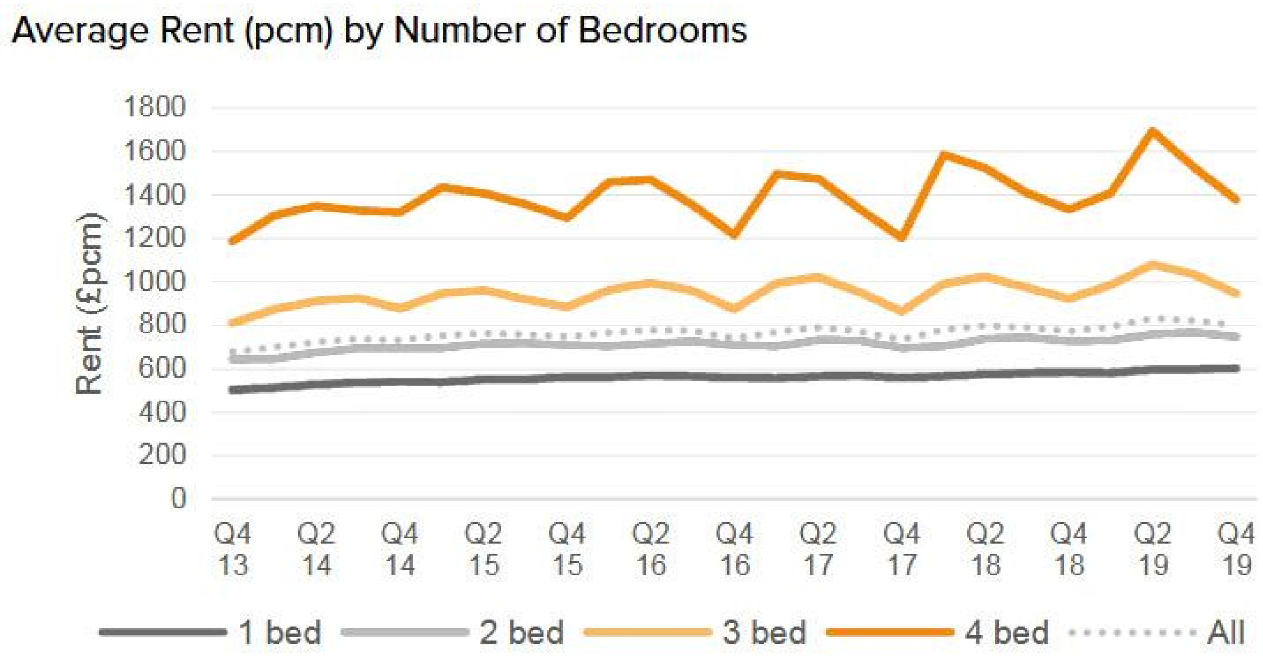
In the Homelet Rental Index it was reported that rents across the UK grew by 1.6% in February 2020 compared to the same month in 2019 with the average UK monthly rent being £955 PM. When London is excluded the UK average rental value is £791 up 1.2% on last year.

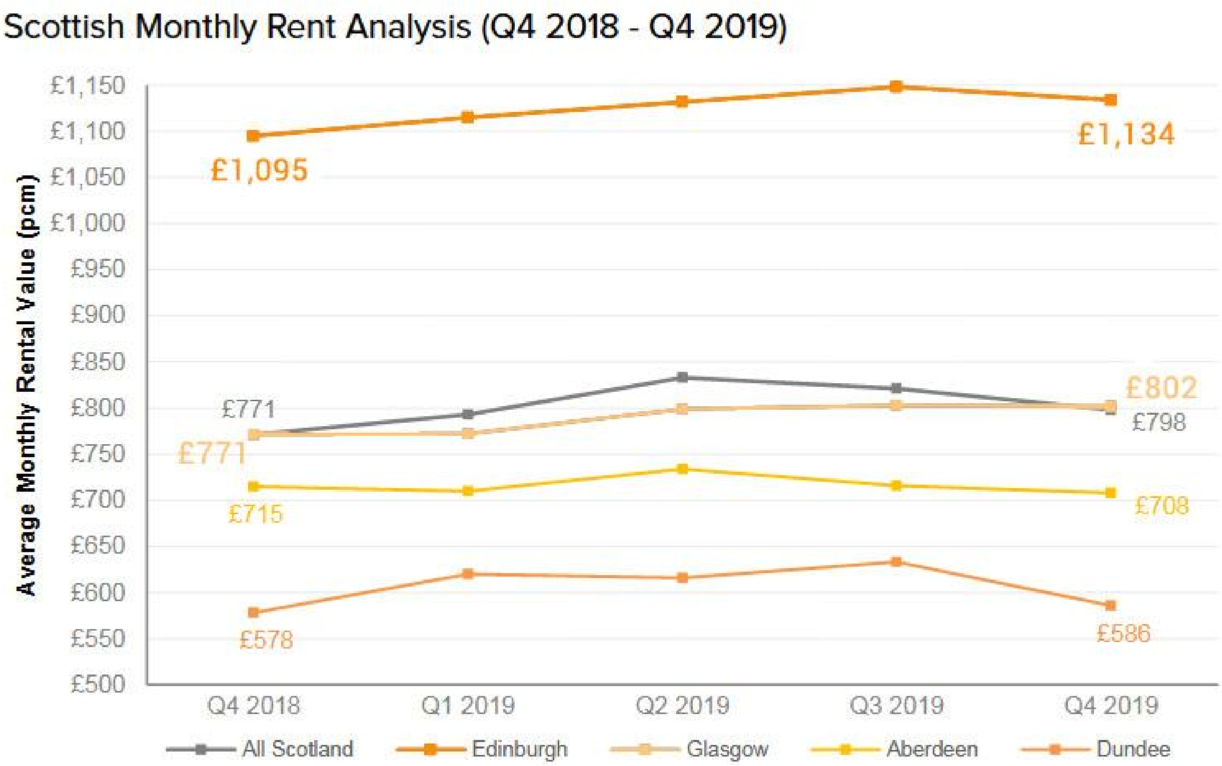
Source: Homelet

Focus on the Scottish Rental Market

Before the Coronavirus outbreak the Scottish rental market looked to be in good shape with landlords expressing confidence in the market which was in stark contrast to the picture in the rest of the UK. The political uncertainty around the whole Brexit debate had not affected the PRS north of the border.

In the Citylets Q4 2019 Report average rents grew at 3.5% year on year (YOY) with the average rental in Scotland standing at £798 PM with average time to let (TTL) being 29 days.





Source: CityLets

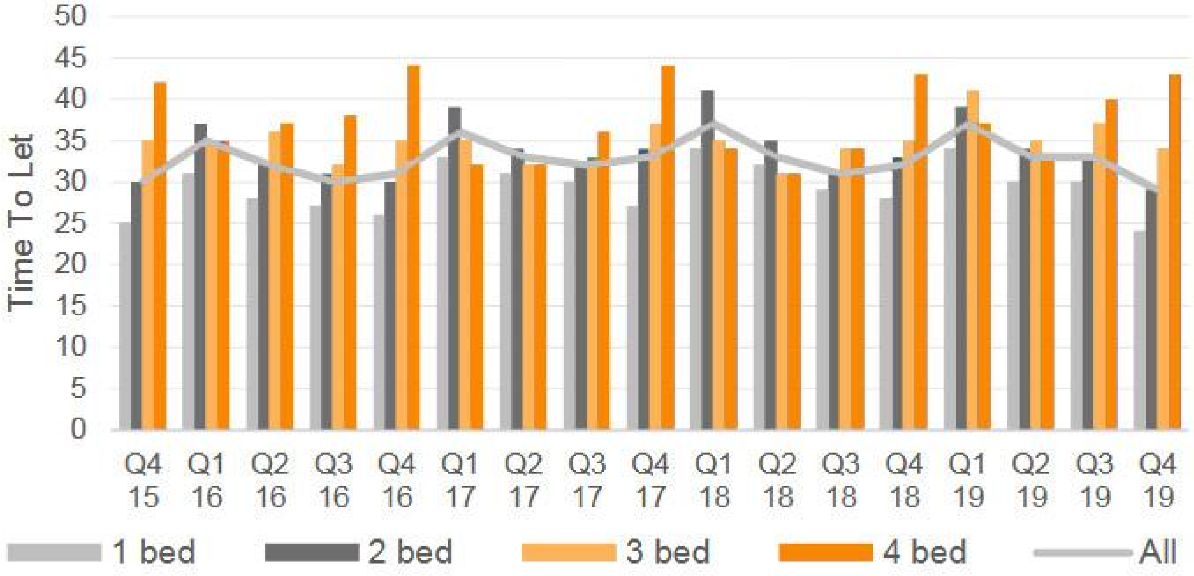
Focus on the Scottish Rental Market

Market Overview - Q4 19

Beds	Average Rent	Rent Change 1yr	Rent Change 5yrs	Rent Change 10yrs	Av. TTL (days)	TTL Change YoY	Let within a week	Let within a month
1 bed	£601	3.1%	11.1%	27.6%	24	-4	25%	71%
2 bed	£747	2.6%	7.3%	24.7%	29	-4	18%	63%
3 bed	£947	2.6%	8.1%	24.4%	34	-1	12%	54%
4 bed	£1,377	3.4%	4.4%	28.7%	43	0	10%	44%
All	**£798**	**3.5%**	**9.0%**	**26.7%**	**29**	**-3**	**19%**	**64%**

According to Homelet the Scottish average rent stands at £672 which is a 2.9% increase YOY which out performs the UK average of 1.6%

Average Time To Let (TTL) by Number of Bedrooms



Source: CityLets

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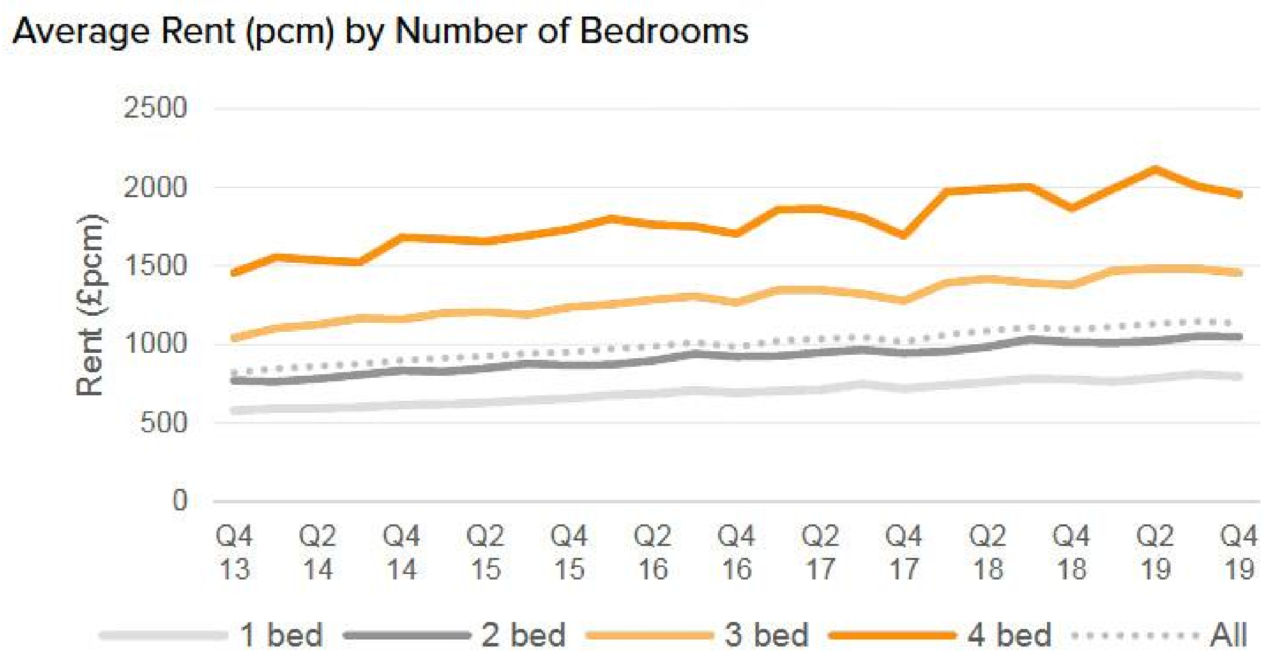
Focus on Edinburgh

Rental inflation in the capital remained relatively subdued at a rate of 3.6% YOY which is quite a reduction from the recent historic peak of 7.8% a year ago and the average rent in the capital stands at £1,134 PM. The 5 and 10 year average growth rate is just over 5% PA.

Market Overview - Q4 19

Beds	Average Rent	Rent Change 1yr	Rent Change 5yrs	Rent Change 10yrs	Av. TTL (days)	TTL Change YoY	Let within a week	Let within a month
1 bed	£796	2.2%	29.2%	54.3%	17	-2	31%	83%
2 bed	£1,050	3.2%	26.1%	57.4%	22	-1	21%	72%
3 bed	£1,455	5.6%	25.3%	51.6%	33	1	10%	53%
4 bed	£1,956	4.7%	16.4%	46.3%	40	1	3%	44%
All	**£1,134**	**3.6%**	**26.0%**	**54.5%**	**22**	**-1**	**24%**	**74%**



Source: CityLets

Average TTL was 22 days with one bed properties flying at a TTL of just 17 days.

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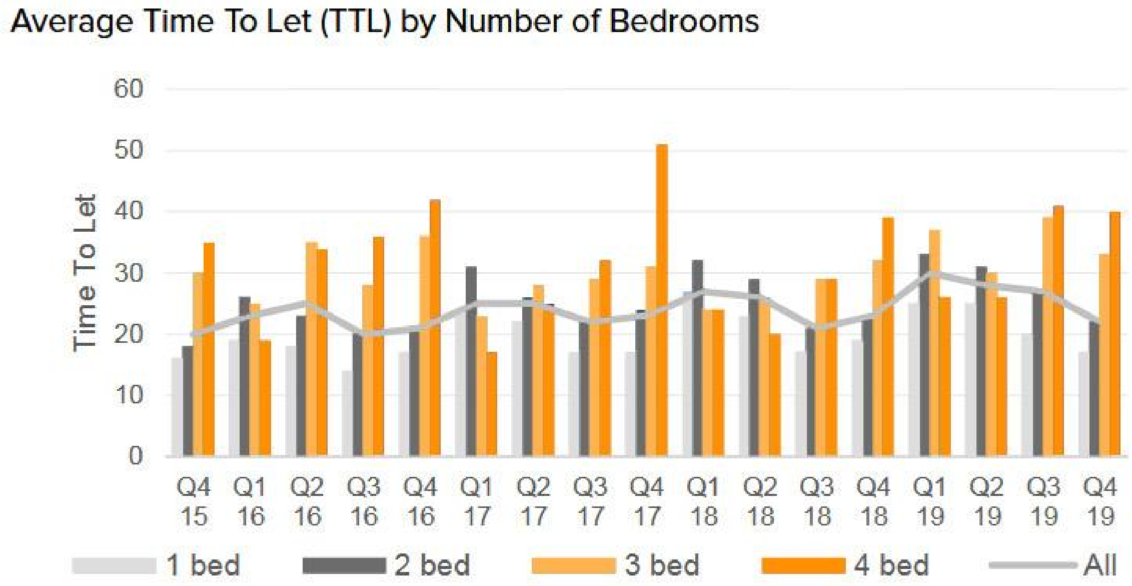
Focus on Edinburgh



Prices in the city are also performing well in the most recent ESPC House Price Report average selling prices across Edinburgh rose by 4.4% to £267,286. The property sales volume decreased by 7.5% while the number of homes coming to market increased by 0.4% with the median time for a property to go under offer in the capital being 26 days.

In the February UK Cities House Price Index Edinburgh was in third place behind Nottingham and Leicester with a year on year growth rate of 3.4%

In January 2020 according to the Registers of Scotland the highest-priced area to purchase a property was City of Edinburgh, where the average price was £272,544.

Case Study

HMO 3 Bed flat - £250,000

3 Bedroom Flat	Cash Purchase	60% LTV Geared Investment
Purchase Price	(£250,000)	(£250,000)
Initial Acquisition Costs (Tax, Legal Fees, Search Fee, Mortgage, Certificates and Contingency)	(£32,600)	(£32,600)
Initial Mortgage Loan	-	(£150,000)
Total Cash Investment	£282,600	£134,100
Monthly Rent	£1,500	£1,500
Gross Yield	7.20%	7.20%
Annual Income (inc 3% Void)	(£17,460)	(£17,460)
Annual Costs (Manag., Ins., Safety, Maintenance)	£3,921	£3,921
Mortgage Costs (4% Interest)	-	£6,000
Net Income after expenses, voids and mortage	**£13,539**	**£7,539**
Approx. Value in 10 Years (4% PA Appreciation)	£370,061	£370,061
Less estimated sales fees and redemption charges	£9,252	£9,252
Less Outstanding Mortgage	**-**	**£150,000**
Future Value of Investment	**£360,810**	**£210,810**
Increase in Equity (Ignoring Rent)	**£78,210**	**£78,210**
Return on capital PA comp. (inc. level net income)	**7%**	**9.80%**

Disclaimer:
Please remember that past performance of a property investment is not necessarily a guide to future performance. The value of an investment as well as the income from it can fall as well as rise as a result of market fluctuations. All calculations above are meant as a guide only, whilst every care has been taken to provide an acurate picture of future performance, Glenham Property Management Limited can accept no responsibility or liability for the performance of any property.

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Case Study

1 Bed flat - £130,000

1 Bedroom Flat	Cash Purchase	75% LTV Geared Investment
Purchase Price	(£130,000)	(£130,000)
Initial Acquisition Costs (Tax, Legal Fees, Search Fee, Mortgage, Certificates and Contingency)	(£12,800)	(£12,800)
Initial Mortgage Loan	-	(£97,500)
Total Cash Investment	£142,800	£45,300
Monthly Rent	£765	£765
Gross Yield	7.1%	7.1%
Annual Income (inc 3% Void)	(£8,905)	(£8,905)
Annual Costs (Manag., Ins., Safety, Maintenance)	£2,365	£2,365
Mortgage Costs (4% Interest)	£3,900	£3,900
Net Income after expenses, voids and mortage	**£2,640**	**£2,640**
Approx. Value in 10 Years (4% PA Appreciation)	£192,432	£192,432
Less estimated sales fees and redemption charges	£4,811	£4,811
Less Outstanding Mortgage	**-**	**£97,500**
Future Value of Investment	**£187,621**	**£90,121**
Increase in Equity (Ignoring Rent)	**£44,821**	**£44,821**
Return on capital PA comp. (inc. level net income)	**7.0%**	**12.0%**

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Effects of Coronavirus on UK Property Market

Normally in this section we would focus on looking at property as an asset class and what that means. We think this is still important but first we must look at what is happening at the moment.

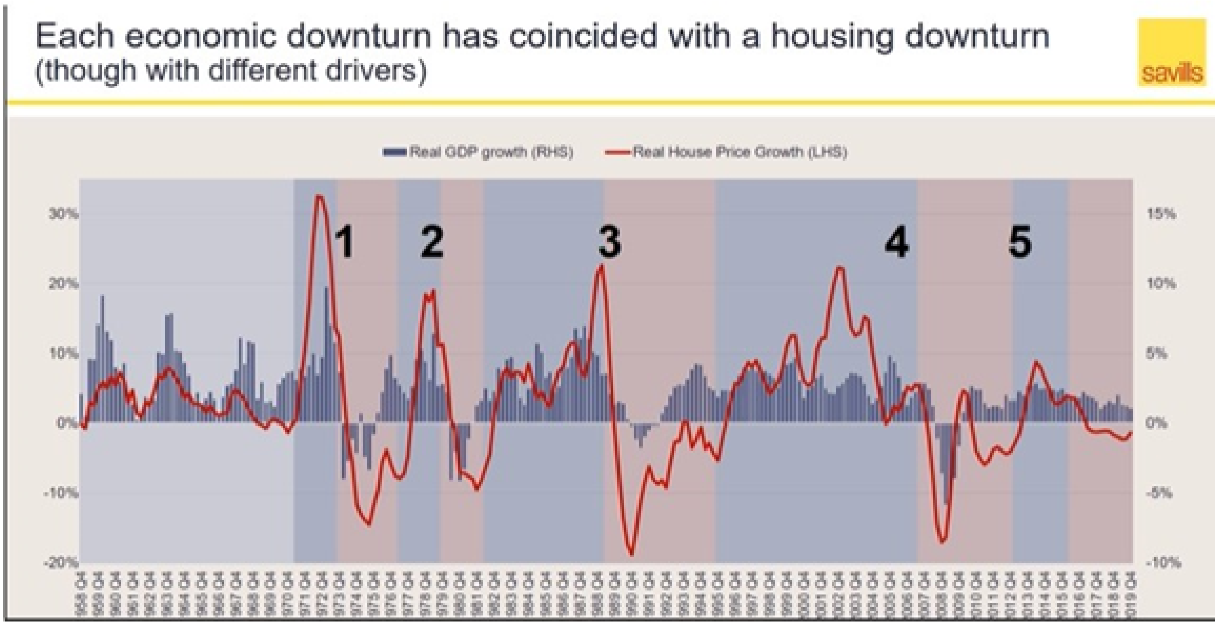
In the last few months, we have gone from the letter B (Brexit) to the letter C (Coronavirus) which is unfortunately extending the period of uncertainty that surrounded Brexit. All the situations that Brexit brought about, such as the turmoil in the stock market and financial uncertainty, are now enhanced and remain a lingering presence, stifling market activity.

One initial response to the crisis was the Bank of England reducing interest rates to 0.1% which is the lowest level in the Banks history. Current forecasts now suggest that rates are likely to remain at this level until around Q3 2021 and are projected to only reach 1.5% by the end of 2024.

How will this affect those people with mortgages? Tracker and standard variable products should see an immediate reduction. But what effect this will have on lenders new loan rates we will need to wait and see.

From a buy to let perspective many lenders have withdrawn products from the market and lending criteria have been tightened with reductions in loan to values available to investors. Other lenders have in fact increased rates as they seek to increase their margins as they are concerned about the increased risk of tenants defaulting on rents and a possible fall in capital values.

As can be seen in the graph below historically, economic uncertainty and market volatility are detrimental to the housing market.



Effects of Coronavirus on UK Property Market

But is there going to be a recession? Most economic forecasters are expecting a sharp economic contraction in 2020 with the most significant impact being felt in Q2. However currently there is hope that there will be a rebound in the global economy late 2020 or early 2021 though the exact trajectory is unknowable. There is no doubt that there is going to be a severe economic shock and we are already seeing the effects of this reported every day. Governments all over the world are looking at ways to soften the impact.

Morgan Stanley forecast (on Monday March 23) that the UK economy will contract by 5% this year due to the impact of the pandemic, which would leave it more than 6% smaller than forecast in the recent Budget. This estimate is also predicated on a “robust” rebound in the second half of this year.

Before the impact of the pandemic, the Office for Budget Responsibility (OBR) projected borrowing to be £55 billion, or 2.4% of national income in the coming financial year. The full scale of both the economic impact of the covid-19 pandemic and the policy response to it will only become clear over time. But based on the information available the Institute of Fiscal Studies has said it would not be surprising if the OBR were to add around £120 billion to borrowing, more than tripling the amount forecast just weeks ago and pushing borrowing up to £177 billion or 8% of national income.

Large scale increases in borrowing are now the new norm, the idea being to support business and households to seek to reduce any long-term scarring effects in the economy. But as happened following the financial crisis, the changes in the public finance landscape that the outbreak has brought about will remain with us long after the immediate crisis has passed. The result of all this is by the end of 2020–21, we will have much-elevated government debt. Hopefully the Covid-19 outbreak will have past, but the tax and spend trade-offs facing policy makers will be made starker for years, and more likely for decades, as they strive to bring debt back down over the longer-term.

According to analysts at the Centre for Economics and Business Research (CEBR) the deepest since the financial crisis is now all but unavoidable with a potential contraction in the UK economy of 15%. Japans Nomura bank have suggested a fall of 13.5% and a steep rise in unemployment. Both have predicted unprecedented economic pain in the second quarter, but both also expect a subsequent rebound, assuming coronavirus restrictions are eased and the government takes economic stimulus measures.

The CEBR said a cut in VAT could help to kickstart consumer spending, and it expects measures to promote investment in business, which would not recover until 2030 otherwise. That would deliver a “sharp bounce back” in the second half of the year, it said, although 2020 GDP would still be 4% lower than 2019.

The timing of any rebound is of course going to depend on when the current restrictions placed upon society will be lifted and then the extent and speed to which individuals and businesses are able to return to some semblance of normality.

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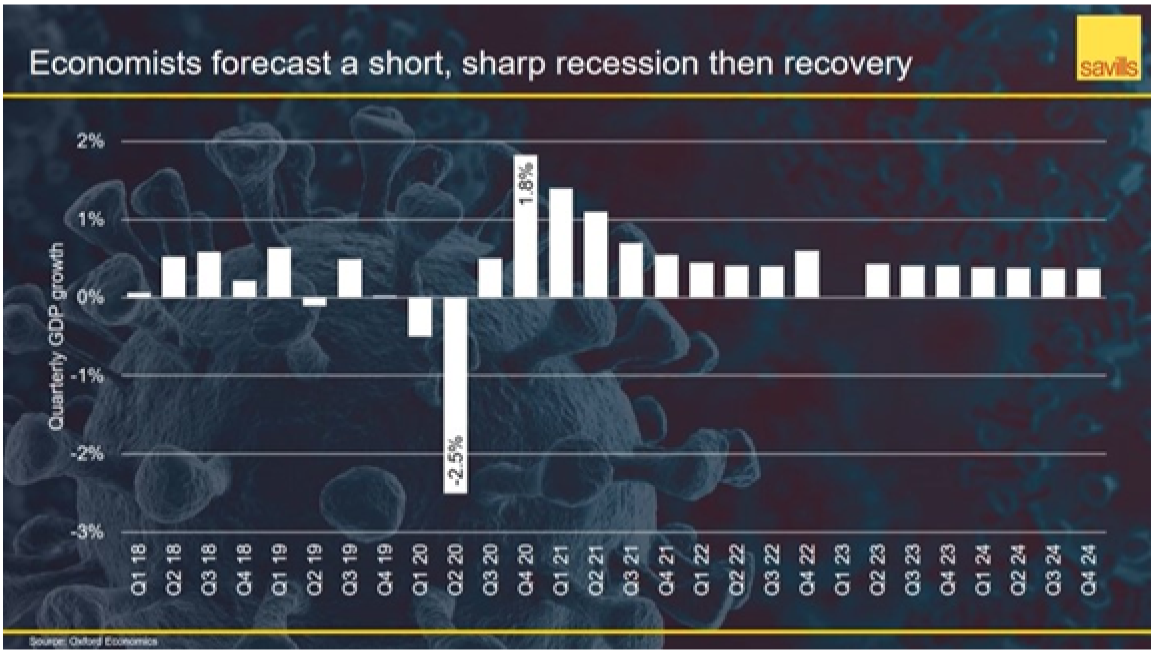
Effects of Coronavirus on UK Property Market

Latest observations on the impacts of coronavirus on the housing market suggest that transactions are set to drop significantly in the short term. In their UK housing update Savills are expecting that transaction levels are going to impacted most heavily over the next three months as the lock down restrictions in place are severely restricting people's ability to move. They expect activity to fall by between 20% and 40% of the five-year average by June and remain there until September. This is between 38% and 53% lower than what they forecasted for 2020 in November of last year.

However, the suppressed activity should result in a build-up of latent demand as people will be desperate to move once the restrictions on movement are relaxed. Savills have suggested that if transactions were to recover to between 60% and 80% of normal levels by January 2021 and return to normal levels by May-21, we could see between 1,122,000 and 1,166,000 sales in 2021.



They are basing their projections on the post-recession recovery predicted by Oxford Economics as shown in the graph above and the expectation is the effects on house prices from the pandemic will be less and shorter lived than those of the Global Financial Crisis with short term falls of -5% to -10% on very low transaction numbers.

Richard Donnell director of research for Zoopla has struck a more optimistic view and has said:

"We do not expect any immediate impact on prices. Beyond this, the outlook for house prices largely depends upon how the Government's major package of support for business and households reduces the scale of the economic impact. Low mortgage rates mean forbearance will remain the preferred choice for lenders, but further Government support in these unique times cannot be ruled out."

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Effects of Coronavirus on UK Property Market

The quoted figures are also based on nationwide averages and do not take into consideration regional markets and the differing variables these will produce. Some areas are better equipped to weather short term volatility than others and we would expect there to be significant variations in the headline numbers when viewed at a more granular level.

Taking a closer look at the rental market currently the constraints on movement is restricting people's ability to view properties and move. There have been a range of measures announced by the UK government and the devolved assemblies to try and support those in the Private Rented Sector (PRS) primarily a moratorium on evictions and mortgage payment holidays for those landlords whose tenants who are in financial difficulty. In the short term we would expect there to be a fall in average rents as landlords act to help those tenants who are struggling and we are already seeing this ourselves. We also expect headline rental growth figures to slow over the short to medium term.

Before the virus hit there was already evidence that landlords were exiting the market as detailed in the UK rental section above. The result of this is we believe there is still likely to be a shortage of supply which will be further exasperated as some landlords are perhaps forced to sell due to the fallout from the pandemic though some of this shortage maybe off set by owners of short term rental (STR) property deciding to move into the long term market. The result is we do not expect there to be a significant fall in rental values rather perhaps a readjustment to the headline inflation figures and again there will be regional variations.

One part of the rental market that has seen an immediate and severe impact due to the pandemic is the STR sector. Over the last few years renting out a property as a short term let has become increasingly popular due to changes in taxation and increasing regulation around long term letting. The result is there has been a massive surge in the numbers of such properties in cities like Edinburgh.

This has of course had a knock-on effect of removing properties from the Private rented Sector (PRS) creating a supply and demand imbalance which has led to further upwards pressure on rents. But the result pf Covid-19 has been that bookings have all but dried up and with the cancellation of large-scale events like The Edinburgh Festival and this looks like it might continue for some time yet.

In a recent poll conducted by the UK Short Term Accommodation Association's (STAA) with its corporate membership has highlighted the severity of impact that the COVID-19 coronavirus has had on companies' reservations and income.

The feedback the STAA received from its corporate members, that represent the majority of the short-term let industry, showed that since 13 March, when the first effects in the UK were felt, most companies have seen more than 70% of their reservations cancelled, with some losing over 90%.

As we have mentioned already some owners are swapping back to long term rental and it will be interesting to see what the impact of this will be on stock availability and rental inflation in the PRS.

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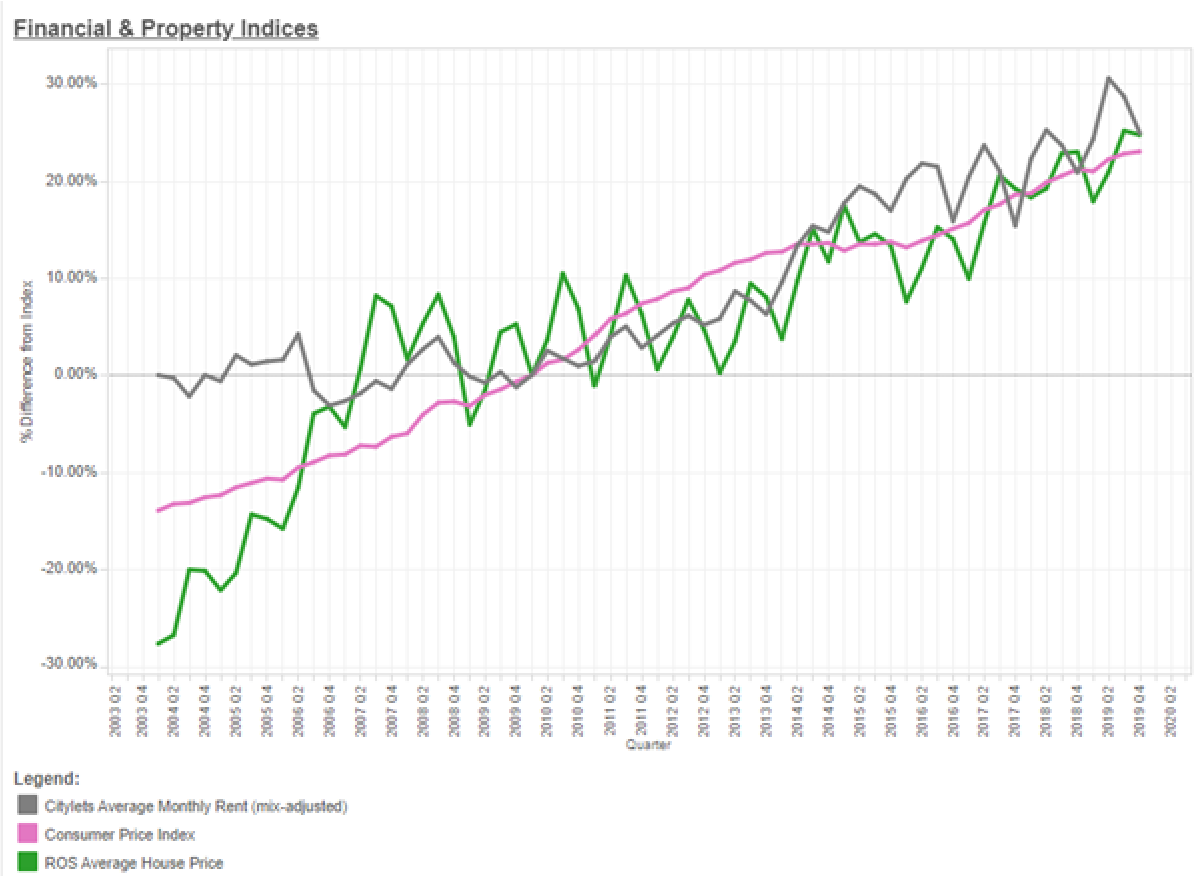
Effects of Coronavirus on UK Property Market

But what of the worst-case scenario that of some level of recession?

From a rental point of view, it is the housing market and not the rental industry that tends to suffer the most during a recession. In a down turn housing is affected as people either can't afford to buy a home so they will rent. Furthermore, many people prefer to rent when times are uncertain due the flexibility it offers them and it could be argued that the Scottish system is particularly well suited to this due to the flexibility of the Private Residential Tenancy. The result is Home ownership will drop and demand for long term rental property tends to remain relatively resilient to external shocks.



Focusing on rental values specifically in Scotland these also tend to remain relatively stable in comparison to house prices. This can be seen using data from the Citylets shown in the graph above average monthly rents during the 2007 financial crisis rents actually rose to begin with and spiked in 2008 Q3 with a growth rate of 3.92%. This may in part be due to an increase in demand as the effects of the crisis hit home. After this point rental growth did slip into negative territory with the lowest point being a rate of -1.25% in Q4 2009 after which there was a recovery and growth rates bounced back.

Effects of Coronavirus on UK Property Market

Another effect of the pandemic has been the reduction of the value of the pound with Sterling hitting its lowest level against the Dollar since 1985 last week. But a weaker pound makes it cheaper for overseas investors to buy property in the UK and there does seem to be appetite. However, the currency markets are in turmoil reacting to the latest developments on a daily basis and this is a constantly changing picture.

One thing that is worth pointing out is that most seasoned investors understand turmoil and volatility is part of what constitutes a market and are in it for the long term. If the market were to take a dip after Covid-19 then would this really be of concern and would it not bounce back after time? The answer is to tune out the noise and play the long game, take emotion out of the equation and stay invested to look beyond temporary market fluctuations.

It is so easy for all of us to get so tied up in what is happening in the moment as we are bombarded on all sides with daily news bulletins and reports all over social media. Most people will be suffering from information overload, everyone is firefighting at the moment. But it is very important that we don't lose sight of the fact that regardless of how this dilemma is resolved, there will come a time when the crisis will be over and the economy will start to operate again. For savvy investors, it's a great time to be more active than ever to spot deals, and using a long-term perspective is the key to success in scenarios such as these.

Warren Buffet once said;

"Be fearful when others are greedy and greedy when others are fearful."

At Glenham we have always been focussed on responding to market conditions and are always seeking ways to react and mitigate our client's risk as much as we can. We have always made sure we have embraced technology which has meant the transition to working from home has been smooth with limited impact on our service levels. We are still open working for both our clients and our tenants and we are still letting properties. We can carry out virtual viewings for properties on the market and the same for valuations for prospective landlords.

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