LEGAL & GENERAL SURVEYING SERVICES ISSUE 10

Perspective

For professionals in the UK property market

Legal & General

Solid returns in a cooling market

Despite the gloomy headlines on property prices, the outlook for residential property investment remains remarkably strong. Recent headlines around the residential property market can be read as depressing to say the least. Halifax found that house price growth fell in April, the Royal Institution of Chartered Surveyors (RICS) saw a continued fall in new instructions and the Office of National Statistics reported that London had the UK's lowest annual house price decrease of 1.0% over the year.

But behind the foreboding headlines, the picture for investors in residential property is actually very different. Part of the reason is some of these statistics deal with turnover in the market, the number of homes listed for sale and then sold, which is key to lenders and estate agents. However, for investors, the important figure is their returns, made up of rents received, increases or falls in rental values and in house prices. If you need confirmation of this then look no further than international investors.

Many of these buyers are from the Far East, Middle East and East Africa and attracted by the weak pound and the hands-off investment that new platforms such as crowdfunding can offer. Many investors via these platforms are turning to high yielding equity investment opportunities and emboldened international investors can now enjoy a variety of new property investment products featuring bridge loans, mezzanine loans and buy to let which will allow them to spread their risk across the entire investment spectrum and diversify their property portfolios.

International investors have always seen the UK and more specifically the UK property market as an attractive place to invest. This is because the UK is considered to be a safe haven compared with other economies around the world. Over recent years, the UK has seen international investment continue to grow thanks to technology and crowdfunding, which makes it more accessible for investors to invest anywhere in the world.

Research from Hamptons International reveals that 30% of homes across London were sold to international buyers last year. Overseas investors bought up more than half of all residential properties for sale in London's most exclusive postcodes in the last half of 2017. The proportion of homes in the capital's prime central spots bought by foreign investors hit the highest level in five years, with a significant increase in Middle Eastern buyers boosting the figures.

For investors and advisers there are several reasons why the outlook for rents and rental values remains strong. There is a continuing shortage of housing and, although there are regional variations across the UK, in most parts of the country there is significant support overall for rents and house prices. The Halifax Housing Market Outlook for April stated its expectation for house price growth due to continuing low mortgage rates, great affordability levels, a robust labour market and the continuing shortage of properties for sale. In addition, the size of the private rental market (PRS) has increased year on year for 20 years, and now provides homes for 20% of all households – recent figures from the Resolution Foundation suggest this growth is set to continue, with a third of today's millennials potentially still renting into retirement.

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But the quality of stock is hugely variable with homes in the PRS being on average older than owner occupied home (35% were been built before 1919, and 27% of them fail to meet Decent Homes Standards). This represents an opportunity for good landlords offering professionally managed modern homes. They can solicit and select the best tenants, who benefit from living in a high quality, well maintained home and in return provide investors with greater, longer-term security over rental income. The average length of stay in such homes is already over two years and is rising, after all a good tenant is an asset and a long-term investor wants them to stay as long as they can.

Although the Office of National Statistics UK House Price Index reported transactions as flat in February, they recorded 101,000 home sales in the month, a figure which had not varied up or down by more than 2% in the whole of 2017. Looking at it another way, there were over 1.2 million housing sales in 2017; hardly a poor market. From an investors perspective this is a liquid enough market in which they can buy and sell, and a market which provides more than adequate evidence for valuations.

All in all, there are plenty of opportunities for property investors despite the 'cooling' market.

Welcome

Welcome to our latest edition of Perspective. We are now in our 10th edition and would like to thank everyone for their support and contributions to the magazine. Over the last 5 years, we have evolved as an industry and as a business in ways we might never have imagined when we started the magazine. Perspective has endeavoured to cover it all and bring other relevant property stories to your attention.

In this edition, we consider the impact of foreign investors on our property market. While other statistics might appear foreboding, the key investor metric of returns is holding up as more innovative means of investing become available.

If investors can still turn a profit, we should spare a thought for those looking to re-mortgage their Help-to-Buy remortgages. As it turns 5 years old and the first swathe of an estimated £8.6billion of lending begins to mature, the lack of options and informed advice available to many borrowers is a cause for concern and there are unresolved issues for valuations.

Conversely, the opportunities for those qualifying for later-life lending continue to bloom. We reflect on the introduction of interest-only lending to the over 55s and consider what other property opportunities and risks this growing cohort offers lenders.

Amidst these markets, of course, there are other dynamics at play that affect property value. The repurposing of urban retail parks by developers to include residential as well as commercial opportunities is continuing apace as online shopping eats into traditional retail models. We look at the 80,000 properties enjoying council tax deductions and consider what impact they might have on local markets as politicians remove the tax breaks.

Finally, I would like to offer my thanks to Graeme Winser of Nationwide for his thoughts on our market in our regular 'View from the Top' back page.

We always enjoy discussing our thoughts with you and addressing the topics that concern you and your business. This year we have launched Perspective TV on our social media channels – a different format for our more bite-size content to complement the magazine. I look forward to seeing and hearing your feedback on that too.

As ever, on behalf of the team here at Legal & General Surveying Services, we thank you for your custom.

Thank you

Kevin Webb
Managing Director

The pitfalls of remortgaging Help-to-Buy

It's five years since the Government launched its flagship Help-to-Buy equity loan scheme, designed to help thousands onto and up the British property ladder. But as the first wave of Help-to-Buy homeowners start to owe interest on these loans, bumping up their monthly payments by some margin, many who bought and chose to fix their mortgage for five years, are also facing the prospect of having to remortgage soon. The higher monthly outgoings of mortgage debt and equity loan will impact on the mortgage they can afford.

To compound the difficulty, Help-to-Buy has been used to support the New Build market where notions of value can appear distorted at the best of times.

Very little appears straight forward about remortgaging Help-to-Buy. Setting aside any change in personal circumstances, the property value in a resale environment like London is likely to prove challenging. Help-to-Buy has been credited with inflating house prices, with one developer referring to the scheme as 'Help-to-Sell'.

Surveyors are used to exercising judgment in this area. Any affordability 'premium' includes Government backed mortgages, where some prospective purchasers may have afforded a property that otherwise wouldn't have been the case. Similarly, where a purchaser is buying a percentage share in the case of shared ownership, they may be prepared to pay a higher figure for the share than is sustainable when the value is calculated based upon the 100% share and then discounted. Existing Red Book guidance, and that of most lenders, states that the market value must be given relative to the 100% share assumption which should negate this problem in those circumstances, with the exception of schemes such as restricted resale price covenants.

Wherever identified, and this is an important point, it should be considered whether an element of price is transferable on resale. Valuers need to exercise judgment and draw upon market knowledge, expertise and experience to decide whether it should be excluded when providing a sustainable market value. A sustainable value is key for lenders and the nation if it is to build houses that go beyond the immediate needs of our housing crises.

Establishing a value for the initial purchase based on resale is straightforward enough. But valuing a property without the knowledge of previous financing schemes may prove more tricky. A property doesn't tell you how it is financed. That cannot be found out by an AVM. Nor does it tell you the equity position of the owner which may have changed over the period.

Ultimately there are three parties interested in the property's value which means re-financing fees will mount up as the Homes and Communities Agency, under whose remit this falls, will need their own valuation to ensure they are getting what is due from the arrangement if the borrower is stair-casing or buying them out. So valuations will need to agree.

But it is not all one way traffic. In April, the Guardian reported that the government had agreed to virtually wipe out a Help-to-Buy loan on an apartment in a London block with cladding similar to that used at Grenfell Tower. It will make the write-down on the grounds that the value of the flat in Greenwich has been reduced from £500,000 to £50,000 because the developer has no plans to remove the cladding.

The unwillingness of freeholders to address this issue has been emboldened by the decision in March by a tribunal that ruled leaseholders in an apartment block covered in Grenfell-style cladding, should pay £500,000 to make their building safe, not the management company who brought the case seeking clarification on who should pay. Is this in anyone's lending criteria and if so how does it affect the property value (there will be no comparables) let alone the borrowers obligation to underwrite it?

The concession on the Greenwich flat raises the prospect of multimillion-pound losses for the government scheme on any flat that goes into negative equity. Unlike high street mortgages, Help-to-Buy loans can be redeemed on the sale value of the property rather than the value of the original loan.

The lack of an exit plan for Help-to-Buy borrowers echoes previous mortgage product from the 1990's – Shared Appreciation mortgages (SAM). The fallout from SAM only became clear several years after the loans were first sold.

Finally, for a borrower to find a way through this will require specialist advice and on current evidence this is in short supply. At the time of writing, there were about 23 lenders willing to provide a mortgage to those buying with the aid of a Help-to-Buy but only a dozen are prepared to accept a remortgage application from borrowers looking to switch from another lender today. There are few brokers who really understand this product.

In a stalling market, and with issues on some new build flats as highlighted above, it's easy to see how this process might prove problematic. With no clear exit strategy for the borrower or government, consumer detriment may be baked in. Accurately understanding the property's liabilities as part of the value for re-sale is incredibly important to all parties but not least the borrower who stands to lose or gain enormously from the correct figure.


Remortgage
Help to Buy

Later-life lending: One size does not fit all

We wrote some months ago about the impending maturity of interest-only lending from the 1980s, 1990s and early 2000s. There are approximately 1.9 million borrowers in the UK on interest-only and estimates suggest that at least 30,000 interest-only borrowers will owe their lender more than 75 per cent of the value of their property when their loans end.

The issue was that not only might they not qualify for a new mortgage, they also may not qualify for equity release and it's unlikely they could buy somewhere else to live with the money left over.

European Union rules effectively created a barrier for thousands of credit-worthy retired borrowers. In order to qualify for an interest-only mortgage, borrowers had to be able to show they have a credible capital repayment strategy, such as savings, investments, another property or enough equity in their home to fund downsizing. Selling their home to repay the mortgage when they died or moved into full-time care was ruled out.

The landscape has changed as the regulator relaxed its stance and now new lending opportunities are apparent. Interest-only mortgages for those over 55 are now a reality and will help those unable to clear interest-only debts or needing to take out mortgages to move in retirement or even wanting to pass on an early inheritance. The attraction to consumers on tight budgets is clear. Unlike most existing equity release products, such mortgages would prevent debts from rolling up and eating into a property's value by allowing borrowers to pay off interest. Indeed, a new generation of interest-only in retirement may well help to prolong the dwindling resources of the Bank of Mum and Dad.

Essentially, as long as the UK property market continues to rise to an extent, any lending is relatively straightforward. Like Equity Release the key here will be understanding if the condition of the property at the beginning of the loan is such at the end that it does not materially impact the value on resale. This may yet become even more important if there is a need for part of the proceeds of the sale to form part of an inheritance. A fire sale at an auction might not achieve the best result for anyone and notions of value will once again underpin the expectations of all concerned. The children of the baby boomers who have found it so hard to get on the housing ladder will not take kindly to inheritances disappearing.

If later-life lending is proving one thing it is that a one-size fits all approach is unlikely to be enough. Later life lending begs some interesting questions for other potential markets. Retirement homes are a case in point. This has become a major theme in housing policy debates. Should downsizing be encouraged to release larger homes for younger families? Are moves to new locations, perhaps on the coast, likely to end badly, as those who have made the move feel increasingly isolated from long-standing networks of friends and family? Are retirement villages part of the solution or a potential source of future problems? Is staying put, perhaps with the benefit of adaptations, a better choice? The answers will be highly personal for each individual or family. They will also be informed by a complex range of factors, and this has always been so.

We know very little in reality about the key in influences which determine the destination of the estimated 450,000 moves made each year by those aged over 50. A study for the NHBC Foundation from the University of Cambridge Centre for Housing and Planning Research found older purchasers considering downsizing are about 20% more likely to choose a new-build home, and are particularly attracted by the prospect of living in a home which is easier to manage and enjoys lower maintenance and running costs. It also found 46% of those surveyed invested more money in their home when making the move, and just under a third upsized to a home with more bedrooms. At the same time there was a strong demand for two-bedroom homes among those choosing to downsize. What is clear that our one size fits all approach to this market is not nuanced enough by half and this market is set to continue to grow for the foreseeable future.

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Traditionally, the concern is that retirement properties are in a limited market and will only be typically available to the over 55s. Therefore, they cannot be re-sold on the open market. But with interest-only loans and the passing of the property or lease to the lender on death, there may be an opportunity to lend for consumers looking for this type of accommodation. It would certainly bring some welcome and overdue scrutiny upon the transactions and offer protection to arguably vulnerable customers. Apart from the age of the borrower and the nature of the site, many of the other considerations are no different to flats elsewhere and the numbers of older people demanding this kind of accommodation will continue to grow.

Lending to the over 55s will develop quickly. Some lenders are already in the market and, for policy makers, it offers a sensible and convenient commitment to allowing people to live however they choose – be that in freehold or leasehold environments. There are risks of course for lenders but there are also huge opportunities.

Homes 'R' Us!

E-commerce has prompted each and every retailer in the country to re-appraise their respective business models. This is prompting new thoughts and opportunities about how we utilise the abandoned space.

The retail sector is continuing to undergo seismic change. This change is structural, rather than anything to do with economic cycles per se, meaning that the landscape is shifting, rather than merely undulating. Digital capability and the unrelenting rise of e-commerce is certainly one of the key catalysts of this change.

Looking at the headlines and news across the retail sector, even in just the last three months, it is remarkable to see how volatile the market has been – DIY and the 'big-box' retail formats are declining with traditional flagship brands facing administration, impacting on the long-term health of retail parks.

One obvious example of the nervousness around the retail park market was the news that the Valentine Retail Park in Lincoln has been put on the market as a £46.33m investment opportunity. The large Lincoln-based retail park is home to Next, TK Maxx, Asda Living, Dreams, DFS, AHF, American Golf, Harveys, Costa and Carphone Warehouse and most recently Hobbycraft. Considering the success of the park, it is interesting that it is being sold at this time, while it is still expanding and securing new brands.

It is possibly a sign that some retail developers are looking to downsize and strip-back their retail portfolios. This isn't unheard of, and in many cases is being linked to the risks associated with retail at this time. Very recently, Hammerson – a large shopping centre owner – backed away from a £3.4bn deal to buy a portfolio of UK-wide centres. The reason cited for this change of plan, was Hammerson's investors' concerns about the health of the UK high street.

Retail park space is undergoing an evolution. The report Better Brownfield, from the Policy Exchange think tank, identified 1,220 retail locations "which we calculate could theoretically accommodate between 250,000 and 300,000 new homes". The recent demise of hundreds of 'Toys 'R' Us-style' giant sheds surrounded by half-empty car parks and scrubland is affording planners and developers the opportunity to re-imagine urban and suburban spaces. The report does not call for the commercial uses to be replaced but suggests they should be integrated into developments "attractive to both residents and businesses". It urges London's Mayor to champion new "London-like neighbourhoods" with terraced streets, mid-rise mansion blocks and green spaces. 'Big box' sites that are inefficiently used for retail and light industry occupy the equivalent of 43 Hyde Parks, according to a new study.

Toys 'R' Us failed in February, leaving 100 empty sheds across Britain. Other retailers on big box sites include Topps Tiles, Carpetright and DFS. Changing consumer habits mean fewer people are driving to them to do shopping, making much of the parking space redundant. Of the 1,220 London sites covering 6,122 hectares, 1,120 are industrial and 100 retail.

There is a precedent for this changing model. St Marks Shopping Centre in Lincoln, is currently undertaking a £150m redevelopment, with plans including riverside restaurants along the River Witham, a cinema, 1,100 space multi-storey car park, a 130-bed hotel, 1,100 student flats and 150 residential flats.

The reapplication of urban land previously used for other purposes is a story that is gathering pace. As our cities increasingly dis-incentivise the use of cars, car parks too provide another opportunity for evolution. Property developer Concord London has unveiled plans for a new residential scheme in Marylebone, central London, after acquiring the Moxon Street Car Park site. The site, now named Marylebone Square, is the last whole city block in London's W1 postcode yet to be developed. Granted in 2015, planning permission for the scheme will include 79 residential homes and 11 retail units. The acquisition is part of a long-term commitment to Marylebone and Prime Central London as a whole – and is part of an ongoing plan to re-develop parts of London.

The vision is not one of total re-invention but of evolving the current community's opportunities and standard of living. Farmer's Market will continue to call the square home, in a new community hall built for locals with affordable rates. The car park that currently occupies the site will be rebuilt underneath the new building.

Our cities need regeneration on many levels but rather than this being a simply top down piece of thinking, the opportunities on the ground are enabling the evolution to occur from the bottom up too. Residential opportunities are emerging from the ashes of previous retail models and public health decisions that will offer new opportunities for new-build that will reinvent our cities and the way we inhabit them.

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Buy-to-Leave under the spotlight

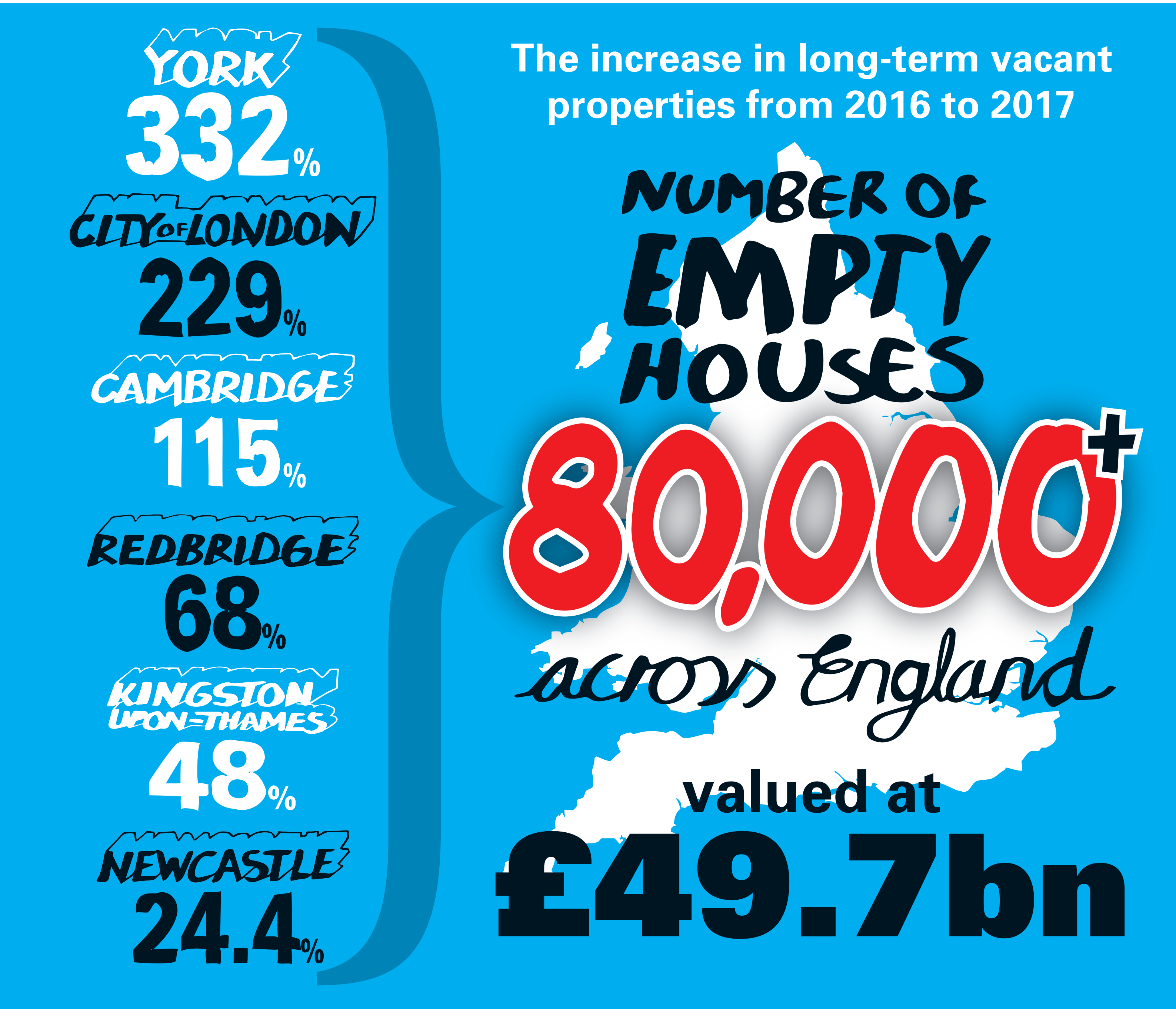
Buy-to-Leave may be a moral problem for policy makers but for lenders it may have regional implications.

There has been some indignant feeling expressed across the media about empty second homes. Almost 80,000 empty houses have been enjoying council tax deductions, according to official government figures seen and published by the Observer, with nearly half of the properties having no council tax applied to them at all. Owners of more than 19,000 second homes were also given money off their council tax bills.

Some of the councils awarding the highest discounts are now moving to end the giveaway. It comes after ministers announced new powers recently for local authorities to charge double the rate of council tax on homes left empty for two years.

The motives of Buy-to-Leave owners are straight-forward enough. Investors hold property empty in order to maximise their return on capital growth or to de-risk the investment. In addition, the cost of letting including administration fees and wear and tear can, in certain areas, outweigh any money taken from rent. Leaving properties empty also reflects the rational economic behaviour in markets that are cooling and take-up rates which are decreasing.

The answer to this unsatisfactory state of affairs lies in the hands of policy makers. Of course, tax punishments are part of the answer but so might be tax incentives. It would certainly hep get the property



market moving again. A temporary capital gains tax relief for sales of empty, second or investment properties to help deal with this issue in the short term might push some, who are clinging on, to realise their gains and move the stock on.

But of equal note to those who lend on properties are the volumes and locations of these empty properties and any impact they may be having on surrounding values.

At a time when public spending remains under fire at a local Government level it seems counter productive to administer tax giveaways on these resources. The Guardian revealed Cheshire West and Chester council, which had 2,562 discounted empty homes – the highest in the country – has moved to stop the discounts after admitting they were costing it £1.4m a year. Many of the beneficiaries were private landlords.

But as pressing is our housing crisis. If we cannot meet the new build targets, as seems probable, then we need to bring other resources to bear. At a micro-level these empty properties are impacting supply and therefore value to some degree. As more councils move to relinquish these discounts and encourage landlords to release these properties, it will be interesting to see if in areas of concentration, there will be a positive impact on value for would-be new home owners.

Worst offenders

BIRMINGHAM
4,280

BRADFORD
3,931

LIVERPOOL
3,889

LONDON

NUMBER OF EMPTY HOUSES
20,237

Highest level of empty properties in London boroughs

1 CROYDON 1,264
2 KENSINGTON 1,260
3 CAMDEN 1,142

valued at
£9.6bn

View from the top

Graeme Winser is Head of Property Risk and Underwriting at Nationwide Building Society. His career has spanned 17 years in property risk including senior posts at UK Valuation, Hometrack, AML Analytics, and now Nationwide. He has been a Chartered Surveyor for over 25 years and was one of the pioneers of Valuation Panel Management. He has worked with analytical and valuation businesses in product, market and proposition development in the UK, with a US bank subsidiary and in Australia.

Nationwide's Property Risk Hub went live in 2017 and facilitates the instant risk assessment of homes leading to instant property decisions and helps prepare the Society for Open Banking. His role in Property Risk has expanded to encompass the Mortgage Risk Underwriting Teams and Credit Bureaus. He is the Chairman of the RICS UK Valuation Board.

How has your view of property risk changed over the last five years?
I guess, it's in sentiment. Actually 5 years ago, Nationwide were the only people talking about 'Property Risk' Not only has intelligent data aggregation shown how much can be done, but it's the belief that data and new ways of doing things will progressively drive the way we all work

What are the most pressing issues for you with regard property risk?
Prioritising the huge number of opportunities, and finding ways of harnessing our ideas and solutions into the legacy platforms which we struggle with. Our Property Risk Hub has facilitated much quicker utilisation of API solutions, but there are still challenges with monolithic origination systems

Do you foresee a time when with regard 'vanilla lending' (Low LTV / employed) there is no 'property risk'?
Property Risk is created through the essence of location, age and occupation, let alone market drivers. All these things are subject to volatility, change etc at different speeds. It would be dangerous if anyone thought property was risk free!

If you do not have scale is it fair to say the real margin business lies around the exceptional circumstances of borrowers and their property?
The point is that some properties, in some locations, at some points in time, are likely to demonstrate 'stress' Today it might be Chelsea, or a new build flat in Manchester, tomorrow, the cheapest homes in Newcastle, etc.

Certainly most losses are generated by customers/Members who suffer unfortunate circumstances; the level of that loss, will often be determined by the factors that mitigate or multiply the haircuts on repossession. Don't lend around the tails of normality!

Is the diverging economy of our cities and other areas demanding significantly different attitudes to risk?
Risk appetite, risk metrics, etc, have to work across a broad spectrum of people and places across markets. We find patterns of accentuated specific risks in many places; some are easier to control than others; some are more easily predicted than others.

Intelligent controls that are able to be monitored by smart data, smart people on the ground and clever modelling all come to together to give a level of protection

What are your main concerns for the UK property market looking forward?
We have a fundamental breakdown in transactional flow; home ownership is on the slide and I see two fundamental challenges:

1. Help-to-Buy whilst aiding the first-time buyer, adds to debt, does nothing to stifle price rises etc, but inherently slows the potential for moving 'up market'
2. Most 'empty nesters' are mortgage free and either don't need to, or can't find appropriate homes to move down market to.

Both of these factors will slow transaction numbers and put pressure on prices.