EnterpriseUK
The Financial Ecosystem

INVESTING IN BUY-TO-LET PROPERTY

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CONTENTS

I. OVERVIEW OF PROPERTY AS AN ASSET CLASS

Property or real estate can be an attractive investment for several reasons.

- It offers the potential for capital growth if property prices rise (N.B. but does come with a sensitivity to economic conditions and levels of interest rates)
- It usually offers a regular yield in the form of rental income
- Can offer partial protection against inflation
- Can add diversification to an investment portfolio.

The available returns, and risks, will depend on the type of property, for example investment property can take any of the following different forms, each with different investment characteristics.

- Residential Property
    1) Owner occupied - primary residence or “second homes”
    2) Buy-to-Let properties
        - Holiday homes
        - Student accommodation
        - Medium-long let apartments
        - Short let apartments and hotel rooms
- Commercial Property
    1) Office space
    2) Factory space
    3) Retail shop space
    4) Warehouse/storage space
    5) Hotel or guest house

This article will focus on the buy-to-let opportunities within the UK residential property categories, and as such will update in part the topics covered in our previous report on Residential Property.

II. POTENTIAL FOR CAPITAL GROWTH

Chart 1 below shows the UK property market has risen strongly over the past 26 years (since 1990). ONS figures for the UK show that house prices rose by over 370% in the 26 years between 1990 and 2016. Prices have increased steadily since 1996, with the notable exception of the two-year period between 2007 and 2009 during the global financial crisis, when prices in all regions fell. Even so, the rise in property values varied greatly between regions of the UK. Perhaps unsurprisingly values rose most in the London area (535% over the 26 years), whereas in the North of England the increase was a more modest, but still substantial 286% for the 26-year period. Of course, one should always remember that past performance is not an indicator of future expectation.

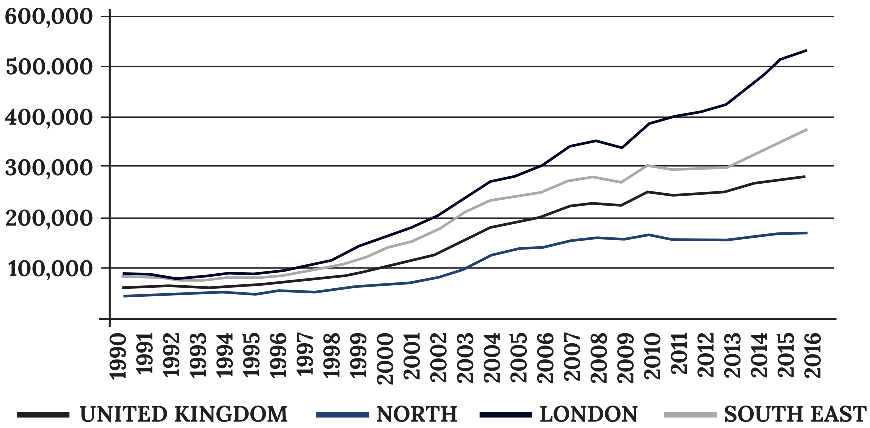


Chart 1. Annual Average Dwelling prices (all - types) within the UK
Source: ONS

LendInvest publishes a periodic report on buy-to-let for investors and compiles a Buy-to-Let Index showing capital gains and rental yields by postal-code area/region in England and Wales. Their report published in February 2017 shows that the home counties, i.e. within commuting distance of London, provide investors with the highest rental yields and best capital gains in the UK, see Table 1 below. In this February 2017 report, Romford replaced Luton as top spot for rental yields, while Dartford in Kent and Watford were the areas recording the best capital gains.

Postcode	Yield	Capital Gains	Rental Price growth	Transaction volume growth
Romford	5.24%	16.55%	8.33%	-7.48%
Luton	4.73%	15.19%	7.49%	-6.06%
Dartford	4.74%	17.75%	6.25%	-12.44%
Rochester	4.71%	13.96%	6.94%	-7.09%
Watford	4.24%	17.17%	6.36%	-15.78%
Enfield	4.60%	16.97%	4.53%	-11.97%
Southend-on-sea	4.50%	14.41%	5.95%	-9.40%
Northampton	4.77%	8.11%	8.33%	0.85%
Colchester	4.44%	12.21%	4.38%	-2.61%
Stevenage	4.06%	9.39%	10.20%	-11.00%

Table 1. Top 10 Buy to let Postcodes
Source: Leninvest

While south-east England consistently represents the best areas for capital gains in England and Wales it is interesting that central London has slipped out of the top-10 fastest appreciating areas. It is also worth noting that the volume of transactions is falling in almost all areas.

III. RENTAL INCOME (YIELD)

Table 1 above shows that Romford in Essex provides the best regional rental yield at 5.24%. The average for the other regions shown is 4.5%. If rental income is the primary interest for an investor then it may be worth looking at those areas in the Midlands with high yields, e.g. Northampton at 4.77% which is within commuting distance of both London and Birmingham. Investors should not only look at the current rental yields but the growth rate of rents. Table 2, below, shows the top 10 regions by growth in rents, i.e. the percentage change in the rents charged.

Postcode	Yield	Capital Gains	Rental Price growth	Transaction volume growth
Stevenage	4.06%	9.39%	10.20%	-11.00%
Coventry	5.10%	7.35%	9.49%	-6.98%
Romford	5.24%	16.55%	8.33%	-7.84%
Northampton	4.77%	8.11%	8.33%	0.85%
Luton	4.73%	15.19%	7.49%	-6.06%
Canterbury	4.44%	9.74%	7.45%	-6.39%
Rochester	4.71%	13.96%	6.94%	-7.09%
Milton Keynes	4.43%	9.51%	6.70%	-7.18%
Manchester	6.15%	6.60%	6.67%	-5.98%
York	4.72%	4.38%	6.67%	-7.59%

Table 2. Top 10 Areas dor rental price rices in the UK
Source: Leninvest

The above rental yields represent average figures by region. However, there is considerable variation in the rents achievable both between and within regions. These variations often go together with the actual investment route chosen, for example, investors may choose to gain their exposure to property in various ways, including:

- Direct purchase, which in turn may be either
    1) freehold, or
    2) leasehold
- Buy & leaseback
- Property bond
- Property ISA
- Property fund or real estate investment trust (REIT)

Interestingly some of these investment mechanisms offer fixed and sometimes guaranteed levels of rental income, for example property bonds and the buy & leaseback options. Obviously, any enhanced income comes with additional terms and conditions. For example, the property bond may offer a significantly enhanced yield (perhaps up to 12% p.a.), but holders may not otherwise participate in any capital appreciation in the underlying property portfolio. The buy & leaseback process involves the investor actually acquiring and owning the property but agrees from the outset to allow the developer (or his designated agent) to manage the property for a pre-agreed fixed period of time, usually between two and five years. During this period the developer/manager lets out the property, manages the collection of rents etc. and bears the risk of the property remaining unoccupied. The investor receives a guaranteed rental income that may or may not be net of fixed charges such as the manager's fee, maintenance costs, ground rent and service charges (where appropriate). At the end of this initial arrangement the investor can choose whether to re-engage the services of the letting agent or to manage the property themselves.

There are many developers and agents offering similar arrangements for investors, however the details vary considerably and investors should make themselves fully aware of the specific terms and conditions relating to each offering. Professional advice and guidance is always recommended.

Other published sources of information on buy-to-let property investments include the national chain of estate agents Rightmove. They produce periodic reports on rental yields by region and include a map showing the changes in yield over recent quarters (see below). Other commentators often pick up on figures reported by Rightmove, including the following quotations.

Liverpool proves profitable for buy-to-let investors in 2017: GoldsmithWilliams: 16 January 2017

"Merseyside is one of the most profitable areas to locate your buy-to-let investment, according to property website Rightmove.

Rightmove has said the highest potential yields for landlords can currently be found in Bootle, Birkenhead and St Helens in Merseyside.

Landlords can expect to make solid returns in these areas due to lower average house prices.

Bootle currently (Jan 2017) offers landlords a yield of 9.3%, while in Birkenhead landlords could get a yield of 7.5%."

Here are the rental hotspots with the highest yields, according to Rightmove:

1	Bootle	Merseyside	9.30%
2	Birkenhead	Merseyside	7.50%
3	Burnley	Lancashire	7.20%
4	Accrington	Lancashire	7.10%
5	Swansea	Wales	7.00%
6	St. Helens	Merseyside	6.90%
7	Glasgow	Scotland	6.90%

Content correct at time of publication (January 2017)

Table 3. Top 10 Areas dor rental price rices in the UK
Source: Leninvest

Landlord Today: Q4 2016

“If rental yields form a crucial part of your property investment strategy in 2017, look no further than the North West of England, according to Rightmove.

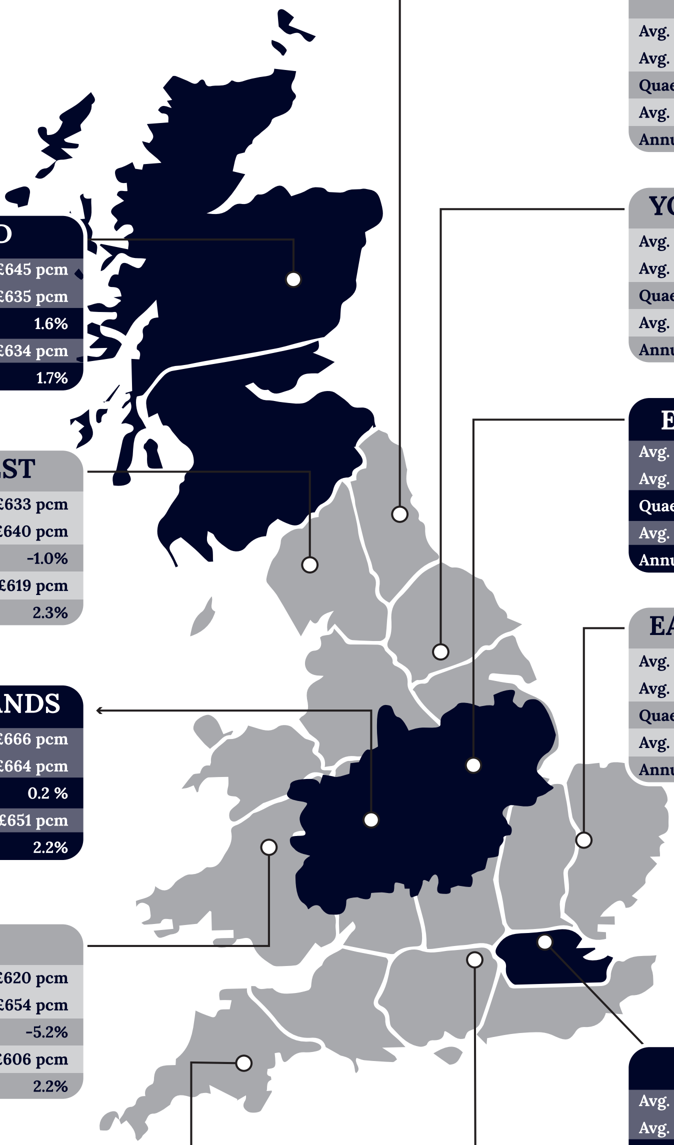
The property website suggests that buy-to-let investors planning to expand their portfolio this year and looking for the best yields should consider places like Merseyside and Lancashire where near double-digit rental returns are typically available.

Bootle in Merseyside currently offers a yield of 9.3%, Birkenhead is 7.5% and in Lancashire Burnley’s yield is 7.2%, while Accrington is 7.1%, Rightmove said.”

“Investors looking for the strongest yields could consider investing in certain areas in the North West where both demand and yields are high,” said Sam Mitchell, Rightmove’s head of lettings.

Regional trends

Increase from previous quarter | Decrease from previous quarter



NORTH EAST

Avg. Price Q1 2017	£551 pcm
Avg. Price Q4 2016	£560 pcm
Quaeterly Change	-1.5%
Avg. Price Q1 2016	£538 pcm
Annual Change	2.5%

SCOTLAND

Avg. Price Q1 2017	£645 pcm
Avg. Price Q4 2016	£635 pcm
Quaeterly Change	1.6%
Avg. Price Q1 2016	£634 pcm
Annual Change	1.7%

YORKS. & HUMBER

Avg. Price Q1 2017	£584 pcm
Avg. Price Q4 2016	£598 pcm
Quaeterly Change	-2.4%
Avg. Price Q1 2016	£572 pcm
Annual Change	2.0%

EAST MIDLANDS

Avg. Price Q1 2017	£607 pcm
Avg. Price Q4 2016	£605 pcm
Quaeterly Change	0.3%
Avg. Price Q1 2016	£597 pcm
Annual Change	1.7%

NORTH WEST

Avg. Price Q1 2017	£633 pcm
Avg. Price Q4 2016	£640 pcm
Quaeterly Change	-1.0%
Avg. Price Q1 2016	£619 pcm
Annual Change	2.3%

EAST OF ENGLAND

Avg. Price Q1 2017	£895 pcm
Avg. Price Q4 2016	£907 pcm
Quaeterly Change	-1.3%
Avg. Price Q1 2016	£885 pcm
Annual Change	1.2%

WEST MIDLANDS

Avg. Price Q1 2017	£666 pcm
Avg. Price Q4 2016	£664 pcm
Quaeterly Change	0.2 %
Avg. Price Q1 2016	£651 pcm
Annual Change	2.2%

WALES

Avg. Price Q1 2017	£620 pcm
Avg. Price Q4 2016	£654 pcm
Quaeterly Change	-5.2%
Avg. Price Q1 2016	£606 pcm
Annual Change	2.2%

GTR. LONDON

Avg. Price Q1 2017	£1.937 pcm
Avg. Price Q4 2016	£1.908 pcm
Quaeterly Change	1.5%
Avg. Price Q1 2016	£2.021 pcm
Annual Change	-4.2%

SOUTH WEST

Avg. Price Q1 2017	£776 pcm
Avg. Price Q4 2016	£777 pcm
Quaeterly Change	-0.1%
Avg. Price Q1 2016	£764 pcm
Annual Change	1.6%

SOUTH EAST

Avg. Price Q1 2017	£1.047 pcm
Avg. Price Q4 2016	£1.058 pcm
Quaeterly Change	-1.0%
Avg. Price Q1 2016	£1.034 pcm
Annual Change	1.3%

Graphic 1: Rightmove changes in GB rental income by region (April 2017)

Source: Rightmove Rental Trends Tracker. April 2017

IV. INFLATION PROTECTION

Chart 2, below, compares the changes in average house prices in the UK (from the Nationwide Building Society) with the inflation rate as measured by the Retail Price Index (published by the ONS). Over the initial ten-year period between 1975 and 1985, house prices kept pace with inflation. That is to say they preserved value but provided no additional or “real” return. However, since the early 1990’s, the growth in the value of UK housing has significantly outpaced retail price inflation. To put some figures on this, since Q1 of 1975 the UK cost of living has risen by 768% but the value of the “average” UK house has risen by 1889%, providing a more than comfortable hedge against inflation. Note however that during the financial crisis of 2007 - 2009 there was a significant loss in the real (inflation adjusted) value of UK housing. After the fall, it took a further five years before the high of 2007 was recovered.

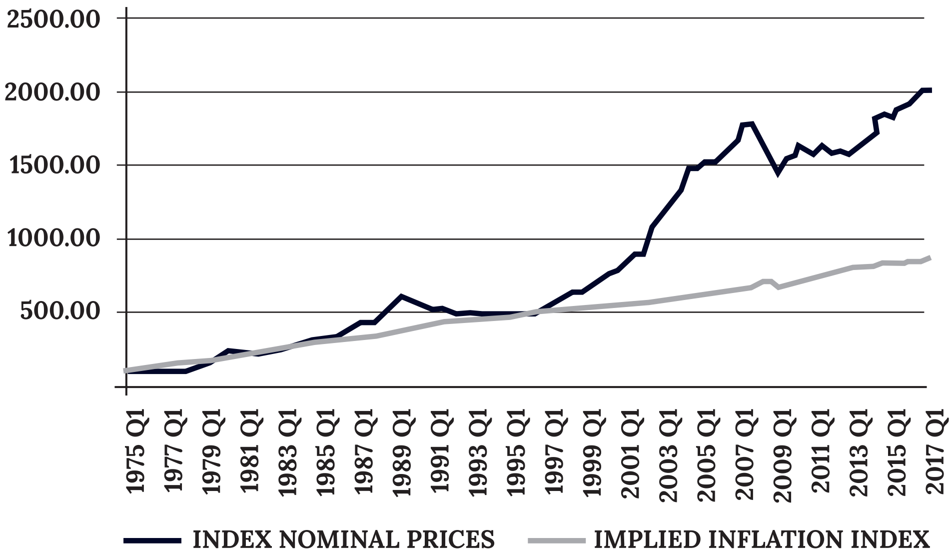


Chart 2: comparison of nominal uk house price gains with inflation (rpi)

Source: Nationwide Building Society, ONS

V. DIVERSIFICATION POTENTIAL

Except in times of extremely stressed markets (2007-2009) the capital returns from UK residential property are relatively uncorrelated with conventional asset classes. For example over the period Q4 2012 - Q1 2017 the correlation between changes in house prices and returns from the FTSE 100 equity index was just 0.27%. Chart 3 below shows the path of returns from these two asset classes over this period.

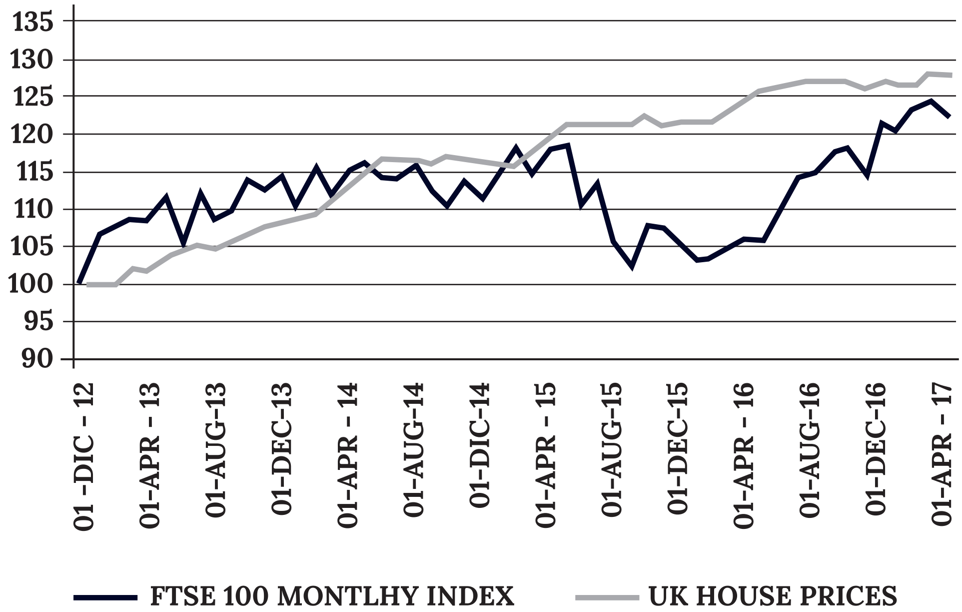


Chart 3: CUMULATIVE RETURNS FROM UK EQUITIES AND UK HOUSING

Source: Nationwide, Google Finance

VI. WAYS TO INVEST IN PROPERTY

As mentioned above, investors may choose to gain their exposure to property in various ways, including:

(a) Direct purchase, which in turn may be either

1) freehold, or

2) leasehold

(b) Buy & leaseback

(c) Broperty bond

(d) Property ISA

(e) Property fund or real estate investment trust (REIT)

The choice of investment route will depend on many factors, such as, the investor's long-term objective, the amount of investment capital available and their ability and willingness to bear risk. For example, it may be the goal of an investor to build and manage a portfolio of buy-to-let properties specifically to be rented as student accommodation. The business plan often looks like this,

(a) Identify a suitable property close to a higher education establishment (university or college) that can accommodate multiple occupancy (apartments, bed-sits or shared house)

(b) Buy property, perhaps for cash but often with a cash deposit and a mortgage facility

(c) Rent property to several students, collect rents

(d) Use rents for maintenance costs (pre-tax) and as a saving toward the deposit for the next acquisition

(e) Next acquisition is made using a combination of cash deposit (accumulated rental income) and collateral (leverage) from the gain in value from the first property.

This is all very well so long as all the properties remain fully let-out, the rents keep coming in and property prices continue to rise. This scenario also assumes that interest rates do not rise rapidly since that would dramatically increase the cost of servicing any mortgage loans outstanding on these properties. Of course, the impact of these factors is significantly reduced where the properties are acquired without recourse to borrowing. Nevertheless, the success of the investment will still depend on many factors, including the wider economic environment, which will generally determine the level of regional property prices and rents, and specifically the attractiveness of the local university/college to students, especially from overseas.

Buy and leaseback arrangements mentioned earlier are also available for certain hotel developments whereby an investor buys a long lease on one or more rooms in a hotel that is then managed by the hotel operator. The capital outlay to invest in these single room buy-to-let properties or indeed most multi occupancy developments is obviously much lower than for individual dwellings.

However, there are many investors that wish to gain exposure to the property market (other than their own residence) and who may not be able to afford the outright purchase of a freehold or leasehold property and for these investors the alternative routes using real estate funds, ISA's or property bonds may be the more appropriate route.

VII. OTHER CONSIDERATIONS

Other factors that investors should consider when making investment decisions in property include the following:

(a) Sensitivity to economic cycle. Real estate may offer some protection against inflation but it is clearly not immune to the general economic cycle and as we saw in 2007-09 can fall significantly in times of recession.

(b) "Location, location, location", the well-known adage relating to domestic property is nevertheless just as relevant to investment property as it is to one's own home. For investors some important factors are:

1) UK (domestic) property

i. Region

ii. Local economic conditions

iii. Regeneration plans

iv. Time horizon

2) Overseas

i. Country

ii. Political & economic situation

(c) Tax (note that this is simply a guide to tax considerations, it is not tax advice, you are strongly advised to consult a professional tax advisor). Buy-to-let property is subject to the following taxes (rates as of April 2016).

1) Stamp Duty Land Tax (SDLT) on purchase of buy-to-let property, with effect from 1 April 2017 the following tax bands came into effect (this also applies to second homes).

• 0% tax on the first £125,000 of the purchase price

• 2% on the additional portion of the price up to £250,000

• 5% on the additional portion of the price up to £950,000

•10% on the additional portion of the price up to £1,500,000

•12% on everything in excess of £1,500,000

SDLT is payable within 30 days of completion of the purchase, but is deductible against CGT when the property is sold.

2) Capital Gains Tax (CGT) is payable on the gain or profit made on the sale of the property after deducting SDLT paid at purchase and professional fees incurred during the sale process (estate agents, solicitors advertising etc.) and any major capital expense incurred (extension, new roof etc.). Of course, each investor will also have a CGT allowance in any one tax year (£ 11,300 for the 2017/18 FY) that may be used against this net gain, if not already used against other investment gains. The applicable CGT rates for buy-to-let gains in FY 2017/18 are either 18% or 28%, depending on the investor's level of income and aggregate capital gains. Presently capital gains on property sales are reported on an investor's annual Self-Assessment tax return and any CGT due is payable before end January of the year after the FY in which the gain was realized. However, from April 2019 this deferral will be scrapped and CGT on property sales will be payable within 30 days of the sale completion.

3) Income Tax on rental income

i. Personal tax impact: where an investor personally owns the buy-to-let property then rent received must be declared on the investor's annual Self-Assessment tax return and will be combined with earned income and other taxable investment income to be taxed at the relevant income tax band. Nevertheless, certain operating expenses may be deducted before tax, as follows:

- Council tax
- Insurance
- Ground rents and service charges for leasehold properties
- Repairs and maintenance (excluding capital expenses - see CGT above)
- Professional fees (legal, letting agency etc.)
- Interest on buy-to-let mortgages and other financing costs, however, the rules governing this relief were changed in the 2015 Budget and from April 2020 tax relief on mortgage interest will only be available at the basic rate of 20%, furthermore this change will be phased in over the 4 years from April 2017 to April 2020. Therefore, higher rate income tax payers will pay more tax on their total income from April 2017 onward. Other income dependent reliefs and benefits may also be affected as a result.

ii. Using a limited company to own the property is not as advantageous as it once was, even though mortgage interest is fully deductible against tax. While Corporation Tax (CT) is lower than the higher rates of income tax, transferring value to the individual investor can be tax inefficient. Dividends will be paid after CT (levied at 19% on total net profits falling to 17% in 2020) and will only be subject to a tax free personal allowance of £5,000 (FY 2017-18), the dividends will then be taxed at 7.5% for a basic rate taxpayer, rising to 32.5% and 38.1% for higher rate payers. Paying the investor a “salary” can be even less efficient as PAYE and NI deductions would also have to be made. Transferring an existing personally owned property to a limited company would incur SDLT and could crystallize current CGT liabilities. These scenarios are very complex and should not be considered without professional tax advice.

4) Inheritance Tax (IHT) applies to buy-to-let properties owned privately and its value, less any outstanding mortgage, will form part of an investor’s estate upon death. Tax is levied at 40% (FY 2017-18) the estate value in excess of £325,000, or £650,000 if the estate is jointly owned by spouses or civil partners.

(d) Overheads/costs, these are relevant considerations whatever route an investor chooses. Freehold owners must provide for maintenance etc. Leaseholders in addition must provide for service charges, ground rents and sinking funds (the latter should cover major repairs and renovation of the building structure but can be excessive). Other investment routes will be subject to individual terms that may be drawn up as deeds, contracts, offering documentation or other legal forms. A short list of some of these costs include the following:

1) Management fees

2) Ground rents and sinking funds

3) Maintenance/service charges

4) Compulsory/mandatory “add-ons”

(e) Liquidity, property is inherently an illiquid asset class, the exceptions being certain real estate funds, unit trusts and investment trusts that are tradeable. This factor must be borne in mind by investors who may need to access cash from their investments at short notice.

VIII. EFFECTS OF BREXIT

The two questions here are a) what impact will Brexit have on the UK property market, in particular the rental market, and b) what impact will it have on investments in overseas property such as holiday villas and apartments in France, Spain or Portugal?

The UK domestic property market will be dependent on the general economic strength of the country. The incentive and ability of people in this country to own their own homes will determine the overall movements in the residential property market. If people cannot afford to buy, then at least for a while the rental market will pick up, possibly resulting in rental properties appreciating in value and eventually, if demand falls, owner occupier prices may then drop back.

Many overseas visitors to the UK, including students and temporary workers, live in rented accommodation. The numbers of such people in the UK may be significantly impacted by Brexit and if so that could be detrimental to the UK rental market.

UK based investors owning property overseas, especially in Europe, may be impacted by any new taxation arrangements. There may be restrictions on acquisitions for investment purposes.

Of course, the answers are unknown and all of the above is simply speculation, we must wait to see how the next few years of negotiation evolve. However, nothing much is likely to happen in the very short term.

IX. CONCLUSION

As shown above property can be an attractive investment for several different reasons. In addition it is an asset class with which most people feel comfortable and have some degree of understanding. Nevertheless, investors are presented with many different avenues through which they can gain economic exposure to the real estate market. Each avenue offers different return and risk characteristics and care and diligence should be exercised in selecting the most appropriate route for any individual investor. Furthermore, each route will involve different counterparty relationships for the investor, some as simply transactional counterparties and others more as partners for a period of time. Investors should ensure that they understand the precise nature of such relationships as well as how that will impact their future economic interest in their chosen investment.

In our previous article on property investment we offered investors a due diligence checklist as a guide when choosing an agent or counterparty. For your information, we show this list again below.

There are a wide range of companies offering property investments and great care needs to be taken before you part with your hard-earned cash. Always look for an investment partner who:

- Has an established and verifiable track record of successfully completing projects in the geographical area
- Has positive reviews from previous customers
- Works within a strong framework of trusted and reliable professional construction partners
- Is represented by a reputable network of lawyers, accountants and other professional partners who can assure valid title of ownership and safe stewardship of your funds
- Offers you notarised translations of all documentation in English
- Comprehensively explains all the costs, benefits and risks associated with a transaction
- Can meet the repayment of any capital obligations at an agreed time
- Is completely transparent
- You trust and are comfortable working with.

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Deemed to carry a higher risk, alternatives, also offer the potential of higher returns.
Through our Invest Safe Initiative, we identify exclusive opportunities that we introduce to our growing community of investors. Opportunities like these tend to appeal to investors who self-manage at least a part of their portfolio.
These investors often will use an IFA or professional wealth advisors, particularly for the design and implementation of their core investments and these core investments will typically be in the traditional asset classes, whether invested directly or through managed funds.
However, if they are savvy and can manage a part of their portfolio themselves, they may want access to innovative opportunities that are often in asset classes that are not systematically or even typically researched or offered by conventional routes.
These alternatives very often have zero correlation to publicly traded investments.
We conduct primary due diligence on the investment concepts we feature so investors can have access to key facts. This usually provides investors with enough information to make up their minds if the proposition is sufficiently interesting for them to carry out the additional research and due diligence they would need to know if the investment is appropriate for their portfolio and whether to make an investment.
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All investments involve a certain amount of risk however, investments in alternative assets are inherently riskier than some other more conventional savings and investment schemes. Investors are reminded that the value of such investments can go down as well as up and that past performance is not necessarily an indicator of future returns. Investors should not consider such investments unless they can withstand the potential loss of all their invested capital.
Alternative investments are only appropriate for investors who are able and willing to accept the higher risk associated with such investments. It is generally recommended that such investments are made part of a broadly diversified portfolio. Professional advice is recommended before making any investment decisions.

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Small things make a big difference.

We support NGO´s that focus on preserving the Amazon and supporting the local people who protect and nurture this beautiful land.

We commit 1% of our revenue to environmental causes close to our heart.

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