Hamptons
THE HOME EXPERTS

PRESS RELEASE

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Hamptons Monthly Lettings Index – August 2022

INVESTORS HUNT HIGHER YIELDING HOMES

As rising rates squeeze landlord profits

- A record 73% of new buy-to-let purchases earnt gross yields above 5% this year, up from 63% in 2016 when the buy-to-let tax system began to change.
- In their search for higher yields, a record two-thirds (66%) of London-based investors purchased their investment properties outside the capital, up from just 26% a decade ago (chart 1).
- The average higher-rate taxpaying landlord who re-mortgaged last month will see their annual net profit fall from £3,198 to £884, a 72% decline compared to last year due to rising rates. If the latest 0.5% base rate rise to 2.25% is passed onto mortgage costs, this will reduce average profits to £212 a year (chart 2).
- If the base rate reaches 2.5%, the average higher-rate taxpaying landlord is likely to make a loss and they will need to yield more than 7.0% to stay in profit - a figure only achievable on average in 23% of local authorities in England and Wales (chart 2, chart 4).
- Rental growth across Great Britain continued to cool from its 11.5% peak in May to 7.4% in August (chart 3).

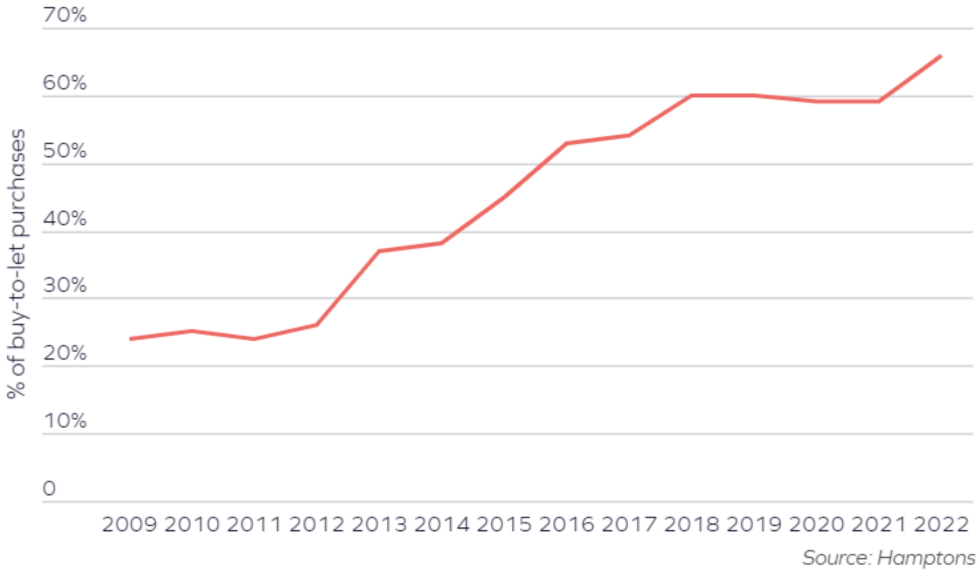
Rising interest rates are eroding the profitability of buy-to-let for mortgaged landlords. To ensure investors stand the best chance of turning a profit, they are increasingly buying properties in higher yielding parts of the country.

So far this year a record 73% of new buy-to-let purchases earnt gross yields (before costs and taxes) above 5%, up from 63% in 2016 when the buy-to-let tax system began to change. More than one in five (23%) new investors earnt gross yields of 8% or above, up from 20% in 2015.

With an average gross yield of 4.9%, London offers the weakest returns of any region in England & Wales. This is one of the main reasons why London based investors are increasingly purchasing buy-to-lets beyond the capital, targeting higher yielding /…

areas. So far this year, a record two-thirds (66%) of London-based investors chose to purchase a buy-to-let property outside the capital, up from just 26% a decade ago (chart 1).

Chart 1 – Share of London-based investors purchasing outside the capital



A fifth (20%) of London investors bought properties in the North of England, up from 9% in 2016 and just 1% a decade ago. Here, gross yields sit at 7.4%, outpacing the 6.1% average across England and Wales. London landlords buying outside the capital bought 105.7 miles away on average – 20.9 miles or 25% further than in 2016.

Today, 29% of all properties in England & Wales bought as a buy-to-let are located in the North West, North East or Yorkshire & Humber, triple the share a decade ago.

Higher yields will cushion investors from rising rates

For the 50% of landlords who use a mortgage to fund a buy-to-let purchase, rising interest rates mean that many will face higher outgoings when they come to re-mortgage. This will eat into the profitability of their buy-to-let.

Since August 2021, the average mortgage rate on a typical 75% LTV (loan-to-value) buy-to-let has risen from 1.79% to 3.51% last month. This means the average landlord who bought a £222,000 buy-to-let last year will likely see their annual interest-only mortgage payments nearly double from £3,010 to £5,903 if they re-mortgaged last month. If Thursday's (22 September) 0.5% base rate rise to 2.25% is fully passed on, this will increase payments to £6,743 for an investor re-mortgaging this month.

As a result, the net annual profit (after costs and taxes) made by a higher-rate taxpaying investor who earns an average yield of 6.1% could fall from £3,198 in

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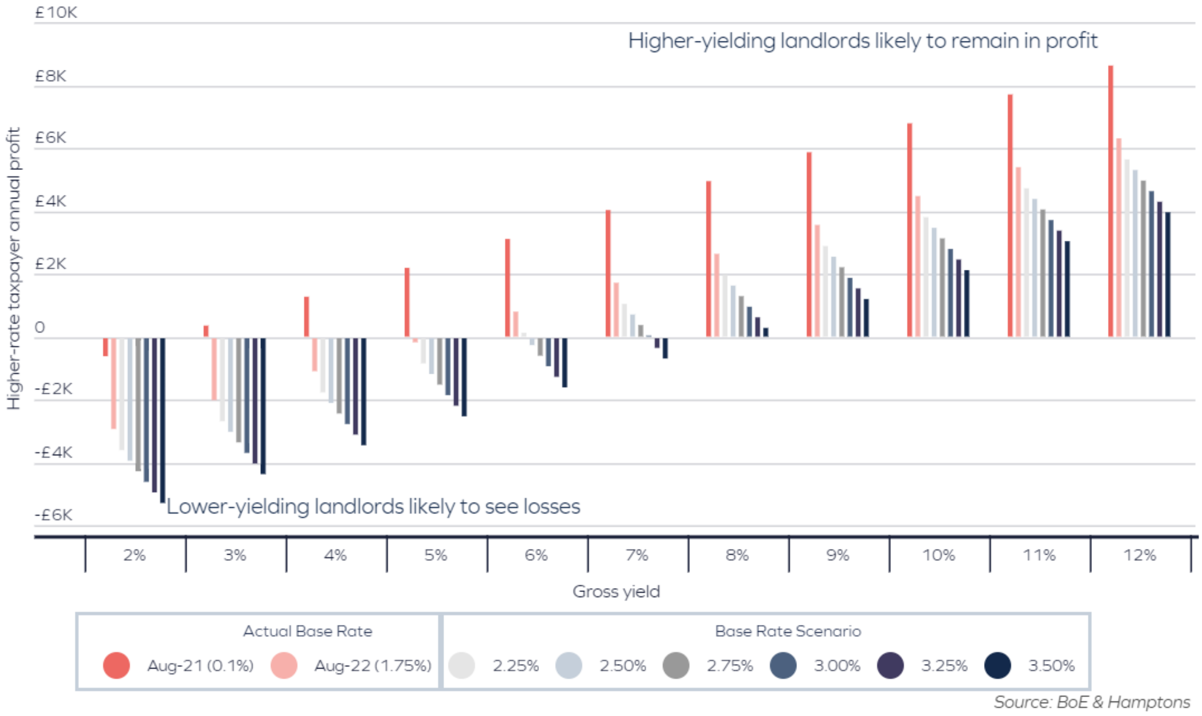
August 2021 to £212 with the new base rate, down 93% due to higher rates when re-mortgaging.

Chart 2 - Higher-rate taxpaying landlords' profitability as rates rise



*We assume a buy-to-let landlord in Great Britain has a 2-year fixed rate 75% LTV mortgage on a £222,000 property, which generates £13,542 a year in rent. Their net profit is based on how much profit they make after mortgage costs, maintenance costs (£4,198) and tax at 40% for a higher-rate taxpayer. We assume that any increase in the base rate is passed onto the average mortgage rate in full.

If the base rate reaches 2.5%, the average higher-rate taxpaying investor with a typical 75% LTV mortgage is likely to start making a loss. They will need to yield around 7.0% or more to stay out of the red – a figure only achievable on average in 23% of local authorities in England and Wales, 65% of which are in the North of England.

Lower-rate taxpayers or limited company landlords have much more wiggle room. While the average lower-rate taxpaying investor achieving the average yield (6.1%) in England and Wales will have also seen their profit shrink over the last year (from £5,070 to £2,750) when re-mortgaging, the base rate would have to reach 4.0% before they start making a loss. Every local authority in the country offers an average gross yield above this mark (chart 4).

Rental Growth

Since hitting a record high of 11.5% in May, rental growth continues to cool. At an average of £1,165 pcm, the cost of a newly let home in Great Britain rose 7.4% year-on-year in August (table 1). In part, this is due to signs that the supply-glut has hit

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rock bottom. There were 8% more new rental homes coming onto the market in August than at the same time last year, although, stock levels remain low compared to historic standards.

Rental growth slowed in every region of the country, apart from the South East, South West and Wales where rents rose at the same pace as last month. But London continues to see the strongest growth (table 1).

In the capital, rents rose 11.3% year-on-year in August, slightly down from the 12.4% growth recorded in July. This has been bolstered by a 29.9% annual rise in Inner London, where rental growth has been running above 10% for the last eight months (chart 3, table 1). However, this strong growth continues to reflect the weaker market last year, and this will begin to drop out of the picture in early 2023.

Chart 3 – Rental growth

Commenting Aneisha Beveridge, Head of Research at Hamptons, said:

"Over the last few years, investors have needed to seek higher-yielding properties in order to make the sums stack up. This is because taxation changes, which removed the ability for landlords to offset mortgage interest from their tax bill, have compelled investors to maximise their rental income in order to cover their costs. This is a trend that has become more embedded in 2022 as rising mortgage rates eat further into profits and in some cases, push those profits into the red.

"If Section 24 changes were reversed, meaning landlords could fully offset their mortgage interest, the average higher-rate landlord would turn a profit of £2,065 each year instead of £884. It also means they could weather a base rate of up to 4.0% before their profit turned negative, instead of 2.5% under the current rules.

"While around half of landlords who own their buy-to-lets outright won't be under the same pressure from rising rates, those looking to purchase a new investment property with a mortgage are increasingly running out of options. If the yield doesn't meet a lenders' rent-cover requirements, they'll have to put down a bigger deposit.

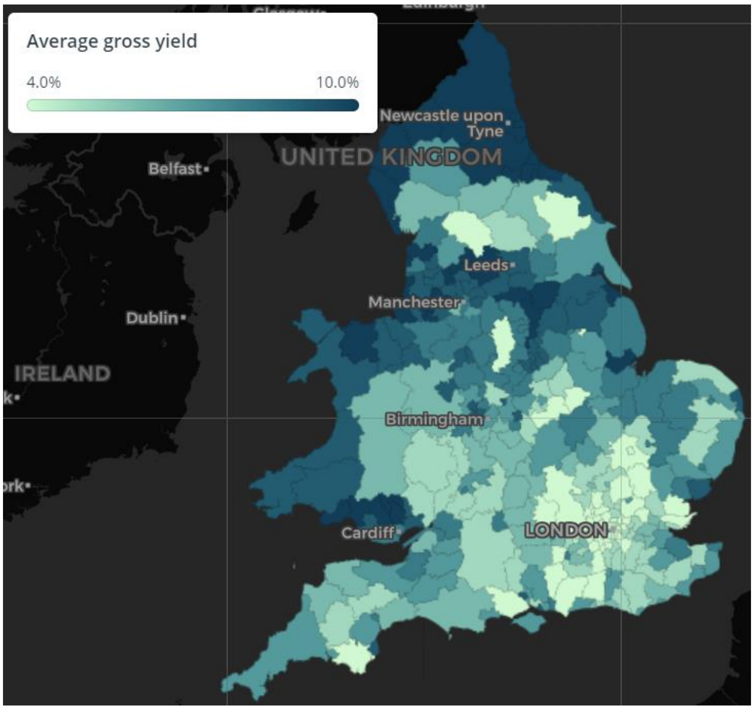
"This is going to make investing in Southern areas, where yields are lower, tricky for landlords who are heavily reliant on mortgage finance, restricting buy-to-let to those with the deepest pockets. In turn this will put further pressure on already low stock levels."

Table 1 – Rental growth on newly let properties

Region	Aug-21		Aug-22		YoY %	YoY £	
Greater London	£	1,790	£	1,992	11.3%	£	202
Inner London	£	2,117	£	2,751	29.9%	£	634
Outer London	£	1,727	£	1,855	7.4%	£	128
East of England	£	1,092	£	1,118	2.4%	£	26
South East	£	1,213	£	1,225	1.0%	£	12
South West	£	989	£	1,082	9.3%	£	93
Midlands	£	763	£	832	9.0%	£	69
North	£	738	£	798	8.2%	£	60
Wales	£	749	£	759	1.4%	£	10
Scotland	£	751	£	824	9.8%	£	73
Great Britain	**£**	**1,085**	**£**	**1,164**	**7.4%**	**£**	**79**
Great Britain (Excl. London)	£	904	£	954	5.6%	£	50

Source: Hamptons

Chart 4 – [Interactive map:] gross yield by local authority in 2022



Source: Land Registry & Hamptons

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Please note the Hamptons Monthly Lettings Index for September will be issued on Friday 21October, embargoed until 00.01 hours Monday 24 October 2022.

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About the Hamptons Monthly Lettings Index
The Hamptons Monthly Lettings Index has been running since 2012.

The index is a mix adjusted series, with rent and rental growth figures for each month based on a three-month rolling average. The most expensive decile of homes let are excluded to reduce volatility and the mix includes the most recently published government stock statistics.

The Hamptons Lettings Index uses data from the Countrywide Group to track changes to the cost of renting. The index is based on the 90,000 homes let and managed by Countrywide each year, adjusting for their location and type. It is based on achieved rather than advertised rents.

About Hamptons
Hamptons is a leading residential estate agent and property services company, operating in London and the South of the UK.

Hamptons offers a wealth of award-winning services including UK and international Sales, Lettings, Property Management, Corporate Services, Residential Development, Development Land, Valuation Property Finance, and is a subsidiary of Connells, the UK's largest estate agency and property services group.