HANDELSBANKEN

Property survey report

6 July 2022

Handelsbanken

Introduction

Despite 40-year-high inflation and 13-year-high interest rates, UK house price growth increased by 12.4% between April 2021 and April 2022 – the equivalent of £31,000[1] . This was approximately the same growth as the market experienced over the preceding four years.

Furthermore, forecasts for the industry have been revised upwards recently, projecting growth of 8% in 2022 compared to an initial estimate of 5%[2]. Rental yields are also expected to grow, with an estimated growth of 4.5% outside London and 3.5% in the UK capital throughout 2022, due to supply shortages combining with the strength of the employment market .

In this context, it is not surprising to see professional landlords favouring residential property as an asset class, with a seeming flight to the relative safety of residential investments, while question marks hang over commercial assets such as high street retail, offices and even logistics.

In this report, we have spoken to 120 professional landlords[4] in the UK, all with a portfolio of at least four properties, in order to map out the challenges and opportunities facing landlords in the UK.

We look at topics that landlords are familiar with – such as the impact of the Covid-19 pandemic – as well as ones they are not, such as new legislation coming into force from April 2023, requiring commercial properties to meet minimum energy efficiency standards in order to be let out or sold.

Demographics and methodology

Handelsbanken's research was conducted among a panel of 120 professional landlords based in the UK, all with a minimum of four properties in their portfolios. Respondents were broadly split by size, falling into categories of 4-5, 6-7, 8-9 and 10+ properties. On average, they had 7.5 properties, with an estimated total market value of £2.76 million. 100% of respondents had exposure to residential real estate, while 58% also had exposure to commercial real estate.

In total, respondents owned and managed a total of 829 properties, which were weighted towards residential properties (74%). The most common property investments by type were terraced houses (17%), detached houses (12%) and semi-detached houses (11%). London accounted for the largest proportion of all managed properties (23%), followed by the East of England (17%), the North West (9%) and Scotland (8%).

[1] UK House Price Index: April 2022, ONS, published 22 June 2022
[2] UK House Price Forecasts revised up for 2022, Knight Frank, published 27 June 2022
[3] Rent increases hit 13-year high as demand in major cities doubles, Zoopla, published 16 November 2021
[4] For the purposes of this report, all mentions of "landlord" refer to professional landlords with a minimum of four properties in their portfolios

Section 1
The outlook for the industry

In light of increasing economic doom and gloom, property appears to be an increasingly safe haven for investors, and this optimism is shared by the landlords we spoke to. Overall, 86% of those with exposure to residential properties expect demand in the sector to increase in the coming year, while four fifths (80%) of those with exposure to commercial property expect to see demand increase.

Not only is this optimism widespread, but it is also highly confident, with half (49%) of residential landlords and 46% of commercial landlords believing that demand will increase "significantly" over this time.

	Residential	Commercial
It will increase significantly	49%	46%
It will increase slightly	37%	33%
It will remain the same	10%	14%
It will decrease slightly	3%	3%
It will decrease significantly	1%	3%
All increase	**86%**	**80%**
All decrease	**4%**	**6%**

How would you expect demand for the following property types to change over the next 12 months?

86% of those with exposure to residential properties expect demand in the sector to increase in the coming year, while four fifths 80% of those with exposure to commercial property expect to see demand increase.

When broken down by portfolio size, landlords with eight or nine properties currently are most optimistic about growing their portfolio, with three quarters (76%) of respondents in this banding actively looking to invest in new properties in the coming year.

This is slightly ahead of landlords with six or seven properties (59%), but the data shows that those with smaller portfolios (four or five properties) and those with larger portfolios (10+ properties) have less appetite, with only 33% and 20% of respondents respectively looking to expand on their existing portfolios.

As a result, respondents are understandably bullish about the future of their portfolios, with a strong focus on expansion over the coming 12 months: overall, almost half (49%) stated that they planned to increase the size of their portfolio in the coming year, with 8% planning on maintaining the size of their portfolio but improving its quality, and 35% planning to retain all of their properties.

This left just 4% who were planning to decrease the size of their portfolios and 3% who were looking to dispose of their portfolio altogether.

How would you expect demand for the following property types to change over the next 12 months?

	All respondents
I will increase the size of my portfolio	49%
I will retain the size of my portfolio and improve the quality	8%
I will retain all of my properties	35%
I will decrease the size of my portfolio	4%
I will dispose of all of my properties	3%

Diversification is the primary consideration among those looking to expand their portfolio, with the desire to branch out into new sectors (73%) slightly preferable to new geographies (58%).

Residential properties – and houses in particular – are viewed as the most attractive sectors for investment over the next 12 months, with two thirds (66%) of landlords listing houses as attractive, ahead of flats (38%) and houses in multiple occupation (34%).

On the commercial side, retail – an area that suffered greatly throughout the pandemic – is viewed as the most attractive sector by the commercial landlords we surveyed, with half (49%) of respondents with exposure to commercial real estate viewing it favourably, ahead of industrial (43%), offices (42%) and healthcare (32%).

Which sectors do you think will be most attractive for investors over the next 12 months?

	Sector	All respondents
Houses	Residential	66%
Flats	Residential	38%
Houses of Multiple Occupation (HMO)	Residential	34%
Retail	Commercial	32%
Offices	Commercial	29%
Industrial	Commercial	27%
Individual mobile homes	Residential	26%
Healthcare	Commercial	18%
Leisure	Commercial	5%

Despite London having the lowest rental yield growth in the UK at just 1.5% in the year up to May, compared to 2.8% outside the capital[5] , it is still the most attractive region for new investment, with 53% of respondents planning to purchase a property in the city over the coming year.

Despite slow rental growth, the region does still command monthly rental prices in excess of £1,800 – nearly twice the average for the rest of the UK[6] , and with affordability considerably lower in the UK capital, these drivers by far outweigh the low yield environment.

Other areas likely to attract new investment from landlords over the coming year include the East of England, cited by two fifths (40%) of respondents, the East Midlands (22%) and Scotland (19%), while the West Midlands (8%), the North East (6%) and Yorkshire and The Humber (6%) are the regions landlords are least likely to expand into in the short term.

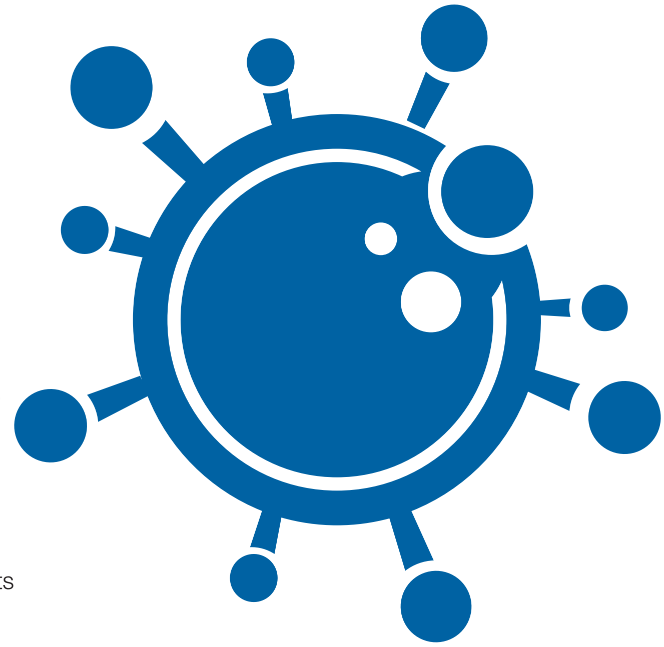
Which UK regions do you think will be most attractive for property investors over the next 12 months?

	All respondents
London	53%
East of England	40%
East Midlands	22%
Scotland	19%
Northern Ireland	18%
North West	14%
South East	12%
South West	10%
Wales	12%
West Midlands	8%
North East	6%
Yorkshire and The Humber	6%

5 Index of Private Housing Rental Prices, UK: May 2022, ONS, published 22 June 2022
6 Homelet Rental Index, May 2022, Homelet, published 3 May 2022

Section 2
Emerging from Covid

It is important to note that this widespread optimism within the property management industry comes after a sustained period of pressure on both residential and commercial real estate brought about by the Covid-19 pandemic.



Between April 2020 and May 2021, only 90,810 residential property transactions were completed – more than 100,000 fewer than the previous financial year[7], while UK business investment saw a 26.5% decrease during between Q1 and Q2 2020[8].

Looking ahead, while the industry survived the pandemic and remains relatively upbeat - the 2022-23 financial year is forecast to see more than 200,000 residential property transactions for the second year in a row, for instance – the wider social and macro environment remains highly uncertain and could still dampen growth. The cost-of-living crisis has become a major political and economic focus, with record levels of inflation dominating the narrative. In May this year, consumer confidence fell to rock-bottom levels, and, with energy prices continuing to rise, prospects for the next 12 months are challenging, to say the least[9].

Our research echoes the challenges faced by landlords during the pandemic, with a third (33%) having had to reduce rental prices, and more than half (52%) having been forced to take more eviction action than usual, as the hit to UK employment filtered through to rents. Subsequently, the number of void months rose by 41% compared to a year ago, as tenants moved on without an immediate replacement available. To combat this, a fifth (21%) of landlords started agreeing more short-term leases to bridge the gaps in income.

As well as creating a challenging environment for their existing properties, the pandemic has also put landlords off investing in certain sectors, with offices (42%) and urban residential (34%) both hit as they wait to see the long-term implications of the rise in working from home and the subsequent relocation of many Britons away from major cities that they had previously had to live in due to proximity to their workplaces.

This issue is particularly relevant, given that 23% of the properties managed by the panel of respondents are based in the capital.

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7 UK monthly property transactions commentary, HMRC, published 21 June 2022
8 Business investment in the UK: April to June 2020 revised results, ONS, published 30 September 2020
9 UK consumer spending rises to 4% above pre-COVID-19 level – ONS, Reuters, published 7 April 2022. Tough summer ahead for retailers as UK consumer confidence hits rock bottom | Consumer spending | The Guardian

How has the COVID-19 pandemic impacted your portfolio/investment strategies over the last 12 months?

	All respondents
More eviction action was required for my tenants than usual	52%
My appetite for office investments has decreased given the rise in working from home	42%
On average, there were more void months in my properties than usual	41%
My appetite for properties in urban areas has decreased given the rise in working from home	34%
I had to reduce rent on some or all of my properties	33%
I have been agreeing a larger number of shorter l ease lengths than usual	21%

Cost of living to squeeze property market

In spite of post-Covid optimism among landlords, the cost-of-living crisis and its potential ramifications cannot be ignored. The crisis is set to put significant pressure on budgets, especially among those who were hardest-hit by the pandemic and unable to build up any savings.

This could ultimately lead to a stagnation in the housing market, due to the prospect of buyers not only having to pay an average of more than 12% more for a home than a year ago, but also having to pay significantly higher interest rates on mortgages than in 2021, as mortgage rates are currently standing at 4.25%, compared to 3.61% a year ago[10].

All of this means that the cost of buying a house is now £57,600 – or 20% – more expensive than it was twelve months ago[11], and with monthly mortgage rates nearly £200 higher as a result, many could be priced out of a move. Ultimately, this could lead to significant drag on the market.

Landlords will be aware of this and may view it as an opportunity to buy up high value stock at a reduced rate. Notwithstanding, given the fast-developing nature of the wider macro-economic environment it remains to be seen how this scenario will affect property professionals, but what is clear is that the market is currently far from "normal".

10 Mortgage Rate in the United Kingdom, Bank of England, published May 2022
11 Handelsbanken analysis based on average house prices of 250,000 in May 2021 and 281,000 in May 2022 and mortgage rates of 3.61% in May 2021 and 4.25% in May 2022. Assumed LTV of 75% and mortgage duration of 25 years.

Section 3
The rise in importance of sustainability

From April 2023, it will be a legal requirement for all commercial rented properties to have an EPC (Environmental Performance Certificate) rating of at least E.

This is currently a legal requirement for *commercial and residential* properties before they can receive a new or renewal lease, but from next year this requirement will be extended to both new and existing *commercial* leases too.

With less than a year for commercial landlords to get their properties up to scratch, our survey reveals that as many as two fifths (39%) of commercial landlords are not aware of this legislation coming into place, suggesting that a lot of work still needs to be done in order for the UK's commercial property stock to meet the new legislation. With these landlords managing approximately 42% of all commercial properties in the sample, this could mean a race against time for landlords to meet the deadline.

One in eleven (9%) commercial landlords already has an EPC rating of E or above for all of their properties. However, for nearly a sixth (19%) of commercial landlords, the prospect of needing to fully refit their properties to meet environmental standards is too overwhelming, and they are planning to sell all of the properties in their portfolio that don't currently meet the EPC targets – primarily as they cannot afford to make the requisite changes.

What are you doing to ensure your portfolio meets the change to EPC legislation?

	All respondents
Installing insulation	43%
Installing a new, energy-efficient boiler	36%
Acquiring newer properties instead of older, less energy-efficient properties	35%
Installing double glazing	30%
Installing an efficient secondary heating source	28%
Installing solar panels	19%
Nothing as I am planning to sell the properties with a rating of less than E as I cannot afford to make them more sustainable	17%
Nothing as all of my properties have a rating of E or above	9%
I was unaware of this legislation	39%

This leaves three quarters (74%) who need to upgrade their portfolios, with installing insulation (43%) the most common option, ahead of installing a new-energy efficient boiler (36%) and installing double-glazing (30%). More than a third (35%) of respondents, meanwhile, plan to focus their efforts on acquiring newer properties that already meet the requirements.

Overall, all commercial landlords surveyed are expecting to invest in their property portfolio in the coming months to improve their energy efficiency. The average spend per portfolio is expected to be £95,400, or 3% of the portfolio's total value.

While landlords are aware of the need to upgrade their portfolios to be more environmentally sustainable, there is still uncertainty in the market about how to go about making these changes. Overall, only 1% of commercial landlords surveyed say they have a clear plan in place to make their portfolios more sustainable, with the biggest barriers being that regulation makes it too difficult to do so (42%), a lack of knowledge about what changes to make (38%), and not believing that they can access the right finance (14%).

The average spend per portfolio is expected to be £95,400, or 3% of the portfolio's total value.

What are the main reasons preventing you from making your portfolio more environmentally sustainable?

	All respondents
The regulations make it too difficult	42%
I don't have enough knowledge about how to make my portfolio more sustainable	38%
I don't believe I could access the finance I'd need	14%
I don't have the Capex to invest in making it more sustainable	12%
Some / all of my property is listed so making upgrades is too difficult	10%
It's not a priority for me	1%
I have a clear plan in place	1%

Section 4
Planning for the future

While this study shows that landlords are confident about many aspects of the property investment market, the research found that many are less confident about financial planning and the effective long-term management of their (often sizeable) portfolios. The success of buy-to-let over the past decade has created huge numbers of wealthy landlords - with a real need for dedicated financial and tax planning.

For instance, more than a fifth (22%) of landlords do not have a succession plan in place for their portfolios. The findings also suggest that there is a trend for putting off planning for retirement as portfolios get larger: while 96% of landlords with a portfolio of four or five properties have a plan in place, this falls to just 52% among those with a portfolio of 10 properties or more.

The findings also suggest a worrying lack of succession planning among older landlords. While the vast majority of younger respondents (aged 25-34) claim to know what they plan to do with their portfolios when the time comes to retire (92%), this falls to 79% among 35–44-year-olds and just 50% among those aged 45 or older.

However, it is worth bearing in mind that younger landlords may feel that they have a firm idea of their succession planning ambitions, it is unlikely that they will need to call on them in the immediate future, and therefore they may not be as formalised as those of older respondents.

Among the number who do not have a succession plan in place, the primary reason is the fact that they have not had the chance to develop one yet (27%), ahead of the fact that it had never crossed their mind (23%), the fact that there is no-one to leave their portfolio to (19%), and it not being a priority for them/ being too complicated (both 15%).

Why do you not have a succession plan in place?

	All respondents
I have not had the chance to develop one yet	27%
It has never crossed my mind	23%
There is no one I want to leave my portfolio to	19%
It is not a priority for me	15%
It is too complicated	15%

Among those with a clear succession plan in place, the majority (54%) plan to convert their portfolio into a property development portfolio in order to attract business property relief (BPR), while 43% are looking into a charitable trust, which would allow them to transfer their business to their heirs with minimal tax exposure. Other popular choices include family trusts (25%), family investment companies (28%) and acquiring agricultural properties to qualify for agricultural relief (26%).

What are your plans and solutions for succession planning?

	All respondents
Converting portfolio to a property development portfolio to attract BPR	54%
Charitable trusts	43%
Family trusts	35%
Family Investment Company	28%
Acquiring agricultural properties for Agricultural Relief	26%

Conclusion

While the data may show that the UK property market isn't quite out of the woods yet, with significant challenges in emerging from the Covid-19 slump posed by the cost-of-living crisis, the industry as a whole is confident, showing willing to invest in more properties across different sectors and regions to diversify their portfolios.

The landlords we surveyed were looking ahead to the coming 12 months with optimism that they will be able to utilise their expertise in the property market to ensure that they can enhance their portfolios to meet the anticipated demand in the coming years.

As a bank, we have deep expertise in the property business sector and provide best in class service to the needs of SME property business owners in the UK. We are committed to building long-term relationships with our customers and with that in mind, we look forward to tracking this core demographic to better understand the challenges and opportunities being experienced by SME landlords.

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For information regarding sustainability at Handelsbanken, please see: handelsbanken.co.uk/en/about-us/sustainability

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